Spin-off Transaction

Extract, IFRS® Discussion Group Report on the Meeting – January 10, 2019

IFRIC 17 *Distributions of Non-cash Assets to Owners* addresses a situation when an entity distributes assets other than cash as dividends to its owners acting in their capacity as owners. In this situation, an entity measures the dividend payable at the fair value of the assets to be distributed. On settlement, any difference between the carrying value of the assets distributed and the carrying amount of the dividend payable is recognized in profit or loss.

Paragraph 5 of IFRIC 17 states, in part, that “[t]his Interpretations does not apply to a distribution of a non-cash asset that is ultimately controlled by the same party or parties before and after the distribution.”

**Fact Pattern**

- An entity (“ParentCo”) decides to spin off one of its non-core assets (e.g., a mineral property) to its shareholders. The entity’s shares are listed on a stock exchange and it has many shareholders. There is no shareholder or group of shareholders that can exercise control over the entity.

- The asset to be spun-off does not constitute a business. Prior to the spin-off, the entity did not prepare separate financial information for the asset other than to capitalize certain expenditures that were incurred in connection with its acquisition and development.

- To conduct the spin-off, the entity will create a new subsidiary (“SpinCo”) and then concurrently:
  - assign the asset to that subsidiary in return for shares of SpinCo;
  - distribute the shares of SpinCo to its shareholders; and
  - apply to list the shares of the SpinCo on a stock exchange.

Before Spin-off

<table>
<thead>
<tr>
<th>ParentCo shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>ParentCo</td>
</tr>
<tr>
<td>Core assets</td>
</tr>
<tr>
<td>Non-core assets</td>
</tr>
</tbody>
</table>

After Spin-off

<table>
<thead>
<tr>
<th>ParentCo shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>ParentCo</td>
</tr>
<tr>
<td>SpinCo</td>
</tr>
<tr>
<td>Core assets</td>
</tr>
<tr>
<td>Non-core assets</td>
</tr>
</tbody>
</table>

Source: [www.frscanada.ca/archive-meeting-reports](http://www.frscanada.ca/archive-meeting-reports)
Issue 1: Is this spin-off transaction within the scope of IFRIC 17?

Analysis

Paragraph 6 of IFRIC 17 refers to paragraph B2 of IFRS 3 Business Combinations, which states that “[a] group of individuals shall be regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities.”

In this fact pattern, no group of individual shareholders would have control over SpinCo or ParentCo because there is no contractual arrangement among them. Since the asset is not controlled by the same party or parties before and after the spin-off transaction, this transaction is within the scope of IFRIC 17.

The Group’s Discussion

Group members agreed with the analysis and noted that paragraphs 13 and 14 of the Basis for Conclusions on IFRIC 17 also supports this analysis.

Issue 2: Assume IFRIC 17 applies to the spin-off transaction, does IFRIC 17 also apply to the recognition and measurement of the asset in SpinCo?

View 2A – No.

Under this view, IFRIC 17 only applies to ParentCo making the non-cash distribution (i.e., accounting for the dividend payable and the asset distributed).

The substance of the spin-off transaction is that a component of ParentCo was carved out and held in a separate legal entity (i.e., SpinCo). However, the shareholders have the same ownership interest in the asset before and after the transaction. Therefore, accounting for the asset should reflect the shareholders’ continuity of interest.

For reporting issuers with shares listed on Canadian stock exchanges, securities regulation may require carve-out financial statements in filings made in connection with certain spin-off transactions. Carve-out financial statements would have an appropriate allocation of historical assets, liabilities and expenses of ParentCo that are relevant to SpinCo. SpinCo’s financial statements would reflect the spin-off transaction as a capital transaction and include historical financial information based on the carve-out financial statements.

View 2B – Yes.

Under this view, since IFRIC 17 applies to the spin-off transaction, SpinCo should apply the requirements in accounting for the asset as well.

Carve-out financial statements and reflecting shareholders’ continuity of interest in an asset are typically used when common control exists. However, the asset transferred is not ultimately controlled by the same party or parties before and after the transaction. In addition, carve-out financial statements may not be relevant and indicative of SpinCo’s future financial performance.
As such, the accounting for SpinCo should mirror the accounting of ParentCo. SpinCo should recognize the asset at fair value with a corresponding entry to equity.

**View 2C – Similar to View 2A, except that using carve-out financial statements is not appropriate.**

Proponents of this view agree with the reasons in View 2B that using carve-out financial statements is not appropriate. However, there was no negotiation between arm’s length parties and no change in relative ownership interests before and after the transaction.

As such, SpinCo should recognize the asset at its existing carrying value prior to the spin-off with a corresponding entry to equity.

**View 2D – There is an accounting policy choice.**

Since there is no specific guidance in IFRS Standards on this issue, an entity can establish an accounting policy and apply it consistently to all similar transactions.

The Group’s Discussion

Group members thought that SpinCo should look to IFRS 2 *Share-based Payment* and measure the asset at fair value. They thought that:

a) IFRS 2 applies to this transaction because SpinCo acquired the asset through the issuance of its shares; and

b) the shares would generally be measured by reference to the fair value of the asset received in accordance with IFRS 2.

Several Group members highlighted other things to consider. For example, one Group member thought it important for entities consider if the spun-off asset constitutes a business as it is possible that the newly created entity could acquire processes surrounding the mineral property.

A few Group members observed seeing some diversity in practice in which the asset in SpinCo is measured at ParentCo’s carrying value of the asset. These Group members thought that this diversity may stem from the application of paragraph 4 of IFRS 2 as it may be viewed to scope out spin-off transactions. Another challenge entities encounter is coming up with a fair value measurement of an early stage mineral property, and therefore, ParentCo’s carrying value of the asset is used. However, a Group member noted that the fair value of the asset would need to be determined because ParentCo would measure the dividend payable to its shareholders (i.e., shares of SpinCo) at the fair value of the asset distributed under IFRIC 17. Overall, Group members acknowledged recognizing the asset at fair value provides transparent and meaningful results to users.

The Group also discussed compliance with securities regulation and noted that presentation of historical information is a separate issue from determining the accounting for SpinCo. If SpinCo needs to produce historical information about the asset to fulfill securities law requirements, the entity could prepare financial statements on a carve-out basis. Representatives from the Canadian Securities Administrators (CSA) agreed that filing requirements of securities regulation do not drive
the accounting for SpinCo. One of the CSA representatives emphasized it is important that useful information be provided to investors, whether through the predecessor entity or some other means of carve-out historical information, to convey what activity has occurred to develop the mineral property. Furthermore, since management plans to list SpinCo shares on an exchange following the transaction, investors will need to have a complete picture of the mineral property’s history.

The Group’s discussion raises awareness about the accounting for spin-off transactions. No further action was recommended to the AcSB.

(For a full understanding of the discussions and views expressed, listen to the audio clip).