PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)
QUESTIONS AND ANSWERS

Q&A No. 2019-06

Accounting for step acquisition of a subsidiary in a parent's separate financial statements

Issue

How should a parent account for the step acquisition of a subsidiary in its separate financial statements?

Fact pattern

- An entity elects to account for its investments in subsidiaries at cost in the separate financial statements by applying par. 10 of PAS 27, *Separate Financial Statements*.
- The entity holds an initial investment in another entity (investee).
- The investment is an investment in an equity instrument as defined in par. 11 of PAS 32, *Financial Instruments: Presentation*.
- The investee is not an associate, joint venture or subsidiary of the entity and, accordingly, the entity applies PFRS 9, *Financial Instruments*, in accounting for its initial investment (initial interest).
- The entity subsequently acquires an additional interest in the investee, which results in the entity obtaining control of the investee—i.e., the investee becomes a subsidiary of the entity.

Consensus

PAS 27 does not define 'cost', nor does it specify how an entity determines the cost of an investment acquired in stages. Cost is defined in other standards (for example, par. 6 of PAS 16, *Property Plant and Equipment*, par. 8 of PAS 38, *Intangible Assets*, and par. 5 of PAS 40, *Investment Property*).

Based on the agenda decision - *Investment in a subsidiary accounted for at cost: Step acquisition* published in January 2019, the IFRIC concluded that a reasonable reading of the requirements in IFRSs could result in the application of either one of the two approaches:

1. Fair value as deemed cost approach

   Under this approach, the entity is exchanging its initial interest (plus consideration paid for the additional interest) for a controlling interest in the investee (exchange view). Hence, the entity's investment in subsidiary is measured at the fair value at the time the control is acquired.

2. Accumulated cost approach

   Under this approach, the entity is purchasing additional interest while retaining the initial interest (non-exchange view). Hence, the entity's investment in subsidiary is measured at the accumulated cost (original consideration).

   Any difference between the fair value of the initial interest at the date of obtaining control of the subsidiary and its original consideration is taken to profit or loss, regardless of whether, before the step acquisition transaction, the entity had presented subsequent changes in fair value of its initial interest in profit or loss or other comprehensive income (OCI).

   In IFRIC's view, this difference meets the definition of income or expenses in the *Conceptual Framework* because the change of status of the investee results from an event (i.e., obtaining control) (Par. 61, September 2018 IFRIC agenda paper on investment in a subsidiary accounted for at cost: Step acquisition).

   Furthermore, no IFRS requires or permits the presentation of any difference between the cost of an investment retained and its fair value other than in profit or loss (Pars. 66-67, September 2018 IFRIC agenda paper on investment in a subsidiary accounted for at cost: Step acquisition). There is also no basis to recognize the difference in equity because the difference does not result from a transaction with owners in their capacity as owners.

   The election in paragraph 4.1.4 of IFRS 9 to present changes in OCI applies only to 'subsequent changes in fair value'. This difference does not arise from a change in the fair value of the instrument—the entity ceases to apply IFRS 9 and immediately applies IAS 27 so no fair value change has occurred. Accordingly, the entity presents the difference in profit or loss. (Par. 68, September 2018 IFRIC agenda paper on investment in a subsidiary accounted for at cost: Step acquisition)

Illustrative example (lifted from September 2018 IFRIC agenda paper on investment in a subsidiary accounted for at cost: Step acquisition)

- Entity X holds a 10% equity interest in Entity Y, which it originally acquired for CU100.
- Entity X subsequently acquires an additional 45% interest in Entity Y and obtains control of Entity Y. Entity X pays CU540 for this additional interest.
- On the date Entity X obtains control of Entity Y, the fair value of the initial 10% interest in Entity Y is CU120.

Applying the two approaches set out in the IFRIC agenda decision, Entity X would determine the cost of its investment in Entity Y on the date it obtains control of Entity Y as follows:

	Fair value as deemed cost	**Accumulated cost**
Consideration paid for the 10% initial interest		CU100
Fair value of the 10% initial interest	CU120	
Consideration paid for the 45% additional interest	540	540
Cost of the investment in Entity Y (55% interest)	**CU660**	**CU640**

The entity using the fair value as deemed cost approach prepares the following journal entries:

Particulars	**Dr**	**Cr**
Investment in Entity Y	CU100	
Cash or payable		CU100
To record initial acquisition of investment in Entity Y		
Investment in Entity Y	20	
Fair value increase*		20
To recognize changes in the fair value of the initial interest in Entity Y		
Investment in Entity Y (subsidiary)	660	
Investment in Entity Y		120
Cash or payable		540
To recognize the step acquisition transaction		

**Entity X would present this increase in profit or loss unless, applying PFRS 9.4.1.4, it elects to present in OCI subsequent changes in fair value of its initial interest. If Entity X avails of the presentation election, it does not subsequently transfer to profit or loss the amounts presented in OCI. However, the cumulative fair value gain or loss may be transferred by Entity X within equity.*

The entity using the accumulated cost approach prepares the following journal entries:

Particulars	Dr	Cr
Investment in Entity Y	CU100	
Cash or payable		CU100
To record initial acquisition of investment in Entity Y		
Investment in Entity Y	20	
Fair value increase**		20
To recognize changes in the fair value of the initial interest in Entity Y		
Investment in Entity Y (subsidiary)	540	
Cash or payable		540
To recognize the purchase of additional interest in Entity Y		
*Adjustment to the cost of equity instrument*** (taken to profit or loss)*	20	
Investment in Entity Y		20
To reset the value of the initial interest from fair value to original cost		

***Entity X would present this increase in profit or loss unless, applying PFRS 9.4.1.4, it elects to present in OCI subsequent changes in fair value of its initial interest. If Entity X avails of the presentation election, it does not subsequently transfer to profit or loss the amounts presented in OCI. However, the cumulative fair value gain or loss may be transferred by Entity X within equity.*

****If the measurement of Entity X's initial interest increases because the fair value of the initial interest on the date of obtaining control is lower than its original cost, the IFRIC thinks that the entity also would need to consider whether its investment in the subsidiary is impaired under IAS 36 Impairment of Assets.*

Transition

If an entity decides to change its accounting policy as a result of the issuance of this PIC Q&A, the change in accounting policy shall be applied retrospectively in accordance with PAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

Effective date

The consensus in this Q&A becomes effective upon approval by the FRSC.

Date approved by PIC: August 28, 2019

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PIC Members

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Date approved by FRSC: October 9, 2019