UITF abstract 31
Exchanges of businesses or other non-monetary assets for an interest in a subsidiary, joint venture or associate

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Background

It is becoming increasingly common for reporting entities to exchange businesses for equity, for example by forming a joint venture combining one of their existing businesses with that of another entity. The UITF has been asked to develop guidance on certain issues that arise in accounting for such transactions. 1

The issues

This Abstract deals with the treatment in consolidated financial statements of transactions in which an entity (A) exchanges a business or other non-monetary assets for an interest in another entity (B) which thereby becomes A's subsidiary or which is or thereby becomes A's joint venture or associate. The Abstract does not prescribe the treatment of barter transactions in general. 2

The issues discussed in this Abstract are: 3

(a) should businesses or other non-monetary assets exchanged for an interest in a subsidiary, joint venture or associate be accounted for at fair value at the date of the transaction or at previous book values?

(b) how should any gain or loss arising on the transaction be reported?

The UITF has considered different approaches to these kinds of exchanges and has decided that they should be analysed in terms of net changes in ownership interests. For example, the exchange of a wholly-owned business for a 50 per cent interest in another entity which absorbs that business should be characterised as an exchange of that part of the business where ownership is wholly given up (the 50 per cent interest now belonging to the other party) for the 50 per cent ownership interest acquired in the other entity's pre-transaction business. Under this approach, any part of the business exchanged that is owned by the transferor both directly before the exchange and indirectly thereafter is treated as having been owned throughout the transaction, and therefore remains at book value. The consideration for the interest acquired in the entity will include that part of the business or non-monetary assets no longer owned by the transferor*. The assets acquired consist of the transferor's 50 per cent share in the pre-transaction net assets of the other entity. Where it is difficult to value the consideration given, the best estimate of its value may be given by valuing what is acquired. 4

* The consideration may also include cash or monetary assets to achieve equalisation of values.

5 The UITF noted that in acquisition accounting, accounting standards and companies legislation require the consideration to be stated at fair value and fair values to be ascribed to the separable assets and liabilities acquired, any difference arising being goodwill. This applies whether the investee is a subsidiary, an associate or a joint venture.

6 If the fair value of the consideration received exceeds the book value of the part of the business or non-monetary assets no longer owned by the transferor (and any related goodwill) together with any cash given up, the transferor will record a gain. In the reverse case, the transferor will record a loss. To the extent that the transferor group retains an interest in a business or non-monetary assets after a transaction covered by this Abstract, even if then held through a different subsidiary or a joint venture or associate, that interest should be included at its pre-transaction carrying amount. The assets acquired through the interest in the entity will be accounted for at fair value and any goodwill arising will be recorded.

7 The UITF noted that International Accounting Standards require recognition of the portion of a gain or loss attributable to the equity interests of other venturers when non-monetary assets are contributed to a jointly controlled entity in exchange for an equity interest in that entity (SIC-13 'Jointly Controlled Entities - Non-Monetary Contributions by Venturers'). This is subject to limited exceptions, one of which is where the non-monetary assets contributed are "similar" to those contributed by the other venturers. However, the UITF noted the intended narrowness of the exception because "similar" is restrictively defined to mean having a similar nature, a similar use in the same line of business and a similar fair value.

8 The UITF concluded that the only exception to the use of fair values in the transactions covered by this Abstract would be rare cases where the transaction is artificial or has no substance such that a gain or loss would be recognised that could not be justified. For example, an exchange might purport to give rise to a recognisable gain even though the assets exchanged would be unlikely otherwise to be saleable. In such a case, no gain should be recognised. Where a gain or loss on exchange is not taken into account because of special circumstances, those circumstances should be explained.

9 The UITF took the view that any unrealised gain arising on the transactions that are the subject of the Abstract should be reported in the statement of total recognised gains and losses. Where a loss arises, all relevant assets should first be reviewed for impairment with any impairment identified accounted for as required by FRS 11 'Impairment of Fixed Assets and Goodwill'. Any remaining loss should be recorded in the profit and loss account. Where an impairment has been identified, similar assets should also be reviewed for impairment.

Application to smaller entities

10 Reporting entities applying the Financial Reporting Standard for Smaller Entities currently applicable are exempt from this Abstract.

UITF consensus

The UITF reached a consensus that where an entity (A) exchanges a business or other non-monetary assets for an interest in another entity (B), which thereby becomes A's subsidiary or which is or thereby becomes A's joint venture or associate, the following accounting treatment should apply in A's consolidated financial statements: 11

(a) to the extent that A retains an ownership interest in a business or non-monetary assets exchanged for an interest in B after such a transaction, even if that business or non-monetary assets is then held through B as a subsidiary, joint venture or associate, that retained interest, including any related goodwill, should be included at its pre-transaction carrying amount.

(b) A's share of net assets acquired through its new interest in B should be accounted for at fair value, with the difference between these and the fair value of the consideration given being accounted for as goodwill.

(c) to the extent that the fair value of the consideration received by A exceeds the book value of the part of the business or non-monetary assets no longer owned by A (and any related goodwill*) together with any cash given up, A should recognise a gain. Any gain arising on the exchange that is not realised should be reported in A's statement of total recognised gains and losses.

(d) where the fair value of the consideration received by A is less than the book value of the part of the business or non-monetary assets no longer owned by A (and any related goodwill) together with any cash given up, A should recognise a loss, either as an impairment in accordance with FRS 11 or, for any loss remaining after an impairment review of the relevant assets, in A's profit and loss account.

No gain or loss should be recognised in those rare cases where the artificiality or lack of substance of the transaction is such that any gain or loss on the exchange could not be justified. Where a gain or loss on the exchange is not taken into account because the transaction is artificial or has no substance, the circumstances should be explained. 12

Date from which effective

The accounting treatment required by this Abstract should be adopted in respect of transactions first accounted for in financial statements relating to accounting periods commencing on or after 23 December 2001, but earlier adoption is encouraged. 13

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* These amounts will include any related goodwill written off under SSAP 22 'Accounting for goodwill' and not reinstated in accordance with the transitional arrangements of FRS 10 'Goodwill and Intangible Assets'.

References

Legislation

Great Britain and Northern Ireland
Companies Act 1985 and Companies (Northern Ireland) Order 1986
Schedule 4A paragraph 9

Republic of Ireland
European Communities (Companies: Group Accounts) Regulations 1992 Regulation 19

Accounting standards

FRS 2 'Accounting for Subsidiary Undertakings' paragraphs 51 and 91
FRS 6 'Acquisitions and Mergers' paragraph 20
FRS 7 'Fair Values in Acquisition Accounting' paragraph 26
FRS 9 'Associates and Joint Ventures' paragraph 31(a)
FRS 10 'Goodwill and Intangible Assets' paragraph 68

Other pronouncements

IASC Standing Interpretations Committee SIC-13 'Jointly Controlled Entities - Non-Monetary Contributions by Venturers'