Subsidiary's Accounting for a Spin-off Transaction

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The Group considered the following fact pattern of a spin-off transaction in which shareholders of a parent entity receive shares of a newly created subsidiary that holds assets or businesses transferred from the parent entity. The Group discussed the subsidiary's accounting for this transaction.

Fact Pattern

- An entity, ParentCo, decides to spin-off one of its non-core assets (e.g., a mineral property) to its shareholders. ParentCo's shares are listed on a stock exchange and it has many shareholders. No shareholder or group of shareholders can exercise control over ParentCo. ParentoCo controlled the assets for several years prior to the transaction.
- To conduct the spin-off transaction, ParentCo creates a wholly owned subsidiary ("SpinCo") and then concurrently:

  (a) assigns the asset to that subsidiary in return for shares of SpinCo;

  (b) distributes SpinCo's shares to its shareholders; and

  (c) applies to list SpinCo's shares on a stock exchange.

  The completion of the spin-off transaction was not contingent on the completion of the listing of SpinCo's shares on a stock exchange.
- The entity transfers assets with a carrying value of $1 million to SpinCo in return for shares of SpinCo. The fair value of the assets transferred is $1.5 million.
- 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 *Distributions of Non-cash Assets to Owners*, for ParentCo. Therefore, ParentCo should record a dividend payable of $1.5 million in its financial statements.

Issue 1: Assuming the assets acquired do not meet the definition of a business, how should SpinCo measure the assets acquired from ParentCo and the shares issued?

View 1A – The assets acquired and equity issued should be measured at the asset's fair value.

Proponents of this view think IFRS 2 *Share-based Payment* applies to this transaction because SpinCo acquired the assets through the issuance of its shares. IFRS 2 generally requires that the shares issued be measured at the fair value of the assets received. This is also consistent with the accounting for the transaction under IFRIC 17 where ParentCo records a dividend payable to its shareholders (i.e. SpinCo's shares) at the fair value of the assets to be distributed.

Proponents of this view also acknowledge that the shares issued at fair value provides transparent and meaningful information to financial statement users.

Source: www.frascanada.ca/archive-meeting-reports

View 1B – The assets acquired should be measured at ParentCo's carrying value, and the equity issued measured at fair value or carrying value.

Proponents of this view think that paragraph 4 of IFRS 2 scopes out this spin-off transaction. As IFRS 2 does not apply, they note no other IFRS Accounting Standards provide specific guidance to assess whether to record the shares issued at their fair value or at the carrying amount of the assets in the financial statements of ParentCo.

Both the asset and the equity would be measured at ParentCo's carrying value of $1 million. Therefore, SpinCo's accounting is as follows:

Dr.	Assets		$1 million	
	Cr.	Common shares		$1 million

Alternatively, the common shares could be measured at fair value with a further adjustment to another component of equity. Therefore, SpinCo's accounting is as follows:

Dr.	Assets		$1 million	
Dr.	Equity reserve		$0.5 million	
	Cr.	Common shares		$1.5 million

View 1C – There is an accounting policy choice.

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

The Group's Discussion

Group members expressed diverse views on this issue.

Some Group members supported View 1A. They thought since the fact pattern stated that the asset was not controlled by the same party or parties before and after the spin-off transaction, the transaction was not between entities under common control. They also noted it was unclear how paragraph 4 of IFRS 2 would apply to this transaction and thus the transaction should be accounted for under IFRS 2.

Some other Group members supported View 1B. They thought the steps conducted in the spin-off transaction should be viewed in sequence as the ParentCo needs to first obtain the shares of SpinCo in step (a) before distributing them to its shareholders (steps (b) and (c)). They considered that step (a) to transfer the asset in return for SpinCo's shares is a transaction between entities under common control. Therefore, they thought paragraph 4 of IFRS 2 would apply and that this transaction would be excluded from the scope of IFRS 2. They also thought the transaction lacks economic substance because SpinCo is a wholly-owned subsidiary of ParentCo and therefore the ultimate ownership of the property has not changed. As a result, the asset should continue to be measured at the carrying value in ParentCo's accounts. A representative from the Canadian Securities Administrators (CSA) also supported this view when the steps involved in the spin-off transaction, as described in this fact pattern, are viewed in sequence.

A few Group members could not exclude either View 1A or 1B based on the rationale described above.

In terms of the measurement of common shares in View 1B, Group members observed that there is no specific guidance for bifurcating the elements within equity. Consequently, as long as the net equity amount is $1 million, Group members found both presentation options (the carrying amount or the fair value with an offset equity reserve) to be acceptable. A few Group members also noted that the laws and regulations in a specific jurisdiction could impact how equity should be measured and should be considered. That said, some Group members found that presenting the common shares at carrying amount to be more intuitive and more common in practice.

Issue 2: Assuming the assets acquired meet the definition of a business, how should SpinCo measure the assets acquired from ParentCo and the shares issued?

Analysis

SpinCo is an entity newly formed to issue equity instruments to effect a business combination. Therefore, SpinCo cannot be identified as the acquirer. Further, the acquired business cannot be identified as the acquirer in a reverse acquisition because SpinCo is not a business. Therefore, the transaction is outside the scope of IFRS 3 *Business Combinations*.

Only in limited circumstances would it be possible to identify SpinCo as the acquirer under IFRS 3. One such scenario would be if the transaction was contingent on completion of an initial public offering resulting in a change of control over SpinCo. In that case, applying the acquisition method would result in fair values being attributed to the assets acquired. In the fact pattern, since the completion of the spin-off transaction was not contingent on completing the listing of SpinCo's shares on a stock exchange, SpinCo was not identified as the acquirer under IFRS 3.

The transfer of the business from ParentCo to SpinCo in return for shares of SpinCo does not have economic substance, therefore, when applying the IAS 8 hierarchy, SpinCo cannot elect to apply the IFRS 3 acquisition method. Accordingly, the financial statements of SpinCo should reflect the transaction as in substance a continuation of the business. Therefore, the assets acquired should be recorded at their carrying value.

The following three views consider how SpinCo should account for the equity issued:

View 2A – The shares issued should be valued at the fair value of ParentCo's assets.

Proponents of this view would gross up the equity issued to the fair value of the assets, with a corresponding offset to another equity account. SpinCo's accounting is as follows:

Dr.	Assets		$1 million	
Dr.	Equity reserve		$0.5 million	
	Cr.	Common shares		$1.5 million

View 2B – The shares issued should be measured at ParentCo's carrying value.

Both the assets and the equity should be measured at ParentCo's carrying value of $1 million. SpinCo's accounting is as follows:

Dr.	Assets		$1 million	
	Cr.	Common shares		$1 million

View 2C – There is an accounting policy choice.

Since there is no specific guidance in IFRS Accounting Standards on this issue, an entity can establish an accounting policy about whether to measure the shares issued at the carrying value of the assets or the fair value of the shares and apply it consistently to all similar transactions.

The Group's Discussion

Group members observed that there is no specific guidance associated with bifurcating elements within equity. As such, most Group members thought an entity can establish an accounting policy about whether to measure the shares issued at the carrying value of the assets or the fair value of the shares (View 2C). That said, several Group members observed that View 2B is more commonly applied in practice. Furthermore, a few Group members thought as the transaction between ParentCo and SpinCo lacks economic substance, they found measuring the common shares at fair value to be counter-intuitive. Similar to Issue 1, these Group members thought the laws and regulations in a specific jurisdiction should be considered as they could impact how equity should be measured.

Issue 3: Assuming the assets acquired meet the definition of a business, for periods subsequent to the acquisition date, how should SpinCo present comparative information?

View 3A – SpinCo's consolidated financial statements should include the results of the acquired business from the acquisition date only.

Proponents of this view think that financial statements should include the results of the business acquired from the date of acquisition only. Comparative information and the current period prior to the acquisition should not be restated.

For offering documents or other prospectus type disclosure (e.g. prospectuses, management information circulars, or offering memorandum), in addition to the presentation and disclosure requirements of IFRS, the applicable requirements of Canadian securities legislation may need to be considered. For example, since management plans to list SpinCo's shares on an exchange following the transaction, investors will need to have a complete picture of the mineral property's history (e.g. historical exploration expenditures incurred on the property).

In Canada, a prospectus should include information concerning the business conducted or to be conducted by the issuer that is sufficient to enable an investor to make an informed investment decision. This includes separate historical financial information of the predecessor entity or some other means of carve-out historical information, to convey what activity has occurred to develop the mineral property.

View 3B – Comparative information should be presented as though the entities had been combined throughout the periods presented

Proponents of this view note that since the transfer of the business from ParentCo does not have economic substance, the financial statements of SpinCo should reflect the transaction as a continuation of the business as it was presented in ParentCo's financial statements throughout all the periods presented.

The Group's Discussion

Some Group members noted that as indicated in the analysis for Issue 2, the spin-off transaction is outside the scope of IFRS 3. Furthermore, given the transfer of the business from ParentCo to

SpinCo lacks economic substance, the financial statements of SpinCo should reflect the transaction as a continuation of the business with the assets acquired recorded at their carrying value. These Group members observed that in this scenario, it is common for Canadian entities to follow View 3B to present comparative information.

One Group member observed that the Ontario Securities Commission issued a Financial Reporting Bulletin in 2012 that strongly recommends presenting comparative information. Another Group member commented that presenting comparative information improves comparability and relevancy of financial information for investors.

Issue 4: Assuming the assets acquired do not meet the definition of a business, for periods subsequent to the acquisition date, how should SpinCo present comparative information?

Analysis

If the assets acquired do not meet the definition of a business and View 1A is applied in Issue 1, this results in a new basis of accounting for the assets acquired.

Consistent with the business acquisition scenario in Issue 3, the financial statements for periods subsequent to the acquisition date should include the results of the assets acquired from the date of acquisition only. Comparative information and the current period prior to the acquisition should not be restated.

SpinCo would also need to include additional historical financial information in an offering document filed for securities law purposes (e.g., historical financial information of the predecessor entity or some other means of carve-out historical information) to convey what activity has occurred to develop the mineral property.

The Group's Discussion

One Group member agreed that if following IFRS 2, the entity creates a new basis of accounting for the assets acquired, and as such the comparative information should not be restated.

A representative of the CSA commented that even if the assets do not meet the definition of a business in IFRS Accounting Standards, the acquisition of these assets may constitute an acquisition of business under securities law. Therefore, in this situation, the securities law requirements set out in the prospectus rules would apply. Entities are encouraged to review the companion policy to the prospectus rules that was issued in 2022 for additional guidance.

Overall, the Group's discussion raised awareness of the subsidiary's accounting for a spin-off transaction. No further action was recommended to the AcSB.