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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**June 2008, London**
Project:	**Annual improvements process**
Subject:	**IFRS 2 – Scope of IFRS 2 and revised IFRS 3 (Agenda paper 6C)**

Proposed amendments

1. When the revised IFRS 3 *Business Combinations* was issued in 2008, some related consequential amendments were made to IFRS 2 *Share-based Payment* to reflect the new requirements. However, the Board has received a request that identified additional amendments needed to reflect clearly the Board's decisions on the application of IFRS 2. The request asked that the Board address the following issue via the annual improvements process.

   Issue: Should IFRS 2 *Share-based Payments* be amended to continue to exclude from its scope the formation of a joint venture?

2. The staff believes that common control transactions may potentially raise the same issues and includes these transactions in the staff analysis below.

Staff recommendation

3. The staff recommends that the Board should:

- add this issue to the annual improvements project; and
- amend paragraph 5 of IFRS 2 so that both the formation of a joint venture and common control transactions continue to be excluded from its scope (Appendix B to this paper includes the proposed drafting for the amendments).

Background

4. Paragraph 5 of IFRS 2 excludes from its scope transactions in which the entity acquires goods as part of the net assets acquired in a business combination *to which IFRS 3 applies* [emphasis added]. Hence, equity instruments issued in a business combination in exchange for control of the acquiree are not within the scope of IFRS 2. However, because the formation of joint ventures and common control transactions were excluded from the scope of IFRS 3 (issued 2004), it could be argued that they were within the scope of IFRS 2.

5. At the request of the IFRIC Agenda Committee, at its September 2004 meeting the Board clarified that its intention was that IFRS 2 'should not apply to transactions in which the entity acquires goods as part of the net assets acquired in a business combination, *as defined* in IFRS 3, not business combinations within the scope of IFRS 3.' [per IASB *Update* September 2004]

6. At the time, the Board also noted that some business combinations were excluded from the scope of IFRS 3 as an interim measure, because the Board was considering issues relating to accounting for those combinations in phase II of its Business Combinations project.

7. Appendix A includes extracts from the IASB Update for the September 2004 meeting discussion of this issue.

8. Although the Board did not amend IFRS 2 as a result of this discussion, the Board's clarification applied to transactions that met the definition of business combination in IFRS 3 (2004) but were excluded from its scope. These included:

    a. business combinations involving entities or businesses under common control

b. business combinations in which separate entities or businesses are brought together to form a joint venture.

c. business combinations involving two or more mutual entities

d. business combinations in which separate entities or businesses are brought together to form a reporting entity by contract alone

9. Consequently, IFRS 2 did not apply to common control business combination transactions and the formation of joint ventures because they met the IFRS 3 (2004) definition of a business combination as 'the bringing together of separate entities or businesses into one reporting entity'.

10. In the second phase of the business combinations project, the Board changed the definition of a business combination. In addition, paragraph 2 of the IFRS 3 issued in 2008 (IFRS 3R) excludes from its scope the following transactions:

    a. the formation of a joint venture.

    b. asset acquisitions.

    c. a combination of entities or businesses under common control.

11. The request received notes that the formation of a joint venture does not meet the revised definition of a business combination — 'a transaction or other event in which an acquirer obtains control of one or more businesses'[1]. Therefore, the scope exemption from IFRS 2 for transactions that met the definition of business combinations, as clarified in IASB Update September 2004, no longer excludes the formation of a joint venture. Consequently, the assets of the business contributed to a joint venture in exchange for shares would be required to be recognised at fair value in the financial statements of the joint venture itself, a change from existing practice.

Staff analysis

12. When applying the definition of a business combination in IFRS 3R to these three types of transactions excluded from its scope, the staff believes that:

[1] Paragraph B5 of Appendix B – Application guidance of IFRS 3 (issued 2008).

a. common control transactions may or may not continue to meet that definition depending on which level of the group reporting entity is assessing the combination – the conclusion may differ for the ultimate parent that always has control of all entities party to the transaction as opposed to the intermediary parent in the group that, some may argue, obtains control of another group entity being transferred by the ultimate parent.

b. asset acquisitions continue to fail that definition and will <u>not</u> be excluded from the scope of IFRS 2, which is consistent with the prior clarification that did not apply to such transactions.

c. the formation of joint venture met the 2004 definition but fail the 2008 definition.

13. Regardless of whether the revised definition of business combination is met, the staff does not believe that the Board intended to change the accounting for either the formation of a joint venture or common control transactions when it revised IFRS 3.

14. The staff's understanding is that, during the development of IFRS 3R, the Board did not discuss whether it intended IFRS 2 to apply to these types of business combinations. Moreover, given that the reason for the continued scope exclusion in IFRS 3R is to give the Board more time to consider accounting issues relating to common control transactions and the accounting by a joint venture upon its formation, it would seem rather odd to introduce a change to existing practice for these transactions by scoping them into another standard (IFRS 2) that does not specifically address those types of transactions.

15. Therefore, the staff recommends that the Board amend paragraph 5 of IFRS 2 to reaffirm that both common control transactions and the formation of a joint venture are not within the scope of IFRS 2.

16. Does the Board agree that paragraph 5 of IFRS 2 should be amended to reaffirm that common control transactions and the formation of a joint venture are not within the scope of IFRS 2?

Annual improvement considerations

17. The staff thinks there are two ways to proceed:

    a. The Board could address this issue in the current Joint Venture and Common Control projects. Presumably the Board could clarify the accounting and measurement for such transactions when issuing the final standards.

    b. The Board could address it in the annual improvements project.

18. Considering the unintended change in practice for such transactions as a result of the revised definition of a business combination, the staff recommends addressing it in the annual improvement project for timing reasons.

19. The Board just added the Common Control project to its agenda in December 2007. Substantive work and discussion of the project have not yet begun. The Board issued an exposure draft on Joint Arrangements in September 2007 and currently expects to publish a final standard in the second half of 2008. The exposure draft did not address the measurement issues related to the formation of a joint venture. The staff also understands that there is no plan to expand that project scope to consider measurement issues of the joint venture itself if the final standard is to be issued on a timely basis and to avoid the need for re-exposure.

20. At this time the staff has not identified any additional consequential amendments that are required to other standards or implementation guidance. The staff will bring any additional amendments as sweep issues if necessary.

21. The staff does not believe that any additional relief for first-time adopters will be necessary.

22. The proposed amendment will retain (<u>not</u> change) the existing measurement of assets of a business contributed to a joint venture on the formation of the joint venture and common control transactions, and therefore, if approved, should be included in Part II of the next exposure draft of *Improvements to IFRSs*.

23. The staff does not believe that the Board should solicit any comments that are unique for this proposed amendment in addition to the standard questions in the ED's invitation to comment.

24. **Does the Board agree with the staff recommendations:**

    a. **To address this issue in the annual improvements project;**

    b. **To propose no consequential amendments to other standards;**

    c. **To provide no relief for first-time adopters;**

    d. **To include the proposed amendment in Part II of the ED; and**

    e. **To solicit comments as part of the ED's standard invitation to comment.**

Effective date and transition provision

25. Ideally, the effective date of the proposed amendments to IFRS 2 would be the same as the effective date of IFRS 3R – 1 July 2009. That would allow entities to apply all of the amendments to IFRS 2 arising from the business combinations project at the same time.

26. Similar to other proposed consequential amendments arising from IFRS 3R that the Board approved at its May 2008 meeting, if the Board aligns the effective date of the proposed amendments to IFRS 2 with the effective date of IFRS 3R, this would provide a three-month period for entities to implement the amendments that are part of *Improvements to IFRSs*, with finalised amendments to be issued on 1 April 2009.

27. Although that would be a short implementation period, the staff believes that it would be acceptable given the limited nature of the proposed amendments (ie that we are clarifying the Board's decisions in the business combinations project to continue a previously available scope exemption of IFRS 2, rather than changing the guidance). In addition, the staff notes that the Board expects to publish the exposure draft to *Improvements to IFRSs* in August 2008, almost a year before the effective date of the revised IFRS 3.

28. The staff recommends that the Board proposes an effective date of 1 July 2009 in the exposure draft and allows respondents to comment on whether that is feasible. Consistent with the transition specified in paragraph 61 of IFRS 2 for all other consequential amendments related to IFRS 3R, entities would be required to apply the amendments retrospectively from the effective date. The drafting in Appendix B reflects these recommendations.

29. If the Board does not support that recommendation, the staff has identified the following options:

    a. An effective date after 1 July 2009 (consistent with the implementation period generally provided in the Annual Improvements package). This would be consistent with the implementation for any additional consequential amendments related to the revised IFRS 3 not yet identified at this time.

    b. Issue the amendments to IFRS 2 in a separate ED. The ED would likely be issued at about the same time as the next ED of *Improvements to IFRSs* in August 2008 (to allow time for the balloting process). Given the limited nature of the proposed amendments, the Board might decide on a comment period of 60 days. The comment letter analysis could be presented to the Board in November or December and the final amendments issued in January 2009. This would provide constituents with almost a six-month period to implement the amendments before their effective date of 1 July 2009.

30. Does the Board agree that

   a. the effective date of the proposed amendments should be 1 July 2009 (to align with the effective date of IFRS 3R) as part of the ED of *Improvements to IFRSs*; and

   b. the proposed application requirement be retrospective?

31. Does the Board have any comments on the drafting proposed in Appendix B?

Appendix A

Extracts from IASB Update September 2004 Meeting

Scope of IFRS 2 and IFRS 3

At the request of the IFRIC Agenda Committee, the staff asked the Board to clarify an issue concerning the respective scope of IFRS 2 and IFRS 3 *Business Combinations*.

IFRS 2 excludes from its scope transactions in which the entity acquires goods as part of the net assets acquired in a business combination to which IFRS 3 applies. [IFRS 2, paragraph 5]

Because certain business combinations are excluded from the scope of IFRS 3, the wording of paragraph 5 of IFRS 2 might lead to the conclusion that those business combinations are within the scope of IFRS 2. In the view of the staff and the IFRIC Agenda Committee, this was not the Board's intention.

Therefore, the staff asked the Board to confirm that, by excluding certain business combinations from the scope of IFRS 3, it did not intend that share-based payments related to these business combinations should be within the scope of IFRS 2. The Board confirmed the staff's interpretation of its intention. It noted that its intention was to exclude from the scope of IFRS 2 transactions in which the entity acquires goods as part of the net assets acquired in a business combination, *as defined* in IFRS 3, not business combinations within the scope of IFRS 3. The Board also noted that some of the business combinations are excluded from the scope of IFRS 3 as an interim measure, because the Board is considering issues relating to accounting for those combinations in phase II of its Business Combinations project.

Appendix B

[Appendix B omitted from Observer Note].