STAFF PAPER

3 November-4 November 2011

IFRS Interpretations Committee Meeting

Project	**Agenda Decision**		
Paper topic	IFRS 11 *Joint Arrangements*-Acquisition of interest in joint operations—Project Options		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

Purpose of the paper

1. The purpose of this agenda paper is to provide the IFRS Interpretations Committee (the Committee) with an analysis of the project options to address the concern that significant diversity in practice is will continue after the adoption of IFRS 11 *Joint Arrangements* (issued 2011) in accounting for the acquisitions of interests in joint operations in circumstances in which the activity of the joint operations constitutes a business as defined in IFRS 3 *Business Combinations* (revised 2008).
2. In order to address that concern this agenda paper includes:
   (a) an analysis of whether a premium paid for synergies can be recognised as a separate asset under another standard;
   (b) an analysis of whether guidance in IFRSs exists to account for the acquisition of an interest in a joint operation in circumstances in which the activity of the joint operation constitutes a business as defined in IFRS 3 (revised 2008);
   (c) an analysis of the options to proceed with this project;
   (d) a staff recommendation; and
   (e) questions for the Committee.

3. We reproduce for ease of reference in Appendix A the paragraphs from the standards that we used to perform our analysis.

Analysis of whether a premium paid for synergies can be recognised as a separate asset under another standard

IAS 38

4. A premium paid for synergies could only be recognised as a separate asset under IAS 38 *Intangible Assets* if it is an identifiable intangible asset (see paragraph 11 of IAS 38). To be identifiable, paragraph 12 of IAS 38 requires that an asset either:

   (a) is separable; or

   (b) arises from contractual or other legal rights.

5. Paragraph 12(a) of IAS 38 defines an asset as separable if it is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so.
6. Synergies that arise from the collection of assembled assets that make up an acquiree or that are created through a business combination do not arise from contractual or other legal rights (see paragraph BC163 of IFRS 3 (revised 2008)).
7. Furthermore, synergies are not separable if they can only be sold with the group of assets that constitutes a business (see paragraphs BC164, BC166, BC167 of IFRS 3 (revised 2008)).
8. Consequently, synergies cannot be recognised as a separate asset under IAS 38 if they relate to a business and can only be sold, transferred, licensed, rented or exchanged together with the entire business or combined businesses. Synergies can be recognised as a separate asset under IAS 38 if they can be sold, transferred, licensed, rented or exchanged together with a related contract, identifiable asset or liability that do not constitute a business as defined in IFRS 3 (revised 2008).

9. Our outreach to interested parties is still continuing, but we have not noticed synergies in the context of joint operations that can be recognised as a separate asset under IAS 38 in our discussions with interested parties so far. We would be interested to hear whether the Committee members can contribute specific examples.
10. Furthermore, we noted from our outreach activities that premiums are mostly paid for synergies that are related to the business or a combination of businesses because they result from combining the acquirer's activities with that of the other joint operators in the joint operation. We understand that it is common for entities to enter into joint arrangements because of such expected synergies. Consequently, we think that premiums paid for synergies on the acquisition of an interest in a joint operation are in many cases not recognised as a separate asset under IAS 38 and further, as a result, accounting guidance is needed.

Other standards

11. We are not aware that premiums paid for synergies can be recognised as separate assets under other standards and would be interested to hear from the Committee members whether they have made different observations.

Analysis of whether guidance in IFRSs exists to account for the acquisition of an interest in a joint operation in circumstances in which the activity of the joint operation constitutes a business as defined in IFRS 3 (revised 2008)

Paragraph 2(b) of IFRS 3 (revised 2008)

12. Paragraph 2(b) of IFRS 3 (revised 2008) addresses the allocation of the cost of a group of assets to the individual identifiable assets and liabilities. The allocation basis given by that paragraph is relative fair values. In addition, it clarifies that the transactions or events addressed by this paragraph do not give rise to goodwill. Consequently, a premium paid for synergies would be allocated to the identifiable assets acquired on the basis of their relative fair values.

13. However, this paragraph addresses the acquisition of a group of assets that does not constitute a business as defined in IFRS 3 (revised 2008). In other words, the reason why such acquisitions are not within the scope of IFRS 3 (revised 2008) is not a lack of control. The reason why such acquisitions are not within the scope of IFRS 3 (revised 2008) is the fact that the group of assets acquired is not an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants; ie it is not a business as defined in Appendix A of IFRS 3 (revised 2008).
14. This conclusion that paragraph 2(b) of IFRS 3 (revised 2008) only addresses the acquisition of a group of assets that does not constitute a business as defined in IFRS 3 (revised 2008) is supported by paragraph BC20 of IFRS 3 (revised 2008). In developing IFRS 3 (revised 2008), the boards considered removing the distinction between groups of assets that qualify as a business and groups of assets that do not. The Board kept the distinction, however, in order not to delay the implementation of the revised standard's improvements to practice. Moreover, paragraph BC20 of IFRS 3 (revised 2008) states that paragraph 2(b) of IFRS 3 (revised 2008) describes the typical accounting for an asset acquisition.
15. In the scenario addressed by the submission, the activity of the joint operations does constitute a business as defined in IFRS 3 (revised 2008). In this case, though, the acquirer does not obtain control of that activity or business.
16. In addition, paragraph 2(b) of IFRS 3 (revised 2008) states that the acquisition addressed by this paragraph does not give rise to goodwill. We think that this indicates that goodwill cannot arise, because goodwill is typically related to a business and paragraph 2(b) of IFRS 3 (revised 2008) addressed only transactions or events that do not include goodwill.

Other guidance

17. In reflection of the view of many Committee members that IFRS 3 (revised 2008) is not one of the IFRSs applicable to the particular assets and liabilities in terms of paragraph 21 of IFRS 11 (issued May 2011), we think that there is no standard

that gives comprehensive and consistent guidance on the accounting for acquisition of interests in joint operations in circumstances in which the activity of the joint operation constitutes a business as defined in IFRS 3 (revised 2008).

18. Accordingly, entities acquiring such an interest must develop an accounting policy that takes into consideration paragraphs 10-12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

19. From our outreach to interested parties we noted that three approaches have been developed by preparers of IFRS financial statements in accounting for the acquisition of interests in jointly controlled operations or assets as specified in IAS 31 in circumstances in which the activity of the joint operation or assets constitutes a business as defined in IFRS 3 (revised 2008). Illustrated below are only the approaches applied by preparers of IFRS financial statements that do not consider such transactions to be within the scope of IFRS 3 (revised 2008):

    (a) **Fair value approach:** the guidance in IFRS 3 (revised 2008) and other standards related to business combinations are applied by analogy. Identifiable assets and liabilities are measured with few exceptions at fair value and the residual is recognised as goodwill. Furthermore, transaction costs are not capitalised and deferred taxes are recognised. Only guidance in IFRS 3 that is not appropriate for the acquisition of interest in a joint operation, eg the guidance on non-controlling interests, is not applied. Although the acquirer does not control the activity of the joint operation, IFRS 3 (revised 2008) and other standards that give guidance related to business combinations deal with a similar issue.

    (b) **Cost approach:** the total cost of acquiring the interest in the joint operation is allocated to the individual identifiable assets and liabilities on the basis of their relative fair values. Accordingly, a premium paid for synergies is allocated to the identifiable assets. Transaction costs are capitalised and deferred taxes are not recognised, because of the initial recognition exceptions in paragraph 15 and 24 of IAS 12 *Income Taxes*. We understand that this approach is based on analogy to the guidance in paragraph 2(b) of IFRS 3 (revised 2008). Notwithstanding the fact that the group of assets acquired in the fact pattern of the submission constitutes a

business as defined in IFRS 3 (revised 2008), the cost approach is considered appropriate by some, because cost is a basis for the initial recognition of assets in many standards, eg IAS 16 *Property, Plant and Equipment*, IAS 38 and IAS 40 *Investment Property*.

(c) **Combination approach:** the identifiable assets and liabilities are measured at fair value with very few exceptions and the residual is recognised as a separate asset, ie goodwill. The basis of this approach is the cost approach, but the guidance in IFRS 3 (revised 2008) is applied to issues that are not addressed elsewhere in IFRSs, eg the recognition and measurement of goodwill as a separate asset. We understand that the combination approach is a cost approach although it measures the identifiable assets and liabilities at fair value. The fair value of identifiable assets and liabilities is considered to be:

i. the consideration that acquirer would have given in a separate acquisition of the assets, ie the cost of an asset is its fair value at the acquisition date (see also paragraph 33 of IAS 38); or

ii. the consideration that the acquirer would have received to incur the liability.

The difference between the fair value approach and the combination approach is that in applying the combination approach the guidance in IFRS 3 on issues that are also addressed in other standards is not applied. Instead, the guidance in the other standards that are applicable to the particular assets and liabilities is applied. Accordingly, transaction costs are capitalised, contingent liabilities and deferred taxes are not recognised, deferred taxes because of the initial recognition exceptions in paragraph 15 and 24 of IAS 12.

20. For further details on these approaches, reference is made to the results from our outreach activities that we presented in paragraphs 4-7 in agenda paper 5 for the September 2011 Committee meeting. For ease of reference, the outreach results presented at the September 2011 Committee meeting are reproduced Appendix B to this paper.

21. We are not aware that any other approaches have been applied by preparers of IFRS financial statements in practice and we would be interested to hear from the

Committee members whether they have observed other approaches being applied in practice.

22. We think that all three approaches can be chosen in applying paragraphs 10-12 of IAS 8 for the following reasons:

    (a) **Fair value approach:** the guidance in IFRS 3 (revised 2008) and other standards related to business combinations deals with a similar issue.

    (b) **Cost approach:** historical cost is the most commonly adopted measurement basis in preparing IFRS financial statements (see paragraph 4.56 of the *Conceptual Framework* (issued 2010).

    (c) **Combination approach:** there is no general principle in IFRSs that determines when any specific measurement basis takes precedence over another. In addition, the recognition of goodwill as a separate asset better reflects the economic substance of the transaction. Allocation to the other assets acquired instead would result in their overstatement in the statement of financial position.

23. However, although these three approaches could be used by applying the guidance in paragraphs 10-12 of IAS 8, the diversity in practice is not addressed.

Analysis of the options to proceed with this project

24. We think that the Committee should address the issue for the following reasons:

    (a) The lack of guidance in IAS 31 on the accounting for the acquisition of an interest in jointly controlled operations or assets in circumstances in which the activity of the jointly controlled operations or assets constitutes a business as defined in IFRS (revised 2008) has resulted in significant diversity in practice.

    (b) It is expected that this diversity will continue after the adoption of IFRS 11 for the acquisition of interests in joint operation in circumstances in which the activity of the joint operation constitutes a business as defined in IFRS 3 (revised 2008); and

(c) entities acquiring interests in jointly controlled operations or assets or joint operations in circumstances in which the activity of the jointly controlled operations or assets or joint operation constitutes a business as defined in IFRS 3 (revised 2008) mostly spend significant time and effort in determining what they think the appropriate accounting should be.

25. Reducing that diversity in practice (and eliminating the need for each entity to develop from first principles its accounting policy) would be an improvement in financial reporting. For these reasons we discuss in the following paragraphs whether the issue should be addressed by the annual improvements process or by an interpretation.

Recommend to the Board not to add this issue to Annual Improvements

26. Proposed amendments qualify for inclusion in annual improvements if the proposed amendment has, among other things, a clarifying or correcting characteristic.
27. In reflection of the view of many Committee members that IFRS 3 (revised 2008) is not one of the IFRSs applicable to the particular assets and liabilities in terms of paragraph 21 of IFRS 11 (issued May 2011), we think that none of the approaches presented in paragraph 19 above would be clarifying or correcting in nature. Instead, they are new principles for a specific type of transaction. Consequently, we think that the approaches presented in paragraph 19 above cannot be addressed by the annual improvements process.

Issue interpretation

28. The Committee can take an issue onto its agenda and develop an interpretation if it can be resolved within the confines of existing IFRSs and the Framework, and within the demands of the interpretation process.
29. In reflection of the view of many Committee members that the IFRS 3 (revised 2008) is not one of the IFRSs applicable to the particular assets and liabilities in terms of paragraph 21 of IFRS 11 (issued May 2011), we are of the

opinion that one of the three approaches identified in paragraph 19 above would be required.

30. An interpretation would give comprehensive guidance for the acquisition of an interest in a joint operation in circumstances in which the activity of the joint operation constitutes a business as defined in IFRS 3 (revised 2008). It would do so by summarising the applicable principles given in other IFRSs.

Agenda criteria assessment

31. The staff's assessment of the Interpretations Committee's agenda criteria is as follows:

    (a) *The issue is widespread and has practical relevance.*

    Yes. Acquisitions of undivided interests in joint operations are expected to occur frequently in the oil and gas industry.

    (b) *The issue indicates that there are significantly divergent interpretations (either emerging or already existing in practice). The Committee will not add an item to its agenda if IFRSs are clear, with the result that divergent interpretations are not expected in practice.*

    Yes. Divergent views are expected to evolve on how to account for the acquisition of an interest in joint operation in circumstances in which the activity of the joint operation constitutes a business as defined in IFRS 3 (revised 2008).

    (c) *Financial reporting would be improved through elimination of the diverse reporting methods.*

    Yes. The different views are likely to lead to significantly different results, especially for goodwill.

    (d) *The issue can be resolved efficiently within the confines of existing IFRSs and the Framework, and the demands of the interpretation process.*

    Yes. All the approaches presented in paragraph 19 above (ie the **fair value approach**, the **cost approach** and the **combination approach**) give a guideline on how to address the issues related to the acquisition of an interest in a joint operation in circumstances in which the activity of the joint operation constitutes a business as defined in IFRS 3 (revised 2008).

    (e) *It is probable that the Committee will be able to reach a consensus on the issue on a timely basis.*

    Yes. See the previous subparagraph 31(d).

    (f) *If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB*

project? (The IFRIC will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the IFRIC would require to complete its due process.)

No. Equity method accounting is a suggested project for the Board's future agenda. However, a project on equity method accounting would only relate to joint ventures as defined in IFRS 11 and not to joint operations as defined in IFRS 11.

Staff recommendation

32. To avoid significant diversity in practice after the adoption of IFRS 11, we recommend developing an interpretation on the accounting for the acquisition of an interest in a joint operation in circumstances in which the activity of the joint operation constitutes a business as defined in IFRS 3 (revised 2008).
33. We recommend developing an interpretation based on either the **fair value** or the **combination approach** presented in paragraph 19(a) and (c) of this agenda paper. We recommend one of these approach because it leads to a separate recognition of goodwill, if any:
    (a) Separate recognition of goodwill as an asset better reflects the economic substance of the transaction. Allocation to the other assets acquired instead typically results in their overstatement in the statement of financial position.
    (b) Measurement of identifiable assets acquired and liabilities assumed at fair value provides information that is more comparable and understandable than measurement on a basis of allocating the total cost of an acquisition, including a premium paid for synergies (see also paragraph BC198 of IFRS 3 revised 2008).
    (c) Separate recognition of goodwill aligns with the transition guidance in Appendix C of IFRS 11 relating to circumstances in which an entity changes from the equity method to accounting for assets and liabilities in respect of the interest in the joint operation. This guidance states that the entity shall recognise 'its share of each of the assets and the liabilities in respect of its interest in the joint operation, **including any goodwill** that might have formed part of the carrying amount of the investment'

(emphasis added. See paragraph C7 of IFRS 11). Following the **cost approach** presented in paragraph 19(b) above instead, goodwill would never be recognised on the formation of a joint operation or the acquisition of an interest in a joint operation. Consequently, the only goodwill related to an interest in a joint operation as defined in IFRS 11 that would be recognised in the financial statements prepared by applying IFRS 11 would be goodwill recognised on the transition from the equity method to accounting for assets and liabilities. This however means that the Board has accepted, merely for transition purposes, an asset that cannot arise from ongoing accounting for interests in joint operations under IFRS 11. Moreover, this mere transition goodwill may last for a long time in the financial statements of the joint operator, because goodwill only disappears from the financial statements if it is impaired or disposed of.

34. Considering the fair value approach and the combination approach, we recommend developing an interpretation based on the combination approach, because:

   (a) it closer aligns with the requirements in the IFRSs that apply to the assets and liabilities recognised on the acquisition of an interest in a joint operation. IAS 16, for example, is the IFRS applicable to property, plant and equipment recognised as an asset on the acquisition of an interest in a joint operation and it requires to capitalise transaction cost. Moreover, contingent liabilities are in compliance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* not recognised until they become provision. Deferred taxes are not recognised at the initial recognition in accordance with paragraphs 15 and 24 of IAS 12 because it is not a business combination.

   (b) the measurement basis most commonly adopted by entities in preparing their financial statements is historical cost.

Questions to the IFRS Interpretations Committee

Questions for the Committee
Does the Committee agree with the staff analysis in paragraphs 4-31?
Can the Committee members give examples of synergies that are recognised as a separate asset under IFRSs other than IFRS 3 (revised 2008)?
The staff observed that three approaches (the **fair value approach**, **cost approach** and **combination approach**) have been developed in practice based on the guidance in paragraph 10-12 of IAS 8 to account for the acquisition of interests in jointly controlled operations or assets as specified in IAS 31 in circumstances in which the activity of the jointly controlled operations or assets constitutes a business as defined in IFRS 3 (revised 2008). Have the Committee members observed any other approaches that have been developed in practice?
Does the Committee agree to take this issue onto its agenda and to develop an interpretation based on the **combination approach** presented in paragraph 19(c) of the agenda paper

Appendix A—relevant IFRS literature

Extracts from the *Conceptual Framework for Financial Reporting* (issued 2010)

4.56 The measurement basis most commonly adopted by entities in preparing their financial statements is historical cost. This is usually combined with other measurement bases. For example, inventories are usually carried at the lower of cost and net realisable value, marketable securities may be carried at market value and pension liabilities are carried at their present value. Furthermore, some entities use the current cost basis as a response to the inability of the historical cost accounting model to deal with the effects of changing prices of non-monetary assets.

Extracts from IFRS 3 *Business Combinations* (revised 2008)

Scope

2 This IFRS applies to a transaction or other event that meets the definition of a business combination. This IFRS does not apply to:

(a) the formation of a joint venture.

(b) the acquisition of an asset or a group of assets that does not constitute a *business*. In such cases the acquirer shall identify and recognise the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, *intangible assets* in IAS 38 *Intangible Assets*) and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative *fair values* at the date of purchase. Such a transaction or event does not give rise to goodwill.

(c) a combination of entities or businesses under common control (paragraphs B1–B4 provide related application guidance).

App. A **business** An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

BC20 The boards considered whether to expand the scope of the revised standards to all acquisitions of groups of assets. They noted that doing so would avoid the need to distinguish between those groups that are businesses and those that are not. However, both boards noted that broadening the scope of the revised standards beyond acquisitions of businesses would require further research and deliberation of additional issues and delay the implementation of the revised standards' improvements to practice. The boards therefore did not extend the scope of the revised standards to acquisitions of all asset groups. Paragraph 2(b) of the revised IFRS 3 describes the typical accounting for an asset acquisition.

Reasons for the contractual-legal criterion

BC163 In developing IFRS 3 and SFAS 141, the IASB and the FASB observed that many intangible assets arise from rights conveyed legally by contract, statute or similar means. For example, franchises are granted to car dealers, fast food outlets and professional sports teams. Trademarks and service marks may be registered with the government. Contracts are often negotiated with customers or suppliers. Technological innovations are often protected by patents. In contrast, goodwill arises from the collection of assembled assets that make up an acquiree or the value created by assembling a collection of assets through a business combination, such as the synergies that are expected to result from combining two or more businesses. Therefore, both boards concluded that the fact that an intangible asset arises from contractual or other legal rights is an important characteristic that distinguishes many

intangible assets from goodwill and an acquired intangible asset with that characteristic should be recognised separately from goodwill.

Reasons for the separability criterion

BC164 As already noted (paragraph BC161), the original version of IAS 38 included separability as a characteristic that helps to distinguish intangible assets from goodwill. In developing IFRS 3, the IASB affirmed that conclusion for the reasons discussed in the following paragraphs.

BC166 The FASB's 2001 Exposure Draft proposed that an intangible asset that was not separable individually would meet the separability criterion if it could be sold, transferred, licensed, rented or exchanged along with a group of related assets or liabilities. Some respondents suggested that the FASB should eliminate that requirement, arguing that unless the asset is separable individually it should be included in the amount recognised as goodwill. Others asked the FASB to clarify the meaning of the term *group of related assets*, noting that even goodwill can be separated from the acquiree if the asset group sold constitutes a business.

BC167 The FASB noted that some intangible assets are so closely related to another asset or liability that they are usually sold as a 'package' (eg deposit liabilities and the related depositor relationship intangible asset). If those intangible assets were subsumed into goodwill, gains might be inappropriately recognised if the intangible asset was later sold along with the related asset or obligation. However, the FASB agreed that the proposed requirement to recognise an intangible asset separately from goodwill if it could be sold or transferred as part of an asset group was a broader criterion than it had intended. For those reasons, SFAS 141 provided, as do the revised standards, that an intangible asset that is not separable individually meets the separability criterion if it can be separated from the entity and sold, transferred, licensed, rented or exchanged in combination with a related contract, other identifiable asset or other liability.

Why establish fair value as the measurement principle?

Identifiable assets acquired and liabilities assumed

BC198 In developing the measurement principle in the revised standards, the boards concluded that fair value is the most relevant attribute for assets acquired and liabilities assumed in a business combination. Measurement at fair value also provides information that is more comparable and understandable than measurement at cost or on the basis of allocating the total cost of an acquisition. Both IFRS 3 and SFAS 141 required allocation of that cost on the basis of the fair value of the assets acquired and the liabilities assumed. However, other guidance in those standards required measurements that were other than fair value. Moreover, SFAS 141's requirements for measuring identifiable assets acquired and liabilities assumed in an acquisition achieved in stages (a step acquisition) and in acquisitions of less than all of the equity interests in the acquiree resulted in another difference between fair value measurement of identifiable assets and liabilities and the process of accumulating and allocating costs. Those requirements were the same as the benchmark treatment in IAS 22, which IFRS 3 replaced. The following paragraphs discuss both the IASB's reasons for that change to IAS 22 and the FASB's reasons for the change to SFAS 141's requirements for step acquisitions, as well as providing additional discussion of the reasons for the fair value measurement principle in the revised standards.

Extracts from IFRS 11 *Joint Arrangements*

21 A joint operator shall account for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the IFRSs applicable to the particular assets, liabilities, revenues and expenses.

C7 When changing from the equity method to accounting for assets and liabilities in respect of its interest in a joint operation, an entity shall, at the beginning of the earliest period presented, derecognise the investment that was previously accounted for using the equity method and any other items that formed part of the entity's net investment in the arrangement in accordance with paragraph 38 of IAS 28 (as amended in 2011) and recognise its share of each of the assets and the liabilities in respect of its interest in the joint operation, including any goodwill that might have formed part of the carrying amount of the investment.

Extracts from IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

10 **In the absence of an IFRS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:**

- **(a) relevant to the economic decision-making needs of users; and**
- **(b) reliable, in that the financial statements:**
  - **(i) represent faithfully the financial position, financial performance and cash flows of the entity;**
  - **(ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;**
  - **(iii) are neutral, ie free from bias;**
  - **(iv) are prudent; and**
  - **(v) are complete in all material respects.**

11 **In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:**

- **(a) the requirements in IFRSs dealing with similar and related issues; and**
- **(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Framework*.***

* In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

12 **In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11.**

Extracts from IAS 12 *Income Taxes*

Taxable temporary differences

15 **A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:**

- **(a) the initial recognition of goodwill; or**
- **(b) the initial recognition of an asset or liability in a transaction which:**
  - **(i) is not a business combination; and**
  - **(ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).**

However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, a deferred tax liability shall be recognised in accordance with paragraph 39.

Deductible temporary differences

24 **A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:**

- **(a) is not a business combination; and**

(b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, a deferred tax asset shall be recognised in accordance with paragraph 44.

Extracts from IAS 38 *Intangible Assets*

Identifiability

11 The definition of an intangible asset requires an intangible asset to be identifiable to distinguish it from goodwill. Goodwill recognised in a business combination is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised. The future economic benefits may result from synergy between the identifiable assets acquired or from assets that, individually, do not qualify for recognition in the financial statements.

12 An asset is identifiable if it either:

(a) is separable, ie is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or

(b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

33 In accordance with IFRS 3 *Business Combinations*, if an intangible asset is acquired in a business combination, the cost of that intangible asset is its fair value at the acquisition date. The fair value of an intangible asset will reflect expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for intangible assets acquired in business combinations. If an asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure reliably the fair value of the asset. Thus, the reliable measurement criterion in paragraph 21(b) is always considered to be satisfied for intangible assets acquired in business combinations.

Appendix B—Extract from agenda paper 5 presented at the September 2011 Committee meeting

Paragraphs 4-7 are an extract from agenda paper 5 presented by us at the September 2011 Committee meeting:

Outreach activities after the July 2011 Committee meeting

Interested parties

4. After the July 2011 Committee meeting, we had some conference calls with interested parties. These were mostly companies in the extractive industries from several jurisdictions all over the world.

5. As a result of those outreach activities, we have received the following observations from interested parties:

   (a) All interested parties experienced a significant lack of explicit guidance in IAS 31 when accounting for the acquisition of interests in jointly controlled operations or assets in circumstances where the activity of the jointly controlled operations or assets constitutes a business as defined in IFRS 3. As a result, some of these entities had spent significant time and effort in determining what they thought the appropriate accounting should be. In addition, we noted from the discussions that this lack of guidance has resulted in significant diversity in practice.

   (b) For transactions in which goodwill is present (eg a premium is paid for synergies), the interested parties observed two different views on accounting for that goodwill:

      i. A minority of interested parties do not recognise such goodwill as a separate asset. Instead, they allocate the amount paid for the synergistic benefits to the other assets acquired (**view** 1). They do not recognise goodwill as a separate asset because they consider the transaction not to be within the scope of IFRS 3,

because the acquirer does not control the (entire) activity/business.

ii. The majority of interested parties, however, support the recognition of goodwill, if any, as a separate asset and apply a policy based on the guidance in IFRS 3 and to the recognition and measurement of goodwill (**view 2**). Proponents of this view think that the recognition of goodwill as a separate asset better reflects the economic substance of the transaction than an allocation of the cost of that goodwill to the other assets acquired.

(c) Among the proponents of **view 2** (ie recognition of goodwill as a separate asset), there are divergent views on whether the guidance in IFRS 3 should in principle be applied in its entirety to acquisitions of interests in jointly controlled operations or assets, or whether only the elements in IFRS 3 that are specific to business combinations and that are not addressed elsewhere in IFRS literature should be applied:

i. A minority of interested parties think that IFRS 3 should be applied in its entirety for various reasons (**view 2A**). Some of those who think that IFRS 3 applies do so because they think that the acquisition of an interest in a joint operation is within the scope of IFRS 3. Others who would also apply IFRS 3 do so because they note that only IFRS 3 gives a comprehensive and consistent set of accounting principles for the different components of the transaction.

ii. The majority of interested parties, however, would only apply the guidance for business combinations in IFRS 3 to issues that are not addressed elsewhere in IFRSs, eg the recognition and measurement of goodwill as a separate asset (**view 2B**). Accordingly, they thought that:

   i. contrary to paragraph 53 of IFRS 3 (amended 2008), transaction costs can be capitalised;

   ii. deferred taxes should not be recognised, because of the initial recognition exceptions in paragraphs 15 and 24 of IAS 12 *Income Taxes*.

iii. Issues on which the proponents of **view 2** did not express a particular view were:

   i. the accounting for contingent consideration; and

   ii. the adjustment of provisional fair values during the measurement period following acquisition date (paragraphs 45-50 of IFRS 3).

   The absence of particular views on these issues resulted from the following reasons:

   i. the issue of contingent consideration has not arisen so far in practice for the interested parties within the context of the acquisitions of interests in jointly controlled operations or assets; and

   ii. several proponents of **view 2** are not concerned about the application of the measurement period, because revisions of significant estimates (recognised in current period profit or loss) are common in their industry.

6. In addition to these general observations from the discussions with interested parties on the application of the guidance in IFRS 3, we also received the following ones:

   (a) One interested party argued that there is no substantial difference from an accounting perspective between:

      i. acquiring an interest in existing jointly controlled operations or assets; and

      ii. the formation of jointly controlled operations or assets by two or more venturers each contributing their businesses to the jointly controlled operations or assets.

      In both scenarios, the venturer acquires shares in the assets of the jointly controlled operations or assets. In the first scenario, the venturer acquires shares in the assets and liabilities of the existing jointly controlled operations or assets. In the second scenario, the venturer acquires shares in the assets and liabilities contributed by the other venturers.

On the basis of this observation, the interested party argued that the scope exemption for formations of joint ventures in paragraph 2(a) of IFRS 3 precludes the application of the guidance in IFRS 3 to the acquisition of interests in jointly controlled operations or assets.

(b) One interested party questioned whether the application of IFRS 3 to the acquisition of interests in jointly controlled operations or assets might result in the recognition of internally generated goodwill. Recognising internally generated goodwill is prohibited by paragraph 48 of IAS 38 *Intangible Assets*.

7. Nearly all interested parties noted that it was too early to say whether the accounting for such transactions will change as a result of the implementation of IFRS 11.