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Project **Annual Improvements—2010-2012 cycle**

Topic **IFRS 11 *Joint Arrangements*—Acquisition of interest in joint operation**

Introduction

1. In May 2011, the IFRS Interpretations Committee (the Committee) received a request to clarify the applicability of IFRS 3 *Business Combinations* by:

   (a) joint operators for the acquisition of interests in joint operations as defined in IFRS 11 *Joint Arrangements*; and

   (b) venturers for the acquisition of interests in jointly controlled operations or assets as specified in IAS 31 *Interests in Joint Ventures*

   in circumstances where the activity of the joint operation, or the activity of the jointly controlled operations or assets, constitutes a business as defined in IFRS 3. The Committee was asked whether the acquirer of such an interest should apply the principles in IFRS 3 on the initial recognition of the interest or whether the acquirer should instead account for it as the acquisition of a group of assets.

2. The Committee discussed the issue in the July 2011 meeting, with the July 2011 IFRIC Update reporting that:

   > The Committee noted that the issue raised the question of what unit of account (the joint arrangement or the interest in the joint arrangement) is to be considered for the application of IFRS 3 and whether the activities and assets related to that unit of account can constitute a business. More specifically, the question is whether, and how, to recognise goodwill, if present, on the acquisition of an

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IFRS Interpretations Committee or the IASB. 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*.

Interpretations are published only after the IFRS Interpretations Committee and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in IASB *Update*.

interest in a joint operation as defined in IFRS 11 or jointly controlled operations or assets as specified in IAS 31. The submitted example was that of the acquisition of an undivided interest in an oil or natural gas producing field.

The Committee directed the staff to do further analysis on this issue with the aim of assessing whether the issue could be solved through annual improvement. The staff will present further analysis at the meeting in September 2011.

Purpose of the paper

3. This paper:

   (a) provides an update on outreach activities carried out since the last Committee meeting;

   (b) analyses the issue further within the context of IFRSs;

   (c) assesses the issue against the Annual Improvements criteria;

   (d) makes a recommendation that the Board should amend IFRS 11 through Annual Improvements; and

   (e) asks whether the Committee agrees with our recommendation.

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.

Outreach request

8. We have undertaken outreach to the National Standard Setters group and IOSCO to assess the Committee's agenda criteria; in particular, whether:

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

   (b) The issue indicates that there are significant divergent interpretations (either emerging or existing in practice).

9. To address these criteria we sent out a request for information to the National Standard Setters group and IOSCO.

10. The questions asked to the National Standard Setters group and IOSCO were as follows:

> 1. What is the prevalence of this issue in practice in your experience? This is, how common or widespread (within your jurisdiction) is the acquisition of interests in jointly controlled operations or assets as specified in IAS 31?
>
> 2. What diversity in accounting for such transactions do you see in practice?
>
> If acquisitions of interests in jointly controlled operations or assets as specified in IAS 31 are common (in your jurisdiction/in practice), I would greatly appreciate it if you could also provide information on the following questions:
>
> 3. What are the industry sectors in which the acquisition of interests in jointly controlled operations or assets as specified in IAS 31 is prevalent?
>
> 4. What accounting policies do preparers of IFRS financial statements apply in recognising interests in jointly controlled operations or assets acquired? Please give details.
>
> 5. Do the accounting policies differ depending on whether the jointly controlled operations or assets constitute a business as defined in IFRS 3? In particular, do preparers of IFRS financial statements apply the guidance in IFRS 3 or the concepts underlying IFRS 3

when accounting for the acquisition of interests in jointly controlled operations or assets that constitute businesses as defined in IFRS 3?

6. Do preparers of IFRS financial statements recognise goodwill and deferred taxes on the acquisition of interests in jointly controlled operations or assets?

7. Do preparers of IFRS financial statements (in your jurisdiction) expect changes in the accounting for the acquisition of interests in jointly controlled operations or assets from the implementation of IFRS 11?

(…) Differences between the questions asked to the National Standard Setters group and IOSCO are presented in brackets.

11. The request was still outstanding as we were preparing this agenda paper. At the September 2011 Committee meeting, we will provide the Committee with an update of the results of this outreach and of the outreach to IOSCO.

Further discussions

12. Constituents told us that acquisitions of interests 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 3 are not only common in extractive industries, but also arise in other industry sectors such as:

    (i) real estate;

    (ii) construction;

    (iii) the automotive industry; and

    (iv) telecommunications.

13. One constituent explained that synergistic benefits in the telecommunications sector result, for example, from:

    (a) being able to negotiate better prices with suppliers and distributers;

    (b) the creation of a joint network that covers more countries and areas. Such a joint network may even become a global network and being able to provide global services is especially relevant for global clients; and

    (c) an increased ability to compete with larger competitors.

14. We will continue our outreach efforts with interested parties and will report any additional views to the Committee.

Staff analysis

15. We analyse the issue and the arguments given by the interested parties against the guidance in IFRS 11 only. This is because any change that might be proposed on this issue through Annual Improvements would probably have an effective date after 1 January 2013, when IFRS 11 supersedes IAS 31.
16. We reproduce for ease of reference in Appendix A the paragraphs from the standards that we used to perform our analysis.
17. In particular, our analysis addresses the following issues:
    (a) unit of account;
    (b) applicable IFRSs;
    (c) recognising goodwill as a separate asset;
    (d) applicable IFRS for goodwill;
    (e) applying IFRS 3 in its entirety;
    (f) controlling the business acquired; and
    (g) responses to other concerns raised by interested parties.

Unit of account

18. Paragraphs BC20 and BC35 of IFRS 11 clarify that the 'unit of account' of a joint arrangement is **the activity** that two or more parties have agreed to control jointly, and that a party should assess its rights to the assets, and obligations for the liabilities, relating to that activity. In addition, Appendix A of IFRS 11 defines joint control as the contractually agreed sharing of control of the arrangement.

19. We conclude from this guidance that the 'unit of account' of a joint arrangement is the activity that the parties contractually agreed to control jointly. A joint operator accounts for this by recognising, in accordance with the contractual arrangement, its (share of) assets, liabilities, revenues and expenses relating to the activity that is subject to joint control, and it does so by applying the applicable IFRSs. We therefore think that it is not the individual assets and liabilities recognised that are the unit of account, but the venturer's interest in the activity as a whole.

Applicable IFRSs

20. IFRS 11 gives guidance on the accounting for interests in joint arrangements. It does so by indicating when it is appropriate to account for this interest according to the equity method (joint venture) and when it is appropriate recognise assets, liabilities, revenues and expenses related to that interest (joint operation). Rather than giving accounting guidance directly, IFRS 11 refers to IAS 28 *Investments in Associates and Joint Ventures* (as amended in 2011) for guidance on applying the equity method for accounting for interests in joint ventures and it refers to the 'IFRSs applicable to the particular assets, liabilities, revenues and expenses' to account for interests in joint operations.

21. We think that the reference to the IFRSs applicable to the particular assets, liabilities, revenues and expenses indicates that the Board thought that there is relevant guidance in other IFRSs to enable the joint operator to account for its interest in a joint operation.

Recognising goodwill as a separate asset

22. Analysing the acquisition of an interest in a joint operation whose activity is a business might result in the conclusion that the acquirer had paid a premium for goodwill, eg for synergies. Synergistic benefits are a typical (and a core) component of separately-recognised goodwill in a business combination (see the Board's analysis presented in paragraphs BC313 to BC318 of IFRS 3). We

understand that it is common for entities to enter into joint arrangements because of the expected synergies.

23. We agree with the proponents of **view 2** that such goodwill should be recognised as a separate asset and should not be allocated to the other assets acquired as part of the interest in the joint operation. We think that separate recognition of goodwill as an 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.

24. We think that there are several aspects of the standards that support the view that goodwill should be recognised as a separate asset within the context of the acquisition of an interest in a joint operation when that joint operation includes a business:

    (a) the Board was aware that goodwill can arise on the acquisition of an interest in an activity that is classified as a joint operation (paragraph BC65 of IFRS 11);

    (b) the Board acknowledged that a 'business' as defined in IFRS 3 can be found in all types of joint arrangements (paragraph BC29 of IFRS 11), which includes joint operations;

    (c) the Board noted only two main differences between recognising assets, liabilities, revenues and expenses relating to the activity of the joint operation and proportionate consolidation (paragraph BC38 of IFRS 11). These two main differences are:

        (i) IFRS 11 requires a joint operator to recognise assets, liabilities, revenues and expenses according to the joint operator's share in the assets, liabilities, revenues and expenses of the joint operation as determined and specified in the contractual arrangement, rather than basing their recognition on the ownership interest that the joint operator has in the joint operation; and

(ii) there is no difference in accounting for the joint operator's interest in the joint operation between the joint operator's separate financial statements and its consolidated financial statements.

We note that paragraph 33 of IAS 31 and paragraph 18 of IAS 27 *Consolidated and Separate Financial Statements* (amended 2010) clearly require the adoption of the concepts underlying IFRS 3 when using proportionate consolidation, which we think would include the recognition of goodwill. However, the Board did not identify the recognition of goodwill as being one of the main differences between the application of proportionate consolidation and accounting for a joint operation;

(d) the transition guidance in Appendix C of IFRS 11 relating to the circumstances when an entity changes from the equity method to accounting for assets and liabilities in respect of the interest in the joint operation 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).

25. Some argue against the recognition of goodwill as a separate asset on the basis that the joint operator does not control the goodwill. We think that the Board decided that the joint operator should ignore the fact that it does not control a jointly held asset when applying the guidance in other IFRSs to that jointly held asset. The fact that it does not control the jointly held asset is reflected in the financial statements of the joint operator, by recognising only the joint operator's share of that asset instead of the entire asset (see paragraph 20(a) of IFRS 11). These conclusions are illustrated by the example used by the Board, namely that the joint operator's share in a jointly controlled physical asset is classified as property, plant and equipment and not as an intangible asset for the right to use the physical asset (see paragraphs BC39 and IE8 of IFRS 11), even though the joint operator does not control the entire item of physical form (eg a pipeline).

Applicable IFRS for goodwill

26. We note that IFRS 11 does not explicitly refer to the application of IFRS 3 for the recognition and measurement of goodwill, but nor does it explicitly state that the application of IFRS 3 would be inappropriate. However, the only IFRS that deals with the recognition of goodwill as a separate asset in the statement of financial position is IFRS 3. Consequently, we think that the guidance in IFRS 3 on the recognition and measurement of goodwill should be applied to goodwill that is acquired as part of an interest in a joint operation.
27. IFRS 3 applies a residual approach to the measurement of goodwill. This approach ensures that the initial recognition of an interest in a business with (positive) goodwill has no impact on profit or loss. The question that arises, and that was present in the discussions that we had with interested parties, is whether IFRS 3 should be applied in its entirety to the acquisition of an interest in a joint operation, or whether only parts of it should be applied, and in which case, which parts?

Applying IFRS 3 in its entirety

28. As noted above, when discussing with interested parties the recognition of goodwill on acquisition of an interest in a joint arrangement, there were different views held on whether IFRS 3 should also be applied to the accounting for transaction costs and to the recognition of deferred tax on the initial recognition of the joint operator's assets and liabilities arising from the joint operation.
29. We understand that the main argument for capitalising transaction costs is that those holding this view consider the accounting for joint arrangements to be generally a cost accumulation approach, unlike IFRS 3 which takes a fair value approach for initial recognition. The argument given against recognising deferred tax on acquisition of an interest in a joint operation is that the initial recognition exemption in IAS 12 *Income Taxes* applies to all circumstances other than business combinations, or when accounting profit or taxable profit is affected on initial recognition; neither of which applies in this circumstance.

30. However, we think that application of the guidance on business combinations in IFRS 3 in its entirety to the acquisition of interests in joint operations is preferable when compared to applying the guidance on business combinations in IFRS 3 only to assets and liabilities and issues for which there is no guidance in other standards. This is because IFRS 3, together with the guidance on business combinations in other standards (for example IAS 12 and IAS 36 *Impairment of Assets*), gives a comprehensive and consistent set of accounting guidance for the acquisition of an interest in a business. We prefer this approach for the following reasons:

    (a) The Board noted that measurement at fair value provides information that is more comparable and understandable than measurement at cost or on the basis of allocating the total cost of an acquisition (see paragraph BC198 of IFRS 3).

    (b) For certain assets and liabilities and issues, only IFRS 3 gives guidance that is tailored to the specific situation of acquiring a group of assets and liabilities that constitute a business. These are, for example:

        (i) indemnification assets (see paragraph 27 and 57 of IFRS 3);

        (ii) the guidance on the measurement period (see paragraphs 45-50 of IFRS 3); and

        (iii) determining what is part of a business combination (see paragraphs 51 and 52 of IFRS 3).

31. Summarising the issue, we think that the all relevant guidance on business combinations in IFRS 3 should be applied when an interest in a joint operation (that includes a business) is acquired. We think that only the parts of IFRS 3 that clearly do not apply, such as accounting for non-controlling interests in the acquiree, should be excluded.

Controlling the business acquired

32. Proponents of the view that the guidance in IFRS 3 does not apply to the acquisition of an interest in jointly controlled operations or assets make particular reference to the fact that a joint operator does not control the (entire) activity of the joint operation.

    We think that this lack of control over the entire activity/business should not preclude the application of the relevant guidance on business combinations in IFRS 3. Control over an activity and related assets within the context of accounting for interests in joint operations can only relate to the joint operator's interest, ie to its participation in the activity including its share of the assets that form part of the joint operation. There would otherwise be an inconsistency with the conclusion of the Board that a share in a physical asset is classified as property, plant and equipment, even though the joint operator does not control the (entire) physical asset (see paragraph BC39 and IE8 of IFRS 11).

Responses to other concerns raised by interested parties

Scope exemption

33. We think that the scope exemption in paragraph 2(a) of IFRS 3 does not preclude the application of the guidance in IFRS 3 on the acquisition of interests in joint operations in which the activity of the joint operation constitutes a business as defined in IFRS 3 (see paragraph 6(a) above).

34. The scope exemption in paragraph 2(a) of IFRS 3 excludes joint ventures, which is one specific type of joint arrangement. We therefore think that accounting for joint operations is not excluded from the scope of IFRS 3.

Recognition of internally generated goodwill

35. We disagree with the assessment that recognition of goodwill would result in the recognition of internally generated goodwill (see paragraph 6(b) above). We think that there are four general elements to the goodwill present, of which only one would represent internally generated goodwill that could not be recognised.

If two venturers contribute their existing businesses to form a joint operation, we think that the four general elements of goodwill are as follows:

(a) The goodwill already included in the business that the venturer itself contributed—this is internally generated goodwill which should not be recognised;

(b) The venturer's share of goodwill present in the business contributed by the other venturer—this is not internally generated goodwill and should be recognised.

(c) The venturer's share of goodwill related to synergies arising from combining the two businesses contributed by the venturers—this is not internally generated goodwill and should be recognised.

(d) The goodwill that arises from synergies between the activities of the jointly controlled operations /assets and the venturer's other existing businesses—this is not internally generated goodwill and should be recognised.

Staff recommendation

36. We conclude from our analysis of the issue that IFRS 3 is the IFRS applicable to the particular assets and liabilities arising from the acquisition of an interest in a joint operation if the joint operation includes a business as defined in IFRS 3.

37. We noted that significant uncertainty (and therefore diversity) exists in accounting for the acquisition of an interest in jointly controlled operations or assets as specified in IAS 31 in circumstances where the activity of the jointly controlled operations or assets constitutes a business as defined in IFRS 3. This is because there is no explicit guidance in IAS 31 for such transactions. We expect that this significant diversity in practice will continue under IFRS 11 unless the Committee or the Board provides some kind of clarification.

38. However, we also note that some of the guidance in IFRS 3 would not be applicable to the acquisition of interests in joint operations. For example, the acquirer of an interest in a joint operation does not recognise non-controlling

interests in the acquiree; it only recognises its share of the assets and liabilities related to its interest in the joint operation, not the shares of the other parties to the joint operation.

39. To avoid significant diversity in practice continuing after the adoption of IFRS 11, we recommend developing application guidance for IFRS 11 on this issue. This guidance could explain how to account for the acquisition of an interest 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. The application guidance would clarify which guidance in IFRS 3, and which guidance related to business combinations in other standards such as IAS 12, should be applied in accounting for this kind of transaction.

40. We think that such application guidance could be introduced to IFRS 11 by an annual improvement because it is clarifying the requirements of IFRS 11.

41. This proposal is subject to the reservation. It is based on the expectation that the forthcoming results from the outreach to the National Standard Setters group and IOSCO, and the results from further discussions with interested parties, will not indicate that the conclusions of the Committee should be different. We will report the results of this further outreach to the Committee at the September meeting.

42. If the Committee agrees with our proposal, we would present a detailed analysis on the applicability of the guidance in IFRS 3 and guidance related to business combinations in other standards, together with a draft annual improvement, in a future Committee meeting.

Annual improvements criteria assessment

43. We have assessed the proposed amendment against the enhanced annual improvements criteria, which are reproduced in full below. In planning whether an issue should be addressed by amending IFRSs within the annual improvements project, the IASB assesses the issue against the following criteria.

All the criteria (a)-(d) must be met to qualify for inclusion in annual improvements:

Annual improvements criteria	Staff assessment of the proposed amendment
(a) The proposed amendment has one or both of the following characteristics: (i) clarifying—the proposed amendment would improve IFRSs by: • clarifying unclear wording in existing IFRSs, or • providing guidance where an absence of guidance is causing concern. A clarifying amendment maintains consistency with the existing principles within the applicable IFRSs. It does not propose a new principle, or a change to an existing principle. (ii) correcting—the proposed amendment would improve IFRSs by: • resolving a conflict between existing requirements of IFRSs and providing a straightforward rationale for which existing requirement should be applied, or • addressing an oversight or relatively minor unintended consequence of the existing requirements of IFRSs. A correcting amendment does not propose a new principle or a change to an existing principle, but may create an exception from an existing principle.	(a) Yes. The proposed amendment clarifies the accounting for the acquisition of interests in joint operations where the absence of explicit guidance is causing concern about significant diversity in practice. The clarifying amendment maintains consistency with the existing principles in IFRS 11 for the accounting for interests in joint operations.
(b) The proposed amendment is well defined and sufficiently narrow in scope such that the consequences of the proposed change have been considered.	(b) Yes. We believe that the proposed amendment is well defined and is sufficiently narrow in scope such that the consequences of the proposed change have been considered—it ensures consistent accounting for the acquisition of an interest in joint operations where the activity of the joint operation constitutes a business as defined in IFRS 3.

(c) It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach conclusion on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.	(c) Yes. We think that the IASB could reach a conclusion on this issue on a timely basis, if it confirms our conclusion that IFRS 3 and the guidance in other standards on business combinations are the applicable IFRSs for assets and liabilities acquired as part of an interest in a joint operation in circumstances where the activity of the joint operation constitutes a business as defined in IFRS 3.
(d) If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a need to make the amendment sooner than the project would.	(d) No. The only project that might be related to joint arrangements is the project on equity method accounting that has been suggested for the Board's future agenda. However, this project would only relate to joint ventures as defined in IFRS 11 and not to joint operations as defined in IFRS 11.

44. Following the analysis in the table above, in our opinion, the proposed amendment satisfies the annual improvements criteria.

Questions for the Committee
1. Does the Committee agree with the staff's analysis in paragraphs 15-35? 2. Does the Committee agree that application guidance would improve consistent application and financial reporting? 3. Does the Committee agree with our proposal that the Committee should recommend that the Board should address this issue through the annual improvements process?

Appendix A—relevant IFRS literature

Extracts from IFRS 3 *Business Combinations*

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).

27 The seller in a business combination may contractually indemnify the acquirer for the outcome of a contingency or uncertainty related to all or part of a specific asset or liability. For example, the seller may indemnify the acquirer against losses above a specified amount on a liability arising from a particular contingency; in other words, the seller will guarantee that the acquirer's liability will not exceed a specified amount. As a result, the acquirer obtains an indemnification asset. The acquirer shall recognise an indemnification asset at the same time that it recognises the indemnified item measured on the same basis as the indemnified item, subject to the need for a valuation allowance for uncollectible amounts. Therefore, if the indemnification relates to an asset or a liability that is recognised at the acquisition date and measured at its acquisition-date fair value, the acquirer shall recognise the indemnification asset at the acquisition date measured at its acquisition-date fair value. For an indemnification asset measured at fair value, the effects of uncertainty about future cash flows because of collectibility considerations are included in the fair value measure and a separate valuation allowance is not necessary (paragraph B41 provides related application guidance).

Measurement period

45 If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of

the amounts recognised as of that date. During the measurement period, the acquirer shall also recognise additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as of that date. The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

46 The measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognised for a business combination. The measurement period provides the acquirer with a reasonable time to obtain the information necessary to identify and measure the following as of the acquisition date in accordance with the requirements of this IFRS:

(a) the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree;

(b) the consideration transferred for the acquiree (or the other amount used in measuring goodwill);

(c) in a business combination achieved in stages, the equity interest in the acquiree previously held by the acquirer; and

(d) the resulting goodwill or gain on a bargain purchase.

47 The acquirer shall consider all pertinent factors in determining whether information obtained after the acquisition date should result in an adjustment to the provisional amounts recognised or whether that information results from events that occurred after the acquisition date. Pertinent factors include the date when additional information is obtained and whether the acquirer can identify a reason for a change to provisional amounts. Information that is obtained shortly after the acquisition date is more likely to reflect circumstances that existed at the acquisition date than is information obtained several months later. For example, unless an intervening event that changed its fair value can be identified, the sale of an asset to a third party shortly after the acquisition date for an amount that differs significantly from its provisional fair value determined at that date is likely to indicate an error in the provisional amount.

48 The acquirer recognises an increase (decrease) in the provisional amount recognised for an identifiable asset (liability) by means of a decrease (increase) in goodwill. However, new information obtained during the measurement period may sometimes result in an adjustment to the provisional amount of more than one asset or liability. For example, the acquirer might have assumed a liability to pay damages related to an accident in one of the acquiree's facilities, part or all of which are covered by the acquiree's liability insurance policy. If the acquirer obtains new information during the measurement period about the acquisition-date fair value of that liability, the adjustment to goodwill resulting from a change to the provisional amount recognised for the liability would be offset (in whole or in part) by a corresponding adjustment to goodwill

resulting from a change to the provisional amount recognised for the claim receivable from the insurer.

49 During the measurement period, the acquirer shall recognise adjustments to the provisional amounts as if the accounting for the business combination had been completed at the acquisition date. Thus, the acquirer shall revise comparative information for prior periods presented in financial statements as needed, including making any change in depreciation, amortisation or other income effects recognised in completing the initial accounting.

50 After the measurement period ends, the acquirer shall revise the accounting for a business combination only to correct an error in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Determining what is part of the business combination transaction

51 The acquirer and the acquiree may have a pre-existing relationship or other arrangement before negotiations for the business combination began, or they may enter into an arrangement during the negotiations that is separate from the business combination. In either situation, the acquirer shall identify any amounts that are not part of what the acquirer and the acquiree (or its former owners) exchanged in the business combination, ie amounts that are not part of the exchange for the acquiree. The acquirer shall recognise as part of applying the acquisition method only the consideration transferred for the acquiree and the assets acquired and liabilities assumed in the exchange for the acquiree. Separate transactions shall be accounted for in accordance with the relevant IFRSs.

52 A transaction entered into by or on behalf of the acquirer or primarily for the benefit of the acquirer or the combined entity, rather than primarily for the benefit of the acquiree (or its former owners) before the combination, is likely to be a separate transaction. The following are examples of separate transactions that are not to be included in applying the acquisition method:

(a) a transaction that in effect settles pre-existing relationships between the acquirer and acquiree;

(b) a transaction that remunerates employees or former owners of the acquire for future services; and

(c) a transaction that reimburses the acquiree or its former owners for paying the acquirer's acquisition-related costs.

Paragraphs B50–B62 provide related application guidance.

Acquisition-related costs

53 Acquisition-related costs are costs the acquirer incurs to effect a business combination. Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account

for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities shall be recognised in accordance with IAS 32 and IFRS 9.

Indemnification assets

57 At the end of each subsequent reporting period, the acquirer shall measure an indemnification asset that was recognised at the acquisition date on the same basis as the indemnified liability or asset, subject to any contractual limitations on its amount and, for an indemnification asset that is not subsequently measured at its fair value, management's assessment of the collectibility of the indemnification asset. The acquirer shall derecognise the indemnification asset only when it collects the asset, sells it or otherwise loses the right to it.

Appendix 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.

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.

Goodwill qualifies as an asset

BC313 The FASB's 1999 and 2001 Exposure Drafts listed six components of the amount that in practice, under authoritative guidance in effect at that time, had been recognised as goodwill. The IASB's ED 3 included a similar, but

not identical, discussion. The components and their descriptions, taken from the FASB's exposure drafts, were:

Component 1—The excess of the fair values over the book values of the acquiree's net assets at the date of acquisition.

Component 2—The fair values of other net assets that the acquiree had not previously recognised. They may not have been recognised because they failed to meet the recognition criteria (perhaps because of measurement difficulties), because of a requirement that prohibited their recognition, or because the acquiree concluded that the costs of recognising them separately were not justified by the benefits.

Component 3—The fair value of the *going concern* element of the acquiree's existing business. The going concern element represents the ability of the established business to earn a higher rate of return on an assembled collection of net assets than would be expected if those net assets had to be acquired separately. That value stems from the synergies of the net assets of the business, as well as from other benefits (such as factors related to market imperfections, including the ability to earn monopoly profits and barriers to market entry—either legal or because of transaction costs—by potential competitors).

Component 4—The fair value of the expected synergies and other benefits from combining the acquirer's and acquiree's net assets and businesses. Those synergies and other benefits are unique to each combination, and different combinations would produce different synergies and, hence, different values.

Component 5—Overvaluation of the consideration paid by the acquirer stemming from errors in valuing the consideration tendered. Although the purchase price in an all-cash transaction would not be subject to measurement error, the same may not necessarily be said of a transaction involving the acquirer's equity interests. For example, the number of ordinary shares being traded daily may be small relative to the number of shares issued in the combination. If so, imputing the current market price to all of the shares issued to effect the combination may produce a higher value than those shares would command if they were sold for cash and the cash then used to effect the combination.

Component 6—Overpayment or underpayment by the acquirer. Overpayment might occur, for example, if the price is driven up in the course of bidding for the acquiree; underpayment may occur in a distress sale (sometimes termed a fire sale).

BC314 The boards observed that the first two components, both of which relate to the acquiree, are conceptually not part of goodwill. The first component is not itself an asset; instead, it reflects gains that the acquiree had not recognised on its net assets. As such, that component is part of those assets rather than part of goodwill. The second component is also not part of goodwill conceptually; it primarily reflects intangible assets that might be recognised as individual assets.

BC315 The fifth and sixth components, both of which relate to the acquirer, are also not conceptually part of goodwill. The fifth component is not an asset in and of itself or even part of an asset but, rather, is a measurement error. The sixth component is also not an asset; conceptually it represents a loss (in the case of overpayment) or a gain (in the case of underpayment) to the acquirer. Thus, neither of those components is conceptually part of goodwill.

BC316 The boards also observed that the third and fourth components are part of goodwill. The third component relates to the acquiree and reflects the excess assembled value of the acquiree's net assets. It represents the pre-existing goodwill that was either internally generated by the acquiree or acquired by it in prior business combinations. The fourth component relates to the acquiree and the acquirer jointly and reflects the excess assembled value that is created by the combination—the synergies that are expected from combining those businesses. The boards described the third and fourth components collectively as 'core goodwill'.

BC317 The revised standards try to avoid subsuming the first, second and fifth components of goodwill into the amount initially recognised as goodwill. Specifically, an acquirer is required to make every effort:

(a) to measure the consideration accurately (eliminating or reducing component 5);

(b) to recognise the identifiable net assets acquired at their fair values rather than their carrying amounts (eliminating or reducing component 1); and

(c) to recognise all acquired intangible assets meeting the criteria in the revised standards (paragraph B31 of the revised IFRS 3) so that they are not subsumed into the amount initially recognised as goodwill (reducing component 2).

BC318 In developing IFRS 3 and SFAS 141, the IASB and the FASB both considered whether 'core goodwill' (the third and fourth components) qualifies as an asset under the definition in their respective conceptual frameworks. (That consideration was based on the existing conceptual frameworks. In 2004, the IASB and the FASB began work on a joint project to develop an improved conceptual framework that, among other things, would eliminate both substantive and wording differences between their existing frameworks. Although the asset definition is likely to change as a result of that project, the boards observed that nothing in their deliberations to date indicates that any such changes are likely to call into question whether goodwill continues to qualify as an asset.)

Extracts from IFRS 11 *Joint Arrangements*

20 A joint operator shall recognise in relation to its interest in a joint operation:

(a) its assets, including its share of any assets held jointly;

(b) **its liabilities, including its share of any liabilities incurred jointly;**

(c) **its revenue from the sale of its share of the output arising from the joint operation;**

(d) **its share of the revenue from the sale of the output by the joint operation; and**

(e) **its expenses, including its share of any expenses incurred jointly.**

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.

24 **A joint venturer shall recognise its interest in a joint venture as an investment and shall account for that investment using the equity method in accordance with IAS 28** ***Investments in Associates and Joint Ventures*** **unless the entity is exempted from applying the equity method as specified in that standard**.

Appendix A – **joint control**	The contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.
Appendix A – **joint operation**	A **joint arrangement** whereby the parties that have **joint control** of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement.
Appendix A – **joint venture**	A **joint arrangement** whereby the parties that have **joint control** of the arrangement have rights to the net assets of the arrangement.

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.

BC20 In ED 9, the proposed definition of ‘joint arrangement’ required ‘shared decision-making’ by all the parties to the arrangement. Some respondents questioned how ‘shared decision-making’ was intended to operate and how it differed from ‘joint control’. The Board introduced the term ‘shared decision-making’ in the exposure draft instead of ‘joint control’ because control was defined in IAS 27 *Consolidated and Separate Financial Statements* in the context of having power over the financial and operating policies of an entity.* During its redeliberation of ED 9, the Board concluded that in joint arrangements, it is the activity undertaken by

the parties that is the matter over which the parties share control or share decision-making, regardless of whether the activity is conducted in a separate entity. Consequently, the Board concluded that 'joint control' is a term that expresses better than 'shared decision-making' that the control of the activity that is the subject matter of the arrangement is shared among the parties with joint control of the arrangement.

* The consolidation requirements in IAS 27 were replaced by IFRS 10 *Consolidated Financial Statements* issued in 2011 and the definition of control was revised.

BC29 The Board considered whether the definition of a 'business', as defined in IFRS 3 *Business Combinations*, would be helpful in distinguishing between a joint venture and a joint operation. Because a 'business' can be found in all types of joint arrangement, the Board decided not to pursue this approach.

BC35 Many respondents to ED 9 were concerned that joint ventures could be merely 'residuals'. This is because these respondents interpreted joint ventures to mean that after parties had identified rights to individual assets or obligations for expenses or financing, joint ventures would be merely any remaining assets and liabilities of the arrangement. As a result of these concerns, the Board clarified that the unit of account of a joint arrangement is the activity that two or more parties have agreed to control jointly, and that a party should assess its rights to the assets, and obligations for the liabilities, relating to that activity. Consequently, the term 'joint venture' refers to a jointly controlled activity in which the parties have an investment.

Joint operation

BC38 In relation to the accounting for a party's interest in a joint operation, some respondents to ED 9 enquired how proportionate consolidation differed from the recognition of (or recognition of shares of) assets, liabilities, revenues and expenses arising from a joint operation. The Board noted that there are two main differences between recognising assets, liabilities, revenues and expenses relating to the activity of the joint operation and proportionate consolidation. The first difference relates to the fact that the rights and obligations, as specified in the contractual arrangement, that an entity has with respect to the assets, liabilities, revenues and expenses relating to a joint operation might differ from its ownership interest in the joint operation. The IFRS requires an entity with an interest in a joint operation to recognise assets, liabilities, revenues and expenses according to the entity's shares in the assets, liabilities, revenues and expenses of the joint operation as determined and specified in the contractual arrangement, rather than basing the recognition of assets, liabilities, revenues and expenses on the ownership interest that the entity has in the joint operation. The second difference from proportionate consolidation is that the parties' interests in a joint operation are recognised in their separate financial statements. Consequently, there is no difference in what is recognised in the parties' separate financial statements and the parties'

consolidated financial statements or the parties' financial statements in which investments are accounted for using the equity method.

BC39 Respondents also suggested that the IFRS should provide more clarity in stating the requirements for the accounting for shares of assets in joint operations. Many respondents to ED 9 were not clear whether parties to a joint operation that had rights to the assets should recognise a 'right to use' or a 'right to a share' or whether they should instead directly recognise 'their share of the joint assets, classified according to the nature of the asset'. The concern raised by this uncertainty was the different accounting implications of these interpretations—ie accounting for rights or accounting for shares of assets. The Board concluded that a party to a joint operation should recognise its assets or its share of any assets in accordance with the IFRSs applicable to the particular assets.

BC65 The Board redeliberated the transition requirements for entities changing from the equity method to accounting for assets and liabilities in respect of their interest in a joint operation. The Board decided to require an entity to recognise each of the assets, including any goodwill arising from acquisition, and the liabilities relating to its interest in the joint operation at its carrying amount on the basis of the information used by the entity in applying the equity method, instead of requiring the entity to remeasure its share of each of those assets and liabilities at the date of transition. The Board did not believe that the costs of requiring entities to remeasure the assets and liabilities relating to the joint operation as a result of the accounting change would outweigh the benefits.

IE8 A and B each recognise in their financial statements their share of the assets (eg property, plant and equipment, accounts receivable) and their share of any liabilities resulting from the arrangement (eg accounts payable to third parties) on the basis of their agreed participation share. Each also recognises its share of the revenue and expenses resulting from the construction services provided to the government through entity Z.

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 27 *Consolidated and Separate Financial Statements* (amended 2010)

18 In preparing consolidated financial statements, an entity combines the financial statements of the parent and its subsidiaries line by line by adding together like items of assets, liabilities, equity, income and expenses. In order that the consolidated financial statements present financial information about the group as that of a single economic entity, the following steps are then taken:

(a) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary are eliminated (see IFRS 3, which describes the treatment of any resultant goodwill);

(b) non-controlling interests in the profit or loss of consolidated subsidiaries for the reporting period are identified; and

(c) non-controlling interests in the net assets of consolidated subsidiaries are identified separately from the parent's ownership interests in them. Non-controlling interests in the net assets consist of:

(i) the amount of those non-controlling interests at the date of the original combination calculated in accordance with IFRS 3; and

(ii) the non-controlling interests' share of changes in equity since the date of the combination.

Extracts from IAS 31 *Interests in Joint Ventures*

33 The application of proportionate consolidation means that the statement of financial position of the venturer includes its share of the assets that it controls jointly and its share of the liabilities for which it is jointly responsible. The statement of comprehensive income of the venturer includes its share of the income and expenses of the jointly controlled entity. Many of the procedures appropriate for the application of proportionate consolidation are similar to the procedures for the consolidation of investments in subsidiaries, which are set out in IAS 27.

Extracts from IAS 38 *Intangible Assets*

48 Internally generated goodwill shall not be recognised as an asset.