STAFF PAPER

13–14 March 2012

IFRS Interpretations Committee Meeting

IFRS IC meetings: July, Sep, Nov 2011 and Jan 2012

Project	**IFRS 11—*Acquisition of an interest in a joint operation***
Paper topic	Recommendation to the Board

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Introduction

1. 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 in which 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 January 2012 meeting, with the January 2012 *IFRIC Update* reporting that:

   > The Committee observed that uncertainty exists in accounting for the acquisition of interests in joint operations and jointly controlled operations or assets in circumstances where the activity of the joint operation or the jointly controlled operations or assets constitutes a

business as defined in IFRS 3, because of the lack of explicit guidance. Neither IFRS 11 nor IAS 31 explicitly addresses this issue, ie the lack of explicit accounting guidance does not result from the replacement of IAS 31 by IFRS 11. As a result of the lack of explicit guidance in IAS 31, significant diversity has arisen in practice and the Committee was concerned that diversity in practice will continue after the adoption of IFRS 11.

In order to reduce the observed diversity in practice, the Committee directed the staff to draft a recommendation of the Committee to the Board to add new guidance to IFRS 11 on the acquisition of an interest in a joint operation in circumstances where the activity of the joint operation constitutes a business as defined in IFRS 3. The Committee does not think that it is appropriate to add new guidance to IAS 31, because IFRS 11 will supersede IAS 31 from 2013. Notwithstanding the fact that the acquirer of an interest in a joint operation does not acquire control over the activity of the joint operation, the Committee noted that the most appropriate approach to account for such transactions is to apply the relevant principles of business combination accounting in IFRS 3 and other IFRSs. These principles include:

- measuring identifiable assets and liabilities at fair value with few exceptions;
- recognising deferred tax assets and deferred tax liabilities arising from the initial recognition of assets or liabilities, except for deferred tax liabilities arising from the initial recognition of goodwill; and
- recognising the residual as goodwill.

The Committee directed the staff to analyse how detailed the guidance should be. The staff will bring this analysis and a draft recommendation to a future Committee meeting.

Purpose of the paper

3. The purpose of the paper is to draft a recommendation of the Committee to the Board to add new guidance to IFRS 11 on 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.

4. The paper also analyses:

   (a) how detailed the new guidance in IFRS 11 should be; and

   (b) whether specific transitional provisions or consequential amendments to other existing IFRSs are needed.

5. It proposes in Appendix A an amendment to IFRS 11 and illustrates in Appendix B the application of the proposed amendment in a simple example. This example is not part of the proposed amendment to IFRS 11. We added it for discussion purposes only.

6. For presenting a recommendation of the Committee to the Board, the paper summarises in Appendix C the conclusions reached by the Committee in its previous meetings and the main basis for these conclusions. Although the main conclusions reached by the Committee on this issue so far have already been summarised in the January 2012 *IFRIC Update*, we think that such a summary is necessary because a recommendation to the Board requires a fuller rationale.

Level of detail for guidance to be developed

7. For analysing the level of detail that the new guidance in IFRS 11 from the limited scope project should have, we consider in substance three different levels:

   (a) **illustrative approach:** detailed illustration of the application of all the relevant guidance on accounting for business combinations in IFRS 3 and other IFRSs, together with the necessary modifications;

   (b) **specific references approach:** specific and comprehensive references in IFRS 11 to the relevant guidance on accounting for business combinations in IFRS 3 and other standards; and

(c) **general reference approach:** general reference to the relevant principles of business combination accounting and related disclosure requirements in IFRS 3 and other IFRSs but with some application guidance.

8. Considering these three basic approaches, we recommend approach (c) (the general reference approach) for the following reasons:

(a) IFRS 11 gives guidance on the accounting for interests in joint arrangements by indicating when it is appropriate to account for this interest according to the equity method (joint venture) and when it is appropriate to recognise assets, liabilities, revenues and expenses related to that interest (joint operation). (See, for example, paragraphs BC25 and BC39 of IFRS 11). With very few exceptions (see paragraphs B34-B37 of IFRS 11), IFRS 11 does not, however, give guidance on the application of the equity method, or on the accounting for the assets, liabilities, revenues and expenses related to an interest in a joint operation. For the application of the equity method, the standard refers to IAS 28 *Investments in Associates and Joint Ventures* in paragraph 24 of IFRS 11. For the accounting for the assets, liabilities, revenues and expenses related to joint operations the standard refers in paragraph 21 to the IFRSs applicable to the particular assets, liabilities, revenues and expenses. Of all the three approaches, the general reference approach aligns most closely with this concept in IFRS 11.

(b) Subparagraph 2(a) of the IFRS Foundation Constitution (updated December 2010)) defines one of the objectives of the IFRS Foundation as being developing financial reporting standards based upon clearly articulated principles. Of all the three approaches, the general reference approach aligns most closely with this objective.

(c) Combining the general reference approach with minimal application guidance addresses the issues on which the submission and our outreach activities have identified significant diversity, without going beyond the areas of significant diversity in practice that were identified.

The areas in which application guidance would be most useful would therefore be:

(i) measuring identifiable assets and liabilities at fair value with few exceptions;

(ii) recognising acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with the exception that the costs to issue debt or equity securities are recognised in accordance with IAS 32 *Financial Instruments: Presentation* and IFRS 9 *Financial Instruments*.

(iii) recognising deferred tax assets and deferred tax liabilities arising from the initial recognition of assets or liabilities, except for deferred tax liabilities arising from the initial recognition of goodwill; and

(iv) recognising the residual as goodwill.

An illustrative draft amendment to IFRS 11 is set out in Appendix A to this paper.

9. We think that the new guidance in IFRS 11 should also make reference to the relevant related disclosure requirements in IFRS 3 and other IFRSs because these disclosure requirements are an integral part of the financial reporting about acquisitions of interests in businesses.

10. In contrast, the specific references approach would make reference to specific paragraphs in IFRS 3 and other IFRSs and would explain which modifications to the guidance in these paragraphs would apply in accounting for the acquisition of an interest in a joint operation, eg:

> *The acquirer 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 applies paragraph 5 of IFRS 3, except that the acquirer does not recognise any non-controlling interest in the acquiree (ie interest of the other parties in the joint operation).*

11. Taking into consideration, however, the scope of the guidance on business combinations accounting in IFRS 3 and other IFRSs and the fact that much of this guidance applies with modifications or only in parts (see also our analysis presented in Agenda Paper 5 for the January 2012 Committee meeting), we expect that these specific references and the accompanying explanations on the modifications would be voluminous.

12. Consequently, we think that guidance based on the specific references approach would not be easy to read and understand and would be likely to give rise to confusion, which might lead to additional significant diversity in practice.

13. Finally, we understand that the illustrative approach would result in new guidance that would be beyond the scope of current IFRS 3, which we think is, in turn, beyond the scope of work that the Committee could realistically do on behalf of the Board.

14. Consequently, we recommend adding new guidance to IFRS 11, with only the level of detail of the general reference approach, 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.

15. In addition, we recommend adding minimal application guidance to:

    (a) address the issues for which we noted significant diversity in practice on the accounting for such acquisitions; and

    (b) highlight the main modification to the relevant guidance on the accounting for business combinations in IFRS 3 and other IFRSs, ie that the guidance on non-controlling interests is not applicable, because a joint operator does recognise the interests of the other parties to the joint operation in the assets held jointly and the liabilities incurred jointly.

16. An illustrative draft amendment to IFRS 11 is set out in Appendix A to this paper. Appendix B illustrates the application of the proposed amendment in a simple example for discussion purposes.

Transition

17. The accounting for some past transactions might be questioned if the proposed amendment were to be applied retrospectively. The question of prospective or retrospective application therefore needs to be considered.

18. If a new standard, or an amendment to a standard, changes the accounting policy of the entity upon initial application, it shall apply the change retrospectively, but only if the new standard or the amendment to a standard does not include a specific transitional provision (see paragraph 19(b) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*).

19. From the outreach results, we conclude that applying the proposed amendments to IFRS 11 as set out in Appendix A to this paper retrospectively might require a party to a joint operation to apply the relevant principles on business combination accounting in IFRS 3 and other IFRSs to acquisitions that have been accounted for in previous periods by applying a cost approach. Accordingly, the acquisition-date fair value of several items recognised in accordance with IFRS 3 may not have been determined in previous periods.

20. In this context, we have in mind assets and liabilities that are only recognised under IFRS 3, eg contingent liabilities or indemnification assets.

21. We are not so much concerned with the fair value of other identifiable assets and liabilities, because we understand that, at the very least, the acquisition-date fair value of these assets and liabilities must have been determined to allocate the purchase price pro rata to those values.

22. The acquisition-date fair value of contingent consideration may be another example of a fair value that may have not been determined in previous periods, because of a different accounting policy for contingent consideration for groups of assets that do not constitute a business as defined in IFRS 3.

23. To avoid the use of hindsight in determining the acquisition-date fair value of the intangible assets acquired, and of the liabilities assumed as part of the business combination transaction, we think that the proposed amendment to IFRS 11 should be applied prospectively.

Consequential amendments

24. We reviewed the proposed change in relation to other existing IFRSs. We identified only one consequential amendment to another standard.

25. In principle, we do not think that paragraphs that explicitly only address business combinations at the moment, eg paragraphs 15(b)(i) and 24(a) of IAS 12 *Income Taxes*, need to be amended to also include the acquisition of an interest in a joint operation. They would be applicable because of the reference that the new guidance in IFRS 11 would make to the relevant principles on business combination accounting in IFRS 3 and other IFRSs.

26. For the same reason, we think that no consequential amendment for first-time adopters is needed, because appropriate relief is already given through the exemptions for business combinations in Appendix C of IFRS 1 *First-time Adoption of International Financial Reporting Standards* that would be applicable because of the reference that the new guidance in IFRS 11 would make to the relevant principles on business combination accounting in IFRS 3 and other IFRSs.

27. However, paragraph C5 of IFRS 1 extends the scope of the transition relief for business combinations that occurred before the date of transition to IFRSs to past acquisitions of investments in associates and of interests in joint ventures and paragraph 18 of IFRS 1 prohibits the application of the exemptions for business combinations by analogy.

28. To avoid confusion about the applicability of exemptions for business combinations to the acquisition of interests in joint operations in circumstances in which the activity of the joint operation constitutes a business as defined in IFRS 3, we recommend to amendment paragraph C5 of IFRS 1.

The Committee's recommendation to the Board

29. We propose that the Committee should recommend to the Board that the Board requests from the Committee to develop guidance 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 define in IFRS 3 on behalf of the Board. Developing such guidance in a limited scope project of IFRS 11 would contribute to consistent application of the IFRS in practice but does not meet the criteria for inclusion within the annual improvements project or the interpretations agenda criteria, although we think that the work can be largely completed by the Committee on behalf of the Board.

30. If the Board agrees with the Committee's recommendation, we propose that the Committee should recommend the draft amendment to IFRS 11 to the Board that is set out in Appendix A to this paper.

Questions for the Committee

1. Does the Committee agree with summary of the conclusions that it reached so far in Appendix C?
2. Does the Committee agree that the level of detail of the proposed new guidance in IFRS 11 should be based on the general reference approach and that only minimal application guidance should be added?
3. Does the Committee agree that the proposed amendment to IFRS 11 should be applied prospectively and that no consequential amendments to other IFRSs, except for the consequential amendment to paragraph C5 of IFRS 1, are needed?
4. Does the Committee agree with the recommendation that the Board should request from the Committee to develop guidance 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 define in IFRS 3 on behalf of the Board?
5. Does the Committee agree with the proposed wording for the amendment to IFRS 11 in Appendix A?

Appendix A—Proposed wording for Amendment to IFRS 11

The proposed amendment to IFRS 11 is presented below.

Amendment to IFRS 11 *Joint Arrangements*

The heading before paragraph B34 is amended (new text is underlined). Headings after paragraphs B37 and C14 and paragraphs 21A, B38, B39, C2 and C14A are added. Paragraphs 20 and 21 have been included for ease of reference but are not proposed for amendment.

Financial statements of parties to a joint arrangement

Joint operations

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.

21A The accounting for the acquisition of interest in a joint operation in circumstances in which the activity of the joint operation constitutes a business as defined in IFRS 3 is specified in paragraphs B38-B39.

[…]

Appendix B
Application guidance

[…]

Financial statements of parties to a joint arrangement (paragraph<u>s</u> <u>21A and</u> 22)

[…]

Accounting for acquisitions of interest in joint operations

B38 When an entity acquires an interest in a joint operation whose activity constitutes a business as defined in IFRS 3, it shall apply the relevant principles on business combination accounting in IFRS 3 and other IFRSs and disclose the relevant information specified in these IFRSs for business combinations. The principles on business combination accounting include:

(a) measuring identifiable assets and liabilities at fair value with the exceptions given in IFRS 3 and other IFRSs;

(b) recognising acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with the exception that the costs to issue debt or equity securities are recognised in accordance with IAS 32 and IFRS 9;

(c) recognising deferred tax assets and deferred tax liabilities arising from the initial recognition of assets or liabilities, except for deferred tax liabilities arising from the initial recognition of goodwill; and

(d) recognising the residual as goodwill.

B39 Application of these principles to the accounting for the acquisition of an interest in a joint operation whose activity constitutes a business does not include recognising and measuring interests of the other parties to the joint operation.

Appendix C

Effective date, transition and withdrawal of other IFRSs

[…]

Effective date

[…]

C2 *[Name of amendment]* issued in [date] amended the heading before paragraph B34, added headings after paragraphs B37 and C14 and paragraphs 27A, B38, B39, C2 and C14A. An entity shall apply this amendment for annual periods beginning on or after [date]. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

Transition

[…]

Accounting for acquisitions of interests in joint operations

C14A *[Name of amendment]* issued in [date] amended the heading before paragraph B34, added headings after paragraphs B37 and C14 and paragraphs 27A, B38, B39, C2 and C14A. An entity shall apply this amendment prospectively for acquisitions of interests in joint operations from the beginning of the first period for which it adopts this amendment. Consequently, amounts recognised for acquisitions of interests in joint operations in prior periods shall not be adjusted.

Basis for Conclusions on proposed amendment to IFRS 11 *Joint Arrangements*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment

Financial statements of parties to a joint arrangement

Accounting for acquisitions of interests in joint operations

BC1 The IFRS Interpretations Committee (Committee) reported to the Board that practice differed 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 constitutes a business as defined in IFRS 3.

BC2 While some apply the relevant principles of business combination accounting in IFRS 3 and other IFRSs, others allocate total cost of acquiring the interest in the joint operation to the individual identifiable assets and liabilities on the basis of relative fair values.

BC3 A third group applies the relevant principles of business combination accounting to issues that are not addressed in other standards.

BC4 The different approaches lead to different results, in particular:

(a) in accounting for premiums paid for synergies;

(b) in capitalising or expensing acquisition-related costs; and

(c) in accounting for deferred tax assets and deferred tax liabilities arising from the initial recognition of assets and liabilities.

BC5 The *[Board]* noted that current IFRSs do not give comprehensive and consistent guidance 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 and this lack of guidance has led to the significant diversity in practice in applying IAS 31. The *[Board]* is concerned that this significant diversity in practice may continue in applying IFRS 11.

BC6 The *[Board]* considered the guidance in current IFRSs on the acquisition of an interest in a business and concluded that the most appropriate approach 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 is to apply the relevant principles on business combination accounting in IFRS 3 and other IFRSs. These principles include:

(a) measuring identifiable assets and liabilities at fair value with few exceptions;

(b) recognising acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with the exception that the costs to issue debt or equity securities are recognised in accordance with IAS 32 and IFRS 9;

(c) recognising deferred tax assets and deferred tax liabilities arising from the initial recognition of assets and liabilities, except for deferred tax liabilities arising from the initial recognition of goodwill; and

(d) recognising the residual as goodwill.

BC7 The *[Board]* reached this conclusion because:

(a) it considers separate recognition of goodwill, if any, as preferable compared to allocating premiums to identifiable assets acquired on the basis of relative fair values;

(b) it thinks that an approach that applies business combination accounting only to issues that are not addressed elsewhere in IFRSs lacks a strong conceptual basis; and

(c) the guidance in IFRS 3 and other IFRSs on business combinations gives a comprehensive and consistent set of accounting principles for the different components of the transaction.

BC8 The *[Board]* also concluded that the acquirer 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 shall disclose the relevant information specified in IFRS 3 and other IFRSs on business combinations because these requirements are an integral part of the financial reporting about the acquisition of interests in businesses.

BC9 Consequently, the *[Board]* proposes to amend IFRS 11 to address 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 and the related disclosure requirements and thereby to resolve the significant diversity in practice.

Effective date and transition

BC10 The *[Board]* considered the transitional provisions and effective date of the amendment to IFRS 11. The *[Board]* noted that applying the relevant principles of business combination accounting in IFRS 3 and other IFRSs to transactions that have previously been accounted for by applying a cost approach might involve the use of hindsight in determining the acquisition-date fair values of the identifiable assets and liabilities to be recognised as part of the transaction. Consequently, the *[Board]* proposes that an entity would apply the proposed amendments to IFRS 11 prospectively for annual periods beginning on or after [the effective date].

Appendix to proposed amendment to IFRS 11

Amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

Paragraph C5 is amended (new text is underlined and deleted text is struck through).

Paragraph 39M is added.

Appendix C

Exemptions for business combinations

[…]

C5 The exemption for past business combinations also applies to past acquisitions of investments in associates, ~~and~~ of interests in joint ventures <u>and of interests in joint operations that include businesses</u>. Furthermore, the date selected for paragraph C1 applies equally for all such acquisitions.

Effective date

[…]

39M *[Name of amendment]* issued in [date] amended paragraph C5. An entity shall apply this amendment for annual periods beginning on or after [date]. If an entity applies related amendments in IFRS 11 from *[Name of amendment]* for an earlier period, the amendment to C5 shall be applied for that earlier period.

Appendix B—Application example

The example illustrates the application of the proposed amendment for discussion purposes. It is not part of the proposed amendment to IFRS 11.

Application example

Entity A acquires a 40 per cent ownership interest in a joint operation (joint operation C) at a cost of CU300* and incurs acquisition-related costs of CU50. The contractual arrangement between the parties establishes that entity A has rights to the assets and obligations for the liabilities relating to the joint operation in proportion to its ownership interest, except for an identifiable patent (patent X) for which entity A has full rights on. The fair value (or the value required by IFRS 3 instead) of the identifiable assets acquired and liabilities assumed (including deferred tax assets and deferred tax liabilities) by entity A, entity A’s share in these assets and liabilities and the amounts that entity A recognises in its financial statements in relation to its interest in the joint operation are set out in the following table.

	Fair value of identifiable assets acquired and liabilities assumed at acquisition date	*Entity A’s share in assets acquired and liabilities assumed*	*Amounts recognised in entity A’s financial statements*
Property, plant and equipment	270	40%	108
Intangible assets (excluding goodwill)	50	100%	50
Accounts receivable	210	40%	84
Inventory	175	40%	70
Retirement benefit obligations	(30)	40%	(12)
Accounts payable	(120)	40%	(48)
Deferred tax liability	(60)	40%	(24)
Fair value of identifiable assets acquired and liabilities assumed, including deferred tax	445		228

Entity A applies the relevant principles on business combination accounting in IFRS 3 and other IFRSs for identifying, measuring and classifying the assets acquired and liabilities assumed on the acquisition of the interest in joint operation C. However, entity A recognises, in relation to its interest in the joint operation, only its share in each of the assets jointly held and each of the liabilities incurred jointly and not the shares of the other parties to the joint operation in these assets and liabilities. The residual is recognised as goodwill.

Consideration transferred	300
Entity A’s share in the identifiable net assets	228
Goodwill	78

Acquisition-related costs are not considered to be part of the consideration transferred for the interest in the joint operation, because they are recognised as expenses in profit or loss in the period the costs are incurred and the services are received.

* In this example, monetary amounts are denominated in ‘currency units (CU)’.

Appendix C—Summary of conclusions reached by the Committee so far

C1. We understand that the Committee has already reached the following conclusions on the issue raised in the submission:

No comprehensive and consistent guidance

C2. Current IFRSs do not give comprehensive and consistent guidance on the accounting for acquisitions 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).

C3. Neither IFRS 11 nor IAS 31 *Interests in Joint Ventures* gives specific guidance on accounting for the acquisition of an interest a joint operation as defined in IFRS 11, or for a jointly controlled operations or assets as specified in IAS 31, in circumstances in which the activity of the joint operation or the jointly controlled operations or assets constitutes a business as defined in IFRS 3.

C4. Paragraph 21 of IFRS 11 only requires that a joint operator must 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. The standard does however not explain what the IFRSs applicable to the assets and liabilities are when they are part of a business in which the joint operator has acquired a share.

C5. The Committee noted that the issue was not addressed or discussed in the project on joint arrangements which led to IFRS 11 being issued.

IFRS 3

C6. The conclusion that current IFRSs do not give comprehensive and consistent guidance on the accounting 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) is based on the assumption that IFRS 3 is not one of the IFRSs applicable to the particular assets and liabilities in terms of paragraph 21 of IFRS 11. This is because IFRS 3 applies to only business combinations, whereas in the acquisition of an interest in a joint operation the acquirer does not obtain control of the business.

C7. The Committee discussed this issue at its September 2011 meeting but did not arrive at a conclusion on, a view that IFRS 3 is not required to be applied to the particular assets and liabilities of a joint operation in circumstances where the joint operator acquires an in interest on a joint operation in which the activity of the joint operation constitutes a business as defined in IFRS 3.

C8. Proponents of the view[1] that IFRS 3 is one of the IFRSs applicable to the particular assets and liabilities in terms of paragraph 21 of IFRS 11 argue instead that the 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 operations. There would be otherwise 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 paragraphs BC39 and IE8 of IFRS 11).

C9. In consideration of this situation and in order to give guidance on this issue of significant diversity in practice, the further analysis on this issue was done based on the assumption that IFRS 3 is not one of the IFRSs applicable to the particular assets and liabilities in terms of paragraph 21 of IFRS 11.[2]

C10. The view that that IFRS 3 is one of the IFRSs applicable to the particular assets and liabilities in terms of paragraph 21 of IFRS 11 implies that the 'unit of account' of a joint arrangement is the activity as a whole that the parties contractually agreed to control jointly (see Appendix A (definition of joint

[1] Refer to paragraph 32 of Agenda paper 5 presented at the September 2011 Committee meeting—http://www.ifrs.org/NR/rdonlyres/CDE68649-5515-4241-B7F6-E8BD7092EF87/0/051109AP05AIPIFRS11Acquisitionofaninterestinajointarrangement.pdf

[2] Refer to paragraphs 5 and 6 of Agenda paper 8 presented at the November 2011 Committee meeting—http://www.ifrs.org/Meetings/Interpretations+Committee+Nov+11.htm

arrangement and joint control) of IFRS 11).[3] The unit of account is not the interest in the joint arrangement or the individual assets and liabilities that are recognised. 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 (see paragraphs 20 and 21 of IFRS 11).

C11. Accordingly, 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.

C12. Assuming that IFRS 3 is not the IFRSs applicable to the particular assets and liabilities, the Committee concluded that current IFRSs lack guidance on the following two issues[4] in particular:

(a) recognising and measuring identifiable assets acquired and liabilities assumed on initial recognition; and

(b) accounting for premiums paid for synergies.

Recognising and measuring identifiable assets acquired and liabilities assumed on initial recognition

C13. With respect to the first issue, the Committee considered paragraph 2(b) of IFRS 3 (revised 2008). Paragraph 2(b) of IFRS 3 (revised 2008) addresses the allocation of the cost of a group of assets that does not constitute a business to the individual identifiable assets and liabilities. The allocation basis given by that paragraph is relative fair values. In addition, it clarifies that transactions or events addressed by this paragraph do not give rise to goodwill. Consequently, a

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[3] Refer to paragraphs 18 and 19 of Agenda paper 5 presented at the September 2011 Committee meeting— http://www.ifrs.org/NR/rdonlyres/CDE68649-5515-4241-B7F6-E8BD7092EF87/0/051109AP05AIPIFRS11Acquisitionofaninterestinajointarrangement.pdf

[4] Refer to paragraphs 4-16 of Agenda paper 8A presented at the November 2011 Committee meeting— http://www.ifrs.org/Meetings/Interpretations+Committee+Nov+11.htm

premium paid for synergies would be allocated to the identifiable assets acquired on the basis of their relative fair values.

C14. However, as mentioned above, 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 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. This means that it is not a business as defined in IFRS 3 (revised 2008).

Accounting for premiums paid for synergies

C15. With respect to the second issue, the Committee considered the recognition of a premium paid for synergies under IAS 38 *Intangible Assets.*

C16. The Committee noted that a premium paid for synergies could only be recognised as a separate asset under IAS 38 if it is an identifiable asset (see paragraph 11 of IAS 38). To be identifiable, paragraph 12 of IAS 38 requires that an asset:

(a) is separable; or

(b) arises from contractual or other legal rights.

C17. 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.

C18. 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)).

C19. 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)).

C20. 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).

C21. The Committee noted from our outreach activities that premiums are mostly paid for synergies that are related to the business or a combination of businesses. This is because they result from combining the acquirer's activities with those of the other joint operators in the joint operation. The Committee understood that it is common for entities to enter into joint arrangements because of such expected synergies. Consequently, the Committee thinks that:

(a) 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 that, as a result, more accounting guidance is needed; and

(b) the amount of premiums paid for synergies is a relevant information for users of financial statements and should therefore be accounted for clearly, ie as part of the separate amount 'goodwill', which has to be explained according to paragraph B64(e) of IFRS 3, instead of just being allocated to the identifiable assets.

Significant diversity in practice

C22. Because there is no comprehensive and consistent guidance 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), 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*.[5]

[5] Refer to paragraphs 17 and 18 of Agenda paper 8A presented at the November 2011 Committee meeting— http://www.ifrs.org/Meetings/Interpretations+Committee+Nov+11.htm

C23. From our outreach activities,[6] the Committee noted that this lack of guidance in IAS 31 has resulted in significant diversity in practice.[7]

C24. The Committee expects that this significant diversity in practice will continue after the adoption of IFRS 11, because it noted that IFRS 11 did not contain anything that might change the situation.

C25. In addition, the Committee noted from our outreach activities that entities acquiring interests in jointly controlled operations or assets mostly spend significant time and effort in determining what they think the appropriate accounting should be. They have to do this because of the lack of guidance.

C26. From our outreach to interested parties, national standard-setters and IOSCO, we noted that three approaches[8] 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). We list below 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 on initial recognition of assets and liabilities. Only guidance in IFRS 3 that is not appropriate for the acquisition of an interest in a joint operation, eg the guidance on non-controlling interests, is not applied.

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6 Refer to paragraphs 4-14 of Agenda paper 5 presented at the September 2011 Committee meeting—http://www.ifrs.org/NR/rdonlyres/CDE68649-5515-4241-B7F6-E8BD7092EF87/0/051109AP05AIPIFRS11Acquisitionofaninterestinajointarrangement.pdf

7 Refer to paragraph 24 of Agenda paper 8A presented at the November 2011 Committee meeting—http://www.ifrs.org/Meetings/Interpretations+Committee+Nov+11.htm

8 Refer to paragraphs 19-23 of Agenda paper 8A presented at the November 2011 Committee meeting—http://www.ifrs.org/Meetings/Interpretations+Committee+Nov+11.htm

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 an 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 the 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 are not recognised based of the initial recognition exceptions in paragraphs 15 and 24 of IAS 12.

Add new guidance to IFRS 11 only

C27. The Committee concluded that reducing the significant diversity in practice (and eliminating the need for each entity to develop its accounting policy from first principles) would be an improvement in financial reporting.

C28. However, the Committee thinks that no new guidance to IAS 31 on this issue should be added. This is because any new guidance on this issue would probably have an effective date after 1 January 2013, when IFRS 11 supersedes IAS 31.[9]

Limited project to amend IFRS 11

C29. For the Committee, resolving diversity in practice on this issue neither qualifies for inclusion in annual improvements nor for issuing an interpretation. Based on the assumption that IFRS 3 is not one of the IFRSs applicable to the particular assets and liabilities in terms of paragraph 21 of IFRS 11, it requires developing new guidance for a specific type of transaction:

(a) It does not qualify for inclusion in annual improvements because developing accounting principles for a specific type of transactions is neither clarifying nor corrective in nature (see paragraph 65A of the *Due Process Handbook for the IASB* (updated February 2012)).

(b) It does not qualify for the development of an interpretation, because the issue cannot be resolved within the confines of existing IFRSs and the

[9] Refer to paragraph 35(d) of Agenda paper 9 presented at the July 2011 Committee meeting—http://www.ifrs.org/NR/rdonlyres/C60A1E6E-5A25-40FE-84AD-09CFBE2C4CDF/0/091107ob09IFRS11Acquisitionofaninterestinajointarrangementfinal.pdf

Conceptual Framework, and the demands of the interpretation process (see paragraph 25(d) of the *Due Process Handbook for the IFRS Interpretations Committee* (updated December 2010). The issue cannot be resolved within the confines of existing IFRSs and the Conceptual Framework, because none of them specifically addresses such acquisitions.

C30. However, the Committee undertakes other tasks at the request of the IASB (see paragraph 43(a) of the IFRS Foundation Constitution (updated December 2010)) and the Committee concluded that it should liaise with the Board about undertaking work on the Board's behalf on this matter and develop new guidance as part of a limited scope project on IFRS 11.

Most appropriate approach

C31. When determining the approach on which the guidance to be developed should be based, the Committee concluded that the most appropriate approach 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 is to apply the relevant principles for business combinations in IFRS 3 and other IFRSs.

C32. The Committee reached this conclusion by assessing the approaches to account for such transactions that it observed in practice.

C33. The Committee rejected the combination approach, because it had concerns about the conceptual basis of an approach that applies business combination accounting only to issues that are not addressed elsewhere in IFRSs and the fact that it might be perceived as cherry-picking from the fair value approach and the cost approach.

C34. When choosing between the fair value approach and the cost approach, the Committee recommends the fair value approach[10] because it leads to a separate recognition of goodwill, if there is 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 the 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 means, however, 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.

[10] Refer to paragraph 33 of Agenda paper 8A presented at the November 2011 Committee meeting—http://www.ifrs.org/Meetings/Interpretations+Committee+Nov+11.htm

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 and we don't think that the Board wanted to carry forward transition items for a long time.

C35. In addition, the following arguments[11] supported the Committee's conclusion to recommend the fair value approach:

(a) IFRS 3 and the guidance in other IFRSs on business combinations give a comprehensive and consistent set of accounting principles for the different components of the transaction.

(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) 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).

(c) 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).

(d) 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.

(e) 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:

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[11] Refer to paragraph 24 of Agenda paper 5 presented at the September 2011 Committee meeting—http://www.ifrs.org/NR/rdonlyres/CDE68649-5515-4241-B7F6-E8BD7092EF87/0/051109AP05AIPIFRS11Acquisitionofaninterestinajointarrangement.pdf

(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.

The Committee noted 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 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.

Guidance in other IFRSs on business combinations

C36. Two of the main arguments for the Committee to consider the fair value approach as being the most appropriate approach were:

(a) IFRS 3 and the guidance in other IFRSs on business combinations give a comprehensive and consistent set of accounting principles for the different components of the transaction;[12] and

(b) to avoid an approach with the potential for cherry-picking.

C37. Accordingly, the Committee recommends that the entire relevant guidance on business combinations, no matter whether it is found in IFRS 3 or in another IFRS, should be applied. This includes recognising deferred tax assets and deferred tax liabilities arising from the initial recognition of assets and liabilities,

[12] Refer to paragraph 6(b) of Agenda paper 5 presented at the January2012 Committee meeting—http://www.ifrs.org/NR/rdonlyres/175FB7AD-C583-41B8-BFB1-0F5AD203F769/0/051201AP5IFRS11Acquisitionofaninterestinajointoperation.pdf

except for deferred tax liabilities recognising from the initial recognition of goodwill.

No recognition of shares attributable to non-controlling interests

C38. The Committee concluded that the main difference between the accounting for a business combination and the accounting for an interest in a joint operation in circumstances in which the activity of the joint operation constitutes a business as defined in IFRS 3 is that a joint operator does not recognise non-controlling interests for the interests of the other parties in the joint operation.[13]

C39. The joint operator accounts instead for its assets and liabilities, which means that in the case in which assets are held jointly, or liabilities are incurred jointly, the joint operator does not recognise the entire assets and liabilities, but only its own share of these assets and liabilities (see paragraph 20 (a) and (b) of IFRS 11).

C40. Accordingly, the joint operator does not attribute revenue and expenses of the other parties in the joint operation in its financial statements. Instead, the joint operator only recognises its own (share of) revenue and expenses (see subparagraphs 20(c)-(e) of IFRS 11).

[13] Refer to paragraph 9(a) of Agenda paper 5 presented at the January2012 Committee meeting—http://www.ifrs.org/NR/rdonlyres/175FB7AD-C583-41B8-BFB1-0F5AD203F769/0/051201AP5IFRS11Acquisitionofaninterestinajointoperation.pdf