STAFF PAPER

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IFRS Interpretations Committee Meeting

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Project	**Acquisition of an Interest in a Joint Operation (Proposed amendment to IFRS 11 *Joint Arrangements*)**		
Paper topic	Comment letter analysis		
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Introduction

1. The Exposure Draft ED/2012/7 *Acquisition of an Interest in a Joint Operation (Proposed amendment to IFRS 11)* published in December 2012 ('the ED') includes the IASB's proposal to amend IFRS 11 *Joint Arrangements*.

2. The objective of the proposed amendment is to introduce guidance on the accounting, by a joint operator, for the acquisition of an interest in a joint operation, as defined in IFRS 11, in which the activity of the joint operation constitutes a business, as defined in IFRS 3 *Business Combinations.*

Objective of the staff paper

3. The objective of this staff paper is to provide an analysis of the comment letters received on the proposed amendment and to obtain a final recommendation from the IFRS Interpretations Committee ('the Interpretations Committee') to publish guidance on the accounting, by a joint operator, for the acquisition of an interest in a joint operation in Q4 of 2013 as planned.

Structure of the staff paper

4. This paper:

   (a) provides background information and explains the issue;

   (b) analyses the comments received as part of the Exposure Draft process and recommends changes to the proposed draft wording; and

   (c) asks the Interpretations Committee to confirm whether they agree with the staff recommendation to proceed with the proposed amendment by adding some minor edits that would make the proposed amendment clearer.

Background information

5. Paragraph 20 of IFRS 11 requires a joint operator to recognise, in relation to its interest in a joint operation, among other things:

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

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

6. In addition, paragraph 21 of IFRS 11 specifies that a joint operator shall account for those assets and liabilities in accordance with the Standards that are applicable.

7. However, neither IFRS 11 nor IAS 31 *Interests in Joint Ventures*, which IFRS 11 replaced, provided guidance on the accounting by a joint operator for the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business.

8. As a result of the lack of guidance in IAS 31, significant diversity has arisen in practice in venturers' accounting for the acquisition of interests in jointly controlled operations or assets in which the activity of the jointly controlled operations or assets constitutes a business, as defined in IFRS 3. Such diversity relates to:

   (a) a premium that is paid in addition to the fair value of identifiable net assets, for example, a premium paid for synergies. Such a premium is

either recognised as a separate asset, ie goodwill, or is allocated to the identifiable assets on the basis of their relative fair values;

(b) deferred tax assets and deferred tax liabilities that arise from the initial recognition of assets and liabilities, except for deferred tax liabilities that arise from the initial recognition of goodwill, are either recognised on the acquisition of the interest in the jointly controlled operations or assets in which the activity constitutes a business, or are not recognised because of the initial recognition exceptions in paragraphs 15 and 24 of IAS 12 *Income Taxes*; and

(c) acquisition-related costs, which are either capitalised or recognised as an expense.

The IASB's proposed amendment

9. The IASB was concerned that this significant diversity in practice might continue after the application of IFRS 11.

10. As a result, the ED proposes to amend IFRS 11 and IFRS 1 *First-time Adoption of International Financial Reporting Standards* so that a joint operator accounting for the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business applies the relevant principles for business combinations accounting in IFRS 3 and other Standards, and discloses the relevant information required by those Standards for business combinations.

11. The principles for business combinations accounting include:

(a) measuring identifiable assets and liabilities at fair value other than those items for which exceptions are 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 *Financial Instruments: Presentation* and IFRS 9 *Financial Instruments*;

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

(d) recognising the excess of the consideration transferred over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed, if any, as goodwill.

12. The proposed amendment does not only apply to the acquisition of an interest in an existing joint operation, but also to the acquisition of an interest in a joint operation on its formation. However, it should not apply if the formation of the joint operation coincides with the formation of the business. This is the case when no existing business is contributed to the joint operation on its formation. Consequently, the scope of the proposed amendment is, in terms of a limited-scope project, limited to the fact patterns that are subject to significant diversity in practice, as observed by the Interpretations Committee.

13. To avoid the use of hindsight when determining the acquisition-date fair values of the identifiable assets and liabilities that are to be recognised as part of the transition, the IASB proposed that an entity would apply the proposed amendment to IFRS 11 and the consequential amendment to IFRS 1 prospectively to acquisitions of interests in joint operations in which the activity of the joint operation constitutes a business, on or after the effective date of the proposed amendment.

Comment letter analysis

14. In the following sections, we summarise and analyse the comments received from respondents to the ED during the comment period, which ended on 23 April 2013.

15. The ED asked three questions on the proposed amendment:

(a) **Question 1 (relevant principles):** *The IASB proposes to amend IFRS 11 and IFRS 1 so that a joint operator accounting for the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business applies the relevant principles on*

business combinations accounting in IFRS 3 and other Standards, and disclose the relevant information required by those Standards for business combinations. Do you agree with the proposed amendment? Why or why not? If not, what alternative do you propose?

(b) **Question 2 (scope):** *The IASB intends to apply the proposed amendment to IFRS 11 and the proposed consequential amendment to IFRS 1 to the acquisition of an interest in a joint operation on its formation. However, it should not apply if no existing business is contributed to the joint operation on its formation. Do you agree with the proposed amendment? Why or why not? If not, what alternative do you propose?*

(c) **Question 3 (transition requirement):** *The IASB intends to apply the proposed amendment to IFRS 11 and the proposed consequential amendment to IFRS 1 prospectively to acquisitions of interests in joint operations in which the activity of the joint operation constitutes a business on or after the effective date. Do you agree with the proposed transition requirement? Why or why not? If not, what alternative do you propose?*

16. The IASB received 70 comment letters on the ED.

Analysis of Question 1

Overview

17. A strong majority of the respondents agreed with proposal that a joint operator accounting for the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business applies the relevant principles on business combinations accounting in IFRS 3 and other Standards, and disclose the relevant information required by those Standards for business combinations.

18. Only few respondents consider the application of the relevant principles on business combinations accounting in IFRS 3 and other Standards to be

inappropriate when accounting for the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business.

19. Furthermore, a majority of respondents to the ED thinks that further guidance should be given. However, this conclusion led them to very different conclusions on how to proceed with the proposed amendment:

    (a) some think that the proposed amendment should not be finalised without this additional guidance; while

    (b) others still agree with the proposal or do not express a specific view on the issue of finalising the proposed amendment.

20. A discussion of the pros and the cons of applying the relevant principles on business combinations accounting in IFRS 3 and other Standards, and disclosing the relevant information required by those Standards for business combinations on the acquisition of an interest in a joint operation in which the activity constitutes a business, is included in the following chapter 'Applying the relevant principles of business combinations accounting in IFRS 3 and other Standards' and in Appendix C of this staff paper. While the following chapter includes the main arguments, other arguments are discussed in Appendix C.

21. A list of the issues on which respondents required further guidance is included in the section *Additional Guidance Needed:* beginning on page 28.

Significant diversity in practice

22. While several respondents confirmed the diversity does exist in practice on this issue observed by the Interpretation Committee, some respondents questioned whether that diversity in practice needs to be addressed by IASB in a limited-scope project.

23. Among these were respondents related to the oil and gas industry (Shell International B.V. (Shell), Oil Industry Accounting Committee (OIAC) and Repsol). They note that most of oil and gas producing companies treat the acquisition of an interest in a joint operation in which the activity of the joint

operation constitutes a business as an asset acquisition. Only a small minority applies the principles in IFRS 3.

24. One respondent (PwC) specifies in further detail the diversity observed in practice:

    (a) The respondent explains that there is diversity in how an acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business is accounted for. However, the respondent observed less diversity in how such transactions are actually measured.

    (b) Most of the joint operation acquisitions, under IFRS, result in the fair value of consideration paid being allocated to the fair value of the assets acquired and the liabilities assumed with little or no goodwill being recognised. For the respondent, this seems to be the most common measurement outcome under IFRS whether a joint operation acquisition is described as an asset acquisition or a business combination.

    (c) If the acquisition of an interest in a joint operation is considered a business combination, some deferred tax might be recognised but the corresponding adjustment may then be absorbed into the fair value of assets.

    (d) Furthermore, the respondent explains that the deferred tax liabilities arising on the acquisition of an interest in a joint operation might be significant. They are either recognised, if business combinations accounting is applied, or not recognised, if asset acquisition accounting is applied.

25. Consequently, the financial statements of preparers differ significantly, depending on whether deferred tax liabilities are recognised on the acquisition of an interest in a joint operation.

26. For us this is significant diversity in practice, because the difference in accounting for deferred taxes significantly impairs the comparability of financial statements.

27. In contrast, we are not convinced that this conclusion should be changed, because:

(a) a strong majority of oil- and gas-producing companies account for the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business as an asset acquisition; and

(b) only a small minority apply the principles in IFRS 3.

28. First of all, assessing whether there is significant diversity in practice is not a matter of merely counting heads. For significant diversity in practice it is not required that specific numbers of preparers apply a different accounting.

29. Secondly, this is not a project only for the oil and gas industry and we expect that many different industry sectors would be affected by the proposed amendment in the future. Although the oil and gas industry was one of the few industry sectors in the past in which the issue was prevalent, we expect that the issue will become prevalent in more industry sectors, because an entity/a separate vehicle is no longer a characteristic that requires using the equity method (BC7 of IFRS 11).

30. Furthermore, one respondent (Institute of Certified Public Accountants of Singapore (ICPAS)) explains that in its experience the proposal in the Exposure Draft only confirms current practice.

31. Finally, we observed from our outreach activities during the process that resulted in the ED and in the submission to the Interpretations Committee that the following issues are also subject to significant diversity in practice:

(a) separate recognition of goodwill; and

(b) capitalising transaction cost or recognising it as an expense.

32. We think the relevance of these issues was confirmed by the comment letters.

Applying the relevant principles on business combinations accounting in IFRS 3 and other Standards

32. Most of the respondents agreed with the proposal to apply the relevant principles on business combinations accounting in IFRS 3 and other Standards on the acquisition of an interest in a joint operation in which the activity constitutes a business.

33. Only a few respondents disagreed with the application of the principles for business combinations accounting in IFRS 3 and other Standards. They disagreed for the reasons given after the following subchapter 'Arguments supporting the principles on business combinations accounting' or in Appendix C of this staff paper. The main arguments are discussed in the following subchapter, and the other arguments are discussed in Appendix C.

Arguments supporting the principles on business combinations accounting

Comments received

34. Arguments given as support for applying the principles on business combinations accounting were:

(a) Based on the rationale in paragraph BC7 of the ED, the separate recognition of goodwill, when present, is preferable compared to allocating premiums to identifiable assets acquired on the basis of relative fair value (Accounting Standards Committee of Germany (ASCG), Dutch Accounting Standards Board (DASB), EFRAG, Baker Tilly, Deloitte Touche Tohmatsu Ltd. (DTT), Australian Accounting Standards Board (AASB), Asian-Oceanian Standard-Setters Group (AOSSG)).

(b) Users of financial statements have indicated that they prefer to recognise goodwill separately, when it is present, in the acquisition of an interest in a joint operation even if the joint operator was not obtaining control, and stressed that it was important to account for transactions that involved businesses in the same way (see comment letters DASB, EFRAG).

(c) All transactions which involve the acquisition of an interest in a 'business' should be treated similarly irrespective of the form the investor's interest takes (Baker Tilly). This does appear to be the most logical practice to follow for such joint arrangements (Association of Chartered Certified Accountants (ACCA)). A business combination,

and the acquisition of an interest in a joint operation which constitutes a business, would then be presented consistently within the same financial statements.

(d) This approach is substantially aligned with that applied to the acquisition of an interest in an associate or joint venture (KPMG). Paragraph 26 of IAS 28 *Investments in Associates and Joint Ventures* requires that the principles underlying the procedures used in accounting for the acquisition of a subsidiary should be used for such acquisitions of associates and joint ventures (DASB, EFRAG). As the acquisition of a subsidiary or associate/joint venture, the acquisition of an interest in a joint operation which constitutes a business should also have the principles of IFRS 3 and other relevant Standards should be applied (South African Institute of Chartered Accountants (SAICA)). It is justified because the current IFRSs already require the recognition of goodwill, if any, upon the acquisition of an interest in an associate or joint venture (that integrates the carrying amount of the investment).

(e) The use of the IFRS 3 is appropriate as a temporary solution to address current diversity in practice (Japanese Institute of Certified Public Accountants (Japanese Institute of CPAs)). It is reasonable because it provides a comprehensive and consistent set of accounting principles for the different components of the transactions, although there remains no agreed rationale for applying it to transactions other than to obtain control. The cost approach may be problematic, because the carrying amount of individual assets may exceed its fair value. The hybrid approach lacks a strong conceptual basis.

(f) Some respondents are not convinced that accounting for the acquisition of an interest in a joint operation which constitutes a business using the historical cost basis will provide useful information to users of financial statements (SAICA).

(g) The proposed amendment is not only proper; it is consistent with IFRS 3 (Institute of Chartered Accountants of Nigeria (Institute of CPAs of Nigeria)).

Staff analysis

35. We agree with these arguments largely.

36. Respondents gave the following main arguments against the application of the principles on business combinations accounting. Other arguments or arguments relating to other projects are discussed in Appendix C.

Goodwill (impairment) because of deferred taxes inappropriate

Comment received

37. The application of the relevant principles on business combinations accounting in IFRS 3 and other IFRSs will result in the recognition of significant amounts of goodwill and perhaps in goodwill impairments by oil- and gas-producing companies that do not appropriately reflect the transactions (FAR, Centrica Plc (Centrica), PwC). This is because:

    (a) There are often high tax rates on investments in joint operations of the extractive industries, eg as high as 70-90 per cent (FAR, PwC).

    (b) When the acquisition of the interest in a joint operation is not taxable, significant differences between the book value assigned to the assets and the tax basis for the assets in the joint operation arise because the acquirer does not get a new tax base in the acquired assets (FAR, PwC).

    (c) The application of the principles of business combinations accounting in IFRS 3 and other IFRSs suspends the initial recognition exception for deferred tax liabilities in paragraph 15 of IAS 12 (FAR).

38. Consequently, the application of the principles of business combinations accounting in IFRS 3 and other IFRSs will very likely result in major deferred tax liabilities and goodwill that may be difficult to support on economic terms because there are seldom synergies or unrecognised assets such as a workforce (FAR, PwC).

39. Accordingly, applying the initial recognition exceptions in IAS 12:

    (a) results in an accounting that is easier to apply;

(b) provides fewer measurement problems with respect to goodwill; and

(c) is more likely to be understood by users (FAR).

40. This significant difference in accounting will 'drive the interpretation and application' of the definition of a business. Consequently, the diversity in accounting for acquisitions of interests in joint operations that are businesses will be replaced by diversity in identifying businesses in joint operations (FAR, PwC).

41. One respondent (PwC) states that the IASB had undertaken a project to replace IAS 12 that would have eliminated the initial recognition exceptions and largely led to convergence of the measurement of the deferred taxes between IFRS and US GAAP. This project was expected to be completed by the time that IFRS 3 (revised 2008) was effective.

42. One respondent (Centrica) thinks that this significant effect from deferred tax accounting should be avoided on the acquisition of an interest in joint operation that is a business by making an amendment to IFRS 3 and/or IAS 12.

Staff analysis

43. We agree that non-recognition of deferred tax assets and liabilities on the acquisition of an interest in a joint operation is easier to apply and might take pressure off the goodwill impairment test.

44. However, we are not convinced that such an accounting is more likely to be understood by users or would result in more relevant information. This is because the issue of goodwill impairment because of the recognition of deferred tax might also arise following a business combination and the IASC considered it preferable to adjust the carrying amount of goodwill for deferred tax assets and deferred tax liabilities than not to recognise the deferred tax (see paragraphs C.82 and following of this staff paper).

45. Furthermore, it is not clear that the joint project of the IASB/FASB would have solved the issue of goodwill impairment because of deferred taxes. Paragraph B13(b) of Exposure Draft ED/2009/2 *Income Tax* proposed to account for the effect of recognising the asset or liability and the deferred tax asset or

liability in a business combination either in goodwill or as a bargain purchase gain.

46. Consequently, the accounting for deferred tax assets and deferred tax liabilities recognised in a business combination was not proposed to be changed. It would also have continued to be applied whenever the principles for business combinations accounting are applied to an acquisition, eg when using the equity method (paragraph 20 of IAS 28 *Investments in Associates*, now paragraph 26 of IAS 28 *Investment in Associates and Joint Ventures*) or proportionate consolidation for jointly controlled entities (paragraph 33 of IAS 31 *Interests in Joint Ventures*) or whenever the principles for business combinations accounting are applied to an acquisition.

47. We think, however, that the issue of adjusting goodwill for the recognition of deferred tax assets and deferred tax liabilities indicates a more fundamental concern:

    (a) On the one hand, deferred tax liabilities are recognised for future tax payments resulting from recovering the carrying amount of an asset (see paragraph 16 of IAS 12).

    (b) On the other hand, measuring the fair value of an asset requires using the assumptions that market participants would make when pricing the asset, assuming that market participants act in their economic best interest (paragraph 22 of IFRS 13 *Fair Value Measurement*). Such assumptions might also include future tax payments resulting from recovering the carrying amount of an asset.

48. Consequently, the question arises whether an acquirer should account for these tax payments on:

    (a) a gross basis, ie these tax payments are represented by a deferred tax asset or a the deferred tax liability in the statement of financial position and excluded from the fair value of the related asset; or

    (b) a net basis, ie these tax payments are represented in the statement of financial position in the fair value of the related asset and excluded deferred tax.

49. We think that this issue cannot be solved as part of this project, whose aim is to give guidance on the accounting for the acquisition of an interest in a joint operation in which the activity constitutes a business. Instead, the issue should be further explored in the Post-Implementation Review of IFRS 3, in the Post-Implementation Review of IFRS 13 *Fair Value Measurement* or in the IASB's research project on income taxes. This is because:

    (a) the issue is not specific to the accounting for acquisitions of interests in joint operations. Instead, we understand that this issue might arise whenever assets are measured at fair value; and

    (b) the scope of the work required for resolving the issue goes beyond the scope of work that can be done in a limited-scope project.

Predetermined or finite life

Comments raised

50. The separate recognition of goodwill on the acquisition of an interest in a joint operation in which the activity constitutes a business does not always result in better information (BusinessEurope). This is because many joint operations have a predetermined or finite life.

51. Consequently, the fact that goodwill acquired with a business is not amortised but only tested for impairment, would result in the recognition of an impairment of goodwill towards the end of the predetermined or finite life of the joint operation.

52. An impairment loss would arise even though the joint operation was always profitable.

Staff analysis

53. The issue is not specific to the acquisition of an interest in a joint operation in which the activity constitutes a business. It results from the impairment-only-approach for goodwill acquired in a business combination.

54. Consequently, the issue should be further explored as part of the Post-Implementation Review of IFRS 3.

Interest in a joint operation itself as a business combination

Comments raised

55. Some respondents (Shell, EFRAG) reject the application of the principles for business combinations accounting in IFRS 3 and other Standards to the acquisition of an interest in a joint operation in which the activity constitutes a business because they question whether the interest in the joint operation constitutes a business:

    (a) For one respondent (Shell) an interest in a joint operation cannot meet the definition of a business because the individual interest does not, on its own, have inputs and processes that have the ability to create outputs.

    (b) For another respondent (EFRAG), the issue of whether and when an individual interest in a joint operation constitutes a business needs to be clarified before finalising the amendment. This is because:

        (i) the essence of IFRS 11 is to reflect the rights and obligations that a party has in a joint arrangement. This is different to accounting for a business combination and also different to accounting for an investment in an associate or a joint venture, regardless of whether the joint operation is a business. The former is **more akin to an acquisition** of assets, rather than an acquisition of a business;

        (ii) unlike IAS 31, IFRS 11 does not **permit proportionate consolidation**, and therefore it is less obvious why a joint operator would apply the principles in IFRS 3 to an acquisition of an interest in a joint operation, particularly because IFRS 3 is based on the **entity concept** whereas a joint operation is by definition not part of the entity;

        (iii) the **definition of a business** in Appendix A of IFRS 3 is not specific on this issue; and

        (iv) IFRSs provide limited guidance on the meaning and application of the term ‘interest’. Only Appendix A of IFRS 12 provides a definition of ‘interest’.

Staff analysis

Proposal in the ED

56. Paragraph 21A of the ED proposes that the acquirer should assess the activity of the joint operation **as a whole** to determine whether it is a business and to determine whether to apply the relevant principles on business combinations accounting in IFRS 3 and other IFRSs.

57. The ED proposes to apply the relevant principles on business combination accounting in IFRS 3 and other IFRS because the relevant principles lead to an appropriate accounting for such an acquisition. The ED does not propose to apply the relevant principles in IFRS 3 and other IFRSs because the **individual interest** in the joint operation meets the definition of a business.

Staff conclusion

58. We think that the assessment of the activity of the joint operation as a whole to determine whether it is a business is preferable compared to assessing whether the individual interest in the joint operation is a business. We reach this conclusion taking into account that US GAAP generally applies the opposite approach when accounting for the acquisition of a mineral interest in a proved property with oil and gas production activities that are already in place.

59. This is because only the first approach addresses all the relevant fact patterns.

60. If, for example, the activity and the assets of the joint operation as a whole meet the definition of a business, but the individual interest in a joint operation does not, IFRSs would still not give guidance on the accounting for the acquirer's (share in) goodwill, if any, related to the joint operations as a whole as a separate asset, if the individual interest approach was taken.

61. Furthermore, paragraph 20 of IFRS 11 requires a joint operator to recognise in relation to its interest in a joint operation its **share** in the assets, liabilities, revenue and expenses. Consequently, an entity has first to identify all the assets, liabilities, revenue and expenses of the joint operation as a whole before it can identify and recognise its share in these.

Proportionate consolidation

62. In addition, applying the relevant principles on business combination accounting in IFRS 3 and other IFRSs to the acquisition of an interest in a joint operation does not result in proportionate consolidation.

63. Paragraph BC38 of IFRS 11 explains that the concern about how proportionate consolidation differs from accounting for joint operations had already been raised in the project that led to IFRS 11. Some were concerned that accounting for joint operations undermines the removal of proportionate consolidation.

64. The IASB noted two main differences between accounting for joint operations and proportionate consolidation:

    (a) 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

    (b) 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.

Entity concept

65. We agree that accounting for business combinations in IFRS 3 and other IFRSs is based on the entity concept, which means that a parent and its subsidiaries are considered to be one reporting entity for the consolidated financial statements, although the parent and its subsidiaries are usually separate legal entities. This results in:

    (a) the application of business combinations accounting only once, ie on the acquisition of control;

    (b) the recognition of the entire assets and liabilities; and

    (c) the recognition of non-controlling interests.

66. A joint operator instead only recognises its shares in the assets and liabilities (ie not the shares of the other parties to the joint operation) and applies paragraphs 20 and 21 of IFRS 11, ie recognises its (additional) share in the assets jointly held and the liabilities assumed jointly whenever it acquires an (additional) interest in a joint operation.

67. Consequently, principles on business combination accounting in IFRS 3 and other IFRSs that a joint operator would apply on the acquisition of an additional interest in a joint operation in which the activity constitutes a business either do not include the principles in IFRS 3 and other IFRSs that are based on the entity concept, or else these principles have to be modified.

68. Furthermore, this difference also existed between business combinations accounting and proportionate consolidation (see paragraph 33 of IAS 31) and required adjusting the principles for business combinations accounting when acquiring an interest in a jointly controlled entity using proportionate consolidation. We think this shows that the relevant principles on business combination accounting in IFRS 3 and other IFRSs can be applied to the acquisition of an interest in a joint operation, notwithstanding this difference.

69. Finally, one respondent (Instituto de Contabilidad Y Auditoria de Cuentas (ICAC)) acknowledges the difference in accounting between acquisitions of interests in joint operations and business combinations from the (in)applicability of the entity concept and asks for guidance on this issue. Notwithstanding this the respondent supports the proposed amendment.

Definition of a business

70. The significant judgement required in identifying a business may result in a grey area in distinguishing business combinations from asset acquisitions. However, the proposed amendment will significantly reduce diversity in practice for the acquisition of interests in joint operations that are identified as businesses.

71. Furthermore, the challenges in the application of the definition of a business are not specific to the acquisitions of interests in joint operations. In fact, they also arise in the context of business combinations and should therefore be further considered as part of the Post-Implementation Review of IFRS 3.

More akin to asset acquisitions

72. We do not see why acquiring rights to assets and incurring obligations for liabilities is more akin to an acquisition of assets.

73. If the business combination is, from a legal perspective, an asset deal, not a share deal, the acquirer obtains rights to the assets and incurs obligations for the liabilities.

74. The difference is that on the acquisition of control over a business the acquirer also recognises the shares of the non-controlling interests, whereas the acquirer of an interest in a joint operation only recognises its own share in the assets and liabilities.

Significant changes in accounting practice

Comment received

75. The proposed amendment would cause a significant change in practice across many IFRS preparers (PwC).

Staff analysis

76. Resolving significant diversity in practice usually causes significant change in practice across many IFRS preparers.

77. This is in the nature of resolving significant diversity in practice and is inherent in limited-scope projects, which are broader in scope than annual improvements, which are clarifying or correcting in nature.

78. Causing significant changes in practice across many IFRS preparers is not confined to major projects of the IASB. What distinguishes major projects of the IASB from limited-scope projects is the scope of work that needs to be done in each of the projects. In particular, if the Interpretations Committee carries out a limited-scope project on the behalf of the IASB, it is subject to the limitations resulting from the scope of work that the Interpretations Committee can do.

79. While some respondents seem to consider this to be a disadvantage of limited-scope projects, it offers the benefit of guidance to resolve significant diversity in practice in a relatively short period of time.

Impracticability for exploration and research activities

Comment received

80. The application of the measurement principles in IFRS 3 is "impracticable" for oil and gas operations, eg for the acquisition of an interest in an exploration or research activity (Petróleo Brasileiro S.A. (Petrobras)).

Staff analysis

81. IFRS 3 applies, if an exploration or evaluation asset as defined in IFRS 6 *Exploration for and Evaluation of Mineral Resources* is acquired in a business combination (paragraph BC31 of IFRS 6).

82. Furthermore, we understand that estimating the fair value exploration and evaluation assets or reserves is part of the ordinary business of oil and gas companies.

83. Consequently, we do not see why the application of the measurement principles in IFRS 3 is impracticable for oil and gas operations.

84. The difference between a business combination and an acquisition of an interest in a joint operation that is a business is that the acquirer does not recognise the entire asset but only its own share.

Address issue on a more holistic basis

Comments received

85. Several respondents asked us to address the accounting for joint operations on a more holistic basis for the following reasons:

    (a) The proposed amendment is not comprehensive and might lead to further diversity in practice in accounting for acquisitions of interests in joint operations and similar arrangements (FAR).

(b) Without a comprehensive analysis of all the potential consequences of the proposed amendment, which implies different accounting treatments for acquisitions of interests in joint operations and joint ventures, it cannot be decided whether the proposal is appropriate (Autorité des Normes Comptables (ANC), BusinessEurope, ACTEO/AFEP/MEDEF).

(c) By approaching measurement issues in a piecemeal fashion, the IASB runs the risk of creating a complex set of rules that may not be internally consistent and may conflict with other Standards (PwC). This approach will:

(i) extend the period over which specific measurement issues are resolved;

(ii) exclude valid measurement issues that have not yet been brought to the attention of the IASB;

(iii) prevent the IASB from assessing the consistency of the measurement approach; and

(iv) create a potential for accounting arbitrage to the extent that classification or legal form is emphasised over the economic substance of the arrangement.

(d) Separate specific accounting guidance within IFRS 11 should be developed (Norwegian Accounting Standards Board). This is because the principles on business combinations accounting in IFRS 3 and other Standards were developed for fundamentally different transactions.

(e) The following exposure drafts are related to accounting for transactions with joint operations and joint ventures and should therefore be considered together in a holistic manner (BusinessEurope, ACTEO/AFEP/MEDEF):

(i) ED/2012/3 *Equity Method: Share of Other Net Asset Changes*;

(ii) ED/2012/6 *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*;

(iii) ED/2012/7 *Acquisition of an Interest in a Joint Operation.*

Staff analysis

86. The ED proposes to amend IFRS 11 so that a joint operator that is accounting for the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business applies the relevant principles for business combinations accounting in IFRS 3 and other Standards.

87. The proposed amendment makes general reference to the relevant principles of business combination accounting and includes minimal application guidance on the issue on which the Interpretations Committee and the staff noted diversity in practice.

88. The Interpretations Committee recommended to the IASB that it should not propose more detailed guidance for the following reasons (see staff paper 4 presented at the March 2012 Interpretations Committee meeting[1]):

    (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.

    (b) Subparagraph 2(a) of the IFRS Foundation Constitution (updated December 2010)) defines one of the objectives of the IFRS Foundation

1 http://www.ifrs.org/Meetings/Documents/041203AP04IFRS11Acquisitionofaninterestinajointoperation.pdf

as being developing financial reporting Standards based upon clearly articulated principles.

(c) Finally, developing detailed and comprehensive guidance is beyond the scope of work that the Interpretations Committee could realistically do on behalf of the IASB.

89. Consequently, the proposed amendment was not intended to resolve or prevent all diversity in practice in accounting for interests in joint operations. The question therefore arises whether the significant diversity can and should be addressed in a limited-scope project to amend IFRS 11 or whether it has to wait for a major IASB project.

90. We think that principles for accounting for the acquisition of an interest in a joint operation in which the activity constitutes a business can and should be given by a limited-scope project to amend IFRS 11. This is because:

(a) the proposed amendment provides accounting principles to practice, which is currently strongly divided on the conceptual approach to accounting for acquisitions of interests in joint operations (IFRS 3 approach, cost approach or combination approach);

(b) the proposed amendment gives application guidance on specific issues that we noted from our outreach are most affected by the diversity in practice. We understand also that the accounting impact of these specific issues significantly influences the discussion on the appropriate conceptual approach to account for the acquisition of an interest in a joint operation in which the activity constitutes a business;

(c) paragraph 26 of IAS 28 requires the application of the concepts underlying the procedures used in accounting for the acquisition of a subsidiary when using the equity method to account for the acquisition of an investment in an associate or a joint venture. In other words, paragraph 26 of IAS 28 also makes general reference to the relevant principles of business combination accounting when using the equity method;

(d) the comment letter analysis did not give clear evidence that the proposed amendment will:

(i) not significantly reduce diversity in practice; or

(ii) instead significantly increase diversity in practice

in accounting for acquisitions of interests in joint operations in which the activity constitutes a business by moving the significant diversity in practice to other issues. Insofar, respondents have only raised concerns.

91. Consequently, we think that the conclusions of the IASB and Interpretations Committee for issuing the ED, ie the proposed amendment will significantly reduce diversity in practice does not need to be reconsidered.

92. We do not agree that the limited-scope project will result in amendments that are not consistent. Taking into consideration our experience so far from the limited-scope projects, including this comment letter analysis, the proposals have been thoroughly discussed. The staff and respondents to the ED, for example, considered the interaction of the different exposure drafts.

93. Furthermore, another respondent (Telefónica S.A. (Telefonica)) asks the address the issue in a comprehensive manner too. However, it does not identify this concern as a reason for not finalising the proposed amendment.

Acquisition of an additional interest

Comment received

94. Applying the relevant principles on business combinations accounting in IFRS 3 and other IFRSs to the acquisition of an additional interest in a joint operation is counterintuitive (Centrica).

95. This affects in particular the oil and gas industry for which acquisitions of additional interests in joint operations are commonplace.

Staff analysis

96. We are not convinced that the application of the relevant principles on business combinations accounting in IFRS 3 and other IFRSs is counterintuitive for the acquisition of an additional interest in a joint operation.

97. These principles do not include the ones on the acquisition of an additional interest in a business/subsidiary that the acquirer already controls because IFRS 3 (revised 2008) and IFRS 10 *Consolidated Financial Statements* include the entity concept.

98. According to the entity concept the parent and its subsidiaries are considered to be one entity for the consolidated financial statement. This means that the acquirer of the business:

    (a) recognises the total identifiable assets and liabilities, ie including the share of the non-controlling interests; and

    (b) acquisitions of additional interests in the business are considered transactions between shareholders in their capacity as shareholders and acquisitions of additional interests in this group are considered transactions among shareholders.

99. Joint operations instead are not considered to be part of the group/entity (see also the definition of a group in Appendix A of IFRS 10). They are instead considered to be contractual arrangements with other groups/entities. Consequently, a joint operator only recognises its share in the assets jointly held and the liabilities incurred jointly and transaction with the other parties to the joint operation are transactions with third parties (see paragraph 20 of IFRS 11).

100. This difference implies that the principles on business combinations accounting in IFRS 3 and other IFRSs that are based on the entity concept are not part of relevant principles on business combinations accounting or that they have to be modified.

101. Most of the principles on business combinations accounting in IFRS 3 and other IFRSs are however not based on the entity concept, eg fair value measurement of

identifiable assets and liabilities, separate recognition of goodwill, recognising acquisition-related cost as an expense, etc.

102. From some comment letters, however, we noted uncertainty on whether the proposed amendment also applies on the acquisition of an additional interest in a joint operation in which the activity constitutes a business if this acquisition does not result in obtaining control.

103. We think it should be clarified that the proposed amendment also applies to the acquisition of such additional interests. This is because such acquisitions of additional interests are acquisitions of interests in joint operations in which the activity constitutes a business.

104. Such a clarification would ensure that in particular:

(a) identifiable assets and liabilities other than those items for which exceptions are given in IFRS 3 and other IFRSs are measured at fair value;

(b) acquisition-related costs are recognised 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*;

(c) deferred tax assets and deferred tax liabilities that arise from the initial recognition of assets and liabilities, except for deferred tax liabilities that arise from the initial recognition of goodwill, are recognised; and

(d) the excess of the consideration transferred over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed, if any, is recognised as goodwill.

105. What the amendment would however not clarify is whether the previously acquired shares are remeasured on the acquisition of the additional interest.

106. The wording of the proposed clarification included in draft paragraph 21A of Appendix A and B to this paper.

Partial or full gain or loss recognition

Comment received

107. Applying the relevant principles on business combinations accounting in IFRS 3 and other IFRSs requires recognising the full gain or loss, if a joint operator contributes a business or assets to a joint operation (Statoil ASA (Statoil), Singapore Accounting Standards Council (ASC)). The full gain or loss is recognised even though the contributor retains joint control in the business.

108. In such a situation, recognising the full gain or loss does not provide useful information if a subsidiary constituting a business is sold or contributed to a joint operation (Statoil). Although the nature of the investment and the composition of the group changes, in most circumstances the investor retains share in the assets and liabilities of the business.

109. Consequently, partial gain or loss recognition provides more useful information in such circumstances. This applies irrespective of whether the subsidiary constitutes a business or not.

Staff analysis

110. The ED proposes applying the relevant principles on business combinations accounting in IFRS 3 and other IFRSs on the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business. This includes formations of joint operations, except when there is no business.

111. Consequently, the contribution of an existing business to a joint operation in exchange for an (additional) interest in a joint operation is within the scope of the ED.

112. However, the ED does not explicitly address the issue of full or partial gain or loss recognition and the general guidance applies:

(a) Paragraph 25 of IFRS 10 requires recognising the **full gain or loss** on the loss of control of a subsidiary.

(b) With the exception of impairment losses, gains and losses resulting from transactions of a joint operator with its joint operation, such as

sales and contributions, are only recognised to the extent of the other parties' interests in the joint operation (paragraph B34 of IFRS 11).

113. The ED/2012/6 *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Proposed amendments to IFRS 10 and IAS 28)* proposes to amend IFRS 10 and IAS 28 so that:

(a) partial gain or loss recognition for transactions between an investor and its associate or joint venture only applies to the gain or loss resulting from the sale or contribution of assets that do not constitute a business, as defined in IFRS 3 *Business Combinations*; and

(b) the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture is recognised in full.

114. In other words, this ED does not solve the already existing conflict between:

(a) paragraph 25 of IFRS 10, which requires full gain or loss recognition on the loss of control on a subsidiary; and

(b) paragraph B34 of IFRS 11, which requires partial gain or loss recognition for transactions between a joint operator and its joint operation.

115. The ED does not solve this already existing conflict because it only addresses sale or contribution of assets between an investor and its **associate** or **joint venture** but not such transactions between a joint operator and its **joint operation.**

116. Notwithstanding this conflict in guidance, we think the proposed amendment should be finalised. This is because the conflict is not introduced by the proposed amendment; it exists already. Consequently, we think that the proposed amendment leaves the issue of full partial or full gain or loss recognition open.

Additional guidance needed

118. Most of the respondents to the ED noted that additional guidance would be needed. However, while many respondents only asked for more guidance on a

few specific issues, some respondents listed lots of issues. Accordingly, some respondents think that the amendment should not be finalised without additional guidance on all these issues, whereas most respondents just ask for additional guidance on specific issues.

Comments received

119. The following issues were raised very often as the ones that require additional guidance:

(a) accounting for an additional interest in a joint operation without acquiring control (eg farm-in arrangements) (Yoshinaga Yuko (Y. Yuko, ASCG, F.Hoffmann-La Roche AG (Roche), DASB, CPA Australia and Institute of Chartered Accountants in Australia (CPA Australia and Institute of CPAs), ESMA, Grant Thornton International Ltd. (GT), KPMG, Shell, EFRAG, Repsol, OIAC, Japanese Institute of CPAs, Baker Tilly, RSM International Ltd. (RSM), FAR, Institute of Certified Public Accountants of Kenya (IPCAK), ICAC, BP p.l.c (BP), Telefonica, DTT, AASB, AOSSG, Financial Executives International Canada (FEI), Belgian Accounting Standards Board (BASB), Ernst & Young, BDO, Norwegian Accounting Standards Board, BHP Billiton Ltd. (bhpbilliton), Institute of Chartered Accountants of Pakistan (ICAP), Italian Standard Setter (OIC), ASC). IFRS 3 requires that a previously held interest is re-measured to fair value on obtaining control of a business. A participant in a joint operation may increase its interest in the joint operation or may take control of the joint operation (PwC). Questions have arisen as to whether the existing interest in either case should be re-measured to fair value. We believe there may already be some diversity in practice in this point (PwC). Some highlight that such transactions are very common in the Oil & Gas industry; and

(b) recognition of full, partial or no gain or loss recognition for assets contributed to a joint operation (see also paragraph 38 of IFRS 3), including accounting for the loss of control over a business that is contributed to a joint operation in exchange for an interest in the same

joint operation (Y. Yuko, Roche, DASB, GT, ANC, SAICA, EFRAG, Japanese Institute of CPAs, Baker Tilly, FAR, IPCAK, Telefonica, DTT, Mazars, FEI, Ernst & Young, BDO, Norwegian Accounting Standards Board, bhpbilliton, ASC).

120. Other issues given in the comment letters for additional guidance were:

(a) accounting for conveyances (Repsol);

(b) accounting for bargain purchases (Y. Yuko, Repsol);

(c) application of the mechanics of accounting for income taxes in IAS 12 (see EFRAG, Repsol);

(d) accounting by parties that participate in a joint operation but do not have joint control (SAICA, Repsol);

(e) accounting for forward contracts between an acquirer and a selling shareholder to buy or sell an acquiree that will result in a business combination at a future acquisition date (see paragraph 2(g) of IAS 39 *Financial Instruments: Recognition and Measurement*) (EFRAG);

(f) accounting for the various ways in which an investor can acquire an interest in a joint operation. Acquiring an interest in a joint operation involves very often not just acquiring an interest but also multiple transactions and arrangements (GT, IPCAK, FEI, BASB, OIC). An entity might become a joint operator of a joint arrangement by:

(i) merely entering into an arrangement whereby every party keeps the rights to its assets and liabilities for its obligations; or

(ii) acquiring in one or several steps (an) interest(s) in an entity or assets and liabilities; or both (ASCG, GT, ANC, IPCAK).

The ED does not consider this, because it focuses on a narrow set of circumstances. In our view, this may result in new uncertainty and diversity in practice (Roche, DASB, EFRAG);

(g) accounting for the acquisition of an interest in a joint operation when keeping own assets and liabilities (Roche, DASB, EFRAG, Mazars);

(h) accounting for step-ups and step-downs in the interest in the joint operation in general (Shell, OIAC, Mazars);

(i) accounting for the acquisition of control over a joint operation (FAR, bhpbilliton);

(j) clarifying how the concepts of joint operation, business, and control relate to one another (Japanese Institute of CPAs);

(k) accounting if the formation of a joint operation coincides with formation of business (Japanese Institute of CPAs, DTT);

(l) does IFRS 3 apply to all assets and liabilities encompassed by the arrangement, or only those within the acquired interest (GT, IPCAK);

(m) determining the shares in assets and liabilities (SAICA);

(n) derecognition guidance from the Lease project for scenarios in which the joint arrangement is only for a limited life, and it is not the entire asset that is contributed to a joint operation but only a usufruct right of the asset for a limited period of time, should be incorporated in the proposed amendment (SAICA);

(o) in assessing whether a joint operation's activities constitutes a business for the purpose of this proposed amendment, clarity is needed as to whether the assessment of IFRS 3's definition of a business considers only inputs, outputs and processes in the acquired interest, or all of the activities encompassed by the arrangement (GT, IPCAK);

(p) a joint arrangement can involve assets and liabilities held directly by the joint operator as well as assets and liabilities held or incurred jointly. It is not clear whether the proposed IFRS 3-based accounting is intended to apply to all assets and liabilities encompassed by the arrangement, or only those within the acquired interest (GT, IPCAK);

(q) contingent consideration liabilities (FAR). Many joint operation acquisitions may have contingent liabilities associated with them and sellers often retain royalty-type interests that may be a form of contingent consideration (PwC);

(r) accounting for the acquisition of an interest in a joint operation in which the activity does not constitutes a business (DTT);

(s) full or partial gain or loss recognition on contribution of an asset or group of assets that does not constitute a business on the formation of the joint operation (DTT);

(t) applicability of the scope exclusion for a combination of entities or businesses under common control in the case of the acquisition of an interest in a joint operation in which the activity constitutes a business (bhpbillition); and

(u) accounting for the formation of a joint arrangement that results from a simple change in contract (ICAP).

Staff analysis

121. While we understand that diversity in practice might develop on some of these issues, eg the acquisition of an additional interest in a joint operation, we are not convinced that significant diversity in practice might develop on other issues, eg the accounting for a bargain purchase.

122. Furthermore, addressing these issues in a limited-scope project requires that the IASB concludes that there is significant diversity in practice on these issues that needs to be addressed.

123. In other words, to address an issue in a limited-scope project, we need sufficient evidence for significant diversity in practice.

124. We do have this evidence for the issues addressed in paragraph B33A of the ED. Entities have been applying different conceptual approaches for the acquisition of interests in jointly controlled operations or assets in which the activity constitutes a business (IFRS 3 approach, cost approach or combination approach) for many years now. The different approaches have resulted in significant diversity in practice on the issues addressed in paragraph B33A of the ED.

125. Considering that IFRS 11 does not currently give guidance on the acquisition of an interest in a joint operation in which the activity constitutes a business and in particular the issues addressed in paragraph B33A of the ED, we expect that the

diversity in practice will remain if the amendment is not finalised. We noted from our discussions with interested parties and the comment letter analysis that preparers are still convinced of the appropriateness of the approach that they have applied so far and their intention is to continue to apply that approach.

126. It is different however for the issues on which respondents ask for additional guidance:

(a) Only very few respondents state that they observe significant diversity in practice in accounting for the acquisition of an additional interest in a joint operation. So far, the vast majority of respondents have only raised the concern that significant diversity in practice might develop on the listed issues on the adoption of the proposed amendment.

(b) We understand that the bases for the concerns so far are mostly discussions on the ED and on the implementation of IFRS 11. IFRS 11, however, does not specifically address the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business.

(c) In the process that led to the Exposure Draft, we discussed with interested parties the acquisition of interests in jointly controlled operations and assets in which the activity constitutes a business. In these discussions we tried to ascertain whether the diversity in practice only relates to the application of the different approaches, ie the IFRS 3 approach, cost approach or combination approach, or whether there was also diversity in practice between the entities applying the same approach. We were not able to get a clear picture because the discussions up to then had mainly focused on the separate recognition of goodwill, accounting for deferred taxes on the initial recognition of assets and liabilities and capitalising acquisition-related cost or recognising it as an expense.

127. Consequently, we think that further work, including additional outreach, would need to be done to identify whether there is significant diversity in practice on

these issues. As part of this project the IASB would need to assess whether there is already sufficient diversity in practice to justify addressing any specific issue.

Analysis of Question 2

Overview

128. Most of the respondents agreed with the proposal that the amendment to IFRS 11 and the consequential amendment to IFRS 1 should apply to the acquisition of an interest in a joint operation on its formation, unless no existing business is contributed to the joint operation.

Arguments supporting the proposal

129. The main arguments given for supporting the proposal are shown below:

(a) Limiting the scope of the project to the fact patterns that are subject to significant diversity in practice, as observed by the Interpretations Committee, is consistent with the purpose of a limited-scope project (KPMG, Baker Tilly).

(b) Not applying the relevant principles on business combinations accounting in IFRS 3 and other IFRSs if no existing business is contributed to the joint operation on its formation is consistent with the fact that in such cases the acquirer does not pay for a premium (goodwill) in addition to the fair value of the identifiable net assets/acquire (a share in) goodwill (DASB, Institute of Certified Public Accountants of Rwanda (ICPAR)).

Arguments for disagreeing with the proposal

130. Most of the respondents that disagree with the proposed scope also disagree with the proposed amendment in general.

131. Others disagree with the proposed scope limitation because they think that it unduly limits the scope of the proposed amendment. This is because:

(a) in their view, the formation of a joint operation very often coincides with the formation of the business (Brazilian Accounting Pronouncements Committee (CPC Brasil)); and

(b) they think there is no reason for not applying the relevant principles on business combinations accounting in IFRS 3 and other IFRSs if the formation of the joint operation coincides with the formation of its business (Hong Kong Association of Banks, SAICA, FAR, PwC, Ernst & Young).

Staff analysis

132. We agree that the relevant principles on business combinations accounting in IFRS 3 and other IFRSs should also be applied if no existing business is contributed to the joint operation on its formation. This is because on the formation of the business synergies and other non-identifiable assets might arise and the joint operator acquires a share in these items. Consequently, recognising goodwill on the formation of an interest in a joint operation in which the activity constitutes a business does not result in the recognition of internally generated goodwill (see paragraphs 48 and following of IAS 38).

133. Notwithstanding this, we do not think that scope of the amendment should be extended to acquisitions of interests in joint operations on their formation if the formation of the joint operation coincides with the formation of the business. This is because the project should be limited to the diversity in practice as observed by the Interpretations Committee.

134. We do not recommend extending the scope of the project because addressing this additional issue would require further outreach, analysis and at least a re-exposure of the proposed amendment. This would delay addressing the observed diversity in practice.

135. Consequently, the accounting for acquisitions of interests in joint operations on their formation if the formation of the joint operation coincides with the formation of its business should be addressed, if at all, in a separate project.

Analysis of Question 3

Comments received

136. The vast majority of respondents agree with the proposal that the proposed amendment should be applied prospectively to acquisitions of interests in joint operations in which the activity of the joint operation constitutes a business on or after the effective date.

137. Only a very few respondents disagreed with the proposal. The majority of them disagreed with prospective application because they disagree with the proposed amendment in general.

138. One respondent (Institute of CPAs of Nigeria) thinks that retrospective application ensures more reliable comparative information and it is not always the use of hindsight that would determine comparative information.

139. Another respondent (Accounting Committee of Chartered Accountants Ireland (AC Ireland)) considers the costs and benefits of prospective and retrospective application and recommends that comparative periods should be restated.

140. A further respondent (BDO) agrees with prospective application. It wants to allow retrospective application however, if information was obtained at the time of the transaction.

Staff analysis

141. While we agree that retrospective application usually results in more relevant information for users of financial statements, our concerns about retrospective application remain.

142. Furthermore, we agree with another respondent (ACCA) that prospective application is consistent with the transition provisions in IFRS 3 in general (see paragraphs 65 and following of IFRS 3).

Drafting suggestions

143. Finally, we received the following comments on the drafting of the proposed amendment:

Draft paragraph 21A

Comment received

144. Paragraph 21A in the ED should specify the 'other IFRSs' that it refers to or delete it because the wording is unnecessarily broad (Ernst & Young).

Staff analysis

145. Draft paragraph 21A of the ED requires that the acquirer of an interest in a joint operation in which the activity constitutes a business applies the relevant principles on business combinations accounting in IFRS 3 and **other IFRSs**.

146. It does not specify these 'other IFRSs'. However, draft 21A of the ED clarifies that other IFRSs must be Standards that include principles on business combinations accounting.

147. Consequently, we think it is in general not a problem to identify these 'other IFRSs' and do not recommend draft paragraph 21A of the ED as proposed by the respondent.

Draft paragraph B33A

Comment received

148. Paragraph B33A should refer to applying "IFRS 3 and related IFRSs dealing with business combinations accounting" and not "the relevant principles on business combinations accounting in IFRS 3 and other IFRSs" (KPMG). This is because IFRS 3 includes exceptions to the measurement and recognition principles that should also be applied when an entity acquires an interest in a joint operation.

Staff analysis

149. We disagree with the proposed change in wording for the following reasons:

(a) Paragraphs 21 and following of IFRS 3 include exceptions to the (general) recognition or measurement principles. These exceptions to the general recognition or measurement principles are part of the relevant principles on business combinations accounting in IFRS 3 and other IFRSs in terms of the ED.

(b) Draft paragraph B33A(a) of the ED already explains that assets and liabilities are not measured at fair value, for which exceptions are given in IFRS 3 and other IFRSs.

(c) The alternative wording proposed by the respondent requires the application of IFRS 3 in total and not merely the relevant principles in IFRS 3. Consequently, the alternative wording would require recognising the whole of the assets and liabilities, including the shares of the other parties to the joint operation, and other requirements that are based on the entity concept. As explained above, these requirements are either not part of the relevant principles in IFRS 3 or other IFRSs or would have to be modified.

Comment received

150. Paragraph B33A should rather say that all principles of IFRS 3 should be applied where relevant, and then either say that paragraph B33A(a)–(d) are examples of the more common principles that will be applied, if this is the case, or alternatively not single out individual principles at all (Ernst & Young, IOSCO). This because:

(a) it is confusing to highlight specific principles, because it gives the impression that not all the principles of IFRS 3 should be applied, such as those to do with bargain purchase situations etc. (Ernst & Young, IOSCO); and

(b) the assessment of which principles on business combinations accounting are not directly applicable should be left to the preparer in the application of the standard (Ernst & Young).

Staff analysis

151. We disagree with this proposal to change the wording of paragraph B33A for the following reasons:

(a) Paragraph B33A already requires the application of all the relevant principles. Adding the word 'all' is consequently a tautology.

(b) The basis for conclusions explains the examples in paragraph B33A(a)–(d) includes the items that the Interpretations Committee observed significant diversity in practice on in developing the exposure draft. We think it contributes to consistent application, if issues of significant diversity in practice are explicitly addressed.

Draft paragraph B33B

Comments received

152. For clarity, the final sentence of BC10 should be added to B33B (KPMG, Ernst & Young, bhpbilliton, OIC).

153. Paragraph B33B of the ED is not consistent with the description in the question. The respondent suggests amending B33B along these lines: "Paragraphs 21A and B33A also apply to transactions in which an existing business is contributed to a joint operation on its formation." (GT).

154. Paragraph B33B of the ED should be amended to clarify that the amendment also addresses the acquisition of an interest in an existing joint operation in which the activity constitutes a business (Telefonica).

Staff analysis

155. We do not think that paragraph B33B of the ED should explicitly clarify that the amendment also addresses the acquisition of an interest in an existing joint operation. We think that it is clear that such transactions constitute an acquisition of an interest in a joint operation and therefore in the scope of the amendment.

156. We agree, however, with the other concern and propose to amend paragraph B33B in the Appendices of this staff paper.

Definition of goodwill and other consequential amendments

Comments received

157. The definition of goodwill in Appendix A of IFRS 3 should be amended as follows: An asset representing the future economic benefit arising from other assets acquired in a business combination or an acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business that are not individually identified and separately recognised (Y. Yuko).

158. The initial recognition exceptions in paragraphs 15 and 24 of IAS 12 need to be amended so that they do not apply on the acquisition of an interest in a joint operation in which the activity constitutes a business. Only deferred tax liabilities resulting from the initial recognition of goodwill should not be recognised (BDO).

Staff analysis

159. We agree that the definition of goodwill in Appendix A of IFRS 3 does not include goodwill acquired as part of the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business.

160. However, we think there is no need to amend the definition of goodwill accordingly because the proposed amendment in the ED requires the application of the relevant guidance for business combinations by analogy.

161. Because of the application by analogy we do not propose to amend other paragraphs, eg paragraphs 15 and 24 of IAS 12 or paragraph 2(g) of IAS 39, as well, although such a clarification was raised (BP).

162. Following the logic of the respondent, the definition of goodwill in Appendix A of IFRS 3 should also be amended for acquisitions of interests in joint ventures and associates. This is because paragraph 26 of IAS 28 makes reference to the concepts underlying the procedures used in accounting for the acquisition of a subsidiary in accounting for the acquisition of an investment in an associate or a joint venture.

Existing or expected business

Comment received

163. Modify the phrase "... in which the activity of the joint operation constitutes a business ..." to read "... is expected to constitute a business .,." (International Association of Consultants, Valuators and Analysts (IACVA)).

Staff analysis

164. We disagree with the comments because the activity of the joint operation has to constitute a business on acquisition date for the proposed amendment to be applicable.

165. This is consistent with the principles in IFRS 3 that the acquisition has to meet the definition of a business combination on acquisition date.

Staff recommendation

166. Summarising the analysis of the comment letters that we have received, we think that the respondents very much confirmed the observation that we made in developing the ED.

167. Practice is strongly divided on the appropriate approach to account for the acquisition of an interest in a joint operation in which the activity constitutes a business. The choice of whether to apply the relevant guidance for business combinations, or a cost approach, or an approach that is a combination of both depends on two factors:

(a) differences in conceptual views; and

(b) the significant differences in accounting implication.

168. The "significant differences" in point 167(b) relate very much to the recognition of deferred tax assets and deferred tax liabilities on the initial recognition of assets and liabilities. If the principles in IFRS 3 and other Standards on business combinations accounting are applied in accounting for the acquisition of an interest in a joint operation, the initial recognition exceptions for deferred tax assets and deferred tax liabilities would not apply.

169. Consequently, the acquirer might have to recognise significant deferred tax liabilities that result in an adjustment of goodwill and subsequently recognise significant impairments of goodwill that result from those liabilities.

170. The Interpretations Committee discussed the issue of recognising deferred tax assets and deferred tax liabilities at its meeting in January 2012 (see paragraphs 10-15 of Staff Paper 5 presented at this meeting[2]).

171. At this meeting the Interpretations Committee asked the staff to draft a recommendation to the IASB that would include 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. This is because:

(a) the recognition of 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, is part of the relevant principles of business combination accounting. These principles constitute the most appropriate approach to account for the acquisition of an interest in a joint operation in which the activity constitutes a business;

(b) the effects of deferred tax assets and liabilities can be adjusted against goodwill or the bargain recognised in profit or loss; and

(c) applying the relevant principles on business combinations accounting except for recognising deferred tax assets and deferred tax liabilities on the initial recognition of assets and liabilities might be perceived as cherry-picking from the IFRS 3 approach.

172. The view of the Interpretations Committee that applying the relevant principles on business combinations accounting IFRS 3 and other IFRSs is the most appropriate approach to account for the acquisition of an interest in a joint operation in which the activity constitutes a business was confirmed by the comment letters on the ED. The overwhelming majority of respondents supports the application of these

[2] http://www.ifrs.org/Meetings/Documents/051201AP5IFRS11Acquisitionofaninterestinajointoperation.pdf

principles. Only a relatively small group considers the application of this guidance to be inappropriate in principle.

173. At the same time a majority of respondents also asked for more guidance on the accounting for acquisitions of interests in joint operations in which the activity constitutes a business. This view leads the respondents to very different conclusions, however:

(a) some recommend not finalising the proposed amendment without such additional guidance;

(b) some assert that this guidance should be given either in this project or at a later stage; and

(c) some respondents do not comment on this issue. They merely cite issues that should be addressed by further guidance.

174. Considering the options, we recommend that the amendment should be finalised and the need for additional guidance should be analysed in a subsequent project. This is because:

(a) applying the relevant principles on business combinations accounting in IFRS 3 and other IFRSs is the most appropriate approach to account for the acquisition of an interest in a joint operation in which the activity constitutes a business;

(b) the amendment will significantly reduce diversity in practice on a timely basis, in particular on the issue addressed in the application guidance:

(i) measuring identifiable assets and liabilities at fair value other than those items for which exceptions are given in IFRS 3 and other IFRSs;

(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;

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

(iv) recognising the excess of the consideration transferred over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed, if any, as goodwill;

(c) the approach to make reference to the relevant principles on business combinations accounting in IFRS 3 and other Standards is also applied for using the equity method (see paragraph 26 of IAS 28); and

(d) Securities regulators (IOSCO) consider the proposed amendment to be enforceable.

175. Addressing the additional issues as part of this project instead would significantly delay any guidance on the accounting for acquisitions of interests in joint operations in which the activity constitutes a business. This is because addressing the additional issues requires, in addition to drafting additional guidance:

(a) exploring whether there is significant diversity in practice on these issues; and

(b) re-exposing the amendments.

176. This would leave the diversity in accounting for acquisitions of interests in joint operations in which the activity constitutes a business unaddressed for several years, and potentially for even longer. Addressing all the issues raised in the comment letters might be beyond the scope of work that the Interpretations Committee could do on behalf of the IASB because it might require a major IASB project. Such a project would need to go through the agenda consultation process first, and it might not be identified by the agenda consultation process as an active project before the Post-Implementation Review of IFRS 11 is completed.

177. In other words, the proposed amendment is a significant step in the right direction and it is appropriate for addressing significant diversity in practice on a timely basis. This matches with the purpose of limited-scope projects.

Questions to the IFRS Interpretations Committee

Questions to the IFRS Interpretations Committee
1. Does the Interpretations Committee agree to recommend to the IASB that it should proceed with the amendment? 2. Does the Interpretations Committee agree with the proposed drafting of the amendment as set out in Appendix A and Appendix B of this Staff Paper?

Appendix A—Changes for finalising the amendment

A1. The amendments are presented below.

Amendment to IFRS 11 *Joint Arrangements*

In IFRS 11, paragraph 21A is added. New text is underlined. Paragraphs 20–21 have been included for ease of reference but are not to be amended.

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 When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in IFRS 3 *Business Combinations*, it shall apply, to the extent of its interest according to paragraph 20, the relevant principles on business combinations accounting in IFRS 3 and other IFRSs and disclose the relevant information that is required in those IFRSs for business combinations. This includes the acquisition of an additional interest in a joint operation in which the activity of the joint operation constitutes a business. The accounting for the acquisition of an interest in such a joint operation is specified in paragraphs B33A–B33B.

Appendix B
Application guidance

In Appendix B, the main heading following paragraph B33 is amended. A subheading and paragraphs B33A–B33B are added after the main heading following paragraph B33. New text is underlined.

Financial statements of parties to a joint arrangement (paragraphs 21A and 22)

Accounting for acquisitions of interests in joint operations

B33A When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in IFRS 3, it shall apply, to the extent of its interest according to paragraph 20, the relevant principles on business combinations accounting in IFRS 3 and other IFRSs and disclose the relevant information required by those IFRSs for business combinations. The principles on business combinations accounting include:

(a) measuring identifiable assets and liabilities at fair value other than those items for which exceptions are 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 *Financial Instruments: Presentation* and IFRS 9;[3]

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

(d) recognising the excess of the consideration transferred over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed, if any, as goodwill.

B33B Paragraphs 21A and B33A apply to the acquisition of an interest in a joint operation on its formation, except when there is no existing business. This is the case if no existing business is contributed to the joint operation on its formation and the formation of the joint operation therefore coincides with the formation of the business.

Accounting for sales or contributions of assets to a joint operation

…

[3] If an entity applies this amendment but does not yet apply IFRS 9, the reference in this amendment to IFRS 9 shall be read as a reference to IAS 39 *Financial Instruments: Recognition and Measurement*.

Appendix C
Effective date, transition and withdrawal of other IFRSs

In Appendix C, paragraph C1AA is added after paragraph C1A and a subheading and paragraph C14A are added after paragraph C14. New text is underlined.

Effective date

...

C1AA *Acquisition of an Interest in a Joint Operation* (Amendment to IFRS 11) issued in [date] amended the heading after paragraph B33 and added paragraphs 21A, B33A–B33B and C14A and headings. An entity shall apply that amendment prospectively for annual periods beginning on or after [date]. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

Transition

...

Accounting for acquisitions of interests in joint operations

C14A *Acquisition of an Interest in a Joint Operation* (Amendment to IFRS 11) issued in [date] amended the heading after paragraph B33 and added paragraphs 21A, B33A–B33B, C1AA and headings. An entity shall apply that amendment prospectively for acquisitions of interests in joint operations from the beginning of the first period for which it applies that amendment. Consequently, amounts recognised for acquisitions of interests in joint operations in prior periods shall not be adjusted.

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

In Appendix C, paragraph C5 is amended and paragraph 39M is added. New text is underlined and deleted text is struck through.

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 and interests in joint operations in which the activity of the joint operation constitutes a business. Furthermore, the date selected for paragraph C1 applies equally for all such acquisitions.

Effective date

...

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

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

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

Financial statements of parties to a joint arrangement

Accounting for acquisitions of interests in joint operations

BC45A The IFRS Interpretations Committee ('the Interpretations Committee') reported to the IASB that practice differed significantly in accounting for the acquisition of interests in jointly controlled operations or assets, as specified in IAS 31 *Interests in Joint Ventures*. In particular, the Interpretations Committee noted significant diversity in practice, if the activity of the jointly controlled operations or assets constitutes a business, as defined in IFRS 3 *Business Combinations*. This includes formations of jointly controlled operations or assets when existing businesses are contributed in the formations.

BC45B While some apply the relevant principles of business combinations accounting in IFRS 3 and other Standards, others allocate the total cost of acquiring interests in jointly controlled operations or assets to the individual identifiable assets and liabilities on the basis of their relative fair values.

BC45C A third group applies the relevant principles of business combinations accounting only to issues that are not addressed in other Standards.

BC45D The different approaches have led to different accounting outcomes, 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 that arise from the initial recognition of assets and liabilities.

BC45E The IASB noted that the significant diversity in practice results from the fact that IAS 31 does not give comprehensive guidance on the accounting for acquisitions of interests in jointly controlled operations or assets, the activity of which constitutes a business, as defined in IFRS 3. The IASB is concerned that this significant diversity in practice may continue in the accounting for acquisitions of interests in joint operations, as defined in IFRS 11,[4] the activities of which constitute businesses.

BC45F The IASB considered the guidance in current Standards on the acquisition of an interest in a business and concluded that the most appropriate approach to account for an acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in IFRS 3, is to apply all the relevant principles on business combinations accounting in IFRS 3 and other Standards.

BC45G The IASB reached this conclusion because:

(a) it considers that separate recognition of goodwill, when present, is preferable to allocating premiums to identifiable assets acquired on the basis of relative fair values;

(b) it thinks that an approach that limits the application of business combinations accounting only to issues that are not addressed elsewhere in the Standards lacks a strong conceptual basis; and

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

BC45H The IASB also concluded that an entity that is acquiring an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in IFRS 3, shall disclose the relevant information that is specified in IFRS 3 and other Standards on business combinations. This is because these requirements are an integral part of the financial reporting about the acquisition of interests in businesses.

[4] IFRS 11 *Joint Arrangements* has to be applied for annual periods beginning on or after 1 January 2013. It replaces IAS 31 *Interests in Joint Ventures*.

BC45I Consequently, the IASB amended IFRS 11 to address the accounting for both the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in IFRS 3, and the related disclosure requirements, as a means to resolve the significant diversity in practice.

BC45J The scope of the amendment to IFRS 11 is, in terms of a limited-scope project, limited to the fact patterns that are subject to significant diversity in practice, as observed by the Interpretations Committee. Consequently, the IASB decided that the amendment should not only apply to the acquisition of an interest in an existing joint operation but also to the acquisition of an interest in a joint operation on its formation. However, the amendment should not apply if the formation of the joint operation coincides with the formation of the business. This is the case when no existing business is contributed to the joint operation on its formation.

Effective date and transition

BC45K The IASB considered the transitional provisions and effective date of the amendment to IFRS 11. The IASB noted that applying the relevant principles of business combinations accounting in IFRS 3 and other Standards to transactions that have previously been accounted for by applying one of the divergent approaches presented in paragraphs BC45B–BC45C 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 IASB decided that an entity would apply the amendment to IFRS 11 prospectively for annual periods beginning on or after [date].

Appendix B—Changes from the Exposure Draft published in December 2012 following our recommendations in this paper

B1. The amendments are presented below. New text that is proposed to be added on the basis of the comment letter analysis, arising from the proposed amendment included in the ED, is shown with a double-underline. Text that is proposed to be deleted with respect to the proposed amendment included in the ED, is shown with a ~~double-strike-through~~.

Amendment to IFRS 11 *Joint Arrangements*

In IFRS 11, paragraph 21A is added. New text is underlined. Paragraphs 20–21 have been included for ease of reference but are not to be amended.

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 When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in IFRS 3 *Business Combinations*, it shall apply, to the extent of its interest according to paragraph 20, the relevant principles on business combinations accounting in IFRS 3 and other IFRSs and disclose the relevant information that is required in those IFRSs for business combinations. This includes the acquisition of an additional interest in a joint operation in which the activity of the joint operation constitutes a business. The accounting for the acquisition of an interest in such a joint operation is specified in paragraphs B33A–B33B.

Appendix B
Application guidance

In Appendix B, the main heading following paragraph B33 is amended. A subheading and paragraphs B33A–B33B are added after the main heading following paragraph B33. New text is underlined.

Financial statements of parties to a joint arrangement (paragraphs 21A and 22)

Accounting for acquisitions of interests in joint operations

B33A When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in IFRS 3, it shall apply, to the extent of its interest according to paragraph 20, the relevant principles on business combinations accounting in IFRS 3 and other IFRSs and disclose the relevant information required by those IFRSs for business combinations. The principles on business combinations accounting include:

(a) measuring identifiable assets and liabilities at fair value other than those items for which exceptions are 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 *Financial Instruments: Presentation* and IFRS 9;[5]

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

(d) recognising the excess of the consideration transferred over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed, if any, as goodwill.

B33B Paragraphs 21A and B33A apply to the acquisition of an interest in a joint operation on its formation, except when there is no existing business. This is the case if no is existing business is contributed to the joint operation on its formation and the formation of the joint operation therefore coincides with the formation of the business.

Accounting for sales or contributions of assets to a joint operation

…

[5] If an entity applies this amendment but does not yet apply IFRS 9, the reference in this amendment to IFRS 9 shall be read as a reference to IAS 39 *Financial Instruments: Recognition and Measurement*.

Appendix C
Effective date, transition and withdrawal of other IFRSs

In Appendix C, paragraph C1AA is added after paragraph C1A and a subheading and paragraph C14A are added after paragraph C14. New text is underlined.

Effective date

...

C1AA *Acquisition of an Interest in a Joint Operation* (Amendment to IFRS 11) issued in [date] amended the heading after paragraph B33 and added paragraphs 21A, B33A–B33B and C14A and headings. An entity shall apply that amendment prospectively for annual periods beginning on or after [date]. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

Transition

...

Accounting for acquisitions of interests in joint operations

C14A *Acquisition of an Interest in a Joint Operation (Amendment to IFRS 11)* issued in [date] amended the heading after paragraph B33 and added paragraphs 21A, B33A–B33B, C1AA and headings. An entity shall apply that amendment prospectively for acquisitions of interests in joint operations from the beginning of the first period for which it applies that amendment. Consequently, amounts recognised for acquisitions of interests in joint operations in prior periods shall not be adjusted.

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

In Appendix C, paragraph C5 is amended and paragraph 39M is added. New text is underlined and deleted text is struck through.

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 and interests in joint operations in which the activity of the joint operation constitutes a business. Furthermore, the date selected for paragraph C1 applies equally for all such acquisitions.

Effective date

...

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

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

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

Financial statements of parties to a joint arrangement

Accounting for acquisitions of interests in joint operations

BC~~1~~45A The IFRS Interpretations Committee (the Interpretations Committee) reported to the IASB that practice differed significantly in accounting for the acquisition of interests in jointly controlled operations or assets, as specified in IAS 31 *Interests in Joint Ventures*. In particular, the Interpretations Committee noted significant diversity in practice, if the activity of the jointly controlled operations or assets constitutes a business, as defined in IFRS 3 *Business Combinations*. This includes formations of jointly controlled operations or assets when existing businesses are contributed in the formations.

BC~~2~~45B While some apply the relevant principles of business combinations accounting in IFRS 3 and other Standards, others allocate the total cost of acquiring interests in jointly controlled operations or assets to the individual identifiable assets and liabilities on the basis of their relative fair values.

BC~~3~~45C A third group applies the relevant principles of business combinations accounting only to issues that are not addressed in other Standards.

BC~~4~~45D The different approaches have led to different accounting outcomes, 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 that arise from the initial recognition of assets and liabilities.

BC~~5~~45E The IASB noted that the significant diversity in practice results from the fact that IAS 31 does not give comprehensive guidance on the accounting for acquisitions of interests in jointly controlled operations or assets, the activity of which constitutes a business, as defined in IFRS 3. The IASB is concerned that this significant diversity in practice may continue in the accounting for acquisitions of interests in joint operations, as defined in IFRS 11,[6] the activities of which constitute businesses.

BC~~6~~45F The IASB considered the guidance in current Standards on the acquisition of an interest in a business and concluded that the most appropriate approach to account for an acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in IFRS 3, is to apply all the relevant principles on business combinations accounting in IFRS 3 and other Standards.

BC~~7~~45G The IASB reached this conclusion because:

(a) it considers that separate recognition of goodwill, when present, is preferable to allocating premiums to identifiable assets acquired on the basis of relative fair values;

(b) it thinks that an approach that limits the application of business combinations accounting only to issues that are not addressed elsewhere in the Standards lacks a strong conceptual basis; and

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

BC~~8~~45H The IASB also concluded that an entity that is acquiring an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in IFRS 3, shall disclose the relevant information that is specified in IFRS 3 and other Standards on business combinations. This is because these requirements are an integral part of the financial reporting about the acquisition of interests in businesses.

[6] IFRS 11 *Joint Arrangements* has to be applied for annual periods beginning on or after 1 January 2013. It replaces IAS 31 *Interests in Joint Ventures*.

BC~~9~~45I Consequently, the IASB ~~proposes to~~ amend~~ed~~ IFRS 11 to address the accounting for both the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in IFRS 3, and the related disclosure requirements, as a means to resolve the significant diversity in practice.

BC~~10~~45J The scope of the ~~proposed~~ amendment to IFRS 11 is, in terms of a limited-scope project, limited to the fact patterns that are subject to significant diversity in practice, as observed by the Interpretations Committee. Consequently, the IASB ~~proposes~~decided that the amendment should not only apply to the acquisition of an interest in an existing joint operation but also to the acquisition of an interest in a joint operation on its formation. However, the ~~proposed~~ amendment should not apply if the formation of the joint operation coincides with the formation of the business. This is the case when no existing business is contributed to the joint operation on its formation.

Effective date and transition

BC~~11~~45KThe IASB considered the transitional provisions and effective date of the amendment to IFRS 11. The IASB noted that applying the relevant principles of business combinations accounting in IFRS 3 and other Standards to transactions that have previously been accounted for by applying one of the divergent approaches presented in paragraphs BC45B–BC45C 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 IASB ~~proposes~~decided that an entity would apply the ~~proposed~~ amendment to IFRS 11 prospectively for annual periods beginning on or after [date].

Illustrative examples
IFRS 11 *Joint Arrangements*

These examples accompany, but are not part of, IFRS 11. They illustrate aspects of IFRS 11 but are not intended to provide interpretative guidance.

After paragraph IE52, a heading and paragraphs IE53–IE56 are added.

Example 7—Accounting for acquisitions of interests in joint operations

IE53 Entity A acquires a 40 per cent ownership interest in a joint operation (Joint Operation C) at a cost of CU300[7] 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 that relate to the joint operation in proportion to its ownership interest.

IE54 IFRS 3 *Business Combinations* requires the entity to measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values with limited exceptions; for example, deferred tax assets and deferred tax liabilities are not measured at fair value but are measured in accordance with IAS 12 *Income Taxes*. The following table sets out:

(a) the acquisition-date amounts required by IFRS 3 for the entire net assets, ie fair value or the measurement required by IFRS 3 instead of the identifiable assets acquired and the liabilities assumed;

(b) Entity A's share in these assets and liabilities; and

(c) the amounts that Entity A recognises in its financial statements in relation to its interest in the joint operation.

	Acquisition-date amounts required by IFRS 3 for the entire net assets	***Entity A's share in these assets and liabilities***	***Amounts recognised in Entity A's financial statements***
Property, plant and equipment	270	40%	108
Intangible assets (excluding goodwill)	125	40%	50
Accounts receivable	210	40%	84
Inventory	175	40%	70
Retirement benefit obligations	(30)	40%	(12)
Accounts payable	(120)	40%	(48)

[7] In this example, monetary amounts are denominated in 'currency units (CU)'.

	Acquisition-date amounts required by IFRS 3 for the entire net assets	*Entity A's share in these assets and liabilities*	*Amounts recognised in Entity A's financial statements*
Deferred tax liability	(60)	40%	(24)
Net assets	**570**		**228**

IE55 Entity A applies the relevant principles on business combinations 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 that is jointly held and in each of the liabilities that is incurred jointly, as stated in the contractual arrangement, and not the shares of the other parties to the joint operation in those assets and liabilities. The excess of the consideration transferred over the amount allocated to its share in the net identifiable assets is recognised as goodwill.

Consideration transferred	CU300
Entity A's share in the identifiable assets and liabilities relating to its interest in the joint operation	CU228
Goodwill	**CU72**

IE56 Acquisition-related costs are not considered to be part of the consideration transferred for the interest in the joint operation. They are recognised as expenses in profit or loss in the period that the costs are incurred and the services are received.

Appendix C—Other arguments against the application of the relevant principles on business combinations accounting

C.1 Next to the arguments discussed in paragraphs 37-117 of the main body of the staff paper, respondents commenting on the ED raised the following arguments against the application of the relevant principles on business combinations accounting in IFRS 3 and other IFRSs on the acquisition of an interest in a joint operation in which the activity constitutes a business:

Definition of a business combination

Comments received

C.2 The acquisition of an interest in a joint operation does not meet the definition of a business combination as defined in IFRS 3 (see Shell, Repsol, Centrica, BusinessEurope, ACTEO/AFEP/MEDEF). This is because only the assets and activities of the joint operation as a whole might constitute a business and the acquirer does not control this business.

Staff analysis

C.3 When assessing whether the acquisition of an interest in a joint operation in which the activity constitutes a business is a business combination, these respondents distinguish between the:

(a) the joint operation as a whole; and

(b) the joint operator's share in the joint operation.

C.4 For them, the activity of the joint operation as a whole might meet the definition of a business. However, this business cannot give rise to a business combination for the party acquiring the interest in a joint operation because it does not control the business of the joint operation as a whole.

C.5 What this party controls instead is its interest in the joint operation, which is its share in the business. This share in the business does not, in the view of these respondents, however, constitute a business as defined in IFRS 3. Consequently,

they think that the acquisition of a share in the business of a joint operation does not give rise to a business combination either and therefore IFRS 3 cannot apply.

C.6 We agree that the acquisition of an interest in a joint operation does not meet the definition of a business combination, even if the assets and activities of the joint operation as a whole meet the definition of a business.

C.7 Appendix A of IFRS 3 defines a business combination as a transaction or other event in which the acquirer obtains control of one or more businesses.

C.8 By definition, a joint operator has joint control over the relevant activities of the joint operation (see definitions of 'joint control', 'joint operation' and 'joint operator' in Appendix A of IFRS 11).

C.9 However, the proposed amendment is not arguing that the acquisition of an interest in a joint operation meets the definition of a business combination. Instead, the amendment proposes to apply the relevant principles on business combinations accounting in IFRS 3 and other IFRSs by analogy.

Clarifying the definition of 'business' first

Comments raised

C.10 The definition of a business needs to be clarified first before the application of IFRS 3 should be expanded to transactions that are not business combinations. This is because:

(a) the definition of a business and the related application guidance are difficult to apply in practice (Roche, BusinessEurope, ACTEO/AFEP/MEDEF);

(b) the definition of a business and the related application guidance in IFRS 3 are not sufficiently clear (bhpbilliton);

(c) not providing additional guidance on when an activity of a joint operation constitutes a business might lead to new diversity in practice in applying the proposed amendment (EFRAG);

(d) the definition of a business is frequently complex to apply, especially when it involves oil and gas operations (Petrobras);

(e) the current definition of a business is not sufficiently robust and will create diversity in practice as far as joint operations are concerned (FAR, SwissHoldings, Norwegian Accounting Standards Board); and

(f) until additional guidance and clarification of the definition of a business exists, there will continue to be inconsistencies based on a constituent's own interpretation of the definition. It would be for the IASB to provide some specific examples, eg whether stand-alone oil and gas fields in the development phase constitute businesses (Centrica).

Staff analysis

C.11 As part of a separate project of the Interpretations Committee, the staff performed outreach to preparers in different industry sectors and to the large accounting and auditing networks and firms to identify challenges that preparers face in practice in distinguishing business combinations from asset acquisitions.

C.12 In its May 2013 meeting, the Interpretations Committee discussed a summary of the outreach results prepared by the staff, and a list, also prepared by the staff, of issues that could be further explored as part of the Post-Implementation Review of IFRS 3.

C.13 In this meeting, the Interpretations Committee decided to contribute this summary of outreach results, the list of issues that could be further explored as part of the Post-Implementation Review of IFRS 3 and a summary of its discussion at the May 2013 meeting on the Post-Implementation Review of IFRS 3.

C.14 From the outreach and the discussions of the Interpretations Committee, we understand that the application of the definition of a business and the related application guidance requires significant judgement and sometimes set challenges to preparers in distinguishing business combinations from asset acquisitions.

C.15 This seems to result in a grey area in distinguishing business combinations from asset acquisitions.

C.16 We also see that this grey area might be expanded to the accounting for acquisitions of interests in joint operations.

C.17 Notwithstanding this concern, we think that the proposed amendment should be finalised. This is because:

(a) beyond the grey area (eg we observed in our outreach for the Interpretations Committee project on the definition of a business[8] that a producing oil and gas field is generally considered a business), the proposed amendment will significantly reduce diversity in practice; and

(b) we expect that the application challenges in identifying a 'business' will be further explored as part of the Post-Implementation Review of IFRS 3. The issue is not specific to accounting for joint arrangements.

C.18 Furthermore, several respondents (The Hong Kong Association of Banks (HKAB), DASB, CPA Australia and the Institute of CPAs, ESMA, SAICA, DTT, AASB, AOSSG, Group of Latin American Accounting Standard Setters (GLASS), BASB, Ernst & Young, BDO) also raise the concern about challenges in identifying a business in practice. However, they consider it a cross-cutting issue that needs to be addressed and nevertheless support the proposed amendment.

Inconsistency with principles in IFRS 11

Comment raised

C.19 The proposed amendment is not consistent with the principles in IFRS 11. IFRS 11 distinguishes joint operations and joint ventures on the basis of rights and obligations from the arrangement, regardless of whether the joint arrangement constitutes a business or not (Repsol).

[8] http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2013/May/AP06A%20-%20WIP%20-%20Definition%20of%20a%20business%20-%20Summary%20of%20outreach%20results%20and%20analysis.pdf

Staff analysis

C.20 The main purpose of IFRS 11 is to determine when it is appropriate to account for an interest in a joint arrangement by:

(a) recognising and measuring the assets, liabilities, revenues and expense in relation to the interest in the joint arrangement in accordance with relevant IFRSs applicable to the particular assets, liabilities, revenues and expenses (for a joint operation, see paragraph 20 onwards of IFRS 11); and

(b) using the equity method in accordance with IAS 28 *Investments in Associates and Joint Ventures* (for a joint venture, see paragraph 24 and following of IFRS 11).

C.21 IFRS 11 does not, however, give guidance on applying the equity method or recognising and measuring the assets, liabilities, revenues and expenses related to the joint operation:

(a) for the application of the equity method, paragraph 24 of IFRS 11 makes reference to IAS 28 *Investments in Associates and Joint Ventures*; and

(b) for accounting for the assets, liabilities, revenues and expenses relating to an interest in a joint operation, paragraph 21 of IFRS 11 makes reference to the IFRSs applicable to the particular assets, liabilities, revenues and expenses.

C.22 Consequently, we think that there is no inconsistency with the principle in IFRS 11 for distinguishing joint ventures and joint operations, if the IFRSs applicable to the particular assets, liabilities, revenues and expenses in terms of paragraph 21 of IFRS 11 distinguish between assets and liabilities that are part of a business and others.

Classification as joint venture

Comments received

C.23 For some respondents (Financial Reporting Council (FRC), ORANGE France Télécom) the definitions of a business and a joint operation are (almost) mutually exclusive. A joint arrangement in which the activity and assets constitute a business is classified as a joint venture.

C.24 Consequently, they think that before finalising the amendment the IASB first needs to discuss and clarify whether and when a joint arrangement in which the activity and the assets constitute a business should be classified as a joint operation.

Staff analysis

C.25 Rights to the assets and obligations for the liabilities relating to the arrangement are what distinguishes a joint operation from a joint venture (see definition of a joint operation in Appendix A of IFRS 11). A joint venture is, instead, a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement (see definition of a joint venture in Appendix A of IFRS 11).

C.26 Consequently, assets and activities can meet the definition of both 'joint operation' and 'business', for example if an integrated set of activities and assets is capable of being conducted and managed for the purpose of providing a return in the form of lower costs to the parties of the joint arrangement.

C.27 Furthermore, paragraph BC29 of IFRS 11 explains that the IASB did not consider the definition of a business in IFRS 3 helpful in distinguishing between joint ventures and joint operations. This is because a 'business' can be found in all types of joint arrangements. Paragraph BC29 of IFRS 11 reads:

> 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.

C.28 This paragraph results from a discussion that the IASB had in May 2009 when it decided not to include in the final Standard the rebuttable presumption that a business is a joint venture (see IASB Update May 2009 and paragraphs 16–36 of Staff Paper 8A presented at the May 2009 IASB meeting9). Such a presumption was included in paragraph 18 of ED 9 *Joint Arrangements*.

C.29 Paragraph 18 of ED9 proposed introducing the term 'business' to describe 'joint ventures' as follows:

> A *business* usually involves assets and resources working together to achieve an outcome, which requires decisions of a financial and operating nature. A business that is subject to joint control is, therefore, a joint venture, unless circumstances indicate otherwise. Such circumstances would indicate that the parties have contractual rights to assets of the business and have contractual obligations for the expenses of the business.

C.30 Consequently, the IASB has already rejected the argument given by the respondents.

Post-Implementation Review of IFRS 3

Comments raised

C.31 The accounting for acquisitions of interests in joint operations should be reviewed as part of the Post-Implementation Review of IFRS 3 instead of leading to an amendment in a limited-scope project. This is because:

(a) the concept of 'business' is under "revision" in the Post-Implementation Review of IFRS 3 (Repsol);

(b) the accounting for joint operations that are business should be considered together with the accounting for collective control arrangements that are businesses to avoid diversity in accounting for them (OIAC). Collective control arrangements do not meet the

[9] http://www.ifrs.org/Meetings/MeetingDocs/IASB/2009/May/20th/JV-0905-AP8A-obs.pdf

definition of joint control in IFRS 11 because more than one combination of parties can pass decisions;

(c) the proposed amendment will be able to resolve any diversity in practice regarding the acquisition of an interest in a joint operation. This is because it does not:

(i) depend on what stage of its life cycle a oil and gas project turns from a group of assets into a business; and

(ii) address collective control transactions; and

(d) the Post-Implementation Review of IFRS 3 would allow to address the following interrelated issues as part of a holistic review of IFRS 3 rather than on a piecemeal basis:

(i) Acquisition of an Interest in a Joint Operation (ED/2012/7)

(ii) Sale or Contribution of Assets between an Investor and its Associate of Joint Venture (ED/2012/6); and

(iii) Annual Improvements to IFRSs 2011–2013 Cycle—Scope exceptions for joint ventures (ED/2012/2).

Staff analysis

C.32 The objective of the Post-Implementation Review of IFRS 3 is to review the implementation of IFRS 3 (revised 2008) and IAS 27 *Consolidated and Separate Financial Statements* (amended 2008). Its focus is not, however, on reviewing the implementation of IFRS 11 or transactions that are outside the scope of IFRS 3.

C.33 Consequently, the Post-Implementation Review of IFRS 3 will not explore the accounting for the acquisition of an interest in a joint operation or collective control arrangements. Gathering information about the experience on the application of IFRS 11 in accounting for joint operations would be one of the objectives of the Post-Implementation Review of IFRS 11, which is not expected to start before 2016.

C.34 The proposed amendment would only incorporate another contact point between IFRS 3 and IFRS 11 because it requires preparers to distinguish between joint operations that are businesses and others. It will however not make the

accounting for joint operations a topic within the scope of the Post-Implementation Review of IFRS 3.

C.35 Finally, a Post-Implementation Review is a process to identify a need to take standard-setting action (see paragraph 6.62 of the *Due Process Handbook for the IASB and the IFRS Interpretations Committee*). Consequently, there is no reason to wait for a Post-Implementation Review, if the need to take standard-setting action has already been identified because of significant diversity in practice.

Collective control arrangements

Comments raised

C.36 The proposal would create diversity in accounting between joint operations and collective control arrangements, ie arrangements that do not meet the definition of joint control in IFRS 11 because more than one combination of parties can pass decisions (OIAC, Repsol, Norwegian Accounting Standards Board).

C.37 This is because:

(a) arrangements in which there is more than one combination of parties that can make decisions about relevant activities are not within the scope of IFRS 11 (paragraph B8 of IFRS 11 and Example 3 illustrating the application of this paragraph); and

(b) if such an arrangement is not structured through a separate vehicle, in which case IFRS 10, IAS 28 or IFRS 9 should be applied (paragraph B11 of IFRS 11), it is usually accounted for similarly to joint operations. This is following the relevant principles in IAS 16 *Property, Plant and Equipment*, IAS 38 *Intangible Assets*, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* etc. (Repsol).

C.38 According to the respondents (OIAC, Repsol, Statoil) both types of arrangement are not unusual in the oil industry and are accounted for similarly, ie as asset acquisitions. The respondents think that in their industry joint operations and collective control arrangements are in substance, economics and practice very similar (OIAC, Repsol). Such arrangements are managed in the "same" way as

joint operations (Statoil). Consequently, they should not be accounted for in different ways.

Staff analysis

C.39 The project to give guidance on the accounting for the acquisition of an interest in a joint operation in which the activity constitutes a business is not a project to provide guidance specifically for the oil and gas industry, and nor is it a project to give guidance in circumstances where there is collective control but not joint control.

C.40 Although the oil and gas industry was one of the few industry sectors in the past in which the issue was prevalent, we expect that the issue will become prevalent in more industry sectors, because an entity/a separate vehicle is no longer a characteristic that requires using the equity method (BC7 of IFRS 11).

C.41 Furthermore, we are not convinced that the proposed amendment will necessarily create diversity in accounting for:

(a) joint operations in which the activity constitutes a business; compared with

(b) collective control arrangements in which the activity does constitute a business.

C.42 The acquisition of an interest in a collective control arrangement:

(a) in which the activity constitutes a business; and

(b) that gives the parties to the collective control arrangement rights to the assets, and obligations for the liabilities, relating to the collective control arrangement

is not explicitly addressed in IFRSs either, ie just like the acquisition of an interest in a joint operation that is a business.

C.43 Consequently, we think it is not clear that an entity that acquires interests in both joint operations and collective control arrangements has to account for both types of investments in a different way, even if they are in substance, economics and practice very similar. Answering this question, however, requires further

outreach and analysis that is outside the scope of this project because collective control arrangements are a different type of investment.

C.44 Finally, we do not think that there is a risk of structuring opportunities, because there is a significant difference in power or in influence for the parties to both types of arrangement. This significant difference in influence or power will drive the parties' decision on a joint operation or a collective control arrangement instead of the different accounting implications.

Significant judgement

Comment received

C.45 It is not only the definition of 'business' whose application requires significant judgement. The same applies to the definitions of a joint operation and a joint venture, which makes an accounting that is based on combining both the more critical (EFRAG, FAR). Furthermore, this difficulty affects both types of financial statements in the case of joint operations' consolidated financial statements and separate financial statements (EFRAG).

Staff analysis

C.46 Our understanding is that the conclusion that the application of the definitions of 'joint operation' and 'joint venture' is 'impracticable' (maybe in combination with the definition of a business) is simply a concern that is based on only limited application experience so far. This is because the definitions of joint operation and of joint venture have been introduced by IFRS 11, which became effective for annual periods beginning on or after 1 January 2013. For preparers from the European Union IFRS 11 becomes effective as from the commencement date of their first financial year starting on or after 1 January 2014.

C.47 Consequently, we think this concern should not stop the finalisation of the proposed amendment because the proposed amendment will remove an area of uncertainty by providing guidance. The concern should await the Post-Implementation Review of IFRS 11 instead.

C.48 Furthermore, the application challenges arising from the definition of a business have been referred by the Interpretations Committee to the Post-Implementation Review of IFRS 3 for further exploration.

C.49 Finally, some respondents share this concern, but do not consider it to be a reason for not finalising the proposed amendment (DASB, ESMA, ICAC) and another respondent considers the proposed amendment to be enforceable (IOSCO).

Expanding scope of business combinations accounting

Comments received

C.50 Instead of distinguishing different concepts of accounting for acquisitions on the basis of the business concept, the IASB should research whether the principles in IFRS 3 should be expanded beyond business combinations (Petrobras).

Staff analysis

C.51 In the project that resulted in IFRS 3 (revised 2008), the IASB and the FASB considered whether to expand the scope of the revised Standards to all acquisitions of groups of assets (paragraph BC20 of IFRS 3).

C.52 However, the boards did not extend the scope of the Standards accordingly because broadening the scope of the revised Standards would have required further research and deliberations of additional issues and would have delayed the implementation of the revised Standards' improvements to practice (paragraph BC20 of IFRS 3).

C.53 We think that this issue should be referred to the Post-Implementation Review of IFRS 3 because removing or reducing the differences between business combinations accounting and asset acquisition would remove or reduce accounting arbitrage.

C.54 Pursuing this proposal should however not stop the finalisation of the proposed amendment. This is because a project that expanded the principles in IFRS 3 to all acquisitions of group of assets would require a major IASB project that

would not start before 2015 because it would need to go through the agenda consultation process first.

C.55 Consequently, the significant diversity in practice in accounting for acquisitions of interests in joint operations that are businesses would last for many years.

C.56 In other words, not finalising the proposed amendment to pursue this proposal undermines the objective of the limited-scope project.

Consistency with IFRS 6

Comment received

C.57 Joint operations are very common and relevant in the oil and gas industry. Consequently, a scope exception to IFRS 3 would be needed, which would state that the acquisition of an ownership interest in a joint operation whose assets and activities are within the scope of IFRS 6 does not constitute a business combination as defined in IFRS 3 (see Repsol).

Staff analysis

C.58 Paragraph BC31 of IFRS 6 explains that:

(a) IFRS 3 applies to all entities asserting compliance with IFRSs; and

(b) any exploration and evaluation asset acquired in a business combination should be accounted for in accordance with IFRS 3.

C.59 Consequently, we do not see the need for a scope exception from IFRS 6 for acquisitions of interests in joint operations.

Contingent consideration

Comment received

C.60 It is not appropriate to record in the income statement the subsequent changes in the fair value of contingent consideration liabilities. This is because the acquisition of an interest in a joint operation represents the acquisition of a portion of the economic benefit in the total assets of the joint operation (Repsol).

C.61 The accounting treatment proposed by the Interpretations Committee for variable payments for the separate acquisition of property, plant and equipment and intangible assets would provide more relevant information to users of financial statements (Repsol).

Staff analysis

C.62 We are not convinced that a business combination is not the acquisition of a portion or all of the economic benefit in the total assets of the business.

C.63 The acquisition of a portion of the economic benefit in a group of assets is not what distinguishes the acquisition of an interest in a joint operation from the acquisition of an interest in a joint venture or a business combination.

C.64 The IASB requires in paragraph 58 of IFRS 3 the recognition of subsequent changes in the fair value of contingent consideration liabilities in profit or loss for the following reasons (see paragraphs BC354 and BC355 of IFRS 3):

(a) The boards observed that many obligations for contingent consideration that qualify for classification as liabilities meet the definition of derivative instruments in IAS 39 or SFAS 133.

(b) To improve transparency in reporting particular instruments, the boards concluded that all contracts that would otherwise be within the scope of those Standards (if not issued in a business combination) should be subject to their requirements if issued in a business combination.

(c) In considering the subsequent accounting for contingent payments that are liabilities but are not derivatives, the boards concluded that, in concept, all liabilities for contingent payments should be accounted for similarly.

C.65 We think that these reasons apply to contingent consideration liabilities for the acquisition of an interest in a joint operation in which the activity constitutes a business as well.

Convergence with US GAAP

Comment received

C.66 The proposed amendment does not fit into the process of convergence between IFRSs and US GAAP, in particular with respect to the accounting for acquisitions of an interest in exploration and evaluation assets in the extractive industry (Repsol).

Staff analysis

C.67 We think that the proposed amendment increases convergence between IFRS and US GAAP. This is because we understand that preparers of US GAAP financial statements generally apply business combinations accounting on the acquisition of an (additional) interest in a mineral interest in a proved property with oil and gas production activities that are already in place.

C.68 However, it is not the purpose of this project to achieve convergence with US GAAP.

C.69 Furthermore, the proposed amendment does not give guidance on whether and when the acquisition of an interest in exploration and evaluation assets in the extractive industries constitutes a business, because it only makes reference to IFRS 3.

Differences in accounting will drive interpretation of 'joint operation'

Comment received

C.70 The significant differences between applying the principles of business combinations accounting and asset acquisitions would depend on, and possibly drive, the interpretation of the untested notion of 'joint operation' (DASB, EFRAG). Significant differences between business combinations accounting and asset acquisition accounting might result from the following:

(a) treatment of acquisition costs;

(b) recognition of goodwill;

(c) treatment of purchase consideration paid in shares, because IFRS 3 provides guidance in the case of business combinations, but IFRS 2 *Share-based Payment* applies to all other types of transactions;

(d) treatment of contingent consideration; and

(e) deferred taxes.

C.71 Consequently, the proposed amendment might end up by exchanging the divergence in practice in accounting for the acquisition of interests in joint operations that are businesses for divergence in classifying joint arrangements as either joint operations or joint ventures (DASB, EFRAG).

Staff analysis

C.72 We are not convinced that the significant accounting differences between business combinations accounting and asset acquisitions accounting will drive the interpretation of the definition of a joint operation. This is because the principles of business combinations accounting would be required no matter whether the joint arrangement is classified as a joint venture or a joint operation:

(a) If the joint arrangement is classified as a joint operation, the proposed amendment would require the acquirer to apply the relevant principles of business combinations accounting in IFRS 3 and other IFRSs.

(b) If the joint arrangement is classified as a joint venture, the application of the same principles is required by paragraph 24 of IFRS 11 and paragraph 26 of IAS 28.

C.73 We disagree with the respondents' argument for the following reason:

(a) it is the regulator's role and responsibility to ensure compliance of preparers' financial statements with IFRSs; and

(b) securities regulators (IOSCO) consider the proposed amendment to be enforceable.

C.74 Furthermore, another respondent (Telefonica) raises the concern about the interpretation of the term 'joint operation' as well. However, it does not consider this concern a reason for not finalising the proposed amendment.

C.75 Consequently, we think that this concern should await the implementation of the proposed amendment and should be reconsidered if there is convincing evidence.

No change in tax base

Comment received

C.76 The tax base of an asset or a liability related to a joint operation does not change or differ depending on whether the acquisition involves a business or not.

C.77 Consequently, there is no justification from a principle perspective to have different deferred tax accounting on the acquisition of an interest in a joint operation, depending on whether the activity of the joint operation is a business or not (Statoil).

Staff analysis

C.78 According to the proposed amendment, deferred tax assets and deferred tax liabilities would:

(a) be recognised on the acquisition of an interest in a joint operation in which the activity constitutes a business; and

(b) not be recognised on the acquisition of an interest in a joint operation in which the activity does not constitute a business.

C.79 This difference in accounting is however not related to the determination of the tax bases of the related assets and liabilities but to limiting the initial recognition exceptions in paragraphs 15 and 24 of IAS 12 to acquisitions of interests in joint operations in which the activity is not a business.

C.80 The initial recognition exceptions in paragraphs 15 and 24 of IAS 12 do not apply to deferred tax assets and liabilities that arise from assets and liabilities recognised in a business combination. Only deferred tax liabilities that arise from the initial recognition of goodwill are not recognised in a business combination (see paragraph 15(a) of IAS 12).

C.81 The use of the initial recognition exception in IAS 12 is an exception to the general requirement in IAS 12 that deferred tax should be recognised for all temporary differences.

C.82 We understand that the IASC, when developing IAS 12, took the view that recognising deferred tax on initial recognition of an asset or liability would require a corresponding adjustment to the carrying amount of that asset or liability if the transaction does not affect accounting profit or taxable profit on initial recognition. The IASC was also concerned that adjusting the carrying amount of other assets and liabilities for the deferred tax assets and liabilities on the initial recognition instead would make financial statements less transparent (see paragraph 22(c) of IAS 12).

C.83 However, we understand that the reason why the initial recognition exceptions do not apply to deferred tax assets and liabilities arising from identifiable assets and liabilities recognised in a business combination is that the impact of the deferred tax assets and the deferred tax liabilities is recognised against goodwill, thus avoiding the need to adjust the carrying amount of the identifiable assets and liabilities to which the deferred tax relates.

C.84 Accordingly the concern about reduced transparency is avoided when the effect of recognising deferred tax on initial recognition of an asset or a liability when that deferred tax effect is recognised against goodwill arising from that transaction.

C.85 In accounting for the acquisition of an interest in a joint operation by measuring (the shares of) identifiable assets and liabilities at fair value (with a few exceptions) and recognising the residual as goodwill or a bargain, the effects of deferred tax assets and liabilities can be adjusted against goodwill or against the bargain recognised in profit or loss.

C.86 Consequently, recognising deferred tax assets and liabilities on the acquisition of an interest in a joint operation would have the same effect on the financial statements as recognising deferred tax assets and liabilities on a business combination. This effect was considered acceptable and appropriate by the IASC.

C.87 Consequently, we think that deferred tax assets and deferred tax liabilities, except for deferred tax liabilities arising from the initial recognition of goodwill, should be recognised on the acquisition of the interest in the joint operation.

C.88 The justification for recognising deferred tax assets and deferred tax liabilities on the acquisition of an interest in a joint operation only if its activity constitutes a business is unrelated to the tax bases of the assets and liability. Instead, it is related to the fact that the effect from deferred taxes can be adjusted against goodwill or against the bargain recognised in profit or loss.

Tax effect of legal entities

Comment received

C.89 Some respondents think that there is a certain logic in recognising deferred tax in a business combination and not on the acquisition of an interest in a joint operation that is a business (DASB, EFRAG, BP). This is because a legal entity is usually acquired, which has its own tax personality and historical tax cost. In the case of investments in joint operations, legal entities are very often not involved.

C.90 Consequently, the application of the requirements in IAS 12 will not necessarily be the same as in the case of a business combination (DASB, EFRAG, BP).

Staff analysis

C.91 The comment highlights differences in accounting for deferred taxes resulting from structuring the investment through a separate vehicle or not.

C.92 However, the different tax consequences arising from whether an investment is structured through a separate vehicle or not are not the reason for the initial recognition exceptions in paragraphs 15 and 24 of IAS 12. These different tax consequences are not the reason for recognising deferred tax assets and deferred tax liabilities on the initial recognition of assets and liabilities only if the transaction:

(a) is a business combination; or

(b) affects, at the time of the transaction, either accounting profit or taxable profit (or tax loss).

C.93 The purpose of the initial recognition exceptions in paragraphs 15 and 24 of IAS 12 is to avoid adjusting the carrying amount of identifiable assets or liabilities for the recognition of deferred tax assets or deferred tax liabilities (see above).

C.94 In other words, the IASC did not introduce the initial recognition exceptions into deferred tax accounting to reflect tax consequences given by tax law in the initial recognition exceptions, as suggested by the respondent. Instead, it was concerned that by adjusting the carrying amount of identifiable assets and liabilities for deferred taxes, financial statements would be less transparent.

C.95 Consequently, the fact that an investment is not structured through a separate vehicle is not the justification of applying the initial recognition exceptions. The reason is instead the fact that the effect of the deferred tax assets and the deferred tax liabilities is recognised in profit or loss or as an adjustment of goodwill.

Moving the dividing line

Comments received

C.96 The proposed amendment would move the dividing line that separates transactions that are accounted for as business combinations from transactions that are accounted for as asset purchases, without removing or justifying that distinction (DASB, EFRAG).

Staff analysis

C.97 The purpose of a limited-scope project is to give guidance in a relatively short time to resolve significant diversity in practice before the IASB is able to address the issue in a major IASB project.

C.98 Consequently, we think it aligns with the purpose of limited-scope projects to require the application of the principles of business combinations accounting to transactions that do not meet the definition of a business combination, without

removing or justifying the distinction in accounting between business combinations and asset acquisitions. We think it is appropriate to do this because the application of the relevant principles of business combination accounting to the acquisitions of interests in joint operations in which the activity constitutes a business results in an appropriate reflection of these transactions in the financial statements of the acquirer.

Additional complexities

Comments received

C.99 The proposed amendment requires the recognition of assets and liabilities at fair value, the recognition of deferred tax assets and deferred tax liabilities at the acquisition, the recognition of goodwill and detailed disclosures.

C.100 It will be adding complexity for preparers of financial statements without adding sufficiently to the decision useful qualities of the related financial information (PwC, BusinessEurope).

C.101 The additional costs resulting from these complexities for preparers and users are not appropriate (Shell, BusinessEurope).

Staff analysis

C.102 We think that the proposed amendment will add sufficiently to the useful qualities of the related financial information because:

(a) it resolves significantly diversity in practice; and

(b) it requires the application of the relevant principles that the IASB has developed for acquisitions of (a share of) a business.

178. Users of financial statements have indicated that they prefer to recognise goodwill separately, when it is present, in the acquisition of an interest in a joint operation even if the joint operator was not obtaining control, and stressed that it was important to account for transactions that involved businesses in the same way (see comment letters DASB, EFRAG).

C.103 Considering this, we think the costs of implementing the proposed amendment for preparers and users are appropriate and the opposite conclusion requires strong evidence from a comprehensive information basis.

C.104 Generating such an information basis requires in our view a project with the scope and the procedures of a Post-Implementation Review, which includes analysing many different sources of information and a public request for information.

C.105 Consequently, we expect that the conclusion that the additional costs for preparers and users from the proposed amendment are not appropriate cannot be sufficiently supported without taking into account the results from the Post-Implementation Reviews of IFRS 3 or IFRS 11.

Acquisition cost

Comments received

C.106 What is the relevance of including acquisition cost in the cost of the associate/joint venture and recognising them as an expense when an interest in a joint operation is acquired (ANC, Mazars, BDO), in particular as equity accounting is often considered as "consolidation in a single line" (BP).

Staff analysis

C.107 Paragraph 53 of IFRS 3 requires recognising acquisition-related cost in a business combination as expenses in the periods in which the costs are incurred and the services are received, with the exception that costs to issue debt or equity securities are recognised in accordance with IAS 32 and IFRS 9:

(a) Costs related to the issuance of financial liabilities that are measured subsequently at amortised cost are capitalised and amortised into profit or loss over the term of the debt in accordance with the effective interest method (paragraph 5.1.1 of IFRS 9).

(b) Costs related to the issuance of financial liabilities classified as at fair value through profit or loss are recognised in profit or loss immediately on initial recognition (paragraph 5.1.1 of IFRS 9).

(c) Costs related to the issuance of equity instruments reduce the proceeds received from the issuance and are recorded in equity (paragraphs 35 and 37 of IAS 32).

C.108 Other Standards instead require capitalising transaction cost as part of the initial measurement of an asset (see for example, paragraph 21 of IAS 40 *Investment Property*) and these Standards apply on the acquisition of an asset or a group of assets that does not constitute a business (see paragraph 2(b) of IFRS 3).

C.109 Consequently, the accounting for acquisition-related costs differs significantly depending on whether business combinations accounting or the guidance in other Standards is applied.

C.110 This is in our view, however, not a reason against applying the principles of business combinations accounting, and in particular its principles on accounting for acquisition-related cost, on the acquisition of an interest in a joint operation in which the activity constitutes a business, taking into consideration the IASB's Basis for Conclusions for issuing paragraph 53 of IFRS 3.

C.111 In developing IFRS 3 (revised 2008) the IASB concluded that acquisition-related costs should generally be recognised as an expense because:

(a) they are not part of the fair value exchange between the buyer and seller for a business. Instead, they are separate transactions in which the buyer pays for the fair value of services received; and

(b) such costs, whether for services performed by external parties or internal staff of the acquirer, do not generally represent assets of the acquirer at the acquisition date. This is because the benefits obtained are consumed as the services are received (paragraph BC366 of IFRS 3).

C.112 The IASB acknowledged that:

(a) recognising most of the acquisition-related costs as expenses differs from other Standards and accepted practices that require or permit particular acquisition-related costs to be included in the cost of an asset acquisition (paragraph BC369 of IFRS 3); and

(b) all asset acquisitions are similar transactions that, in concept, should be accounted for similarly, regardless of whether assets are acquired separately or as part of a group of assets that may meet the definition of a business (paragraph BC369 of IFRS3).

C.113 However, the IASB decided not to extend the scope of the revised Standards to all acquisitions of groups of assets (paragraph BC369 of IFRS 3). This is because broadening the scope of the revised Standards beyond acquisitions of businesses would have required further research and deliberation of additional issues and would have delayed the implementation of the revised Standards' improvements to practice (paragraph BC20 of IFRS 3).

C.114 Consequently, the IASB accepted that, at this time, the differences in accounting (paragraph BC369 of IFRS 3).

C.115 Furthermore, the IASB also observed that in practice under IFRS 3 (issued 2004), most acquisition-related costs were subsumed in goodwill, which was also not consistent with accounting for asset acquisitions (paragraph BC360).

Obtaining control and joint control is very different

Comment received

C.116 Applying IFRS 3 to acquisitions of interests in joint operations will be very difficult because obtaining (sole) control and obtaining joint control is very different (Statoil).

C.117 On the acquisition of an interest in a joint operation businesses neither cease to exist nor are they combined or integrated with acquirer's business (Statoil).

Staff analysis

C.118 While we agree that (sole) control and joint control are different, they are mutually exclusive, we are not convinced that applying the principles on business combinations accounting in IFRS 3 and other IFRSs to acquisitions of interests in joint operations will cause significant difficulties.

C.119 As explained above, some principles do not apply or have to be modified, eg the principles that are based on the entity. Most of the principles are, however, appropriate.

More akin to an asset acquisition

Comment received

C.120 On the acquisition of an interest in a joint operation the composition of the group changes.

C.121 However, the composition of the group changes by the joint operator recognising in relation to its interest in the joint operation its share in the assets, liabilities, revenues and expenses of the joint operation, which makes it akin to an asset acquisition (Statoil).

Staff analysis

C.122 Although joint operations are not part of the group consisting of the parent and its subsidiaries, the composition of the group changes on the acquisition of an interest in a joint operation. This is because the joint operator recognises its share of the assets and liabilities acquired as part of the interest in the joint operation and it derecognises the assets and liabilities given as consideration.

C.123 As explained above, we do however not see why acquiring rights to assets and incurring obligations for liabilities is more akin to an acquisition of assets.

C.124 If the business combination is, from a legal perspective, an asset deal, not a share deal, the acquirer obtains rights to the assets and incurs obligations for the liabilities and its share in these liabilities might not always be 100 per cent.

C.125 The difference is that on the acquisition of control over a business, the acquirer also recognises the shares of the non-controlling interests, whereas the acquirer of an interest in a joint operation only recognises its own share in the assets and liabilities.

C.126 Finally, the definition of a business does not require that the acquirer obtains rights to the net cash flows of a business.

All relevant requirements need to be discussed

Comment received

C.127 The proposed amendment requires that all relevant principles on business combinations accounting should be applied (see also BC6 of the ED).

C.128 Draft paragraph B33A of the ED addresses certain relevant aspects but not others.

C.129 Failure to consider and discuss all of the potentially relevant requirements of IFRS 3 and its application to joint operation acquisitions may well create further diversity in practice (PwC, BASB, BusinessEurope, ACTEO/AFEP/MEDEF).

C.130 Some readers will understand that only the specific requirements in paragraph B33A apply and others may assume that all aspects of IFRS 3 should be applied.

Staff analysis

C.131 Paragraphs B33A of the ED clarifies that these four issues are not all of the relevant principles on business combinations accounting in IFRS 3 and other IFRSs ("The principles on business combinations accounting include:").

C.132 Furthermore, a general reference to the relevant principles is not unique to the proposed amendment:

(a) A general reference to the relevant principles on business combinations is also the approach applied for the equity method in paragraph 26 of IAS 28.

(b) A general reference to the IFRSs applicable to the particular assets, liabilities, revenues and expenses is guidance that paragraph 21 of IFRS 11 for the accounting for the assets, liabilities, revenues and expenses related to an interest in a joint operation.

C.133 We are not convinced that principle-based guidance needs to consider and discuss all of the potentially relevant requirements of IFRS 3. Only very complex, complicate or critical requirements need to be addressed.

C.134 Finally, we think that the proposed amendment will significantly reduce diversity in practice.

Change structure of IFRS 11

Comment received

C.135 Significant difficulties with measurement are arising in practice, particularly for joint operations. These result from the fact that IFRS 11 focuses on the classification of joint arrangements and refers to other relevant Standards for measurement (PwC).

C.136 Consequently, the IASB should include comprehensive measurement guidance in IFRS 11 rather than embark on a series of narrow-scope amendments (PwC).

Staff analysis

C.137 A project to develop comprehensive measurement guidance for joint arrangements would in our view be a major IASB project that would need to go through the IASB's agenda consultation process, which will not start before 2015.

C.138 Consequently, the significant diversity in practice in accounting for the acquisition of an interest in a joint operation in which the activity constitutes a business would remain unaddressed for many years. Meanwhile, the proposed amendment would at least significantly reduce this diversity in practice.

Classification as joint operation implies asset acquisition accounting

Comment received

C.139 When the classification as a joint operation is appropriate based on the interest in the underlying assets, the consideration paid should be treated as the cost of those assets unless a separate intangible asset is also recognised (FRC).

C.140 The amount that the acquirer is prepared to pay for the assets represents the value of those assets to the acquirer. Accordingly, this amount should be treated as the cost of those assets (as with any other fixed asset). Alternatively, part of the amount may be treated as a separate intangible asset where this is justified by the circumstances (FRC).

Staff analysis

C.141 The respondent explains asset acquisition accounting is outlined in paragraph 2(b) of IFRS 3 but does not explain why the classification of a joint arrangement as a joint operation implies asset acquisition accounting.

Cross-cutting issues

Comment received

C.142 The following cross-cutting issues should be considered in a comprehensive way rather than in a series of separate Standards (ICAC):

(a) the acquisition of an interest in a joint operation in which the activity constitutes a business;

(b) the accounting for acquisitions of assets and business combinations;

(c) contingent consideration in a business combination;

(d) sales or contributions of assets between an investor and its associate/joint venture; and

(e) variable payments for separate acquisition of PPE and intangibles.

Staff analysis

C.143 Considering all these issue in a comprehensive way would require a major IASB project that would need to go through the IASB's agenda consultation process first. We expect that a major IASB project on these issues would not result in (revised) guidance for a relatively long time.

C.144 Accordingly, the significant diversity in practice on some of these issues would not be addressed for a relatively long time too.