

STAFF PAPER

IFRS Interpretations Committee
Meeting

May 2013

Project	2011-2013 Annual improvements cycle (ED November 2012)—Comment letter analysis		
Topic	IFRS 3 <i>Business Combinations</i> —Scope Exception for Joint Ventures		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in *IFRIC Update*. The approval of a final Interpretation by the Board is reported in *IASB Update*.

Introduction

1. The Exposure Draft ED/2012/2 *Annual Improvements to IFRSs 2011–2013 Cycle* published in November 2012 ('the ED') includes a proposal for an amendment to IFRS 3 *Business Combinations* to clarify the scope exception in paragraph 2 of the Standard for joint ventures.

Objective

2. The objective of this paper is to provide an analysis of the comment letters received on the proposal to amend IFRS 3 and to obtain a recommendation from the IFRS Interpretation Committee ('the Interpretations Committee') for the IASB to include the amendment in the final *Annual Improvements to IFRSs* that are planned to be published in 2013.

Structure of the paper

3. This paper:
 - (a) provides background information and a description of the issue that led to the proposed amendment;
 - (b) analyses the comments received as part of the Exposure Draft process; and
 - (c) asks the Interpretations Committee to confirm whether it agrees with the staff recommendation to proceed with the proposed amendment.

Background information

4. Paragraph 2(a) of IFRS 3 states:
 - 2 This IFRS applies to a transaction or other event that meets the definition of a business combination. This IFRS does not apply to:
 - (a) the formation of a joint venture.

Description of the issue

5. In May 2011, the Interpretations Committee received a request to clarify the applicability of IFRS 3 by:
 - (a) joint operators for the acquisition of interests in joint operations as defined in IFRS 11 *Joint Arrangements*; and
 - (b) venturers for the acquisition of interests in jointly controlled operations or assets as specified in IAS 31 *Interests in Joint Ventures*.

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

6. At the September 2011 meeting, the Interpretations Committee discussed whether paragraph 2(a) of IFRS 3, which excludes the formation of joint ventures

from the scope of IFRS 3, should have been amended when IFRS 11 was issued to refer to joint arrangements. IFRS 11 had changed the use of the term ‘joint venture’ from having a general meaning that included jointly controlled operations, jointly controlled assets and jointly controlled entities, to mean a specific type of joint arrangement, which does not include joint operations. The Interpretations Committee noted that the scope exception should apply to the financial statements of a joint operation as well as to the financial statements of a joint venture, as defined in IFRS 11.

7. At the November 2011 meeting, the Interpretations Committee observed that there is a lack of clarity as to whether paragraph 2(a) of IFRS 3 is also intended to address the accounting in the financial statements of the joint venturer/joint operator. The Interpretations Committee noted that the scope exception in paragraph 2(a) of IFRS 3 relates only to the accounting in the financial statements of the joint arrangement, and not to the accounting for the joint venturer’s/joint operator’s interest in the joint arrangement.
8. Consequently, the Committee decided to recommend that the IASB should amend paragraph 2(a) of IFRS 3 through *Annual Improvements*:
 - (a) to exclude the formation of all types of joint arrangements as defined in IFRS 11 (ie joint ventures and joint operations) from the scope of IFRS 3; and
 - (b) to clarify that the scope exception only applies to the accounting in the financial statements of the joint arrangement itself¹.
9. At the February 2012 meeting, the IASB decided to include the amendment proposed by the Interpretations Committee in the ED.

¹ For further details see Agenda Paper 8B <http://www.ifrs.org/Meetings/Pages/Interpretations-Committee-Nov-11.aspx>

Comment letter analysis

10. In this section, we discuss and analyse the comments received from interested parties on the ED during the comment period, which ended on 18 February 2013.

11. The ED asked two general questions that were answered individually for each proposed amendment:

(a) Question 1: Do you agree with the IASB's proposal to amend the Standard as described in the Exposure Draft? If not, why and what alternative do you propose?

(b) Question 2: Do you agree with the proposed transitional provisions and effective date for the issue as described in the Exposure Draft? If not, why and what alternative do you propose?

12. The IASB received 65 comment letters on the ED in total; 60 respondents expressed their views on the proposed amendment to paragraph 2(a) of IFRS 3.

Analysis of Question 1

13. With respect to Question 1, about 80 per cent of the respondents who replied to this question agreed with the proposed amendment to IFRS 3.

14. The reasons why some of those respondents support the IASB's proposal are shown below:

(a) The proposed amendment will eliminate any unintended consequences (HKAB).

(b) This amendment is consistent with IFRS 11 and the Exposure Draft *Acquisition of an Interest in a Joint Operation* (Hydro-Quebec).

(c) It removes uncertainty about this issue on a timely basis (GASB).

(d) It provides helpful and necessary clarification (RMS).

(e) ESMA is of the view that the issue should be timely addressed within the annual improvements project as proposed and not be delayed until the planned post-implementation review of IFRS 3.

(f) It clarifies two important issues (Repsol).

15. A few of those who agreed with the proposal to exclude the formation of all types of joint arrangements from the scope of IFRS 3, went on to disagree with the proposal to clarify that the scope exception only applies to the financial statements of the joint arrangement itself. The main reasons why these respondents disagreed with the latter proposal are as follows:

- (a) The proposal creates uncertainties because some may interpret it to mean that IFRS 3 shall be applied in the investors' financial statements when the joint arrangement is established. This confusion is reinforced by the proposed BC 5. The respondent thinks that the IASB should explain in the Basis for Conclusions why IFRS 3 does not apply to the formation of a joint arrangement in the financial statements of the joint arrangement itself. The respondent believes that the Basis for Conclusions should also consider that IFRS 3 does not apply to the investor's accounting for the formation of a joint arrangement since such a transaction does not meet the definition of a business combination. (Mazars)
- (b) It is not necessary to clarify that the scope exclusion only addresses the accounting by the joint arrangements themselves in their financial statements or the accounting by the parties to the joint arrangement for their interests in the joint arrangement. Indeed, the acquirer of an interest in a joint arrangement does not obtain control of it and it therefore does not correspond to the definition of a business combination. This clarification could create confusion, as it seems to reduce the current scope exemption (ANC).
- (c) The proposal is redundant; IFRS 3 only applies to a transaction or other event that meets the definition of a business combination (ie an acquirer obtains control). As a consequence, it cannot *de facto* apply to the accounting for an interest in a joint arrangement in the financial statements of the joint venture or joint operation itself (IFRS 3 is a shareholder issue). Neither can it apply to the acquisition of an interest in a joint arrangement, since in such a case the investor does not obtain control of the investee (BusinessEurope).

- (d) IFRS 3 establishes requirements for how to account for a business combination by the acquirer, not the acquiree. Since the acquirer is the entity that obtains control of another entity, IFRS 3 only applies to the acquisition of a subsidiary. In fact, we recommend deleting “in the financial statements of the joint arrangement itself” from the scope exception (GLASS, FACPCE, CINIF).
- (e) One respondent (Nestlé) think that two divergent views exist concerning the current scope exclusion in IFRS 3.2(a):
- i. Under the first view, a business combination is defined as a transaction in which an acquirer obtains control (no joint control) over one or more business. In a joint arrangement, by definition the investor does not obtain control, so IFRS 3 is not applicable in the accounts of the investor.
 - ii. The second view is that IAS 28.26 makes reference to the adoption of “concepts underlying the procedures used in accounting for the acquisition of a subsidiary” when accounting for the acquisition of a stake in a joint venture (or an associate). Consequently, in this view all the requirements of IFRS 3 are applicable to such transactions. This seems to be the view supported by paragraphs BC4 and BC5(b) of the Basis for Conclusions on the proposed amendment.

Nestlé supports the first view. While reference must be made to relevant ‘concepts’ in IFRS 3 when accounting for an acquisition of an interest in a joint venture (as required by IAS 28.26), the respondent does not consider that IFRS 3 is written in such a way as to apply in its entirety to such transactions.

In its view, the proposal does not clarify the applicability of IFRS 3 to the accounting for formations of joint ventures in the accounts of the investors, because it does nothing to address or invalidate the first view, which is premised on the basic definitions of transactions that are within the scope of IFRS 3.

The respondent also thinks that there could be increased confusion about the IASB's intention, particularly when the proposed text of the Standard is read within the context of the Basis for Conclusions on the proposed amendment. Furthermore, there could be confusion about whether to combine the disclosures related to acquisitions of interests in joint ventures with those related to business combinations.

In its view, specific and relevant requirements should be added directly in IAS 28 and IFRS 12. This would be coherent with the approach taken in ED/2012/7, which proposes related changes to IFRS 11. (Nestlé)

- (f) The Exposure Drafts ED/2012/6: *Sale or Contribution of Assets between an Investor and its associate or Joint Venture* and ED/2012/7: *Acquisition of an Interest in a Joint Operation - Proposed amendment to IFRS 11* are interconnected with this proposal. The IASB should consider addressing comprehensively, as part as a separate project, how some provisions of IFRS 3 shall be applied in the accounting for joint operations, joint ventures and associates (clarification of interactions between IFRS 3, IFRS 11 and IAS 28). (Mazars, BusinessEurope, ACTEO/MEDEF/AFEP, Roche and SwissHoldings).

16. Some respondents believe that the IASB should refrain from any amendments to IFRS 3, because the Standard will be soon be subject to a post-implementation review (ACTEO/MEDEF/AFEP, BusinessEurope and ANC).

17. We have grouped the concerns above into the issues below:

- (a) the proposal is redundant and could create confusion;
- (b) the proposal should be included in a comprehensive project; and
- (c) wait for the post-implementation review of IFRS 3.

18. We will analyse the concerns that we have identified above in the following paragraphs.

The proposal is redundant and could create confusion

19. Some respondents think that it is not necessary to clarify that the scope exception only applies to the financial statements of the joint arrangement itself and that it could create confusion because some may interpret it to mean that IFRS 3 shall

be applied in the investors' financial statements when the joint arrangement is established.

20. We disagree with these comments. We think that the clarification is necessary, because two different views exist on the current scope exclusion in paragraph 2(a) of IFRS 3 (see paragraph 15(e) above). We noted uncertainty² about which transactions are excluded from the scope of IFRS 3, and in fact to clarify this issue we retraced the development of paragraph 2(a) of IFRS 3 and liaised with the FASB staff³.
21. We also think that the proposal does not create confusion. We understand that some respondents think that the acquisition of an interest in a joint arrangement on its formation does not meet the definition of a business combination. Consequently, they do not think that there is a need to clarify that paragraph 2(a) of IFRS 3 only applies to the financial statements of the joint arrangement itself (ie it is already obvious). However, others think that paragraph 2(a) addresses the accounting by the parties to a joint arrangement in their financial statements because of the inadequate wording of paragraph 2(a). In addition, some think that the acquisition of an interest in a joint arrangement can be a business combination. We think that the accounting in the financial statements of the parties to the joint arrangement is not within the scope of the proposed amendment. Consequently, we disagree with the comment that some may interpret the proposed amendment to mean that IFRS 3 shall be applied in the financial statements of the parties to the joint arrangement when the joint arrangement is established.

The proposal should be included in a comprehensive project

22. Some respondents think that this proposed amendment is interconnected with other projects (ie ED/2012/6: *Sale or Contribution of Assets between an Investor and its associate or Joint Venture* and ED/2012/7: *Acquisition of an Interest in a*

² This is also confirmed by the November 2011 IFRIC *Update*: “In discussing this issue, the Committee observed that there is a lack of clarity as to whether paragraph 2(a) of IFRS 3 is also intended to address the accounting in the financial statements of the joint venturer/joint operator”.

³ For further details see Agenda Paper 8B <http://www.ifrs.org/Meetings/Pages/Interpretations-Committee-Nov-11.aspx>

Joint Operation) and that the IASB should investigate these issues in a single project.

23. We disagree with this comment, because we think that:

- (a) this proposal is independent from the other two projects, because the scope exception only addresses the accounting in the financial statements of the investee (ie the joint arrangement), while the other Exposure Drafts address the accounting in the investors' financial statements;
- (b) the finalisation of this proposal cannot have unexpected consequences on the other two Exposure Drafts, because we are only clarifying that a joint arrangement is not required to apply IFRS 3 in accounting for its formation in its financial statements. In other words, this issue can be finalised without reaching a final conclusion on the issues addressed in the other two Exposure Drafts.

Wait for post-implementation review of IFRS 3

24. Some respondents suggested that the IASB should refrain from any amendments to IFRS 3, because the Standard will be soon be subject to a post-implementation review (PIR).

25. We disagree with this suggestion, because we think that:

- (a) the comment letters received have shown us that the Annual Improvements project is an opportune way to address this issue, and
- (b) the purpose of the PIR is to gather information about the implementation of a new Standard or a major amendment. This should enable the IASB to assess the effect of the new requirements on investors, preparers and auditors. As a result, the IASB might conclude that we should:
 - i. continue to monitor the implementation of IFRS 3, if the results of the PIR are inconclusive;
 - ii. retain IFRS 3 as issued, if no significant problems are identified by the PIR; or
 - iii. revise IFRS 3 to remedy any problems identified by the PIR.

Consequently, the purpose of a PIR is to identify whether standard-setting action needs to be taken. However, it is not its purpose to delay clarifications for which a need has been already identified. Consequently,

we should not wait for the conclusion of the PIR on IFRS 3, when we have the opportunity to clarify the issue now (the effective date of IFRS 11 is 1 January 2013).

Analysis of Question 2

26. With respect to Question 2, about 10 per cent of the respondents who replied to this question disagreed with the proposed transitional provisions. The main reasons are shown below:

- (a) This clarification should be applied prospectively in order to be consistent with the ED/2012/6: *Sale or Contribution of Assets between an Investor and its associate or Joint Venture* and ED/2012/7: *Acquisition of an Interest in a Joint Operation* (Roche, Nestlé and Swissholdings).
- (b) In the case in which IFRS 3 was applied in the financial statements of a joint arrangement, a retrospective application would entail a change in the joint arrangement's initial carrying amounts for assets and liabilities. The proposed amendments do not clarify what Standard shall then be applied to determine the initial carrying amounts of assets and liabilities (Mazars).
- (c) The proposal should be applied prospectively in order to be consistent with prospective initial application of IFRS 3 (AFME).
- (d) The proposal should be applied prospectively in order to be consistent with the simplified initial application of IFRS 11 (Repsol).
- (e) The proposed amendment should be applied prospectively to avoid the use of hindsight in retrospectively amending the accounting for a previous transaction (Deloitte).

27. We disagree with the comments above, because the effect of the proposed clarification is that: a joint operation (as defined by IFRS 11) is not required to apply IFRS 3 in accounting for its formation in its financial statements. Thus, the joint operation should develop an accounting policy for their formation based on paragraphs 10-12 of IAS 8, which may still be to apply IFRS 3. Consequently, we think that the restatement would be a choice, rather than a requirement.

28. Consequently, we do not think that retrospective application would cause undue cost and effort.

Staff recommendation

29. On the basis of the analysis in the previous section of the paper, we think that the Interpretations Committee should recommend to the IASB that it should proceed with the proposed amendment to paragraph 2(a) of IFRS 3, which proposes:

- (a) to exclude the formation of all types of joint arrangements as defined in IFRS 11 from the scope of IFRS 3, and
- (b) to clarify that the scope exception only applies to the accounting in the financial statements of the joint arrangement itself.

30. Appendix A shows the proposed final amendment, highlighting differences from the currently effective Standard.

31. Appendix B shows revisions to the wording in the previously published Exposure Draft.

Questions for the Interpretations Committee

1. Does the Interpretations Committee agree to recommend to the IASB that it should proceed with the amendment to paragraph 2(a) of IFRS 3?
2. Does the Interpretations Committee agree with the proposed wording of the amendment as shown in Appendix A of the paper?

Appendix A—Proposed final amendment to IFRS 3

A1. The proposed amendment to paragraph 2(a) of IFRS 3 is presented below.

Amendment to IFRS 3 *Business Combination*

Paragraph 2 is amended and paragraph 64H is added. New text is underlined and deleted text is struck through.

Scope

- 2 This IFRS applies to a transaction or other event that meets the definition of a business combination. This IFRS does not apply to:
- (a) the accounting for the formation of a joint arrangement ~~joint venture~~ in the financial statements of the joint arrangement itself.
 - (b) ...

Effective date

- 64H Annual Improvements Cycle 2011–2013 issued in [date] amended paragraph 2(a). An entity shall apply that amendment retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for annual periods beginning on or after 1 January 2014. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

Basis for Conclusions on the amendment to IFRS 3 *Business Combinations* (as revised in 2008)

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

Scope

- BC1 The IFRS Interpretations Committee (the Interpretations Committee) observed that there was uncertainty about whether paragraph 2(a) of IFRS 3, which excludes the formation of joint ventures from the scope of IFRS 3, should have been amended to refer to joint arrangements when IFRS 11 was issued. The IASB did not change the wording of the scope exclusion in paragraph 2(a) of IFRS 3 for ‘the formation of a joint venture’ when it replaced IAS 31 *Interests in Joint Ventures* with IFRS 11 *Joint Arrangements*, although the Interpretations Committee understood that the IASB intended not to change the scope of IFRS 3. IFRS 11 had changed the use of the term ‘joint venture’ from having a general meaning that included ‘jointly controlled operations’, ‘jointly controlled assets’ and ‘jointly controlled entities’, to meaning a specific type of joint arrangement, which does not include ‘joint operations’.
- BC2 There was also uncertainty about whether the scope exclusion in paragraph 2(a) of IFRS 3 addresses:
- (i) the accounting by the joint arrangements themselves in their financial statements only; or

- (ii) also the accounting by the parties to the joint arrangement for their interests in the joint arrangement.

BC3 The IASB noted that paragraph 2(a) of IFRS 3 should exclude formations of every type of joint arrangement (ie joint ventures and joint operations) from the scope of IFRS 3. It also noted that paragraph 2(a) of IFRS 3 only addresses the accounting by the joint arrangements themselves in their financial statements, ie it does not apply to the accounting by the parties to the joint arrangement for their interests in the joint arrangement.

BC4 The IASB concluded that paragraph 2(a) of IFRS 3 should be amended to address all types of joint arrangements and to remove uncertainty about the financial statements to which it applies.

BC5 Consequently, the IASB amended paragraph 2(a) of IFRS 3 to:

- (a) exclude the formation of all types of joint arrangements from the scope of IFRS 3 by replacing 'joint venture' with 'joint arrangement'; and
- (b) clarify that it only excludes the accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself from the scope of IFRS 3.

Appendix B— Changes from the Exposure Draft published in December 2012

- A2. The proposed amendment to paragraph 2(a) of IFRS 3 is presented below. New text that is proposed to be added, is shown with a double-underline. Text that is proposed to be deleted with respect to the proposed amendment included in the ED (December 2012), is shown with a ~~double-strike-through~~.

Amendment to IFRS 3 *Business Combination*

Paragraph 2 is amended and paragraph 64H is added. New text is underlined and deleted text is struck through.

Scope

- 2 This IFRS applies to a transaction or other event that meets the definition of a business combination. This IFRS does not apply to:
- (a) the accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself.
 - (b) ...

Effective date

- ...
- 64H *Annual Improvements Cycle 2011–2013* issued in [date] amended paragraph 2(a). An entity shall apply that amendment retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for annual periods beginning on or after 1 January 2014. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

Basis for Conclusions on the amendment to IFRS 3 *Business Combinations* (as revised in 2008)

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

Scope

- BC61A The IFRS Interpretations Committee ('the Interpretations Committee') observed that there was uncertainty about whether paragraph 2(a) of IFRS 3, which excludes the formation of joint ventures from the scope of IFRS 3, should have been amended to refer to joint arrangements when IFRS 11 was issued. The IASB did not change the wording of the scope exclusion in paragraph 2(a) of IFRS 3 for 'the formation of a joint venture' when it replaced IAS 31 *Interests in Joint Ventures* with IFRS 11 *Joint Arrangements*, although the Interpretations Committee understood that the IASB intended not to

change the scope of IFRS 3. IFRS 11 had changed the use of the term ‘joint venture’ from having a general meaning that included ‘jointly controlled operations’, ‘jointly controlled assets’ and ‘jointly controlled entities’, to meaning a specific type of joint arrangement, which does not include ‘joint operations’.

BC61B There was also uncertainty about whether the scope exclusion in paragraph 2(a) of IFRS 3 ~~only~~ addresses:

- (i) the accounting by the joint arrangements themselves in their financial statements only; or
- (ii) also the accounting by the parties to the joint arrangement for their interests in the joint arrangement.

BC61C The IASB noted that paragraph 2(a) of IFRS 3 should exclude formations of every type of joint arrangement (ie joint ventures and joint operations) from the scope of IFRS 3. It also noted that paragraph 2(a) of IFRS 3 only addresses the accounting by the joint arrangements themselves in their financial statements, ie it does not apply to the accounting by the parties to the joint arrangement for their interests in the joint arrangement.

BC61D The IASB concluded that paragraph 2(a) of IFRS 3 should be amended to address all types of joint arrangements and to remove uncertainty about the financial statements to which it applies.

BC61E Consequently, the IASB ~~proposes to~~ amended paragraph 2(a) of IFRS 3 to:

- (a) exclude the formation of all types of joint arrangements from the scope of IFRS 3 by replacing ‘joint venture’ with ‘joint arrangement’; and
- (b) clarify that it only excludes the accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself from the scope of IFRS 3.