IASB Agenda ref **12B**

STAFF PAPER

October 2015

IASB Meeting

Project	**IFRS 11 *Joint Arrangements***
Paper topic	Remeasurement of previously held interests—cover memo

CONTACT(S) Jawaid Dossani jdossani@ifrs.org +44 (0)20 7332 2742

This paper has been prepared for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Background

1. The IFRS Interpretations Committee ('the Interpretations Committee') received a request to clarify whether a previously held interest in the assets and liabilities of a joint operation should be remeasured to fair value when an investor's acquisition of an additional interest results in the investor becoming a joint operator (ie assuming joint control) of the investee.

2. The Interpretations Committee first discussed this issue in its meeting in May 2015. It had found that there are different views on whether or not the previously held interests in the assets and liabilities of the joint operation should be remeasured. It also noted that some respondents to the outreach highlighted other transactions involving previously held interests in which there were different views on whether such interests should be remeasured or not. The Interpretations Committee observed that it would be useful to analyse these other transactions simultaneously with its analysis of the fact pattern submitted.

3. The Interpretations Committee, at its meeting in July 2015, discussed which transactions should be included within the scope of this project. These specific transactions were then analysed by the Interpretations Committee at its meeting in September 2015.

Structure of papers

4. This paper provides:

(a) an overview of the approach taken by the Interpretations Committee in determining which transactions should be included within the scope of this project;

(b) a summary of the Interpretations Committee's approach to analysing those transactions; and

(c) a brief summary of the conclusions reached by the Interpretations Committee.

5. Agenda Papers 12C and 12D:

(a) discuss recommendations by the Interpretations Committee for amendments to IFRS 3 *Business Combinations* and IFRS 11 *Joint Operations* respectively in the form of annual improvements; and

(b) ask the IASB whether it agrees with the recommendations of the Interpretations Committee.

6. Agenda Paper 12E:

(a) discusses loss of control transactions that result in an entity having joint control in, or being a party to, a joint operation subsequent to the transaction; and

(b) asks the IASB for its input on whether the Interpretations Committee should defer its deliberations on this transaction, because of similarities with a recent amendment to IAS 28 *Investment in associates and joint ventures* that the IASB has recently proposed to postpone.

Approach used by the Interpretations Committee in analysing these transactions

7. The Interpretations Committee, at its meeting in July 2015, analysed other transactions involving changes of interests in a business (as defined by IFRS 3) for which there is a lack of guidance and/or diversity of views in determining whether or

not previously held interests should be remeasured. A copy of the staff analysis can be found in Agenda Paper 6 of the Interpretations Committee's meeting in July 2015..

8. Appendix A (reproduced from Agenda Paper 6 of the Interpretations Committee's meetings in July 2015) lists transactions involving changes of interest in a business (as defined in IFRS 3). It identifies transactions involving previously held interests where there is sufficient guidance versus those for which there appears to be either a lack of guidance and/or diversity of views in determining whether or not the previously held interests should be remeasured.

9. The analysis identified 14 transactions (shaded in yellow) for which, the Interpretations Committee noted that there is an apparent lack of guidance and/or diversity of views in determining the appropriate accounting for previously held interests. The transactions have been numbered (TR#1-TR#14) for ease of reference.

10. For ease of reference, we have used the term 'party to a joint operation' throughout the remainder of this paper to indicate an investment in which a party participates in, but does not have joint control of, a joint operation. The party has rights to the assets and obligations for the liabilities relating to the joint operation. The party therefore accounts for its interests in the arrangement in accordance with the guidance in paragraphs 20–22 of IFRS 11 *Joint Arrangements*.

11. Our analysis and outreach indicated that several of these transactions were either not widespread, were not leading to diversity in practice or were the subject of another IASB project. The Interpretations Committee agreed that the scope of the project should include transactions involving:

    (a) obtaining control of a joint operation, either from having joint control in, or being a party to, a joint operation prior to the transaction (TR#13 and TR#14);

    (b) change of interests resulting in a party to a joint operation obtaining joint control in a joint operation (TR#6); and

    (c) loss of control resulting in the entity having joint control in, or being a party to, a joint operation subsequent to the transaction (TR#7 and TR#12).

12. The Interpretations Committee observed that it would be useful to also analyse similar transactions involving assets, or groups of assets and liabilities, that do not meet the definition of a business.

13. In performing our analysis, we first reviewed existing guidance on the remeasurement of previously held interests for transactions for which IFRSs contain explicit requirements and identified a few general principles that could be applied to other similar transactions. Our full analysis can be found in Agenda Paper 5 of the Interpretations Committee's meeting in September 2015.

14. The Interpretations Committee noted that the key factors that should be used in assessing whether previously held interests should be remeasured are:

    (a) the significance of the underlying economic event (for example, obtaining control of a business and loss of control of a subsidiary are characterised in IFRS 3 and IFRS 10 *Consolidated Financial Statements* as significant economic events); and

    (b) the measurement model applicable to the recognition of the previously held/retained interests (for example, IFRS 3 and IFRS 9 *Financial Instruments* use fair value-based measurement models, which would indicate that previously held interests should be remeasured).

    Several members of the Interpretations Committee also noted that the structure of the investment may have a bearing on the analysis and should be a relevant consideration. The Interpretations Committee also decided that the accounting for previously held interests should be separately analysed for transactions involving assets, or groups of assets, that meet the definition of a business versus those that do not.

15. These principles were then applied to the analysis of the specific transactions listed in paragraph 11.

Summary of conclusions reached by the Interpretations Committee in its analysis of the transactions

16. The following section provides a summary of the conclusions reached by the Interpretations Committee in its analysis of the specific transactions identified as being within the scope of this project.

Obtaining control of a joint operation, either from having joint control in, or being a party to, a joint operation prior to the transaction

17. The Interpretations Committee observed that for transactions in which the joint operation *meets the definition of a business*, the previously held interests should be remeasured to fair value. The Interpretations Committee noted that:

    (a) the transaction results in a significant economic event; and

    (b) remeasurement of previously held interests is consistent with the fair value measurement requirements of IFRS 3.

18. However, the Interpretations Committee noted that the current wording in paragraphs 41–42 of IFRS 3 requires an entity to remeasure previously held ‘equity interests’. There is a lack of clarity on whether an entity’s interests in a joint operation meet the definition of ‘equity interests’, which has led to divergent views in practice. Consequently, the Interpretations Committee recommends an amendment to IFRS 3 in the form of an annual improvement to reflect its conclusion.

19. The proposed amendment and further details of the Interpretations Committee’s discussion and analysis of this transaction are presented in Agenda Paper 12C.

20. If the asset, or group of assets involved in this transaction *does not meet the definition of a business*, the Interpretations Committee noted that paragraph 2(b) of IFRS 3 provides guidance on the typical accounting for an asset acquisition. The Interpretations Committee also observed that it was not aware of significant diversity in practice and therefore tentatively decided not to add the accounting for this transaction to its agenda. The tentative agenda decision reflecting this conclusion was

published in the [September 2015 *IFRIC Update*] and is open for comments until 23 November 2015.

Change of interests resulting in a party to a joint operation obtaining joint control in a joint operation.

21. The Interpretations Committee observed that for transactions in which the joint operation meets the definition of a business, the previously held interests should not be remeasured when obtaining joint control. The Interpretations Committee noted that:

    (a) the transaction does not result in a significant economic event; and

    (b) not requiring remeasurement of previously held interests is consistent with the requirements of IFRS 11, which require an entity to account for its assets and liabilities relating to its interest in the joint operation in accordance with the applicable Standards.

22. However, the Interpretations Committee noted that the wording in IFRS 11 could be understood to require the remeasurement of previously held interests. Consequently, it recommends an amendment to IFRS 11 in the form of an annual improvement to reflect its conclusion.

23. The proposed amendment and further details of the Interpretations Committee's discussion and analysis of this transaction are presented in Agenda Paper 12D.

24. If the asset, or group of assets involved in this transaction does not meet the definition of a business, the Interpretations Committee noted that paragraph 2(b) of IFRS 3 provides guidance on the typical accounting for an asset acquisition. The Interpretations Committee also observed that it was not aware of significant diversity in practice and therefore tentatively decided not to add the accounting for this transaction to its agenda. The tentative agenda decision reflecting this conclusion was published in the [September 2015 *IFRIC update*] and is open for comments until 23 November 2015.

Loss of control resulting in the entity having joint control in, or being a party to, a joint operation subsequent to the transaction

25. The Interpretations Committee observed that, consistently with IFRS 10 *Consolidated Financial Statements*, loss of control is a significant economic event. A number of Interpretations Committee members expressed a preference for remeasurement of the retained interests in loss of control transactions where the asset, or group of assets, met the definition of a business.

26. However, the Interpretations Committee noted that this transaction has similarities with a sale or contribution of assets to a joint venture or an associate, which has been the subject of recent discussions by the IASB. Consequently, the Interpretations Committee decided to consult the IASB to assess whether it should postpone further discussion on this transaction (both for transactions in which the asset, or group of assets, meets the definition of a business and for those where it does not) until the research project on the equity method of accounting progresses and a decision is made on accounting for sale or contribution of assets to an associate or a joint venture.

27. Further details of the Interpretations Committee's discussion and analysis of this transaction are presented in Agenda Paper 12E.

Appendix A—Matrix of transactions involving changes of interest in a business and guidance on the remeasurement of previously held/ retained interests

To: ***From:***		**Financial asset**	**Equity-accounted investee (significant influence/joint venture)**	**Joint operations**		**Control**
				Joint control—joint operation	**Party to a joint operation***	
Financial asset		Follow guidance in IFRS 9 (note 1)	Guidance not clear (TR#1)	Guidance not clear (TR#4)	Guidance not clear (TR#8)	Remeasure—IFRS 3.42**
Equity-accounted investee (significant influence/joint venture)		Remeasure—IAS 28.22(b) and IFRS 9.5.1.1**	Do not remeasure—IAS 28.24**	Guidance not clear (TR#5)	Guidance not clear (TR#9)	Remeasure—IFRS 3.42**
Joint Operations	**Joint control—joint operation**	Remeasure—IFRS 9.5.1.1**	Guidance not clear (TR#2)	Do not remeasure—IFRS 11.B33C	Guidance not clear (TR#10)	Guidance not clear (TR#13)
	Party to a joint operation*	Remeasure—IFRS 9.5.1.1**	Guidance not clear (TR#3)	Guidance not clear—original submission (TR#6)	Guidance not clear (TR#11)	Guidance not clear (TR#14)
Control		Remeasure—IFRS 10.25(b) and IFRS 9.5.1.1 **	Remeasure—IFRS 10.25(b)	Guidance not clear (TR#7)	Guidance not clear (TR#12)	Do not remeasure—IFRS 10.23**

** Party to a joint operation refers to a party that participates in, but does not have joint control of, a joint operation. The party has rights to the assets and obligations for the liabilities relating to the joint operation. The party therefore accounts for its interests in the arrangement in accordance with the paragraphs 20–22 of IFRS 11.*

*** Guidance referenced in the matrix has been reproduced below for ease of reference.*

Cells shaded in yellow indicate transactions in which there is a lack of guidance and/or diversity of views in determining the appropriate accounting for previously held interests.

Notes to the matrix

Note 1: From an investment in a financial asset to an investment in a financial asset:

A1. IFRS 9 *Financial Instruments* provides guidance on the initial and subsequent measurement of financial assets. The appropriate measurement of previously held interests would depend on the nature (for example, debt vs equity) and classification (for example, fair value through profit or loss, amortised cost, etc) of the financial asset.

Guidance referenced in matrix:

A2. Paragraph 42 of IFRS 3 states:

> 'In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its <u>acquisition-date fair value</u> and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate …' (emphasis added).

A3. Paragraph 5.1.1 of IFRS 9 states:

> 'Except for trade receivables within the scope of paragraph 5.1.3, at initial recognition, an entity shall <u>measure a financial asset</u> or financial liability <u>at its fair value</u> plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability' (emphasis added).

A4. Paragraph 23 of IFRS 10 states

> 'Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (ie transactions with owners in their capacity as owners).'

A5. Paragraph 25 of IFRS 10 states:

> 'If a parent loses control of a subsidiary, the parent ... (b) recognises any <u>investment retained in the former subsidiary at</u>

> its fair value when control is lost and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant IFRSs. That fair value shall be regarded as the fair value on initial recognition of a financial asset in accordance with IFRS 9 or, when appropriate, the cost on initial recognition of an investment in an associate or joint venture.'

A6. Paragraph BC33C of IFRS 11 states:

> 'A joint operator might increase its interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in IFRS 3, by acquiring an additional interest in the joint operation. In such cases, previously held interests in the joint operation are not remeasured if the joint operator retains joint control' (emphasis added).

A7. Paragraph 22 of IAS 28 states:

> 'An entity shall discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture as follows: … (b) If the retained interest in the former associate or joint venture is a financial asset, the entity shall measure the retained interest at fair value. The fair value of the retained interest shall be regarded as its fair value on initial recognition as a financial asset in accordance with IFRS 9' (emphasis added).

A8. Paragraph 24 of IAS 28 states:

> 'If an investment in an associate becomes an investment in a joint venture or an investment in a joint venture becomes an investment in an associate, the entity continues to apply the equity method and does not remeasure the retained interest' (emphasis added).