STAFF PAPER

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IASB Meeting

Project	**IFRS 11 *Joint Arrangements***
Paper topic	Remeasurement of previously held interests—'change of interests' transaction resulting in obtaining joint control

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Introduction

1. The IFRS Interpretations Committee ('the Interpretations Committee') discussed whether previously held interests in the assets and liabilities of a joint operation should be remeasured to fair value when the acquisition of an additional interest results in an investor obtaining joint control over the joint operation. The joint operation over which joint control is obtained constitutes a business.

2. The Interpretations Committee noted that previously held interests should not be remeasured in the fact pattern discussed. However, it acknowledged that there is a lack of clarity in the wording in IFRS 11 *Joint Operations*, which has led to diversity in practice. Consequently, the Interpretations Committee recommends an amendment to IFRS 11 in the form of an annual improvement.

Purpose of this paper

3. The purpose of this paper is to:
   (a) present background information on the issue;
   (b) provide a summary of the staff's analysis and the Interpretations Committee's discussions;
   (c) provide an assessment against the criteria for an annual improvement; and

(d) ask the IASB whether it agrees with the recommendation of the Interpretations Committee.

4. Appendix A provides a draft of the proposed amendment to IFRS 11. This has been included for information purposes only and the IASB will not be asked to provide comments on the wording at the meeting. Editorial comments on the draft wording, if any, should be sent to the staff outside of the meeting.

Background

5. The submitter described a scenario in which:

(a) an entity participates in, but does not have joint control of, a joint operation that constitutes a business in accordance with IFRS 3 *Business Combinations*. The entity has rights to the assets, and obligations for the liabilities, relating to the joint operation. In accordance with paragraph 23 of IFRS 11, the entity recognises its share of revenue from the sale of the output by the joint operation, the assets held jointly and the expenses and liabilities incurred jointly.

(b) the entity acquires an additional interest in the joint operation, at which point the joint arrangement agreement is amended so that the entity is now a joint operator (ie it has joint control of the joint operation).

(c) in accordance with paragraph 21A of IFRS 11, the entity applies the principles on business combinations to account for this transaction.

6. The submitter asked whether applying the principles of business combinations accounting to the transaction includes remeasurement of the entity's previously held interests in the joint operation.

7. Our outreach provided indications that the transaction could be widespread. We understand that there are two divergent views that are developing in practice:

(a) View 1—the entity's original interest is remeasured.

Proponents of View 1 argue that paragraph BC45M of IFRS 11 cites the requirement in paragraph 42 of IFRS 3 to remeasure a previously held interest upon obtaining control of an investee and states that 'this is the analogous transaction to the acquisition of an interest in a business that results in the acquirer obtaining joint control of the business'. This statement suggests that the reference in paragraph 21A of IFRS 11 to applying the business combinations accounting requirements '… to the extent of its share in accordance with paragraph 20 …' requires the investor to remeasure its aggregate interest in the joint operation and that '… the principles on business combinations accounting in IFRS 3 …' includes the remeasurement requirements of paragraph 42 of IFRS 3.

They also note that the requirement of paragraph B33C of IFRS 11, which states that 'previously held interests in the joint operation are not remeasured if the joint operator retains joint control', could be interpreted to mean that previously held interests are remeasured when joint control is obtained (instead of being retained).

(b) View 2—the entity's original interest is not remeasured.

Proponents of this view think that the reference in paragraph 21A of IFRS 11 to applying business combinations accounting 'to the extent of its share in accordance with paragraph 20' refers to the interest being acquired in the subsequent transaction, instead of the entity's total interest in the joint operation, including the entity's original interest. This is, in part, due to concerns over applying the principles of IFRS 3 more than once to the same share of assets and liabilities. It is also partly due to the fact that in the circumstances described, while the nature of the investor's previously held interest in the joint operation has changed (from passive investment to joint control), the method of accounting for that interest has not changed.

Paragraph BC30 of IAS 28 *Investments in Associates and Joint Ventures* states that a change between associate and joint venture status should not result in the remeasurement of an investment accounted for using the equity method, because 'there is neither a change in the group boundaries nor a change in the measurement requirements'. Proponents of this view argue that the acquisition of joint control is not a significant economic event.

Summary of the staff's analysis and the Interpretations Committee's discussions

8. The following section presents a summary of the staff's analysis and the discussions of the Interpretations Committee. Our full analysis of the issue can be found in Agenda Paper 5C of the Interpretations Committee meeting in September 2015.

9. As discussed in Agenda Paper 12B, 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; and

   (b) the measurement model applicable to the recognition of the previously held/retained interests.

   Several members also noted that the structure of the investment and whether or not it is structured through a separate legal entity may have a bearing on the analysis and should be a relevant consideration.

Does the transaction represent a significant economic event?

10. The Interpretations Committee observed that the change that occurs upon the acquisition of joint control over a joint operation is not as significant as a change that occurs upon the acquisition of control over an associate, a joint venture or a financial asset within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9.

11. This is because the entity, despite not being a joint operator prior to the transaction, had rights to the assets, and obligations for the liabilities, relating to the joint operation that it continues to have subsequent to the transaction. There is no change in the method of accounting for the entity's interest in the joint operation.

12. The Interpretations Committee noted that this transaction is therefore more analogous to a transaction that results in an investment in an associate becoming an investment in a joint venture compared to an event that warrants remeasurement, such as obtaining control.

13. Paragraph 24 of IAS 28 specifies the accounting treatment to be applied and states that (emphasis added) '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.'

14. Paragraph BC28 of IAS 28, in explaining the rationale for this decision states:

> During its redeliberation of ED 9, the Board reconsidered whether its decision in the second phase of the business combinations project to characterise loss of joint control or loss of significant influence as a significant economic event (ie in the same way that loss of control is characterised as a significant economic event) was appropriate. If it were, the Board thought that the entity should be required to recalibrate the accounting as required by IFRS 10. However, the Board concluded that, although significant, the events are fundamentally different. In the case of loss of control, the cessation of the parent-subsidiary relationship results in the derecognition of assets and liabilities because the composition of the group changes. If joint control or significant influence is lost the composition of the group is unaffected.

15. Paragraph BC30 of IAS 28 further goes on to state (emphasis added):

> In the case of loss of joint control when significant influence is maintained, the Board acknowledged that the investor-investee relationship changes and, consequently, so does the nature of the investment. However, in this instance, both investments (ie the joint venture and the associate) continue to be measured using the equity method. Considering that there is *neither a change in the group boundaries nor a change in the measurement requirements*, the Board concluded that losing joint control and retaining significant influence is not an event that warrants remeasurement of the retained interest at fair value.

16. The Interpretations Committee observed that a similar rationale is applicable to this transaction, because there has been neither a change in the group boundaries nor a change in the measurement requirements in respect of the entity's original interest. It concluded that the transaction does not represent a significant economic event.

What is the applicable measurement model that should be applied to the previously held interests?

17. Paragraph 21 of IFRS 11 notes that a joint operator shall account for the assets, liabilities, revenues and expenses relating to its interests in a joint operation in accordance with the Standards applicable to the particular assets, liabilities, revenues and expenses. Some of those Standards, such as IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*, provide a cost-based model for initial recognition.

18. The Interpretations Committee noted that not remeasuring previously held interests would be consistent with the requirements of IFRS 11, which specifies that an entity should account for the assets and liabilities relating to its interests in a joint operation in accordance with the applicable Standards.

Does the structure of the joint operation affect the analysis of the appropriate accounting treatment?

19. The structure of a joint arrangement is important in determining the appropriate classification of a joint arrangement. However, the accounting requirements for a joint operation in IFRS 11 do not distinguish between a joint operation that is structured through a separate legal entity and one that is not.

20. When the IASB developed its recent guidance on the acquisition of interests in a joint operation, it noted in paragraph BC45M of IFRS 11 that:

    (a) the acquisition of additional interests in a business that is already controlled by the acquirer is analogous to the acquisition of interests in a business that is already jointly controlled by, and will continue to be jointly controlled by, the acquirer; and

    (b) the acquisition of control over a business by an acquirer is analogous to an acquirer obtaining joint control over a business.

    The IASB thought that there were grounds for developing an analogy to this guidance and did not distinguish between joint operations that are structured through a separate legal entity and those that are not.

21. Consequently, the Interpretations Committee concluded that the structure of the joint operation should not affect the analysis of the appropriate accounting treatment for previously held interests.

Other considerations—analysing the requirements of IFRS 11

22. Paragraph BC45M of IFRS 11 cites the requirement in paragraph 42 of IFRS 3 to remeasure a previously held interest upon obtaining control of an investee and states that '… this is the analogous transaction to the acquisition of an interest in a business that results in the acquirer obtaining joint control of the business'. This statement suggests that the reference in paragraph 21A of IFRS 11 to applying the business combinations accounting requirements '… to the extent of its share in accordance with paragraph 20 …' requires the investor to remeasure its aggregate interest in the joint operation and that '… the principles on business combinations accounting in IFRS 3 …' include the remeasurement requirements of paragraph 42 of IFRS 3.

23. In addition, paragraph B33C of IFRS 11 states that 'previously held interests in the joint operation are not remeasured if the joint operator retains joint control', which could be interpreted to mean that previously held interests are remeasured when joint control is obtained (instead of being retained).

24. The Interpretations Committee observed that the wording in these paragraphs, while not explicitly addressing the transaction, could be interpreted by some as requiring (or permitting) a remeasurement of the entity's original interest.

25. In paragraph BC45L, the IASB acknowledges that:

> … the reference to "all of the principles on business combinations accounting in IFRS 3 and other IFRSs" is ambiguous for acquisitions of additional interests in joint operations that result in the joint operator retaining joint control of the joint operation. It might be understood as a reference to either:
>
> (a) paragraph 42 of IFRS 3 with the result of remeasuring a previously held interest in a joint operation on the acquisition of an additional interest while retaining joint control; or

(b) paragraph 23 of IFRS 10 with the result of not remeasuring a previously held interest in a joint operation on the acquisition of an additional interest while retaining joint control.

26. In order to address this, the IASB clarified in paragraph B33C of IFRS 11 that previously held interests in a joint operation are not remeasured if the joint operator retains joint control. However, the clarification was *limited to the circumstances in which joint control is retained by the entity*. The Interpretations Committee observed that this clarification should not be read as implying that previously held interests should (or are permitted to) be remeasured when an entity obtains joint control.

Interpretations Committee's conclusion and recommendation

27. On the basis of its analysis and discussions, the Interpretations Committee concluded that previously held interests <u>should not be remeasured</u> in the transaction. It acknowledged that the wording in paragraphs 21A, B33C and BC45M of IFRS 11 could lead some to understand that previously held interests should be remeasured.

28. Consequently, the Interpretations Committee recommends amending the guidance in IFRS 11 to clarify that previously held interests in a joint operation should not be remeasured in the transaction when joint control is obtained.

Proposed amendment to IFRS 11

29. The proposed amendment to IFRS 11 is shown in Appendix A of this Agenda Paper. The amendment makes it clear that the previously held interests in the assets and liabilities of a joint operation should not be remeasured when an investor's acquisition of an additional interest results in the investor obtaining joint control of the joint operation.

30. The proposed amendment has been included for information purposes only and the IASB will not be asked to provide comments on the wording at the meeting. Editorial comments on the draft wording, if any, should be sent to the staff outside of the meeting.

Transition provisions

31. The Interpretations Committee proposes that an entity should apply the amendments prospectively. Earlier application should be permitted. It recommends a prospective approach for transition, because it thinks that the benefits of applying this guidance on a retrospective basis do not outweigh the costs and efforts.

Consequential amendments and first-time adopters

32. We reviewed the other Standards for potential consequential amendments triggered by this proposed amendment. As a result of this review, it does not propose any consequential amendments.

33. We also considered whether special provisions are required for first-time adopters to IFRS. Appendix C of IFRS 1 *First-time adoption of International Financial Reporting Standards* already provides an exemption from retrospective restatement of acquisitions of interests in a joint operation that meets the definition of a business. Paragraph C5 of IFRS 1 states (emphasis added):

> The exemption for past business combinations also applies to past acquisitions of investments in associates, interests in joint ventures and *interests in joint operations in which the activity of the joint operation constitutes a business*, as defined in IFRS 3.

34. Consequently, the Interpretations Committee does not think a clarifying amendment to IFRS 1 is necessary.

Assessment against the criteria for annual improvements

35. The Interpretations Committee assessed the proposed amendment against the criteria for annual improvements, as shown in the following table:

Criteria for annual improvements	
An annual improvement should (6.11, 6.12): • replace unclear wording; • provide missing guidance; or • correct minor unintended consequences, oversights or conflict.	**Yes.** The Interpretations Committee observed that the guidance currently does not address the situation described by the submitter. It noted that the wording in paragraphs 21A, B33C and BC45M of IFRS 11 could lead some to understand that previously held interests should be remeasured. It does not think that this was an intended consequence of the recent amendments made to IFRS 11.
Not change an existing principle or propose a new principle.	**Yes.** The Interpretations Committee noted that the proposal is not changing an existing principle or proposing a new principle. Instead, it thinks that the proposal is providing missing guidance that is in line with the principles of IFRS 11, other relevant Standards (ie IAS 28, IFRS 10 and IFRS 3) and analogous transactions.
Not be so fundamental that the IASB will have to meet several times to conclude (6.14).	**Yes.** The Interpretations Committee thinks that the proposed amendment is not so fundamental that the IASB will have to meet several times to conclude.

36. On the basis of this assessment the Interpretations Committee thinks that the proposed amendment meets the criteria for inclusion in the *Annual Improvements to IFRS 2015–2017* Cycle.

Questions for the IASB

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1. Does the IASB agree with the Interpretations Committee's analysis and conclusion that the previously held interests in the assets and liabilities of a joint operation should not be remeasured when joint control is obtained over a joint operation?
2. Does the IASB agree with the Interpretations Committee's assessment that the proposed amendment meets the criteria for inclusion in the *Annual Improvements to IFRS 2015–2017* Cycle?
3. Does the IASB agree with the Interpretations Committee's recommendation that the proposed amendment should be applied on a prospective basis with early application permitted?

Appendix A
Proposed amendment to IFRS 11 *Joint Arrangements*

A1. Appendix A provides a draft of the proposed amendment to IFRS 11. This information has been included for information purposes only and the IASB will not be asked to provide comments on the wording at the meeting. Editorial comments on the draft wording, if any, should be sent to the staff outside of the meeting.

Paragraph B33C has been amended and paragraph C1AB has been added. Deleted text is struck through and new text is underlined.

Accounting for acquisitions of interests in joint operations

…

B33C ~~A joint operator~~ An entity 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~~ entity obtains, or retains, joint control and there has been no change to the method of accounting for the previously held interests.

…

Effective date

…

C1AB *Annual Improvements to IFRS [2015–2017] Cycle*, issued in [date], amended paragraph B33C. An entity shall apply that amendment prospectively to transactions occurring in annual periods beginning on or after [date]. Earlier application is permitted.