STAFF PAPER

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IFRS Interpretations Committee Meeting

Project	IFRS 11 *Joint Arrangements*		
Paper topic	Remeasurement of previously held interests—Acquisition of control over a joint operation		
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Introduction

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. As part of its analysis of this issue, the Interpretations Committee observed that it would be useful to analyse other transactions involving previously held interests in which there are different views on whether such interests should be remeasured or not. At its meeting in July 2015, the Interpretations Committee agreed that the scope of the project should, initially, 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 (hereafter referred to as the 'acquisition of control over a joint operation');

   (b) loss of control resulting in the entity having joint control in, or being a party to, a joint operation subsequent to the transaction; and

   (c) change of interests resulting in a party to a joint operation obtaining joint control in a joint operation.

3. Agenda Paper 05 of this meeting (hereafter referred to as 'the Covering Memo') provides an overview and an analysis of the existing guidance in relation to the measurement of previously held interests. It also identifies some guiding principles that we think can be used in performing the analysis of the specific transactions noted in paragraph 2.

4. The objective of this agenda paper is to provide the Interpretations Committee with our analysis and recommendation on the transaction described in paragraph 2(a) (ie a transaction leading to acquisition of control over a joint operation). The analysis draws on the general principles developed in the Covering Memo.

5. This paper provides:

   (a) background information;

   (b) staff analysis; and

   (c) staff recommendation.

Background information

6. An investor may have joint control of a joint operation. Paragraph 20 of IFRS 11 *Joint Arrangements* requires that a joint operator recognises 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.

7. Consequently, the question arises of how to account for this previously held interest in the joint operation, if:

   (a) the joint operation as a whole constitutes a business as defined in IFRS 3 *Business Combinations*; and

   (b) the joint operator obtains control over the business of the joint operation as the result of acquiring an additional interest in the joint operation.

8. An entity could also participate in, but not have joint control of, a joint operation. If the party has rights to the assets and obligations for the liabilities, it would also account for its arrangement in accordance with paragraphs 20–22 of IFRS 11

(hereafter referred to as 'party to a joint operation'). Accordingly, a similar question arises if such an entity obtains control over the business of that joint operation.

9. We understand from our outreach (see results of outreach in Agenda Paper 6 of the Interpretation Committee's meeting in July 2015) that there are three divergent views that are developing in practice:
   (a) View 1—the entity's previously held interest is remeasured;
   (b) View 2—the entity's previously held interest is not remeasured; and
   (c) View 3—the entity's previously held interest is remeasured if the joint operation is structured through a separate legal entity.

10. While the issue has primarily arisen within the context of a joint operation that meets the definition of a business, we will also analyse transactions involving assets, or groups of assets, that do not meet the definition of a business later in this paper.

View 1—the entity's previously held interest is remeasured

11. Proponents of this view refer to paragraphs 41–42 of IFRS 3 and note that these paragraphs give specific guidance on the accounting for business combinations, if control is acquired in more than one transaction. In particular, for business combinations achieved in stages, paragraphs 41–42 of IFRS 3 require that:
    (a) a previously held equity interest in the acquiree is remeasured to its acquisition-date fair value; and
    (b) any resulting gain or loss is recognised in profit or loss or other comprehensive income, as appropriate.

12. Proponents of this view note that the transaction meets the definition of a business combination, in accordance with IFRS 3. IFRS 3 requires all identifiable assets and liabilities to be measured at fair value on the date of acquisition and specifies that previously held interests should be remeasured. They consider the previously held net interest in the assets and liabilities of the joint operation to be the previously held 'equity interest', even though the entity is required to report directly its assets and liabilities and its share of assets and liabilities related to the joint operation.

13. For them, the substance of the transaction is that control has been obtained over a business and this represents a significant economic event that changes the nature of the investment and warrants a remeasurement of previously held interests.

14. Proponents of this view note that not requiring a remeasurement of previously held interests would lead to a cost accumulation approach for a business combination. Paragraph BC199 of IFRS 3 notes that users have long criticised this approach, because it leads to information that lacks consistency, understandability and usefulness. The IASB specifically rejected the cost accumulation model when developing the guidance in IFRS 3.

View 2—the entity's previously held interest is not remeasured

15. The accounting requirements of IFRS 11 require an entity to recognise directly its assets and liabilities and its share of assets and liabilities held jointly and to look through its equity interests (if any). Accordingly, proponents of this view note that there are no equity interests in a joint operation. They think that the requirement of paragraph 42 of IFRS 3 is not applicable, because it makes reference to remeasurement of previously held 'equity interests'.

16. Proponents of this view also point to paragraph 38 of IFRS 3, which states that:

> … sometimes the transferred assets or liabilities remain within the combined entity after the business combination ⋯, and the acquirer therefore retains control of them. In that situation, the acquirer shall measure those assets and liabilities at their carrying amounts immediately before the acquisition date and shall not recognise a gain or loss in profit or loss on assets or liabilities it controls both before and after the business combination.

17. They think that this exemption from the general requirements to remeasure previously held interests in IFRS 3 is applicable when control is obtained over a joint operation. This is because IFRS 11 requires a joint operator to account for its assets and liabilities and its share of assets and liabilities held jointly as if they are direct assets and liabilities of the operators. When control is obtained, those assets and liabilities

(and the share of the assets and liabilities that were previously held jointly) remain in the combined entity subsequent to the acquisition of control.

View 3—the entity's previously held interest is remeasured only if the joint operation is structured through a separate legal entity

18. Proponents of this view note that the guidance in paragraph 42 of IFRS 3 refers to the remeasurement of a previously held equity interest. A joint operation may or may not be structured through a separate legal entity. They think that in cases in which there is no separate legal entity, there are no 'equity interests' and the guidance is not applicable. In effect, proponents of this view distinguish the accounting for business combinations depending on whether the business is housed in a separate legal entity or not:

    (a) if a business is housed in an entity, and the investor has an equity interest in the entity, the requirements in paragraph 42 of IFRS 3 would be applicable and any previously held interests would be remeasured.

    (b) if the business is not housed in an entity, the guidance in paragraph 42 is not applicable and the acquirer who has obtained control over such a business in stages should account separately for each acquisition and therefore for each share in the assets and liabilities. Previously held interests should not be remeasured in this instance.

Staff analysis

Determining the appropriate accounting treatment for transactions involving businesses

19. This section presents our analysis of the appropriate accounting treatment for the acquisition of control in joint operations that meet the definition of a business (as defined in IFRS 3). In developing our analysis, we have drawn on the general principles identified in the Covering Memo.

20. As noted in the Covering Memo, we think:

(a) the significance of the underlying economic event should be the primary factor in assessing whether or not previously held interests should be remeasured. A change in the basis of accounting may indicate that a significant economic event has occurred and can be used as a factor to assess whether or not there has been a significant economic event;

(b) the measurement model (ie a cost model or a fair value model) applicable to the recognition of the previously held/retained interests should be considered;

(c) the accounting for previously held interests should be separately analysed for transactions involving assets or groups of asset that meet the definition of a business versus those that do not; and

(d) the use of a cost accumulation model should be avoided where this can be justified because users have criticised its use as resulting in information that lacks consistency, understandability and usefulness.

We do not think the structure of the investment, and whether or not the investment is housed in a separate legal entity, should affect the analysis.

Does the acquisition of control over a joint operation represent a significant economic event?

21. Paragraph BC384 of IFRS 3 explains that there is a significant change in the nature of and economic circumstances surrounding the investment resulting from the acquisition of control, because the investor-investee relationship is replaced by a parent-subsidiary relationship. In particular:

(a) the change warrants a change in the classification and measurement of the investment;

(b) the acquirer is no longer the owner of a non-controlling investment asset in the acquiree;

(c) the acquirer ceases its accounting for an investment asset and begins reporting the underlying assets, liabilities and results of the operations of the acquiree in its financial statements; and

(d) in effect, the acquirer exchanges its status as an owner of an investment asset in an entity for a controlling financial interest in all of the underlying assets and liabilities of that entity (acquiree), together with the right to direct how the acquiree and its management use those assets in its operations.

22. The acquisition of control over a joint operation changes the nature of the investment and the nature of the relationship between the investor (who was previously either a joint operator or a party to the joint operation) and the business that has been acquired.

23. This is because the acquirer has exchanged its status as a joint controller or a party to a joint operation for a controlling interest in all the underlying assets and liabilities of the previous joint operation. It has acquired the right to *unilaterally direct* how the acquiree and its management use those assets in its operation. It has the *unilateral decision-making power* over the wealth-generating abilities of the business.

24. Consequently, we think that the acquisition of control over a joint operation that is a business represents a significant economic event.

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

25. 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 IFRSs 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.

26. However, IFRS 3 provides guidance specific to business combinations and requires a fair value model to be applied to the initial recognition of identifiable assets and liabilities acquired in a business combination. It also requires previously held equity interests to be remeasured to fair value.

27. Because the acquisition of control over a joint operation results in a business combination, we think the fair value measurement model of IFRS 3 should take precedence over the measurement models of the Standards that are applicable to the

individual assets and liabilities. We think that previously held interests should be remeasured to fair value on the date control is acquired.

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

28. Paragraph 42 of IFRS 3 requires an entity to remeasure it's previously held 'equity interests'. Proponents of View 3 (see paragraph 9(c)) argue that in instances in which there is no separate legal entity, there are no 'equity interests' and accordingly, the remeasurement requirements of paragraph 42 do not apply.

29. Proponents of View 2 (see paragraph 9(b)) note that even in instances in which there is a legal entity, IFRS 11 requires a joint operator (or a party to a joint operation) to look through the equity in the joint operation and to account directly for the assets and liabilities related to its interests in a the joint operation. Consequently, they argue that even in instances in which there is a legal entity, there are no 'equity interests' that are subject to the remeasurement requirements in IFRS 3.

30. As evidenced by the rationale of the IASB in paragraph BC384 of IFRS 3, we think the focus in developing the guidance on remeasurement in paragraph 42 of IFRS 3 was not on the structure of the investment, but on the substance of the underlying transaction and the change in the nature of the investment.

31. Appendix A of IFRS 3 notes that 'for the purposes of this IFRS, *equity interests* is used broadly to mean ownership interests of investor-owned entities and owner, member or participant interests of mutual entities'. A mutual entity is further defined as:

> … an entity, other than an investor-owned entity, that provides dividends, lower costs or other economic benefits directly to its owners, members or participants. For example, a mutual insurance company, a credit union and a co-operative entity are all mutual entities.

32. In addition, the definition of the term 'equity interests' in IFRS 3 does not require the existence of a separate legal entity. Some constituents have noted that a joint operation (whether or not structured through a separate legal entity) could meet the

definition of a mutual entity, because it generally exists to provide some form of economic benefit to the joint operators and other parties to the joint arrangement.

33. We also note that the term ‘entity’ is not a defined term within IFRS. The recently published Exposure Draft *Conceptual Framework for Financial Reporting* notes that a ‘reporting entity’ is (emphasis added) ‘an entity that chooses to, or is required, to present general purpose financial statements’. It could be argued that all joint operations, however structured, are entities, because they could choose to (and in many cases, may be required to) prepare general purpose financial statements.

34. However, we do not think that it is necessary for the Interpretations Committee to determine whether or not a joint operation is an entity or a mutual entity in order to determine the appropriate treatment for the previously held interests.

35. 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 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.

36. We acknowledge that the definition of the term ‘equity interests’ in IFRS 3 could provide a technical basis for View 2 or View 3. However, we do not think that the structure of the joint operation should affect the analysis of the appropriate accounting treatment. In other words, we do not think that there should be a different accounting treatment for joint operations that are structured through a separate legal entity versus those that are not.

Would the use of the cost accumulation model be appropriate in the acquisition of control over a joint operation?

37. The IASB has specifically acknowledged the inconsistencies and deficiencies of the *cost accumulation model* when developing the remeasurement guidance in IFRS 3. Paragraph BC199 of IFRS 3 notes that users of financial statements have long criticised those practices as resulting in information that lacks consistency, understandability and usefulness.

38. In developing the guidance in IFRS 3, the IASB concluded that no useful purpose is served by reporting the assets or liabilities of a newly acquired business by using a mixture of their fair values at the date acquired and the acquirer's historical costs or carrying amounts (see paragraph BC200 of IFRS 3). In other words, the IASB rejected cost accumulation approaches in developing IFRS 3 and thereby had in mind the accounting consequences of cost accumulation practices for step acquisitions.

39. Consequently, we think that the rejection of cost accumulation practices by the IASB in developing IFRS 3, and in particular the IASB's reasons for rejecting the cost accumulation approaches, indicate that the remeasurement approach (ie View 1) should be applied on the acquisition of control over a joint operation. Otherwise, the different shares of the assets and liabilities of the joint operation are reported using a mixture of their fair values at the acquisition date and the acquirer's historical costs.

Other considerations

40. Proponents of View 2 point to paragraph 38 of IFRS 3, which states that:

> … sometimes the transferred assets or liabilities remain within the combined entity after the business combination ⋯, and the acquirer therefore retains control of them. In that situation, the acquirer shall measure those assets and liabilities at their carrying amounts immediately before the acquisition date and shall not recognise a gain or loss in profit or loss on assets or liabilities it controls both before and after the business combination.

41. They think that this exception is applicable because the assets and liabilities are accounted for as if they are direct assets and liabilities of the operators and they remain in the combined entity subsequent to the acquisition of control.

42. Prior to this transaction the acquirer has rights to the assets and obligations for the liabilities of the joint operation, but does not have control of those assets and liabilities. The acquirer may either be a party to the joint operation who does not have joint control or it may be a joint operator who has joint control of the assets and liabilities of the joint operation.

43. Paragraph 38 of IFRS 3 requires an entity to *retain control* of the assets and liabilities both before and after the transaction. Prior to this transaction, an acquirer only has joint control at best and subsequently obtains control of those assets and liabilities. Consequently, we do not think that this exception from the remeasurement requirements of IFRS 3 is applicable.

Conclusion

44. On the basis of this analysis, it is our view that previously held interests <u>should be remeasured</u> (ie View 1) in the acquisition of control over a joint operation where the joint operation meets the definition of a business. We think the transaction results in a significant economic event. Remeasurement of previously held interests is consistent with the fair value measurement requirements of IFRS 3 and avoids the use of the cost accumulation model. We think that the structure of the joint operation (ie whether or not it is structured through a separate legal entity) does not affect the analysis and should not result in a different accounting outcome for the previously held interests.

45. We acknowledge that the definition of the term ‘equity interests’ could provide a technical basis for View 2 or View 3. We have provided an assessment of the transaction against the Interpretation Committee’s agenda criteria and provided a recommendation for the appropriate way forward below.

Assessment against the Interpretations Committee’s agenda criteria

46. We have assessed this issue against the agenda criteria of the current IFRS Foundation *Due Process Handbook*:

Paragraph 5.16 states that the Interpretations Committee should address issues:	Agenda criteria satisfied?
that have widespread effect and have, or are expected to have, a material effect on those affected;	**Yes.** On the basis of our outreach (see [Agenda Paper 6]() of the Interpretations Committee meeting in July 2015), we think there are indications that the issue is widespread. The issue has a material effect on those affected.
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and	**Yes.** We think that financial reporting would be improved through the elimination of diverse reporting methods.
that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial Reporting*.	**Yes.** We think that the issue could be interpreted within the confines of IFRS 3 and IFRS 11.
In addition:	
Can the Interpretations Committee address this issue in an efficient manner (paragraph 5.17)?	**Yes**. We think that the issue can be addressed by the Interpretations Committee in an efficient manner.
The solution developed should be effective for a reasonable time period (paragraph 5.21).	**Yes.** We are not aware of any current IASB projects that are likely to affect this issue.

Staff recommendation

47. On the basis of our assessment of the Interpretations Committee's agenda criteria, and our analysis in this paper, we think that the acquisition of control over a joint

operation that meets the definition of a business is widespread and should be addressed.

48. On the basis of our analysis, we think that the previously held interests should be remeasured.

49. We think that the issue can be effectively addressed through an amendment to paragraph 41 of IFRS 3. We think the amendment meets the criteria for an annual improvement and have provided an assessment of the amendment against the additional criteria for annual improvements below:

Additional criteria for annual improvements	
In addition to the implementation and maintenance criteria, an annual improvement should (6.11, 6.12): • Replace unclear wording; • Provide missing guidance; or • Correct minor unintended consequences, oversights or conflict.	**Yes.** We think that the guidance currently does not address the situation described by the submitter and we think that the wording in paragraphs 41 and 42 of IFRS 3 could provide a technical basis for not remeasuring an entity's original interest in the transaction. We do not think this was an intended consequence of the wording in these paragraphs.
Not change an existing principle or propose a new principle	**Yes.** We think that the proposal is not changing an existing principle or proposing a new principle. Instead, we think that the proposal is providing missing guidance that is in line with the principles of IFRS 3.
Not be so fundamental that the IASB will have to meet several times to conclude (6.14)	**Yes.** We think that the proposed amendment is not so fundamental that the IASB will have to meet several times to conclude.

Transition provisions

50. We propose that an entity should apply the amendments prospectively. Earlier application should be permitted. We recommend a prospective approach for

transition, because we think that for transactions in which the previously held interests were not remeasured:

(a) the application of this guidance on a retrospective basis might involve the use of hindsight in determining the acquisition-date fair value of the retained interests; and

(b) the benefits of applying this guidance on a retrospective basis do not outweigh the costs and efforts.

First-time adopters

51. Appendix C of IFRS 1 already provides an exemption from retrospective restatement of past business combinations. Paragraph C1 of IFRS 1 states:

> ‘An first-time adopter may elect not to apply IFRS 3 retrospectively to past business combinations (business combinations that occurred before the date of transition to IFRSs).’

52. Consequently, we do not think a clarifying amendment to IFRS 1 *First-time adoption of International Financial Reporting Standards* is necessary.

Consequential amendments

53. We have reviewed the other Standards for potential consequential amendments triggered by this proposed amendment. As a result of this review, we do not propose any consequential amendments.

Proposed amendment

54. The proposed amendment to paragraph 41 of IFRS 3 is shown in Appendix A of this agenda paper.

Transactions involving assets, or groups of assets, that do not meet the definition of a business

55. We note that the guidance on business combinations accounting in IFRS 3 does not apply to the acquisition of an asset, or group of assets, that does not constitute a business. Paragraph 2(b) of IFRS 3 states:

> … in such cases the acquirer shall identify and recognise the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, intangible assets in IAS 38 *Intangible Assets*) and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative *fair values* at the date of purchase. Such a transaction or event does not give rise to goodwill.

56. Paragraph 2(b) of IFRS 3 describes the typical accounting for an asset acquisition. The guidance notes that a cost-allocation approach should be used. We think that this implies that previously held interests should not be remeasured.

57. The guidance in IFRS 3 has been applicable for several years. Remeasurement of previously held interests in an asset acquisition has not been raised by constituents in the past. In addition, the fact patterns raised by constituents in the past on this issue relate to joint operations that constitute a business. We are not aware of any significant diversity in practice.

58. For these reasons we think the Interpretations Committee should not include within the scope of this project acquisition of control of a joint operation that does not meet the definition of a business.

Questions for the Interpretations Committee

1. Does the Interpretations Committee agree with our analysis in this paper and our conclusion that, in a transaction in which a joint operation meets the definition of a business, previously held interests should be remeasured?

2. Does the Interpretations Committee agree that the wording in paragraph 41 of IFRS 3 should be amended? Does it agree with the proposed wording and transition requirement for the amendment?

3. Does the Interpretations Committee agree with our assessment that the amendment meets the criteria for an annual improvement?

4. Does the Interpretations Committee agree with our conclusion that the acquisition of control over a joint operation that does not meet the definition of a business should not be included within the scope of this project?

Appendix A—Proposed amendment

Proposed Amendment to IFRS 3 Business Combinations

Paragraph 41 has been amended. Paragraph 42 has not been amended but has been included for ease of reference. Paragraph 64M has been added. New text is underlined and deleted text is struck through.

A business combination achieved in stages

41 An acquirer sometimes obtains control of an acquiree in which it held an equity interest immediately before the acquisition date. For example, on 31 December 20X1, Entity A holds a 35 per cent non-controlling equity interest in Entity B. On that date, Entity A purchases an additional 40 per cent interest in Entity B, which gives it control of Entity B. This IFRS refers to such a transaction as a business combination achieved in stages, sometimes also referred to as a step acquisition. For the purposes of a business combination achieved in stages, equity interests shall also include an acquirer's interests in the assets and liabilities of a joint operation held immediately before the acquisition date.

42 In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate. In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in other comprehensive income. If so, the amount that was recognised in other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

Effective date

C1AA *Annual Improvements to IFRSs [2015-2017] Cycle* issued in [date] amended paragraphs 41 and 42. An entity shall apply that amendment prospectively in annual periods beginning on or after [date]. Earlier application is permitted. If an entity applies the amendment in an earlier period, it shall disclose that fact.