Post-implementation Review (PIR) of IFRS 10, IFRS 11 and IFRS 12

Prepared by MASB staff. It does not represent official position of the Board.

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IFRS 11 *Joint Arrangements*

- How to account for the acquisition of an additional stake in a Joint Venture without a change in joint control?
- What about …
  - ❖ Accounting for Joint Venture
  - ❖ Other?

Photo courtesy of Janice Chiang

Currently,

- ❑ Changes in a parent's ownership interest in a subsidiary that does not result in the parent losing control
  - ✓ IFRS 10.23: *equity transactions (transactions with owners in their capacity as owners)*
- ❑ Changes in stake in which an associate becomes a joint venture or vice versa
  - ✓ IAS 28.24: *continues to apply equity method & does not remeasure the retained interest*

What about

- ❑ Changes in stake (acquisition of an additional stake) of a joint venture without a change in joint control
  - IFRS 11 *(nothing*)
  - IAS 28 paragraph 26 (IFRS 10.25)) vs. IAS 28 paragraph 32?

An additional stake in an existing joint venture that does not result in a change in joint control

Scenario

- Company XYZ owns 40% equity interest in Company A, which is its joint venture entity in accordance with IFRS 11
- During the year, Company XYZ acquired additional 5% equity interest in Company A
- Company A remains a joint venture entity of Company XYZ after the acquisition.

Issue:

How to account for the acquisition of the additional 5% stake?

Proposal

- **To consider examining the appropriate accounting treatment for the acquisition of an additional stake in an existing joint venture which does not result in a change in joint control as part of the PIR on IFRS 11 *Joint Arrangements.***
  - although IASB does not plan to review IAS 28 during PIR but consider that this interaction between IFRS 11 and IAS 28 merits attention

- **Alternatively, if the issue is not within PIR for IFRS 11, suggest the issue to be taken up in the Equity Method Project** (as discussed in IASB Oct 2020 Meeting).

Issue: Divergent Practice

View 1	View 2
The difference between the consideration paid and the increase in the investor's share of net assets arising from acquisition of an additional stake is recognised in the investor's equity. There is no requirement to recognise the additional share of net assets at net fair value, and any difference between the additional cost of investment and additional share of the investee's net assets is recognised in the investor's equity such as retained earnings.	On acquisition of the additional stake, any difference between the cost of the additional stake and the entity's share of the additional net fair value of the investee's identifiable net assets is accounted for either as (i) goodwill (included in the carrying amount of the investment) or (ii) the excess of the entity's share of net fair value of the investee's identifiable net assets over the cost of investment included as income in profit or loss The share of net assets on the existing stake is not revalued.

The View 1

- IAS 28.26 stipulates that the concepts underlying the procedures in accounting for acquisition of a subsidiary are also adopted in the accounting for the acquisition of an investment in an associate or joint venture. IAS 28.26 states,

  Many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in IFRS 10. Furthermore, the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate or a joint venture.

IFRS 10.B96 prescribes that, when the proportion of the equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent.

- The accounting treatment is also consistent with the thinking in the proposed amendments to IAS 28 *Investment in Associates and Joint Ventures* in the IASB Exposure Draft ED/2012/3 *Equity Method: Share of Other Net Asset Changes.*

The View 1

- In reality, it is sometimes difficult to obtain information required to prepare the fair value adjustments when applying the equity method of accounting since the investor does not control the investee and consequently, does not have unrestricted access to information.
  - What's rationale on the requirement to measure the share of investee's identified assets and liabilities at fair value on acquisition as prescribed in IAS 28.32, particularly when the:

    (a) unit of account is the investment in the joint venture as a whole, because under the equity method the interest in the joint venture is recognised as a single asset; and

    (b) investor has neither separately recognised the individual assets and liabilities, nor does it separately disclose goodwill attributable to the investment.

- Apart from the impracticality, application of IAS 28.32 may result in misleading representation of the joint venture's performance by recognising income (*because the additional stake in the joint venture is not performance related*) when the entity's share of the net fair value of the investee's identifiable assets and liabilities exceeds the cost of the investment.
  - the thinking for a 'step acquisition' accounting in IFRS 3 (2008) indicates there is only one acquisition date even though IAS 28.32 does not specify that *on acquisition date* means *on initial acquisition date* (rather than *on initial and subsequent acquisition dates*).

The View 2

The entity (investor) should apply IAS 28.32. The share of net assets on the existing stake is not revalued. IAS 28.32 states,

An investment is accounted for using the equity method from the date on which it becomes an associate or a joint venture. On acquisition of the investment, any difference between the cost of the investment and the entity's share of the net fair value of the investee's identifiable assets and liabilities is accounted for as follows:

(a) Goodwill relating to an associate or a joint venture is included in the carrying amount of the investment…

(b) Any excess of the entity's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is included as income in the determination of the entity's share of the associate or joint venture's profit or loss in the period in which the investment is acquired.

…

IAS 28.32 is not limited to the initial acquisition of the joint venture but should also be applied to each additional acquisition of an interest in the joint venture. That is, IAS 28.32 applies to a joint venture using the equity method of accounting.

- IAS 28.26 (IFRS10.25) is not intended to apply to changes in ownership interests, particularly given the different nature of a subsidiary in which an entity has unilateral control compared with an associate or joint venture, in which an entity only has significant influence or joint control.

Implications of View 1 vs. View 2

Using the case scenario, say:

- Company XYZ owns 40% equity interest in Company A, which is its joint venture entity in accordance with IFRS 11 *Joint Arrangements*

  The cost of investment of this 40% equity interest was CU500 million and the share of net book value which was also the fair value of Company A's net identifiable assets at the acquisition date of 1 July 2015 was CU400 million.

- During the year, Company XYZ acquired an additional 5% equity interest in Company A

  The cost of investment of this additional 5% equity interest was CU70 million. Company XYZ's share of net book value and the share of the estimated fair value of Company A's net identifiable assets at the date of acquisition of 1 February 2019 was CU115 million and CU125 million respectively.

- Company A remains a joint venture for Company XYZ after the acquisition.

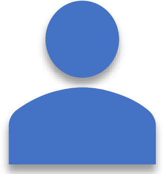
The fact pattern is not necessarily intended to be commercially realistic, and has been designed to demonstrate the differing accounting implications of View 1 versus View 2.

	Original stake (40%) CU million	Additional stake (5%) CU million
Cost of investment	500	70
Share of net assets, at fair value	400	125
Goodwill on acquisition	100	-
Excess of the Company XYZ's share of net assets of Company A over the cost of the investment	-	(55)

The accounting implications of View 1 vs. View 2

	Dr CU' million	Cr CU' million
On acquisition of the 40% stake		
Investment in JV	500	
Bank		500
The additional 5% stake		
View 1:		
Investment in JV	115	
Bank		70
Retained earnings		45
View 2		
Investment in JV	125	
Bank		70
Profit & Loss		55

- ❑ Is View 1 or View 2 more prevalent in your jurisdiction?
- ❑ Are you aware of any other approaches?



What Have We Heard …

- ❑ ***Accounting for Joint Venture*** ***(proportionate consolidation has its merits)***
- ❑ ***AD on IFRS 11***

Some have said …

IFRS11.24: A joint venturer shall recognise its interest in a joint venture as an investment and shall account for that investment using the equity method…

- **Proportionate consolidation has its merits, as allowed under IAS 31**
  - though the investor cannot 'control' what the JV can do, it certainly can 'control' what the JV cannot do, i.e. prohibit the JV from doing things investor does not want to be involved in.

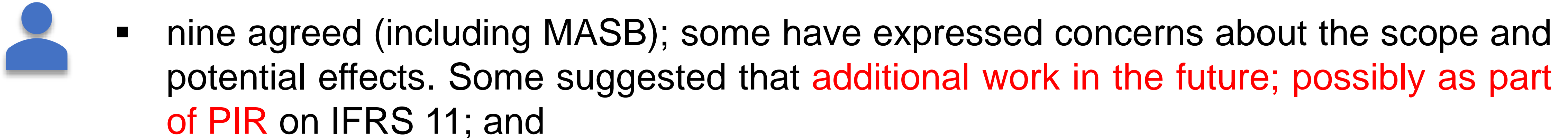
- **Equity accounting *'short-changed'* the investors P/L because revenue is excluded due to equity accounting.**
  - It is not uncommon for a project that is of such size that a company needs to JV with others to provide the necessary weight to carry out the job.

- **Impact on gearing calculation**
  - All big-ticket borrowings excluded from the group borrowings arising from equity accounting.

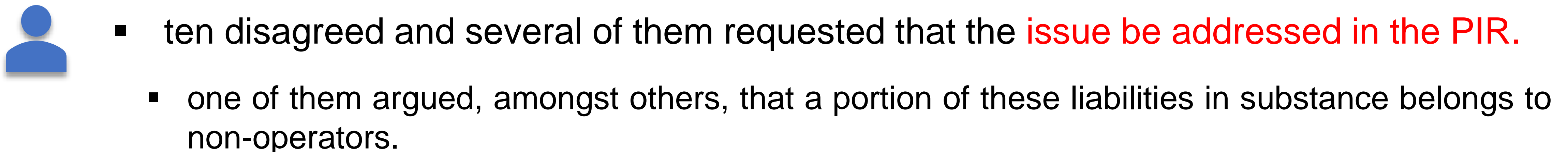
Agenda Decision: *Liabilities in relation to a Joint Operator's Interest in a Joint Operation*

- At the 2020 WSS Conference, a comment was raised on this AD – IFRS 11

- Of the 19 that responded, *(Extract from Agenda Paper 9 (March 2019),*



  - nine agreed (including MASB); some have expressed concerns about the scope and potential effects. Some suggested that additional work in the future; possibly as part of PIR on IFRS 11; and



  - ten disagreed and several of them requested that the issue be addressed in the PIR.
    - one of them argued, amongst others, that a portion of these liabilities in substance belongs to non-operators.

THANK YOU