STAFF PAPER

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IASB Meeting

Project	**Amendments to IFRS 3 and IFRS 11: Previously Held Interest**
Paper topic	Clarification of 'previously held interest'

CONTACT(S)	Kan Hara	khara@ifrs.org	+44 (0)20 7246 6968
	Takashi Yamagami	tyamagami@ifrs.org	+44 (0)20 7246 6937

Introduction

1. As outlined in Agenda Paper 12D, the IFRS Interpretations Committee (the Committee) discussed feedback on the proposed amendments to IFRS 3 *Business Combinations* and IFRS 11 *Joint Arrangements* at its March 2017 meeting. The Committee did not conclude on how an entity applies the remeasurement requirements in IFRS 3 to its previously held interest in a joint operation—for example, whether an entity remeasures only assets and liabilities previously recognised or its overall previously held interest. The Committee recommended that the International Accounting Standards Board (the Board) discuss this topic at a future meeting.

2. The purpose of this paper is to:

   (a) analyse how an entity remeasures its previously held interest when it obtains control of a business that is a joint operation (clarification of previously held interest); and

   (b) ask the Board if it agrees with our recommendation that an entity remeasures its overall previously held interest in the joint operation.

Structure

3. This paper is structured as follows:

   (a) background;

   (b) staff analysis;

   (c) staff recommendation; and

   (d) Appendix A—example.

Background

Summary of the proposed amendments to IFRS 3

4. The proposed amendments to IFRS 3 would clarify that when an entity obtains control of a business that is a joint operation, the entity applies the requirements for a business combination achieved in stages, including remeasuring its previously held interest in the joint operation at fair value.

Feedback related to the clarification of previously held interest

5. A few respondents suggested that the Board clarify whether an entity remeasures its overall interest in the joint operation[1] or only any previously recognised share of individual assets and liabilities relating to the joint operation. For example, one respondent suggested:

> …It be made clear, either by amending the wording of proposed paragraph 42A or by addition of an illustrative example, how the requirement to 'remeasure previously held interests in the joint operation' applies to a previously held interest accounted for by recognising shares of individual assets and liabilities (which may or may not be held via ownership of equity instruments) rather than (as for an associate, joint venture or financial asset accounted for under IFRS 9 or IAS 39) as a single asset.

[1] References to 'joint operation' throughout this paper refer to a business that is a joint operation.

Specifically, it is unclear whether it refers to remeasurement of the overall interest in the joint operation (i.e. including the value of any goodwill or unrecognised intangible assets) or only of previously recognised individual assets and liabilities. [Deloitte Touche Tohmatsu]

Discussion at the March 2017 Committee meeting

6. In response to these comments, we (the staff) initially recommended that the amendments clarify that an entity remeasures only assets and liabilities relating to the joint operation that it had previously recognised. Our analysis was included in paragraphs 37–40 of Agenda Paper 9 of the Committee's March 2017 meeting.

7. Some Committee members suggested we analyse this matter further. These members identified the following three possible views:

   (a) an entity remeasures assets and liabilities relating to the joint operation that it had previously recognised (View 1);

   (b) an entity remeasures all identifiable assets and liabilities in which it previously had an interest (View 2); or

   (c) an entity remeasures its overall previously held interest in the joint operation (View 3).

8. The following section discusses each of these views.

Staff analysis

Alternative views and implications

9. Appendix A to this paper presents an example in which two joint operators, Entity A and Entity B, have proportionate interests in the assets and liabilities relating to a joint operation. Entity A acquires all of Entity B's interest in the joint operation, which results in Entity A obtaining control of the joint operation. We will refer to this example throughout this section to illustrate the effects of applying each view.

10. In the example in Appendix A to this paper, Entity A pays CU90 to acquire all of Entity B's 50% interest in the joint operation. The consideration paid of CU90 comprises CU45 relating to the fair value of Entity B's interest in the assets and liabilities previously recognised by Entity A; CU20 relating to Entity B's interest in an unrecognised intangible asset; and CU25 relating to Entity B's interest in unrecognised goodwill.

View 1: remeasure only previously held interests in recognised assets and liabilities

11. Applying View 1, an entity remeasures only the individual assets that it had rights to, and liabilities that it had obligations for, relating to the joint operation that it had recognised immediately before it obtains control. Accordingly, the entity would not remeasure any previously held interests in unrecognised identifiable assets and liabilities, or unrecognised goodwill, relating to the joint operation.

12. Using the example in Appendix A to this paper, the fair value of Entity A's interests in the assets and liabilities relating to the joint operation that it had recognised before it obtains control is CU45 ((assets of CU270 less liabilities of CU180) X 50%).

13. Applying this view, Entity A would first recognise a remeasurement gain of CU20 (CU45 less CU25—carrying amount of Entity A's previously held interest in the joint operation). Entity A would not recognise any gain relating to its previously held interest in the unrecognised intangible asset (CU20) or its previously held interest in unrecognised goodwill (CU25). The result is that Entity A recognises goodwill of CU5 on obtaining control of the joint operation.

View 2: remeasure previously held interests in all identifiable assets and liabilities

14. Applying View 2, an entity remeasures all identifiable assets that it had rights to, and liabilities that it had obligations for, relating to the joint operation immediately before it obtains control. The entity remeasures its previously held interests in all identifiable assets and liabilities, regardless of whether it recognised those assets and liabilities in its financial statements before obtaining control of the joint operation.

15. Using the example in Appendix A to this paper, the fair value of Entity A's previously held interests in all identifiable assets and liabilities (including its interest in the unrecognised intangible asset) is CU65 ((assets of CU310 less liabilities of CU180) X 50%).

16. Applying this view, Entity A would first recognise a remeasurement gain of CU40 (CU65 less CU25—carrying amount of Entity A's previously held interest in the joint operation). Entity A would not recognise any gain relating to its previously held interest in unrecognised goodwill (CU25). The result is that Entity A recognises goodwill of CU25 on obtaining control of the joint operation.

View 3: remeasure overall previously held interest in the joint operation

17. Applying View 3, an entity remeasures its overall previously held interest in the joint operation. Accordingly, the entity would remeasure:
    (a) its previously held interests in any recognised assets and liabilities relating to the joint operation;
    (b) its previously held interests in any unrecognised identifiable assets and liabilities relating to the joint operation; and
    (c) its previously held interest in any unrecognised goodwill relating to the joint operation.

18. Using the example in Appendix A to this paper, the fair value of Entity A's overall previously held interest in the joint operation is CU90 (fair value of the joint operation of CU180 X 50%).

19. Applying this view, the entity would first recognise a remeasurement gain of CU65 (CU90 less CU25—carrying amount of Entity A's previously held interest in the joint operation). The result is that Entity A recognises goodwill of CU50 on obtaining control of the joint operation.

Applying existing requirements

A business combination achieved in stages

20. Paragraph 42 of IFRS 3 states (emphasis added):

> 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*.

21. Paragraph BC384 of IFRS 3 explains the Board's rationale for requiring an entity to remeasure any previously held equity interests at fair value in a business combination achieved in stages:

> …The boards concluded that a change from holding a non-controlling investment in an entity to obtaining control of that entity is a significant change in the nature of and economic circumstances surrounding that investment. That change warrants a change in the classification and measurement of that investment. Once it obtains control, the acquirer is no longer the owner of a non-controlling investment asset in the acquiree. As in present practice, the acquirer ceases its accounting for an investment asset and begins reporting in its financial statements the underlying assets, liabilities and results of operations of the acquiree.…

22. Paragraph BC389 of IFRS 3 explains the Board's rationale for recognising in profit or loss a gain or loss arising from remeasuring its previously held equity interests:

> …In a business combination achieved in stages, the acquirer derecognises its investment asset in an entity in its consolidated financial statements when it achieves control. Thus, the boards concluded that it is appropriate to recognise any resulting gain or loss in profit or loss at the acquisition date.

23. Accordingly, IFRS 3 views a business combination achieved in stages as a two-step transaction in which an entity first disposes of any previously held interest and subsequently obtains control. Applying these requirements, an entity in effect assumes that it disposes of its previously held interest at fair value and then obtains control.

24. Appendix A of IFRS 3 defines fair value as follows:

> *Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See IFRS 13.)

25. We think View 3 (ie remeasuring the overall previously held interest in a joint operation) is consistent with the two-step approach in IFRS 3 that requires an entity to assume a disposal of any previously held interest. This is because it results in the entity recognising a gain or loss on remeasurement that is consistent with the gain or loss that it would recognise if it were to dispose of its interest in the joint operation in an orderly transaction between market participants. The price an entity would be expected to receive on disposing of its interest in a joint operation would be determined based on its overall interest in the joint operation.

Why we think View 1 and View 2 are not appropriate

26. As discussed earlier (see paragraphs 11—13 of this paper), applying View 1 (remeasuring only previously held interests in recognised assets and liabilities), an entity does not recognise any remeasurement gain or loss on its previously held interests in any unrecognised identifiable assets and liabilities. Instead, the entity offsets any such gain or loss against any goodwill or bargain purchase that arises on obtaining control of the joint operation.

27. Similarly, applying either View 1 (remeasuring only previously held interests in recognised assets and liabilities) or View 2 (remeasuring previously held interests in all identifiable assets and liabilities), the entity does not recognise any remeasurement gain or loss on its previous interest in any unrecognised goodwill relating to the joint operation. This results in the entity recognising goodwill on obtaining control of the joint operation only to the extent of other parties' interests in the joint operation. If the joint arrangement were a joint venture rather than a joint operation, on obtaining control, the entity would recognise the total goodwill relating to the joint venture and not only to the extent of other parties' interests. This is because the entity would remeasure its overall previously held equity interest in the joint venture, which would also include its interest in any unrecognised goodwill relating to the joint venture. We do not see a basis to conclude that the structure of the joint arrangement (ie as a joint operation or joint venture) before the transaction should result in the entity recognising and measuring goodwill at different amounts on obtaining control of the joint arrangement.

Would View 3 result in additional costs for entities?

28. As outlined above, we think that View 3 (remeasuring the overall previously held interest in the joint operation) is consistent with existing requirements in IFRS 3. However, we considered whether applying this view could result in additional costs for entities when determining fair value—in particular, whether entities would be required to undertake additional fair value calculations only for the purpose of applying the remeasurement requirements.

29. When an entity acquires a business, it is generally required to recognise and measure all identifiable assets and liabilities at their fair value. Accordingly, the entity will be required to determine fair value for each identifiable asset and liability (subject to some exceptions in IFRS 3). Because of this, we expect an entity to be able to remeasure either its previously held interests in the recognised assets and liabilities (View 1) or its previously held interests in all the identifiable assets and liabilities (View 2) without incurring significant additional costs.

30. If an entity has a proportionate interest in all the assets and liabilities relating to the joint operation, we think it would also be able to remeasure its overall previously held

interest in the joint operation (View 3) without incurring significant additional costs. This is because the entity could use the price it has paid for other parties' interests as a basis for determining the fair value of its overall previously held interest in the joint operation. For example, in the example in Appendix A, Entity A could use CU90 paid for Entity B's 50% interest in the joint operation as the basis for determining the fair value of its previously held interest in the joint operation.

31. If an entity's previously held interest in a joint operation did not represent a proportionate share of all the assets and liabilities, it is possible that the entity may not be able to readily determine the fair value of its overall previously held interest. In this situation, View 3 might require the entity to separately determine that fair value only to apply the remeasurement requirements.

32. Based on our experience and informal discussions with some stakeholders, we understand that such situations (ie situations in which entities do not share proportionately in all the assets and liabilities of a business that is a joint operation) are rare in practice. We also think that when an entity obtains control of a joint operation, it would be interested in understanding the value of the entire business. Accordingly, we would expect the entity to be able to determine the fair value of its overall previously held interest in the joint operation without incurring significant additional costs.

Staff recommendation

33. Based on our analysis, we recommend that the Board clarify that an entity remeasures its overall previously held interest in a business that is a joint operation when it obtains control of that joint operation.

Question for the Board
Does the Board agree with the staff recommendation to clarify that an entity remeasures its overall previously held interest in a business that is a joint operation when it obtains control of that joint operation?

Appendix A—example

Assumptions

A1. Entity A (joint operator) has a 50% interest in the assets and liabilities relating to Entity C, a joint operation. Entity B, the other joint operator, also has a 50% interest in the assets and liabilities relating to Entity C. Entity C's balance sheet is as follows (in CUs):

Assets		**Liabilities and equity**	
Building No. 1	120	Accounts payable	120
Building No. 2	100	Other liabilities	50
		Equity	50
Total assets	**220**	**Total liabilities and equity**	**220**

A2. The fair value of the entire joint operation is CU180, which comprises (in CUs):

Building No.1	150
Building No.2	120
Unrecognised intangible assets	40
Total identifiable assets	*310*
Accounts payable	(120)
Other liabilities	(60)
Total identifiable liabilities	*(180)*
Unrecognised goodwill	50
Fair value	**180**

A3. Entity A acquires Entity B’s 50% interest, which results in Entity A obtaining control of Entity C (100% interest). Entity A pays cash of CU 90 to acquire Entity B’s interest.

A4. The carrying amount (CA) and fair value (FV) of assets and liabilities relating to Entity C of which Entity A already had an interest (ie 50%) are as follows (in CUs):

Assets	**CA**	**FV**	**Liabilities and equity**	**CA**	**FV**
Building No. 1	60	75	Accounts payable	60	60
Building No. 2	50	60	Other liabilities	25	30
Unrecognised intangible assets	-	20	Equity	25	90
Unrecognised goodwill	-	25			
Total assets	**110**	**180**	**Total liabilities and equity**	**110**	**180**

Applying the alternative views

A5. The following paragraphs present the entries Entity A would record when it obtains control of the joint operation applying each view.

View 1: remeasure previously held interests in recognised assets and liabilities

(Remeasurement of previously held interest—in CUs)

Dr. Net assets - 50%	20		
Cr. Remeasurement gain		20	***1**

(Business combination accounting—in CUs)

Dr. Identifiable assets - 100%	310		
Dr. Goodwill	5 ***2**		
Cr. Identifiable liabilities - 100%		180	
Cr. Derecognised net assets - 50%		45	*(CA of 25 plus gain of CU20)*
Cr. Cash		90	

***1:**	**CA**	**FV**	**Gain**
Build. No.1	60	75	15
Build. No.2	50	60	10
Accounts payable	(60)	(60)	-
Other liabilities	(25)	(30)	(5)
Total	**25**	**45**	**20**

***2:** Calculated as the residual amount applying paragraph 32 of IFRS 3

View 2: remeasure previously held interests in all identifiable assets and liabilities

(Remeasurement of previously held interest—in CUs)

Dr. Net assets - 50%	40		
Cr. Remeasurment gain		40	***3**

(Business combination accounting—in CUs)

Dr. Identifiable assets - 100%	310		
Dr. Goodwill	25 ***4**		
Cr. Identifiable liabilities - 100%		180	
Cr. Derecognised net assets - 50%		65	*(CA of 25 plus gain of CU40)*
Cr. Cash		90	

***3:**	**CA**	**FV**	**Gain**
Build. No.1	60	75	15
Build. No.2	50	60	10
Intangible assets	-	20	20
Accounts payable	(60)	(60)	-
Other liabilities	(25)	(30)	(5)
Total	**25**	**65**	**40**

***4:** Calculated as the residual amount applying paragraph 32 of IFRS 3

View 3: remeasure overall previously held interest in the joint operation

(Remeasurement of previously held interest—in CUs)

Dr. Net assets - 50%	65		
Cr. Remeasurment gain		65	***5**

(Business combination accounting—in CUs)

Dr. Identifiable assets - 100%	310		
Dr. Goodwill	50 ***6**		
Cr. Identifiable liabilities - 100%		180	
Cr. Derecognised net assets - 50%		90	*(CA of 25 plus gain of CU65)*
Cr. Cash		90	

***5:**	**CA**	**FV**	**Gain**
Overall interest in the JO	25	90	65

***6:** Calculated as the residual amount applying paragraph 32 of IFRS 3