Agenda ref **05C**

STAFF PAPER

September 2015

IFRS Interpretations Committee Meeting

Project	**IFRS 11 *Joint Arrangements***
Paper topic	Remeasurement of previously held interests – Change of interests' transaction resulting in an acquisition of joint control

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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;

   (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 (hereafter referred to as a 'change of interests' transaction').

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 remeasurement of previously held interests. It also identifies some general 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 for the transaction described in paragraph 2(c) (ie a change of interests' transaction). 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. Paragraph 21A of IFRS 11 *Joint Arrangements* requires an entity to apply '… all of the principles on business combinations accounting in IFRS 3, and other IFRSs, that do not conflict with the guidance in this IFRS …' upon acquisition of an interest in a joint operation that meets the definition of a business in accordance with IFRS 3 *Business Combinations*.

7. The submitter described a scenario in which:

   (a) an entity participates in, but does not have joint control of, a joint operation that meets the definition of a business in accordance with IFRS 3.

   (b) 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 output by the joint operation, assets held jointly and expenses and liabilities incurred jointly.

   (c) at a later date, 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).

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

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

9. The submitter identified the following two divergent views that are developing in practice:

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

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

10. While the issue has primarily arisen within the context of change of interests' in a business (as defined in IFRS 3), 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 original interest is remeasured

11. 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.

12. In addition, proponents of this view 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).

View 2—the entity's original interest is not remeasured

13. 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.

14. 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.

15. Paragraph B33A(d) of IFRS 11 requires the recognition of goodwill at 'the excess of the consideration transferred over the net of … assets acquired and the liabilities assumed'. Proponents of this view argue that because no consideration has been transferred in respect of the previous interest, the recognition of additional goodwill in respect of this holding is not appropriate.

Staff analysis

Determining the appropriate accounting treatment for transactions involving a business

16. This section presents our analysis of the appropriate accounting treatment for a change of interests transaction in which the asset, or group of assets, meets 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.

17. 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 change of interests transaction represent a significant economic event?

18. 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 in its financial statements the underlying assets, liabilities and results of the operations of the acquiree; 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.

19. We understand that paragraph BC384 of IFRS 3 analyses the acquisition of control over investments that were either accounted for using the equity method (ie associates or joint ventures/jointly controlled entities) or as financial assets within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments*.

20. On the basis of the analysis above, we think 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 or IFRS 9.

21. This is because we understand that the entity, in the fact pattern submitted, 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. Subsequent to the transaction, the investor continues to have rights to the assets, and obligations for the liabilities relating to the joint operation.

22. Prior to the transaction, the entity would have applied the requirements of paragraph 23 of IFRS 11 to account for its interest in the joint operation. Paragraph 23 of IFRS 11 requires such an entity to account for its interest in the arrangement in accordance with paragraphs 20-22. Paragraphs 20-22 describe the accounting to be applied by a joint operator in preparing its financial statements.

23. Subsequent to the transaction, the entity would continue to apply the requirements of paragraphs 20-22 of IFRS 11 in accounting for its interest in the joint operation.

24. As a consequence of this, there is no change in the method of accounting for the entity's original interest.

25. In our view, this transaction is, therefore, more analogous to a transaction that results in an investment in an associate becoming an investment in a joint venture rather than being an event that warrants remeasurement, such as obtaining control.

26. Paragraph 24 of IAS 28 specifies the accounting treatment to be applied to such transactions and states that '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 <u>does not remeasure</u> the retained interest.' (emphasis added)

27. 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.'

28. Paragraph BC30 further goes on to state:

> '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 (i.e. the joint venture and the associate) continue to be measured using the equity method. Considering that there

> is <u>neither a change in the group boundaries nor a change in the measurement requirements</u>, 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.' (emphasis added).

29. On the basis of the conclusion reached in IAS 28, we think that a similar rationale should be applied 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.

30. We think that the change of interests transaction does not represent a significant economic event. Accordingly, we think that the previously held interests should not be remeasured.

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

31. 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.

32. We think that not requiring remeasurement of previously held interests is consistent with the requirements of IFRS 11, which require an entity to account for the assets and liabilities relating to its interests in a joint operation in accordance with the applicable IFRSs.

33. We also think that prohibiting remeasurement of the entity's original interest results in a less complex application of the accounting requirements for such transactions.

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

34. 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.

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 do not think the structure of the joint operation affects the analysis of the appropriate accounting treatment for previously held interests.

Other considerations—analysing the requirements of IFRS 11

37. The submitter notes 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…' include the remeasurement requirements of paragraph 42 of IFRS 3.

38. In addition, proponents of this view 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).

39. We agree with the submitter that the wording in the paragraphs described above, while not explicitly addressing the transaction, could be interpreted by some as requiring (or permitting) a remeasurement of the entity's original interest.

40. The above-referenced paragraphs (paragraphs 21A, B33C and BC45M of IFRS 11) were added to IFRS 11 as part of the amendments issued in May 2014 in order to address the accounting for acquisitions of interests in joint operations.

41. 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.'

42. In order to address this, the IASB clarified 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*. We think that the amendments should not be read as implying that previously held interests should (or are permitted to) be remeasured when an entity obtains joint control.

Conclusion

43. On the basis of this analysis, it is our view that previously held interests should not be remeasured (ie View 1) in a change of interests transaction involving a business that results in a party to a joint operation obtaining joint control of the joint operation involving a business. We think the transaction does not result in a significant economic event.

44. We acknowledge that the wording in IFRS 11 could provide a technical basis for permitting/requiring remeasurement of previously held interests. 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

45. We have assessed this issue against the agenda criteria of the current *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 previous outreach, 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.

Paragraph 5.16 states that the Interpretations Committee should address issues:	Agenda criteria satisfied?
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 11.
In addition:	
Can the Interpretations Committee address this issue in an efficient manner (paragraph 5.17)?	**Yes**. We think 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

46. On the basis of our assessment of the agenda criteria, and our analysis in this paper, we think that the issue should be addressed.

47. On the basis of our analysis, we think that <u>previously held interests should not be remeasured.</u>

48. We recommend including additional guidance in Appendix B of IFRS 11 to clarify that previously held interests in a joint operation should not be remeasured in the transaction. We think the amendment meets the criteria for an annual improvement and have provided an assessment 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 21A, B33C and BC45M of IFRS 11 could provide a technical basis for requiring (or permitting) remeasurement of an entity's original interest in the transaction. We do 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.** 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 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.** We think that the proposed amendment is not so fundamental that the IASB will have to meet several times to conclude.

Transition provisions

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

First-time adopters

50. Appendix C of IFRS 1 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.’

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

Consequential amendments

52. 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

53. The proposed amendment to the application guidance in Appendix B of IFRS 11 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

54. The IASB recently proposed some amendments to address the accounting for acquisition of interests in a joint operation. In developing its proposals, the IASB noted the following:

> … the IASB noted that the fact patterns raised with the Interpretations Committee were limited to circumstances involving a business, as defined in IFRS 3. The IASB noted that IFRS already provides guidance for the acquisition of an interest in an asset or a group of assets that is not a business, as defined in IFRS 3. Consequently, the amendments apply only when an entity acquires an interest in a joint operation in which the activity constitutes a business, as defined in IFRS 3, either on formation of that joint operation or when acquiring an interest in an existing joint operation.

55. 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. On this basis, we are not aware of significant diversity in practice and do not think the Interpretations Committee should 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 conclusion that previously held interests should not be remeasured in a change of interests transaction in a joint operation that meets the definition of a business?
2. Does the Interpretations Committee agree with the staff's recommendation to add this issue to its agenda for annual improvements?
3. Does the Interpretations Committee agree with the staff's recommendation to provide additional guidance in Appendix B of IFRS 11 as shown in **Appendix A** of this paper?
4. Does the Interpretations Committee agree with the staff's recommendation that change of interests transaction in 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 11 **Joint Arrangements**

Paragraph B33C has been amended. New text is underlined and deleted text is struck through.

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

Effective date

C1AA *Annual Improvements to IFRSs [2015-2017] Cycle* issued in [date] amended paragraph B33C. 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.