IFRS

STAFF PAPER

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Project	**Acquisition of a group of assets**		
Paper topic	Initial consideration		
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This paper has been prepared for discussion at a public meeting of the IFRS Interpretations Committee (the Committee). Comments on the application of IFRS Standards do not purport to set out acceptable or unacceptable application of IFRS Standards—only the Committee or the International Accounting Standards Board (the Board) can make such a determination. Decisions made by the Committee are reported in IFRIC® *Update*. The approval of a final Interpretation by the Board is reported in IASB® *Update*.

Introduction

1. The IFRS Interpretations Committee (the Committee) received a request to clarify the accounting for the acquisition of a group of assets[1] that does not constitute a business. In the fact pattern in the submission, the group of assets acquired includes financial instruments and non-financial items.

2. This paper:

    (a) provides a summary of the request;

    (b) presents a summary of outreach and the staff analysis on the matter; and

    (c) asks the Committee whether it agrees with the staff recommendation not to add the matter to its standard-setting agenda.

[1] Paragraph 2(b) of IFRS 3 uses the term 'group of assets' but then specifies that an entity identifies and recognises the individual identifiable assets acquired and liabilities assumed. It can therefore be concluded that the term 'group of assets' in paragraph 2(b) of IFRS 3 means a group of assets and liabilities that does not constitute a business. Consistent with this meaning, when we use the term 'group of assets' or 'acquired group' in this paper, we mean a group of assets and liabilities.

Structure of the paper

3. This paper includes:

   (a) background information;

   (b) summary of outreach;

   (c) staff analysis; and

   (d) staff recommendation.

4. There are two appendices to the paper:

   (a) Appendix A—proposed wording of the tentative agenda decision; and

   (b) Appendix B—the submission.

Background information

5. The submission describes a scenario in which an entity acquires a group of assets that includes both financial instruments and non-financial items. The group of assets does not meet the definition of a business applying IFRS 3 *Business Combinations*. The transaction price represents the fair value of the group of assets, but differs from the sum of the individual fair values of the identifiable assets acquired and liabilities assumed within the acquired group. The entity has concluded that there are no other identifiable assets or liabilities that might explain the difference between the transaction price of the group and the sum of fair values of the individual assets and liabilities. The submission does not mention transaction costs, so for simplicity throughout this paper we have assumed that transaction costs are zero.

6. Paragraph 2(b) of IFRS 3 says that IFRS 3 excludes from its scope the acquisition of an asset or a group of assets that does not constitute a business. Instead, for such acquisitions, paragraph 2(b) of IFRS 3 requires the following:

   > … 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.

7. Paragraph 5.1.1 of IFRS 9 *Financial Instruments* requires the following with regard to the initial measurement of financial instruments:

> Except for trade receivables …, at initial recognition, an entity shall measure a financial asset or financial liability at its fair value …

8. Paragraph B5.1.1 of IFRS 9 includes requirements on how to determine the fair value at initial recognition:

> The fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also paragraph B5.1.2A and IFRS 13) …

9. Paragraph B5.1.2A of IFRS 9 specifies what to do if the fair value of a financial instrument differs from the transaction price at initial recognition:

> The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also IFRS 13). If an entity determines that the fair value at initial recognition differs from the transaction price as mentioned in paragraph 5.1.1A, the entity shall account for that instrument at that date as follows:
>
> (a) at the measurement required by paragraph 5.1.1 if that fair value is evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) or based on a valuation technique that uses only data from observable markets. An entity shall recognise the difference between the fair value at initial recognition and the transaction price as a gain or loss.

(b) in all other cases, at the measurement required by paragraph 5.1.1, adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability.

10. The submitter thinks there is a potential conflict between the requirements in IFRS 3 and those in IFRS 9[2] in the scenario described in the submission (refer to paragraph 5 of this paper). In the submitter's view:

    (a) IFRS 9 generally requires an entity to initially measure a financial instrument at fair value; whereas

    (b) IFRS 3 requires an entity to initially measure a financial instrument acquired as part of a group of assets at cost, based on the relative fair values of the identifiable assets acquired and liabilities assumed at the date of the acquisition.

11. The submitter asked the Committee to clarify which Standard takes precedence in this scenario, and has identified three possible views in the submission:

    (a) **View 1:** IFRS 3 and IFRS 9 both apply.

    (b) **View 2:** IFRS 9 takes precedence but only for financial instruments whose fair value meets the observability conditions in paragraph B5.1.2A(a) of IFRS 9.

    (c) **View 3:** IFRS 9 takes precedence for all financial instruments.

12. The submission also suggests a fourth view, which says that different approaches might be appropriate depending on the specific facts and circumstances.

[2] Throughout this paper for simplicity, we refer only to the initial measurements requirements in IFRS 9. However, because those requirements were largely carried forward from IAS 39 *Financial Instruments: Recognition and Measurement*, this matter is no different when an entity applies IAS 39 to financial instruments than when IFRS 9 is applied.

13. Applying View 1, as a first step, an entity applies IFRS 3 to allocate the transaction price to each identifiable asset and liability in the acquired group, including each identifiable financial instrument, based on its relative fair value. As a second step, the entity initially measures each financial instrument applying paragraph 5.1.1 of IFRS 9. If the allocated transaction price differs from the fair value of a financial instrument acquired as part of the group of assets, the entity applies paragraph B5.1.2A of IFRS 9:
    (a) if the fair value of the financial instrument meets the observability conditions in paragraph B5.1.2A(a), the entity measures the instrument at fair value, and recognises a gain or loss on initial recognition.
    (b) otherwise, the entity measures the instrument at fair value, adjusted to defer any difference between the allocated transaction price and fair value.
14. Applying View 2, as a first step an entity measures each financial instrument whose fair value meets the observability conditions in paragraph B5.1.2A(a) of IFRS 9 at fair value. As a second step, the entity allocates the residual transaction price to the remaining identifiable financial instruments and non-financial assets and liabilities based on their relative fair values. Applying this approach, the submitter says an entity does not recognise any day 1 gain or loss on initial recognition of the financial instruments.
15. Applying View 3, firstly an entity measures every financial instrument at fair value, and secondly allocates the residual transaction price to the remaining identifiable non-financial assets and liabilities based on their relative fair values. The submitter says this approach also does not result in the recognition of a day 1 gain or loss on initial recognition of the financial instruments.
16. We have reproduced the submission in Appendix B to this paper.

Summary of outreach

17. To gather information about the transaction described in the submission, we sent requests to securities regulators, members of the International Forum of Accounting Standard-Setters (IFASS) and the large accounting firms.

18. The request asked those participating to provide information, based on their experience, of the prevalence of the transaction, and the predominant and any other accounting treatment observed in practice.

19. We received 13 responses—five from national standard-setters, two from organisations representing groups of regulators and six from the large accounting firms. The views received represent informal opinions and do not reflect the official views of those respondents or their organisations.

Prevalence

20. About half of respondents said the transaction was not uncommon or occurred reasonably regularly, whereas the other half said it was not prevalent or relatively rare. One respondent said any difference between the transaction price and the sum of the fair values of the assets and liabilities acquired is often not material in asset acquisitions.

21. Jurisdictions in which the transaction is not uncommon include Australia, Canada, France, Hong Kong and Norway. Jurisdictions in which the transaction is not prevalent or relatively rare include Germany, Belgium and Japan.

22. Five respondents said the transaction occurred most commonly in the real estate industry. Two referred to single-asset investment property entities with corresponding bank financing, cash balances and rent receivables. Some respondents said similar transactions occur in the mining industry, and a few mentioned the pharma, biotech, oil and gas, and media industries. One respondent said, for such transactions, the financial instruments acquired are often a small proportion of the acquired group.

23. Respondents said the transaction might arise more frequently in the future if the International Accounting Standards Board (the Board) finalises its proposed

amendment to the definition of a business in IFRS 3. This is because some transactions that constitute the acquisition of a business applying the existing definition are likely to constitute the acquisition of a group of assets applying the proposed definition.

Accounting treatment observed and related comments

24. Respondents had observed both View 1 and View 3 in practice—a majority of those commenting on the accounting treatment indicated that View 3 is the predominant accounting treatment observed in practice. Only one respondent said it had observed the application of View 2.

25. One respondent indicated that the accounting treatment depends in part on the reason why the transaction price is different from the sum of the fair values of the assets and liabilities within the acquired group—for example, if the difference arises because of estimation uncertainty, thus indicating that the entity might need to reassess the fair values of the identifiable assets and liabilities, or because of an underlying economic reason.

26. One respondent said a similar question arises when a group of non-financial assets and liabilities contains a deferred tax asset that arises from the carryforward of unused tax losses. The initial measurement requirements in IAS 12 *Income Taxes* for such deferred tax assets are different from measuring the asset at cost, based on the relative fair values of the identifiable assets and liabilities within the acquired group.

Staff Analysis

What do the requirements in paragraph 2(b) of IFRS 3 say?

27. The submission says there is a potential conflict between the requirements in paragraph 2(b) of IFRS 3 and the initial measurement requirements in other Standards (such as IFRS 9). That potential conflict exists if paragraph 2(b) of IFRS 3 is read to provide initial measurement requirements. In that case, for the acquisition of a group of assets that does not constitute a business, there would be initial measurement

requirements in both IFRS 3 and other Standards for the identifiable assets and liabilities in the acquired group. Those respective initial measurement requirements may not be the same.

28. In our view, there is no conflict. This is because paragraph 2(b) of IFRS 3 does not provide initial measurement requirements. Paragraph 2(b) requires an entity to do two things regarding the acquisition of a group of assets:

    (a) To identify the assets acquired and liabilities assumed, which it recognises on the date of the acquisition. Paragraph 2(b) of IFRS 3 says: 'the acquirer shall identify and recognise the individual identifiable assets acquired…and liabilities assumed'.

    (b) To determine the individual transaction price for each identifiable asset and liability within the acquired group by allocating the cost based on the relative fair values of those assets and liabilities. Paragraph 2(b) of IFRS 3 says: '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'.

29. Having applied the requirements in paragraph 2(b) of IFRS 3 to identify the assets and liabilities and determine an individual transaction price for each, an entity would then apply the initial measurement requirements in the applicable Standard.

30. Our view of paragraph 2(b) of IFRS 3 reflects the outcome of applying View 1 in the submission.

31. The submission describes a transaction for which the transaction price for the group of assets (which is the fair value of that group) is different from the sum of the fair values of the individual assets acquired and liabilities assumed. We would expect that if an entity initially identifies such a difference, it would first review the procedures it has used to determine the individual fair value of each asset and liability within the acquired group, in a similar manner to the acquisition of a business that initially appears to be a bargain purchase (paragraph 36 of IFRS 3). Having conducted such a review, that initial difference may not exist or may be smaller than initially anticipated.

32. The steps would be as follows:

Steps	Additional information about the steps
1. Identify the assets acquired and liabilities assumed to be recognised at the date of purchase (paragraph 2(b) of IFRS 3)	
2. Determine the individual transaction price for each identifiable asset and liability by allocating the cost of the group of assets based on their relative fair values (paragraph 2(b) of IFRS 3)	Fair value is as defined in IFRS 13 *Fair Value Measurement*. If there is any difference between the transaction price of the group and the sum of the fair values of the identifiable assets and liabilities, then review the procedures used to determine their fair values.
3. Apply the initial measurement requirements in the applicable Standard for each identifiable asset and liability	For example, IFRS 9 for financial instruments; IAS 40 *Investment Property* for investment property. If there is a difference between the individual transaction price and the amount at which the asset or liability is initially measured, recognise that difference applying the applicable Standard. For example, paragraph B5.1.2A of IFRS 9 specifies how to account for any such difference for financial instruments; paragraph 26 of IAS 41 *Agriculture* specifies how to account for any such difference for biological assets.

33. To illustrate, assume an entity acquires a group of assets (that does not constitute a business) for CU330. The group of assets includes financial and non-financial assets, but no liabilities. Although we would expect this to be unusual (see paragraph 54 for further discussion), for illustrative purposes assume that the transaction price for the group of CU330 is different from the sum of the individual fair values of the identifiable assets within the acquired group. The entity has reviewed the procedures it used to determine the individual fair values.

34. Step 1—the entity identifies the following assets acquired:

	Fair value
Property, plant and equipment (PPE)	CU100
Biological asset	CU200
Financial asset	CU50

35. Step 2—the entity determines the individual transaction price for each identifiable asset by allocating the cost of the group of assets based on the relative fair values of the identifiable assets:

	Transaction price	
PPE	CU94	(CU330 * CU100/CU350)
Biological asset	CU189	(CU330 * CU200/CU350)
Financial asset	CU47	(CU330 * CU50/CU350)

36. Step 3—the entity applies the initial measurement requirements in IAS 16 *Property, Plant and Equipment*, IAS 41 and IFRS 9 to the respective identifiable assets. IAS 16 specifies that an entity initially measures PPE at cost—thus the entity initially measures the PPE at CU94. The entity initially measures the biological asset and the financial asset at fair value. Because the transaction price of CU189 is different from the fair value of the biological asset (CU200), the entity recognises a gain on initial recognition of CU11 applying paragraph 26 of IAS 41. Because the transaction price of CU47 is different from the fair value of the financial asset (CU50), the entity applies paragraph B5.1.2A of IFRS 9 to account for the difference of CU3.

Consequences of the staff view

37. Applying the requirements in this way might result in an immediate gain or loss on initial recognition of identifiable assets and liabilities initially measured at an amount other than cost (as illustrated in the example above). Although some might suggest that this is inappropriate, we do not agree. A number of IFRS Standards require the recognition of a gain or loss on initial recognition in particular scenarios (such as IFRS 9 and IAS 41), or include requirements that might result in such recognition of a gain or loss on initial recognition or immediately thereafter.

Is there only one way to read the requirements in paragraph 2(b) of IFRS 3?

38. Paragraph 2(b) says: ‘The acquirer shall identify and recognise the individual identifiable assets acquired…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.’ If those requirements are read to require

an entity to initially measure the identifiable assets and liabilities at cost (based on allocating the cost of the group on a relative fair value basis), then there would be a potential conflict for any assets or liabilities initially measured at an amount other than cost applying applicable Standards. For example, in the transaction described in the submission, the group of assets acquired includes financial instruments, which an entity initially measures at fair value applying IFRS 9. The submission says the transaction is such that the cost allocation required by paragraph 2(b) (in this case, read as providing initial measurement requirements) would result in allocating an amount to each financial instrument that does not reflect its fair value. In that case, the entity might decide not to apply the requirements in paragraph 2(b), and instead apply the initial measurement requirements in IFRS 9. The entity would do so on the grounds that IFRS 9 provides the more specific requirements that apply to the initial measurement of financial instruments.

39. Accordingly, an alternative view of the requirements on the acquisition of a group of assets would be as follows:

(a) Step 1: An entity identifies the assets acquired and liabilities assumed within the acquired group, which it recognises on the date of the acquisition (paragraph 2(b) of IFRS 3).

(b) Step 2: For any identified asset or liability initially measured at an amount other than cost applying applicable Standards, the entity initially measures that asset or liability applying the Standard that specifies initial measurement requirements for the particular asset or liability. For example, IFRS 9 for financial instruments; IAS 41 for biological assets.

(c) Step 3: The entity deducts from the transaction price of the acquired group the amounts determined in Step 2 above. The entity then allocates the residual transaction price of the acquired group to the remaining identifiable assets and liabilities based on their relative fair values.

Applying this alternative view, an entity in effect assumes that the individual transaction price for any asset or liability initially measured at an amount other than

cost is the amount at which that asset or liability is initially measured applying the applicable Standard.

40. To illustrate the alternative view using the same example as outlined in paragraph 33, an entity acquires the following group of assets for CU330 (Step 1):

	Fair value
Property, plant and equipment (PPE)	CU100
Biological asset	CU200
Financial asset	CU50

41. Step 2—the entity initially measures the biological asset and financial asset at their respective fair values of CU200 and CU50.

42. Step 3—the entity then allocates the residual transaction price of the group of CU80 (CU330 transaction price less CU200 and CU50 determined in Step 2) to the PPE.

43. The requirements in paragraph 2(b) of IFRS 3 were carried forward largely unchanged when the Board amended IFRS 3 in 2008. Paragraph BC20 of IFRS 3 explains why the Board did not reconsider at that time how an entity accounts for the acquisition of a group of assets. However, there is no further explanation in the Basis for Conclusions on IFRS 3 as to the Board's intentions when it first developed those requirements in IFRS 3, as issued in 2004. Without such additional explanation or further (more detailed) requirements, we are unable to conclude that our view of the requirements in paragraph 2(b) of IFRS 3 (described in paragraphs 27-37 of this paper) is the only way that stakeholders might reasonably read those requirements. In other words, we can see how some might read the requirements in paragraph 2(b)—'identify and recognise the individual assets and liabilities…the cost of the group shall be allocated to the individual assets and liabilities'—to provide initial measurement requirements. If read in that way, then an entity might apply the initial measurement requirements within other Standards before applying the allocation requirements in paragraph 2(b) of IFRS 3 on the grounds that other Standards provide more specific requirements.

44. This alternative view reflects neither View 2 nor View 3 in the submission. Although both of those views suggest a similar approach to the alternative view, they treat financial instruments differently from all other assets and liabilities acquired as part of

a group of assets. We think there is no basis on which to read the requirements in a way that would treat financial instruments acquired as part of a group of assets differently from all other assets and liabilities initially measured at an amount other than cost. Nonetheless, if the transaction were such that financial instruments were the only identifiable assets and liabilities initially measured at an amount other than cost, the outcome of View 3 in the submission would be the same as that of the alternative view.

Consequences of the alternative view

45. To discuss the consequences of the alternative view, consider the following scenarios, which are derived from the example outlined in paragraph 33. These scenarios are again hypothetical, but have been used for illustrative purposes. The entity pays CU330 for the group of assets, and has reviewed the procedures it used to determine the individual fair values:

Identifiable assets within the acquired group	**Scenario A Fair value CU**	**Scenario B Fair value CU**
PPE	20	-
Biological asset	280	300
Financial asset	50	50
Sum of the fair values of the identifiable assets	**350**	**350**

46. Applying the alternative view, we think the outcomes would be as follows:

(a) In **Scenario A**, the entity would allocate the transaction price of CU330 to the identifiable assets and liabilities as follows: CU280 biological asset, CU50 financial asset and CU0 PPE.

(b) In **Scenario B**, the entity would be unable to strictly apply the steps outlined in paragraph 39 of this paper. The requirements in IAS 41 and IFRS 9 specify that an entity initially measures biological assets and financial instruments at fair value. However, in this scenario, the sum of the individual fair values of the biological asset and the financial asset acquired is CU350, whereas the entity paid only CU330 for the group of

assets. The entity would thus need to determine how to allocate the difference of (CU20) to those assets.

47. The scenarios illustrate that the alternative view might result in different approaches to the allocation of the transaction price, and consequently the initial measurement of some assets and liabilities in different scenarios. For example:

    (a) In **Scenario A**, the alternative view results in the entity assuming that the individual transaction price of the biological asset and the financial asset are their fair values, whereas the transaction price of the PPE is CU0, even though the PPE has a fair value of CU20.

    (b) In **Scenario B**, we would assume the entity would allocate the difference between the transaction price for the group (CU330) and the sum of the individual fair values of the biological asset and the financial asset to those assets. In doing so, the entity would *not* assume that the transaction price for the financial asset and the biological asset are their fair values, as it did in **Scenario A**. Depending on how that difference is allocated, the entity might recognise a gain on initial recognition of the acquired assets.

48. Consequently, it might be difficult to explain why, applying the alternative view:

    (a) the transaction price for some assets and liabilities are their fair values whereas the transaction price for others are not (**Scenario A**); and

    (b) the transaction price for, for example, financial instruments and biological assets are their fair values when the acquired group includes other assets initially measured at cost (**Scenario A**) whereas it is not their fair values when the acquired group includes only financial instruments and biological assets (**Scenario B**).

Question 1 for the Committee

1. Does the Committee agree with the staff analysis of the requirements in IFRS Standards on this matter as follows?
    a. When an entity acquires a group of assets that does not constitute a business, it:
        (i) identifies the individual identifiable assets acquired and liabilities assumed that it recognises at the date of the acquisition (as required by paragraph 2(b) of IFRS 3);
        (ii) determines the individual transaction price for each identifiable asset and liability within the acquired group of assets by allocating the cost of the group based on the relative fair values of those assets and liabilities (as required by paragraph 2(b) of IFRS 3); and then
        (iii) applies the initial measurement requirements in applicable Standards to each asset acquired and liability assumed. The entity accounts for any difference between the individual transaction price allocated and the amount at which the asset or liability is initially measured applying the applicable requirements.
    b. An entity might also interpret the requirements as specified in paragraph 39 of this paper.

Should the Committee add this matter to its standard-setting agenda?

49. We think that without additional requirements or explanation beyond those in paragraph 2(b) of IFRS 3, we cannot conclude that our view of how to account for the acquisition of a group of assets, outlined in paragraph 32 of this paper, is the only way that stakeholders might reasonably read the requirements. As a consequence, we would conclude that it is necessary to change IFRS 3 to address the matter, if it is expected to have a material effect on the amounts that entities report.

Is the matter widespread and expected to have a material effect on those affected?[3]

50. The outreach responses indicate that, although not common in all jurisdictions, transactions similar to the one in the submission occur in several jurisdictions around the world. We also agree with respondents to the outreach that, if the Board finalises its proposals on the definition of a business, the population of such transactions might increase. The outreach responses, however, do not indicate whether the differing accounting treatments that entities might apply would be expected to have a material effect on those affected.

When might the matter have a material effect?

51. There would be no difference in the amounts recognised applying either of the views discussed earlier in the paper in a number of scenarios as follows:

    (a) When the group of assets includes only assets and liabilities initially measured at cost applying the applicable Standards.

    (b) When the group of assets includes only assets and liabilities initially measured at cost or fair value, and there is no difference between the transaction price for the group of assets and the sum of the individual fair values of the identifiable assets and liabilities within the acquired group.

52. Consequently, the matter might have a material effect on those affected if:

    (a) there is a material difference between the transaction price for the group of assets and the sum of the individual fair values of the identifiable assets and liabilities within the group; or

    (b) there is a material difference between the transaction price allocated to an asset or liability that an entity initially measures at an amount other than cost or fair value (determined by allocating the transaction price for the group of assets on a relative fair value basis) and its initial measurement—

[3] Paragraph 5.16(a) of the *Due Process Handbook*.

for example, a deferred tax asset arising from the carryforward of unused tax losses.

53. At present, we do not have any evidence to suggest that the matter is expected to have a material effect on the amounts that entities report. We have asked the submitter for any such evidence that it has identified.

54. Assuming transactions between unrelated parties, we would expect it to be relatively infrequent that the transaction price for a group of assets would be materially different from the sum of the individual fair values of the identifiable assets and liabilities within the acquired group. As noted earlier in the paper, if an entity initially identifies such a difference, we would expect the entity to first review the procedures it has used to determine the individual fair values of each of the assets and liabilities within the group. Having conducted such a review, that initial difference may not exist or be smaller than initially anticipated.

Can the matter be resolved efficiently (is it sufficiently narrow in scope)?[4]

55. If the Committee were to undertake a standard-setting project on this matter, we would recommend a narrow-scope project to amend IFRS 3 to clarify the staff view of the existing requirements.

56. We would not recommend a project to clarify the alternative view of the existing requirements because, as discussed in paragraphs 45-48 of this paper, we think an entity could not apply the alternative view in the same way in all possible scenarios. Consequently, such a project would require additional work to identify the different scenarios that warrant a different way of allocating the transaction price. In our view, this is likely to lead to the need to consider more comprehensively the accounting for the acquisition of a group of assets, and how that compares to the accounting for the acquisition of a business. Such a project would not be sufficiently narrow in scope to be resolved efficiently.

57. An additional consideration regarding this matter is that US GAAP includes similar requirements to those in paragraph 2(b) of IFRS 3 (although the initial measurement

[4] Paragraphs 5.16(c) and 5.17 of the *Due Process Handbook*.

requirements for individual assets and liabilities in US GAAP is not always the same as those in IFRS Standards). We understand that a question similar to the one raised in the submission has not been raised with the Financial Accounting Standards Board (FASB). We note, however, that the FASB has a project on its agenda titled 'Improving the Accounting for Asset Acquisitions and Business Combinations (Phase 3 of the Definition of a Business Project)'. That project is at the initial deliberations stage, with the objective of discussing whether there are differences in the acquisition and derecognition requirements for assets and businesses that could be aligned.

Staff conclusion, having considered the Committee's agenda criteria

58. Having considered the agenda criteria in paragraphs 5.16-5.17 of the *Due Process Handbook* (as discussed above in paragraphs 49-57), we think that it is not clear that the matter is expected to have a material effect on the amounts that entities report. Without such evidence, we recommend that the Committee does not add the matter to its standard-setting agenda.

59. We could undertake further research to gather evidence to support a conclusion that the matter is expected to have a material effect on the amounts that entities report, however we are sceptical of its success. We think it is unlikely to be evident from publicly available information (a) how entities have accounted for the acquisition of a group of assets, and (b) whether there would have been a material difference in the amounts reported had those entities applied a different approach.

Staff recommendation

60. On the basis of our assessment of the Committee's agenda criteria, we recommend that the Committee does not add the matter to its standard-setting agenda, and instead publishes a tentative agenda decision. Appendix A to this paper outlines the proposed wording of the tentative agenda decision.

61. We propose that the tentative agenda decision:

(a) narrow the possible approaches applied when accounting for the acquisition of a group of assets to the staff view and the alternative view outlined in this paper; and

(b) explain that the Committee did not add the matter to its standard-setting agenda because it did not obtain evidence that the matter is expected to have a material effect on the amounts that entities report. This, thereby, provides stakeholders with the opportunity to provide us with such evidence in their responses to the tentative agenda decision.

Questions 2 and 3 for the Committee

2. Does the Committee agree with the staff recommendation not to add this issue to its standard-setting agenda?

3. Does the Committee have any comments on the proposed wording of the tentative agenda decision outlined in Appendix A to this paper?

Appendix A

Proposed wording of the tentative agenda decision

IFRS 3 ***Business Combinations*****—Acquisition of a group of assets that does not constitute a business**

The Committee received a request to clarify how an entity accounts for the acquisition of a group of assets that does not constitute a business (the group). More specifically, the submitter asked for clarity on how to allocate the transaction price to the identifiable assets acquired and liabilities assumed when (a) the sum of the individual fair values of the identifiable assets and liabilities is different from the transaction price, and (b) the group includes identifiable assets and liabilities initially measured both at cost and at an amount other than cost.

Paragraph 2(b) of IFRS 3 requires an entity to do the following on acquisition of a group pf assets:

a. identify and recognise the individual identifiable assets acquired and liabilities assumed; and
b. allocate the cost of the group to the individual identifiable assets and liabilities based on their relative fair values at the date of the acquisition.

Other IFRS Standards then include initial measurements requirements for particular assets and liabilities.

Accordingly, the Committee observed that an entity accounts for the acquisition of the group as follows:

a. it identifies the individual identifiable assets acquired and liabilities assumed that it recognises at the date of the acquisition;
b. it determines the individual transaction price for each identifiable asset and liability by allocating the cost of the group based on the relative fair values of those assets and liabilities at the date of the acquisition; and then
c. it applies the initial measurement requirements in applicable Standards to each identifiable asset acquired and liability assumed. The entity accounts for any difference between the amount at which the asset or liability is initially measured and its individual transaction price applying the applicable requirements.

If an entity initially considers that there might be a material difference between the transaction price for the group and the sum of the individual fair values of the identifiable assets and liabilities, the entity reviews the procedures it has used to determine those individual fair values to assess whether such a difference exists.

The Committee also discussed an alternative way to interpret the requirements in paragraph 2(b) of IFRS 3. Applying that alternative approach, for any identifiable asset or liability initially measured at an amount other than cost, an entity initially measures that asset or

liability at the amount specified in the applicable IFRS Standard. The entity then deducts from the transaction price of the group the amounts allocated to the assets and liabilities initially measured at an amount other than cost, and allocates the residual transaction price to the remaining identifiable assets and liabilities based on their relative fair values at the date of the acquisition.

The Committee concluded that the two interpretations outlined in this agenda decision are the only ways that the requirements for the acquisition of a group of assets could reasonably be read.

In the light of its analysis, the Committee considered whether to add a project on the acquisition of a group of assets to its standard-setting agenda. The Committee has not obtained evidence that the outcomes of applying the two interpretations outlined above would be expected to have a material effect on the amounts that entities report. Consequently, the Committee [decided] not to add this issue to its agenda.

Appendix B
Submission

B1. The submission is reproduced below.

Re: IFRIC Submission: IFRS 3 and IAS 39/IFRS 9: Transaction Price Allocation

We are enclosing our submission to the IFRS Interpretations Committee (IFRIC) to raise concerns on conflicting guidance between IFRS 3 *Business Combinations* and IAS 39 *Financial Instruments: Recognition and Measurement*. The relevant paragraphs referred to in IAS 39 that appear to create the conflict with IFRS 3 also exist in IFRS 9 *Financial Instruments;* therefore the issue is not resolved once IFRS 9 becomes effective[5].

The conflict arises in determining how the total transaction price should be allocated to individual assets and liabilities when:

- the group of assets acquired include both financial instruments and non-financial items and is not a business; and
- there is a difference in the sum of the fair values of the net identifiable assets acquired and consideration paid.

The issue arises because IFRS 3 indicates that the cost of the group of assets should be allocated to individual identifiable assets and liabilities based on their relative fair value. However, IAS 39/IFRS 9 generally require an initial measurement of individual financial instruments at fair value.

Our IFRS Discussion Group identified that there is significant diversity in views on how the transaction price should be allocated between financial and non-financial assets that are acquired as part of a bundle when a difference exists. We understand that these diverse views coupled with the conflicting guidance in the current standards, is resulting in significant diversity in practice globally. We think that this issue is sufficiently important that it needs to be addressed in the immediate future. As a result, resolution of this issue should not be delayed so that it can be dealt with at the same time as other potentially-related issues.

In addition, we think that this issue will not be resolved if the proposed amendments to the Definition of a Business in IFRS 3 are issued and become effective.

The Appendix to this letter, expands on our points above.

[5] Given that certain entities that will apply IFRS 4 *Insurance Contracts* will be eligible for a temporary exemption from applying IFRS 9, IAS 39 will continue to be applied after IFRS 9 becomes effective.

APPENDIX

IFRIC SUBMISSION

Issue

1. IFRS 3 *Business Combinations* provides specific guidance on how to allocate the cost when an entity acquires a group of assets that does not constitute a business. Paragraph 2(b) of IFRS 3 indicates that the cost of the group of assets should be allocated to the individual identifiable assets and liabilities on the basis of their relative fair values at the date of purchase.

2. However, a potential conflict arises when the group of assets acquired include financial instruments. Paragraph 43 of IAS 39 *Financial Instruments: Recognition and Measurement* and paragraph 5.1.1 of IFRS 9 *Financial Instruments* generally requires an entity to measure individual financial instruments at fair value. Paragraphs AG64 and AG76 of IAS 39 and paragraphs B5.1.1 and B5.1.2A of IFRS 9 also provide guidance on whether the difference between the transaction price and the fair value of the individual financial instruments at the date of acquisition should be recognized as an immediate gain or loss.

Fact Pattern

3. An entity acquires a group of assets, including both financial instruments and non-financial items that do not meet the definition of a business under IFRS 3. While the transaction price represents the fair value of the group of assets, there is a difference in the sum of the fair values of the net identifiable assets acquired and consideration paid. The entity has assessed that there are no other identifiable assets or liabilities causing the difference.

Views and Discussion

IFRS 3 and IAS 39/IFRS 9 both apply: The transaction price is allocated to all identifiable assets and liabilities acquired based on relative fair value and IAS 39/IFRS 9 is applied subsequently

4. Under this view, the entity should first follow IFRS 3 to allocate the transaction price to each of the identifiable assets and liabilities in the bundle based on relative fair value and then apply paragraph AG76 of IAS 39 or paragraph 5.1.2A in IFRS 9 to determine the fair value of each financial instrument. To the extent that a difference exists, a Day 1 gain or loss should be recognized if the fair value of the financial instrument meets the observability conditions in paragraph AG76(a) of IAS 39 or paragraph 5.1.2A(a) in IFRS 9.

5. Proponents of this view note that there are no initial measurement scope exceptions in IAS 39/IFRS 9 for financial instruments recognized in a bundled purchase.

IAS 39/IFRS 9 takes precedence

6. Proponents of this view note that IAS 39/IFRS 9 takes precedence over IFRS 3 because IAS 39/IFRS 9 contain the more specific guidance that pertains to the initial recognition and measurement of a financial asset or liability. Further, there is no scope exclusion in IAS 39/IFRS 9 for the initial measurement of financial assets or liabilities acquired as part of a bundle. There are two views on how to apply IAS 39/IFRS 9 first.

Measure those financial instruments whose fair value meets the observability conditions at fair value

7. Under this view, the entity should first measure at fair value only the financial instruments that have an observable fair value and then allocate the residual to the remaining identifiable assets based on relative fair value. This approach results in no Day 1 gain or loss recognition, pursuant to IAS 39/IFRS 9.

Measure all financial instruments at fair value.

8. Under this view, the entity should first measure all financial instruments at fair value and then allocate the residual to the remaining identifiable non-financial assets based on relative fair value. This approach results in no Day 1 gain or loss recognition.

Different views may be appropriate depending on facts and circumstances

9. Proponents of this view note that absent any specific guidance over which standard takes precedence, different interpretations are possible and may depend on the specific facts and circumstances.

Summary of views

10. Below is a summary of the different views on allocating the total transaction price:

Approach	First Step	Second Step	Result
IFRS 3 and IAS 39/IFRS 9 both apply	Allocate the transaction price based on relative fair value to all identifiable assets and liabilities	For the identifiable assets and liabilities that are financial instruments, apply paragraph AG76 of IAS 39 or B5.1.2A of IFRS 9 to determine whether fair value is equal to the transaction price, and how to account for the difference	Day 1 gain or loss would be recognized for differences between the allocated transaction price and fair value of the financial instruments that meets the observability conditions
IAS 39/IFRS 9 takes precedence	Measure, at fair value, only those financial instruments that meet the observability conditions in paragraph AG76 of IAS 39 or B5.1.2A of IFRS 9	Allocate the residual transaction price to the remaining identifiable assets and liabilities based on relative fair value	No Day 1 gain or loss would be recognized, pursuant to IAS 39/IFRS 9
	Measure all financial instruments at fair value		No Day 1 gain or loss would be recognized
Depends on facts and circumstances	Different views may be appropriate depending on facts and circumstances		

11. Our IFRS Discussion Group also considered two additional views:

    a) IAS 39/IFRS 9 takes precedence: measure those financial instruments subsequently measured at fair value; and

    b) IFRS 3 takes precedence.

    We have not included further details on these views because the Group agreed that both lacked technical merit as they do not reconcile to the initial measurement requirements of IAS 39/IFRS 9.

Reasons for IFRIC to address the issue

12. Below we have assessed this issue against the IFRIC agenda criteria:

Criteria	Assessment
1. Is the issue widespread and has, or is expected to have, a material effect on those affected?	The fact pattern described in paragraph 3 is common and the different accounting treatments can result in materially different results. We observe in the market place that differences between the transaction price and the fair value of the individual assets in a group created by control premiums are prevalent and frequent. We understand that there is currently diversity in practice globally, which could have a material effect on financial reporting outcomes, especially if the proposed amendments to the Definition of a Business are issued and become effective. We think that those proposed amendments will result in more transactions that do not meet the definition of a business.
2. Would financial reporting be improved through the elimination, or reduction, of diverse reporting methods?	Our IFRS Discussion Group identified this issue and we understand that, globally, diversity in practice currently exists as each of the four views outlined above have technical merit. We think that the existing guidance is insufficient to determine the appropriate accounting for how to allocate the transaction price between financial and non-financial assets that are acquired as part of a bundle when the group of assets does not meet the definition of a business.
3. Can the issue be resolved efficiently within the confines of IFRSs and the Conceptual Framework for Financial Reporting?	We think this issue can be resolved efficiently by addressing the conflicting guidance in IFRS 3 and IAS 39/IFRS 9.
4. Is the issue sufficiently narrow in scope that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process that would be required when making changes to IFRSs?	We think the issue is sufficiently narrow because it relates to specific application of IFRS 3 and IAS 39/IFRS 9.

Criteria	Assessment
5. Will the solution developed by the Interpretations Committee be effective for a reasonable time period? The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified.	There is no relevant IASB project currently that addresses this issue.