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Project	**IFRS IC Work in progress**
Paper topic	IFRS 11—*Acquisition of an Interest in a Joint Operation*

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Introduction

1. The IFRS Interpretations Committee (the Interpretations Committee) received a request to clarify the applicability of IFRS 3 *Business Combinations* by:

   (a) joint operators, for the acquisition of interests in joint operations as defined in IFRS 11 *Joint Arrangements* in circumstances in which the activity of the joint operation constitutes a business as defined in IFRS 3 (joint operations that are businesses); and

   (b) venturers, for the acquisition of interests in jointly controlled operations or assets as specified in IAS 31 *Interests in Joint Ventures* in circumstances in which the activity of the jointly controlled operations or assets, constitutes a business as defined in IFRS 3 (jointly controlled operations or assets that are businesses).

2. More specifically, the Interpretations Committee was asked whether the acquirer of such interests should apply the principles in IFRS 3 on initial recognition of the interest or whether the acquirer should instead account for it as the acquisition of a group of assets.

3. The Interpretations Committee discussed the request for clarification at its meetings in:

   (a) July 2011[1];

   (b) September 2011[2];

   (c) November 2011[3];

   (d) January 2012[4]; and

   (e) March 2012[5].

4. As a result of these discussions the Interpretations Committee developed a recommendation to the IASB, which is explained below.

Purpose of the paper

5. The purpose of the paper is to present the Interpretations Committee's recommendation to the IASB:

   (a) to develop new guidance in a limited-scope project on IFRS 11 on accounting for the acquisition of an interest in a joint operation as defined in IFRS 11, in circumstances in which the activity of the joint operation constitutes a business as defined in IFRS 3 (a joint operation that is a business) on the basis of the business combinations guidance in IFRS 3 and other IFRSs; and

   (b) that the Interpretations Committee should carry out specific work on behalf of the IASB.

[1] http://www.ifrs.org/NR/rdonlyres/C60A1E6E-5A25-40FE-84AD-09CFBE2C4CDF/0/091107ob09IFRS11Acquisitionofaninterestinajointarrangementfinal.pdf

[2] http://www.ifrs.org/NR/rdonlyres/CDE68649-5515-4241-B7F6-E8BD7092EF87/0/051109AP05AIPIFRS11Acquisitionofaninterestinajointarrangement.pdf

[3] http://www.ifrs.org/Meetings/Interpretations+Committee+Nov+11.htm

[4] http://www.ifrs.org/NR/rdonlyres/175FB7AD-C583-41B8-BFB1-0F5AD203F769/0/051201AP5IFRS11Acquisitionofaninterestinajointoperation.pdf

[5] http://www.ifrs.org/NR/rdonlyres/3CA160AC-20C9-4567-9F11-99015D5F7385/0/041203AP04IFRS11Acquisitionofaninterestinajointoperation.pdf

Structure of the paper

6. The paper will therefore:

   (a) summarise the background of that issue;

   (b) explain the diversity in practice observed by the Interpretations Committee;

   (c) set out the conclusions and recommendation of the Interpretations Committee;

   (d) propose a comment period; and

   (e) ask questions of the IASB.

Background of the issue

7. Neither IFRS 11 nor IAS 31 explicitly addresses the acquisition of interests in joint operations or jointly controlled operations or assets that are businesses.

IAS 31

8. A venturer in jointly controlled operations has to recognise in respect of its interests in jointly controlled operations the assets that it controls and the liabilities that it incurs (see paragraph 15 of IAS 31).

9. Paragraph 21 of IAS 31 requires a venturer of jointly controlled assets to recognise, among other things:

   (a) its share of jointly controlled assets, classified according to the nature of the assets;

   (b) any liabilities that it has incurred; and

   (c) its share of any liabilities that it has incurred jointly with the other venturers in relation to the joint venture.

10. Paragraph 22 of IAS 31 illustrates the requirement that the venturer must recognise its share of jointly controlled assets, classified according to the nature of the assets by giving an example: a share of a jointly controlled oil pipeline is classified as property, plant and equipment.

11. IAS 31 does not give further guidance on the accounting for assets and liabilities related to jointly controlled operations or jointly controlled assets; in particular, it gives no guidance on the acquisition of interests in jointly controlled operations or assets.

IFRS 11

12. Paragraph 20 of IFRS 11 requires a joint operator to recognise, in relation to its interest in a joint operation, among other things:

    (a) its assets, including its share of any assets held jointly; and

    (b) its liabilities, including its share of any liabilities incurred jointly.

13. In addition, paragraph 21 of IFRS 11 specifies that a joint operator shall account for these assets and liabilities in accordance with the IFRSs applicable to the particular assets and liabilities.

14. Just as in the case of IAS 31, IFRS 11 does not give further guidance on the accounting for assets and liabilities related to the joint operations; in particular, it gives no guidance on the acquisition of an interest in a joint operation.

15. Developing guidance on the acquisition of an interest in a joint operation was not within the scope of the project that led to IFRS 11.

Diversity in practice

Outreach results

16. The Interpretations Committee observed, on the basis of:

    (a) outreach to the International Forum of Accounting Standard-Setters (IFASS) and International Organization of Securities Commissions (IOSCO);

    (b) discussions with interested parties held by the staff; and

    (c) the Interpretations Committee members' own observations that this lack of explicit guidance has resulted in significant diversity in practice in accounting for acquisitions of interests in jointly controlled operations or assets that are businesses.

17. The principal approaches seen in practice are:

(a) **IFRS 3 approach:** some preparers of IFRS financial statements, when accounting for the purchase of interests in jointly controlled operations or assets that are businesses, apply IFRS 3 and the guidance on business combinations in other IFRSs. Identifiable assets and liabilities are measured, with exceptions, at fair value and the residual is recognised as goodwill. Furthermore, transaction costs are not capitalised and deferred taxes are recognised on initial recognition of assets and liabilities. The only guidance that is not applied is the guidance on business combinations in IFRS 3 and other IFRSs that is not appropriate for the acquisition of an interest in a joint operation, eg the guidance on non-controlling interest.

(b) **Cost approach:** others allocate the total cost of acquiring the interest in the joint operation to the individual identifiable assets on the basis of their relative fair values. Accordingly, an amount paid for synergies is allocated to the identifiable assets rather than being recognised as goodwill. Transaction costs are capitalised and deferred taxes are not recognised, because of the initial recognition exceptions in paragraphs 15 and 24 of IAS 12 *Income Taxes*.

(c) **Combination approach:** a third group of preparers of IFRS financial statements measures the identifiable assets and liabilities at fair value, with exceptions, and the residual is recognised as a separate asset, ie goodwill. The basis of this approach is the cost approach, but the guidance in IFRS 3 is applied to the issues that are not addressed elsewhere in IFRSs, eg recognition and measurement of goodwill as a separate asset. We understand that the combination approach is a cost approach, although it measures the identifiable assets and liabilities at fair value. The fair value of identifiable assets and liabilities is considered to be:

(i) the consideration that the acquirer would have given in a separate acquisition of the assets, ie the cost of an asset is its fair value at the acquisition date (see also paragraph 33 of IAS 38); or

(ii) the consideration that the acquirer would have received to assume the liability.

The difference between the IFRS 3 approach and the combination approach is that, in applying the combination approach, the guidance in IFRS 3 on issues that are also addressed in other IFRSs is not applied. Instead, the guidance in the other Standards that are applicable to the particular assets and liabilities is applied. Accordingly, transaction costs are capitalised and contingent liabilities and deferred taxes are not recognised. Deferred taxes are not recognised, because of the initial recognition exceptions in paragraphs 15 and 24 of IAS 12.

Effect of significant diversity in practice

18. The application of the three different views observed in practice results in a significantly different accounting practices on the following issues:

(a) the accounting for a **premium paid** in addition to the identifiable net assets, eg a premium paid for synergies. Such a premium is either recognised as a separate asset, ie goodwill, or is allocated to the identifiable assets based on their relative fair values;

(b) the accounting for **deferred taxes**. Deferred tax assets and deferred tax liabilities arising from the initial recognition of assets and liabilities, except for deferred tax liabilities arising from the initial recognition of goodwill, are either recognised on the acquisition of the interest in the joint operation that is a business, or not recognised because of the initial recognition exceptions in paragraphs 15 and 24 of IAS 12; and

(c) the accounting for **acquisition-related costs**. They are either capitalised or recognised as an expense.

Illustrative example

19. Appendix B to this paper illustrates the application of the principal approaches seen in practice and thereby highlights the different results.

Conclusions and recommendation of the Interpretations Committee

20. In the course of its discussions, the Interpretations Committee reached the following conclusions.

Significant diversity in practice needs to be addressed

21. The Interpretations Committee concluded that the significant diversity in practice in accounting for the acquisition of an interest in a joint operation that is a business needs to be addressed, because of the significantly different accounting results following from the three principal approaches seen in practice.

Most appropriate approach

22. When determining the approach on which the guidance to be developed should be based, the Interpretations Committee concluded that the most appropriate approach to account for the acquisition of an interest in a joint operation that is a business is to apply the relevant principles for business combinations in IFRS 3 and other IFRSs.

23. The Interpretations Committee reached this conclusion by assessing the approaches to account for such transactions that it had observed in practice.

24. The Interpretations Committee rejected the combination approach, because it had concerns about the conceptual basis of an approach that applies business combination accounting only to issues that are not addressed elsewhere in IFRSs and also because such an approach might be perceived as cherry-picking from the IFRS 3 approach and the cost approach.

25. When choosing between the IFRS 3 approach and the cost approach, the Interpretations Committee recommends the IFRS 3 approach because it leads to a separate recognition of goodwill.

(a) Separate recognition of goodwill as an asset better reflects the economic substance of the transaction. Allocation to the other assets acquired instead typically results in their overstatement in the statement of financial position.

(b) Measurement of identifiable assets acquired and liabilities assumed at fair value provides information that is more comparable and understandable than measurement on the basis of allocating the total cost of an acquisition, including a premium paid for synergies (see also paragraph BC198 of IFRS 3 revised 2008).

26. In addition, the following arguments supported the Interpretations Committee's conclusion that it should recommend the IFRS 3 approach:

(a) IFRS 3 and the guidance in other IFRSs on business combinations give a comprehensive and consistent set of accounting principles for the different components of the transaction.

(b) For some assets and liabilities and issues, only IFRS 3 gives guidance that is tailored to the specific situation of acquiring a group of assets and liabilities that constitute a business. These are, for example:

(i) indemnification assets (see paragraphs 27 and 57 of IFRS 3);

(ii) guidance on the measurement period (see paragraphs 45-50 of IFRS 3); and

(iii) determining what is part of a business combination (see paragraphs 51 and 52 of IFRS 3).

(c) The IASB acknowledged that a 'business' as defined in IFRS 3 can be found in all types of joint arrangements (paragraph BC29 of IFRS 11), which includes joint operations.

(d) The IASB noted only two main differences between recognising assets, liabilities, revenues and expenses relating to the activity of the joint operation and proportionate consolidation (paragraph BC38 of IFRS 11). These two main differences are:

(i) IFRS 11 requires a joint operator to recognise assets, liabilities, revenue and expenses according to the joint operator's share in the assets, liabilities, revenues and expenses of the joint operation as determined and specified in the contractual arrangement, rather than basing their recognition on the ownership interest that the joint operator has in the joint operation; and

(ii) there is no difference, in accounting for the joint operator's interest in the joint operation, between the joint operator's separate financial statements and its consolidated financial statements.

The Interpretations Committee noted that paragraph 33 of IAS 31 and paragraph 18 of IAS 27 *Consolidated and Separate Financial Statements* (amended 2010) clearly require the adoption of the concepts underlying IFRS 3 when using proportionate consolidation, which would include the recognition of goodwill. However, the IASB did not identify the recognition of goodwill as being one of the main differences between the application of proportionate consolidation and accounting for a joint operation.

Limited-scope project to amend IFRS 11

27. The Interpretations Committee proposes to develop guidance on this matter as part of a limited-scope project on IFRS 11 to resolve the significant diversity in practice.

28. In the Interpretations Committee's opinion, the issue neither qualifies for inclusion in annual improvements nor for developing an interpretation, because the issue relates to a gap in the literature rather than to literature that needs clarification or interpreting.

29. The lack of literature on the accounting for the acquisition of interests in jointly controlled operations or assets that are businesses is the reason for the diversity in practice that has been identified.

Scope of the new guidance

30. The Interpretations Committee members think that the proposed limited-scope project should address only the issue raised in the submission and on which they had noted significant diversity in practice.

31. Consequently, the new guidance should only address the accounting for an interest in a joint operation when:

    (a) the acquisition of the interest is in an existing joint operation that is a business; or

    (b) the joint operation is formed and (an) existing business(es) is/are contributed.

32. The proposed limited-scope project would therefore not address the accounting for an interest in a joint operation when the joint operation is formed and this coincides with the formation of the business.

33. The proposed limitation of the scope is illustrated in the following two examples:

Example of the acquisition of an interest in a joint operation that is a business on its formation, and that should be within the scope of the new guidance:

34. Entity A and Entity B set up a contractual arrangement to run a producing oil and gas field on the basis of a joint operation. Entity B contributes the producing oil and gas field (ie a business), of which it currently owns 100 per cent, to the joint operation. Entity A contributes cash.

35. Entity A should apply the new guidance to its acquisition. It acquires an interest in a joint operation on its formation and the business already existed on its contribution.

*Example of the acquisition of an interest in a joint operation that is a business on its formation, and that should **not** be within the scope of the new guidance:*

36. Entity A, Entity B and Entity C set up a contractual arrangement to run a bakery on the basis of a joint operation. Entity A contributes a baking oven, Entity B contributes a dough mixer and Entity C contributes cash. They hire staff with baking skills externally on the formation of the bakery.

37. Entity A, Entity B and Entity C should not apply the new guidance to its acquisition. It acquires an interest in a joint operation on its formation. However, the business did not exist before the formation of the joint operation.

Level of detail of the new guidance

38. The Interpretations Committee recommends that the new guidance should not be too detailed.

39. Instead, it should make reference to the relevant principles of business combination accounting and related disclosure requirements in IFRS 3 and other IFRSs.

40. Only some application guidance should be added to explicitly address the issues for which the diversity in practice leads to significantly different accounting results (see paragraph 18 above).

41. Finally, an illustrative example should explain the application of the new guidance.

42. The Interpretations Committee recommends this level of detail for the new guidance because it best meets the different requirements for this new guidance:

    (a) The proposed level of detail of the new guidance aligns most closely with the concept in IFRS 11. IFRS 11 provides guidance on the accounting for interests in joint arrangements by indicating when it is appropriate to account for this interest according to the equity method (joint venture) and when it is appropriate to recognise assets, liabilities, revenues and expenses related to that interest (joint operation). (See, for example, paragraphs BC25 and BC39 of IFRS 11). With few exceptions (see paragraphs B34-B37 of IFRS 11), IFRS 11 does not, however, give guidance on the application of the equity method, or on the accounting for assets, liabilities, revenues and expenses related to an interest in a joint operation. For the application of the equity method, the standard refers to IAS 28 *Investments in Associates and Joint Ventures* in paragraph 24 of IFRS 11. For the accounting for the assets, liabilities, revenues and expenses related to joint operations, the Standard refers in paragraph 21 to the IFRSs applicable to the particular assets, liabilities, revenues and expenses.

    (b) Explicitly addressing in the application guidance the issues on which the Interpretations Committee noted significant diversity in practice (see paragraph 18 above) ensures consistent accounting on these issues in the future.

(c) Consistent application is also supported by the illustrative example. Such guidance is appropriate because there was no explicit guidance at all on the accounting for acquisitions of interests in jointly controlled operations or assets that are businesses.

(d) New guidance that makes references to specific paragraphs in IFRS 3 and other IFRSs would be voluminous and not easy to read and understand and would be likely to give rise to confusion, because of:

   (i) the huge scope of the guidance on business combinations accounting in IFRS 3 and other IFRSs; and

   (ii) the fact that most of this guidance applies with modifications or only in parts (eg the guidance on non-controlling interests does not apply).

   Accordingly, such guidance would be likely to give rise to confusion, which might lead to additional significant diversity in practice.

(e) It would be beyond the scope of a limited-scope project and beyond the scope of work that the Interpretations Committee could realistically do on behalf of the IASB to develop new guidance with detailed illustration of the application of all the relevant guidance on accounting for business combinations in IFRS 3 and other IFRSs, together with what the Interpretations Committee thought would be the necessary modifications. The Interpretations Committee understands that such guidance would even be beyond the scope of the current IFRS 3.

43. The Interpretations Committee thinks that the new guidance in IFRS 11 should also make reference to the relevant related disclosure requirements in IFRS 3 and other IFRSs, because these disclosure requirements are an integral part of the financial reporting about the acquisition of interests in businesses. However, the Interpretations Committee did not identify any further disclosure requirements that should be added.

44. An illustrative draft amendment to IFRS 11 is set out in Appendix A to this paper.

No amendment to IAS 31

45. The Interpretations Committee thinks that no new guidance to IAS 31 on this issue should be added. This is because any new guidance on this issue would have an effective date after 1 January 2013, when IFRS 11 supersedes IAS 31.

Transition

46. From the outreach results, the Interpretations Committee concluded that applying the proposed amendment to IFRS 11 as set out in Appendix A to this paper retrospectively might cause a problem by requiring a party to a joint operation to apply the relevant principles on business combination accounting in IFRS 3 and other IFRSs to acquisitions that had previously been accounted for in previous periods by applying a cost approach. Accordingly, the acquisition-date fair value of several items recognised in accordance with IFRS 3 may not have been determined in previous periods.

47. In this context, the Interpretations Committee has in mind assets and liabilities that are only recognised under IFRS 3, eg contingent liabilities or indemnification assets.

48. The Interpretations Committee members are less concerned with the fair value of other identifiable assets and liabilities, because they understand that, at the very least, the acquisition-date fair value of these assets and liabilities must already have been determined, because it would have been needed to allocate the purchase price pro rata to those values.

49. The acquisition-date fair value of contingent consideration may be another example of a fair value that may have not been determined in previous periods, because of different accounting policies for contingent consideration for groups of assets that do not constitute a business.

50. To avoid the use of hindsight in determining the acquisition-date fair value of the intangible assets acquired, and of the liabilities assumed as part of the acquisition of the interest in the joint operation, the Interpretations Committee thinks that the proposed amendment to IFRS 11 should be applied prospectively.

Consequential amendments

51. On the basis of a review of the proposed amendment in relation to other existing IFRSs, the Interpretations Committee identified only one consequential amendment to another Standard.

52. In principle, the Interpretations Committee does not think that paragraphs that explicitly only address business combinations at the moment, eg paragraph 15(b)(i) and 24(a) of IAS 12, need to be amended to also include the acquisition of an interest in a joint operation. They would be applicable because of the reference that the new guidance in IFRS 11 would make to the relevant principles on business combination accounting in IFRS 3 and other IFRSs.

53. For the same reason, the Interpretations Committee thinks that no consequential amendment for first-time adopters is needed, because appropriate transition relief is already given through the exemptions for business combinations in Appendix C of IFRS 1 *First-time Adoption of International Financial Reporting Standards*, which would be applicable because of the reference that the new guidance in IFRS 11 would make to the relevant principles on business combination accounting in IFRS 3 and other IFRSs.

54. However, paragraph C5 of IFRS 1 extends the scope of the transition relief for business combinations that occurred before the date of transition to IFRSs to past acquisitions of investments in associates and of interests in joint ventures. In addition, paragraph 18 of IFRS 1 prohibits the application of the exemptions for business combinations by analogy.

55. To avoid confusion about the applicability of the exemptions for business combinations to the acquisition of interests in joint operations that are businesses, the Interpretations Committee recommends amending paragraph C5 of IFRS 1 to also apply to acquisitions of interests in joint operations that are businesses.

The Interpretations Committee's recommendation to the IASB

56. The Interpretations Committee recommends to the IASB that additional guidance on the accounting for the acquisition of interests in joint operations that are businesses should be made in a limited-scope project to amend IFRS 11.

57. Developing such guidance in a limited-scope project to amend IFRS 11 would contribute to consistent application of IFRSs in practice but does not meet the criteria for inclusion within the annual improvements project or the interpretations agenda criteria (see paragraphs 27-29 above).

58. If the IASB agrees with the Interpretations Committee's recommendation, the Interpretations Committee recommends to the IASB the draft amendment to IFRS 11 that is set out in Appendix A to this paper.

59. If the IASB agrees with the Interpretations Committee's recommendation, we propose that the Interpretations Committee also carries out the initial review of comments received on the exposure draft, and recommends to the IASB how the amendment should be finalised. This would be similar to what the Interpretations Committee does for Annual Improvements.

Comment period

60. Assuming the IASB agrees with the Interpretations Committee's recommendation to issue an exposure draft of amendments to address the issue, we recommend a comment period of not less than 120 days (see paragraph 100 of the *Due Process Handbook for the International Accounting Standards Board* (IASB) (as amended in 2008).

Questions for the IASB

1. Does the IASB agree with the conclusions and the recommendation of the Interpretations Committee?
2. Does the IASB agree that the comment period should not be less than 120 days?
3. Does the IASB have any comments on the illustrative draft amendment to IFRS 11 as set out in Appendix A?

Appendix A—Proposed wording for Amendment to IFRS 11

The proposed amendment to IFRS 11 is presented below.

Amendment to IFRS 11 *Joint Arrangements*

The heading before paragraph B34 is amended (new text is underlined). Headings after the heading before paragraph B34 and after paragraph C14 and paragraphs 21A, B33A, B33B, C1AA and C14A are added. Paragraphs 20 and 21 have been included for ease of reference but are not proposed for amendment.

Financial statements of parties to a joint arrangement

Joint operations

20 A joint operator shall recognise in relation to its interest in a joint operation:

(a) its assets, including its share of any assets held jointly;

(b) its liabilities, including its share of any liabilities incurred jointly;

(c) its revenue from the sale of its share of the output arising from the joint operation;

(d) its share of the revenue from the sale of the output by the joint operation; and

(e) its expenses, including its share of any expenses incurred jointly.

21 A joint operator shall account for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the IFRSs applicable to the particular assets, liabilities, revenues and expenses.

21A When an entity acquires an interest in a joint operation whose activity constitutes a business as defined in IFRS 3 *Business Combinations* it shall apply, to the extent of its interests according to paragraph 20, the relevant principles on business combination accounting in IFRS 3 and other IFRSs and disclose the relevant information specified in these IFRSs for business combinations. The accounting for the acquisition of an interest in such a joint operation is specified in paragraphs B33A-B33B.

[…]

Appendix B
Application guidance

[…]

Financial statements of parties to a joint arrangement (paragraph<u>s</u> <u>21A and</u> 22)

Accounting for acquisitions of interest in joint operations

B33A When an entity acquires an interest in a joint operation whose activity constitutes a business as defined in IFRS 3, it shall apply, to the extent of its interests according to paragraph 20, the relevant principles on business combination accounting in IFRS 3 and other IFRSs and disclose the relevant information specified in these IFRSs for business combinations. The principles on business combination accounting include:

(a) measuring identifiable assets and liabilities at fair value with the exceptions given in IFRS 3 and other IFRSs;

(b) recognising acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with the exception that the costs to issue debt or equity securities are recognised in accordance with IAS 32 and IFRS 9;

(c) recognising deferred tax assets and deferred tax liabilities arising from the initial recognition of assets or liabilities, except for deferred tax liabilities arising from the initial recognition of goodwill; and

(d) recognising the residual as goodwill.

B33B Paragraphs 21A and B33A apply to the acquisition of an interest in a joint operation on its formation, unless the formation of the joint operation coincides with the formation of the business (ie there was no business at all before the formation).

Appendix C

Effective date, transition and withdrawal of other IFRSs

[…]

Effective date

[…]

C1AA *[Name of amendment]* issued in [date] amended the heading before paragraph B34, added headings after the heading before paragraph B34 and after paragraph C14 and added paragraphs 21A, B33A, B33B, C1AA and C14A. An entity shall apply this amendment for annual periods beginning on or after [date]. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

Transition

[…]

Accounting for acquisitions of interests in joint operations

C14A *[Name of amendment]* issued in [date] amended the heading before paragraph B34, added headings after the heading before paragraph B34 and after paragraph C14 and added paragraphs 21A, B33A, B33B, C1AA and C14A. An entity shall apply this amendment prospectively for acquisitions of interests in joint operations from the beginning of the first period for which it adopts this amendment. Consequently, amounts recognised for acquisitions of interests in joint operations in prior periods shall not be adjusted.

Basis for Conclusions on proposed amendment to IFRS 11 *Joint Arrangements*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

Financial statements of parties to a joint arrangement

Accounting for acquisitions of interests in joint operations

BC1 The IFRS Interpretations Committee (Committee) reported to the *[IASB]* that practice differed in accounting for the acquisition of interests in jointly controlled operations or assets as specified in IAS 31 in circumstances in which the activity of the jointly controlled operations or assets constitutes a business as defined in IFRS 3.

BC2 While some apply the relevant principles of business combination accounting in IFRS 3 and other IFRSs, others allocate total cost of acquiring the interest in the jointly controlled operations or assets to the individual identifiable assets and liabilities on the basis of their relative fair values.

BC3 A third group applies the relevant principles of business combination accounting to issues that are not addressed in other IFRSs.

BC4 The different approaches lead to different results, in particular:

(a) in accounting for premiums paid for synergies;

(b) in capitalising or expensing acquisition-related costs; and

(c) in accounting for deferred tax assets and deferred tax liabilities arising from the initial recognition of assets and liabilities.

BC5 The *[IASB]* noted that current IFRSs do not give comprehensive and consistent guidance on the accounting for the acquisition of interests in joint operations/jointly controlled operations or assets in circumstances in which the activity of the joint operations/jointly controlled operations or assets constitutes a business as defined in IFRS 3 and that this lack of guidance has led to the significant diversity in practice in applying IAS 31. The *[IASB]* is concerned that this significant diversity in practice may continue in applying IFRS 11.

BC6 The *[IASB]* considered the guidance in current IFRSs on the acquisition of an interest in a business and concluded that the most appropriate approach to account for the acquisition of an interest in a joint operation in circumstances in which the activity of the joint operation constitutes a business as defined in IFRS 3 is to apply the relevant principles on business combination accounting in IFRS 3 and other IFRSs. These principles include:

(a) measuring identifiable assets and liabilities at fair value with few exceptions;

(b) recognising acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with the exception that the costs to issue debt or equity securities are recognised in accordance with IAS 32 and IFRS 9;

(c) recognising deferred tax assets and deferred tax liabilities arising from the initial recognition of assets and liabilities, except for deferred tax liabilities arising from the initial recognition of goodwill; and

(d) recognising the residual as goodwill.

BC7 The *[IASB]* reached this conclusion because:

(a) it considers separate recognition of goodwill, if any, as preferable compared to allocating premiums to identifiable assets acquired on the basis of relative fair values;

(b) it thinks that an approach that applies business combination accounting only to issues that are not addressed elsewhere in IFRSs lacks a strong conceptual basis; and

(c) the guidance in IFRS 3 and other IFRSs on business combinations gives a comprehensive and consistent set of accounting principles for the different components of the transaction.

BC8 The *[IASB]* also concluded that the an entity acquiring an interest in a joint operation in circumstances in which the activity of the joint operation constitutes a business as defined in IFRS 3 shall disclose the relevant information specified in IFRS 3 and other IFRSs on business combinations because these requirements are an integral part of the financial reporting about the acquisition of interests in businesses.

BC9 Consequently, the *[IASB]* proposes to amend IFRS 11 to address the accounting for the acquisition of an interest in a joint operation in circumstances in which the activity of the joint operation constitutes a business as defined in IFRS 3 and the related disclosure requirements and thereby to resolve the significant diversity in practice.

BC10 The *[IASB]* proposes to limit the scope of the amendment to IFRS 11 to the fact patterns for which the Interpretations Committee observed significant diversity in practice. Consequently, the *[IASB]* proposes that the amendment should apply to the acquisition of an interest in a joint operation on its formation. However, the proposed amendment should not apply when the formation of the joint operation coincides with the formation of the business. This is the case when no existing business is contributed to the joint operation on its formation.

Effective date and transition

BC11 The *[IASB]* considered the transitional provisions and effective date of the amendment to IFRS 11. The *[IASB]* noted that applying the relevant principles of business combination accounting in IFRS 3 and other IFRSs to transactions that have previously been accounted for by applying one of the divergent approaches presented in paragraphs BC2 and BC3 might involve the use of hindsight in determining the acquisition-date fair values of the identifiable assets and liabilities to be recognised as part of the transaction. Consequently, the *[IASB]* proposes that an entity would apply the proposed amendments to IFRS 11 prospectively for annual periods beginning on or after [the effective date].

Illustrative examples

IFRS 11 *Joint Arrangements*

These examples accompany, but are not part of, IFRS 11. They illustrate aspects of IFRS 11 but are not intended to provide interpretative guidance.

After paragraph IE52 a heading and paragraphs IE53 to IE56 are added.

Example 7—Accounting for acquisitions of interests in joint operations

IE53 Entity A acquires a 40 per cent ownership interest in a joint operation (Joint Operation C) at a cost of CU300* and incurs acquisition-related costs of CU50. The contractual arrangement between the parties establishes that Entity A has rights to the assets and obligations for the liabilities relating to the joint operation in proportion to its ownership interest.

IE54 The fair value (or the value required by IFRS 3 instead, eg deferred tax liabilities are not measured at fair value but according to IAS 12 *Income Taxes*) of the identifiable assets acquired and liabilities assumed (including deferred tax assets and deferred tax liabilities) by Entity A, Entity A's share in these assets and liabilities and the amounts that Entity A recognises in its financial statements in relation to its interest in the joint operation are set out in the following table.

	Fair value of identifiable assets acquired and liabilities assumed at acquisition date (in CU)	*Entity A's share in assets acquired and liabilities assumed*	*Amounts recognised in Entity A's financial statements*
Property, plant and equipment	270	40%	108
Intangible assets (excluding goodwill)	125	40%	50
Accounts receivable	210	40%	84
Inventory	175	40%	70
Retirement benefit obligations	(30)	40%	(12)
Accounts payable	(120)	40%	(48)
Deferred tax liability	(60)	40%	(24)
Fair value of identifiable assets acquired and liabilities assumed, including deferred tax	570		228

* In this example, monetary amounts are denominated in 'currency units (CU)'.

IE55 Entity A applies the relevant principles on business combination accounting in IFRS 3 and other IFRSs for identifying, measuring and classifying the assets acquired and liabilities assumed on the acquisition of the interest in Joint Operation C. However, Entity A recognises, in relation to its interest in the joint operation, only its share in each of the assets jointly held and in each of the liabilities incurred jointly in proportion to its ownership interest in the joint operation as stated in the contractual arrangement and not the shares of the other parties to the joint operation in these assets and liabilities. The residual is recognised as goodwill.

Consideration transferred	CU300
Entity A’s share in the identifiable assets and liabilities relating to its interest in the joint operation	CU228
Goodwill	CU72

IE56 Acquisition-related costs are not considered to be part of the consideration transferred for the interest in the joint operation, because they are recognised as expenses in profit or loss in the period the costs are incurred and the services are received.

Appendix to proposed amendment to IFRS 11

Amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

Paragraph C5 is amended (new text is underlined and deleted text is struck through).

Paragraph 39M is added.

Appendix C

Exemptions for business combinations

[…]

C5 The exemption for past business combinations also applies to past acquisitions of investments in associates<u>,</u>~~ and~~ of interests in joint ventures<u> and of interests in joint operations that include businesses</u>. Furthermore, the date selected for paragraph C1 applies equally for all such acquisitions.

Effective date

[…]

39M *[Name of amendment]* issued in [date] amended paragraph C5. An entity shall apply this amendment for annual periods beginning on or after [date]. If an entity applies related amendments in IFRS 11 from *[Name of amendment]* for an earlier period, the amendment to paragraph C5 shall be applied for that earlier period.

Appendix B—Illustration of the application of principal approaches

B1. The example illustrates the application of the principal approaches seen in practice. It is not part of the proposed amendment to IFRS 11.

Fact pattern

B2. Entity A acquires a 40 per cent ownership interest in a joint operation (Joint Operation C) that is structured through a separate vehicle (a separate legal entity) at a cost of CU300 and incurs acquisition-related costs of CU50.

B3. The contractual arrangement between the parties establishes that entity has rights to the assets and obligations for the liabilities relating to the joint operation in proportion to its ownership interest

B4. Joint Operation C files separate tax returns.

B5. The fair value (or the value required by IFRS 3 instead) of the identifiable assets acquired and liabilities assumed (including deferred tax assets and deferred tax liabilities) by Entity A and Entity A's share in these assets and liabilities are set out in the following table:

	Fair value of identifiable assets acquired and liabilities assumed at acquisition date (in CU)	*Entity A's share in assets acquired and liabilities assumed (in per cent)*	*Amounts recognised in Entity A's financial statements (in CU)*
Property, plant and equipment	270	40%	108
Intangible assets (excluding goodwill)	125	40%	50
Accounts receivable	210	40%	84
Inventory	175	40%	70
Retirement benefit obligation	(30)	40%	(12)
Accounts payable	(120)	40%	(48)
Deferred tax liability	(60)	40%	(24)
Fair value of identifiable assets acquired and liabilities assumed, including deferred taxes	570		228

IFRS 3 approach

B6. Entity A applies the relevant principles on business combination accounting in IFRS 3 and other IFRSs for identifying, measuring and classifying the assets acquired and liabilities assumed on the acquisition of the interest in Joint Operation C.

B7. However, Entity A recognises, in relation to its interest in the joint operation, only its share in each of the assets jointly held and each of the liabilities incurred jointly and not the shares of the other parties to the joint operation in these assets and liabilities.

B8. The residual is recognised as goodwill:

Consideration transferred	CU300
Entity A's share in the identifiable assets and liabilities relating to its interest in the joint operation (CU570 x 40%)	CU228
Goodwill	CU72

B9. Acquisition-related costs of CU50 are not considered to be part of the consideration transferred for the interest in the joint operation, because they are recognised as expense in profit or loss in period in which the costs are incurred and the services are received.

B10. Consequently, Entity A recognises the following amounts in its financial statements on the acquisition of its interest in Joint Operation C when applying the IFRS 3 approach:

	Amounts recognised in entity A's financial statements (in CU)
Property, plant and equipment	108
Intangible assets (excluding goodwill)	50
Goodwill	72
Accounts receivable	84
Inventory	70
Retirement benefit obligation	(12)
Accounts payable	(48)
Deferred tax liability	(24)
Total	300

Cost approach

B11. Entity A allocates the total cost of acquiring the interest in the joint operation to the identifiable assets on the basis of their relative fair values.

B12. Total costs are CU350 and are made up of the fixed payment of CU 300 and the acquisition-related costs of CU50. Entity A's share in the retirement benefit obligation of CU12 and in the accounts receivable of CU48 are not part of total costs because they are not obligations incurred by Entity A to the seller to acquire the interest in Joint Operation C and therefore not part of the consideration given (see for example the definition of cost in paragraph 6 of IAS 16 *Property, Plant and Equipment*, in paragraph 8 of IAS 38 *Intangible Assets* and in paragraph 5 of IAS 40 *Investment Property*).

B13. The relative fair values of Entity A's identifiable assets and the amounts recognised for these assets in entity's financial statement are:

	Fair value of Entity A's share in identifiable assets (in CU)	*Share of total fair value of identifiable assets (in CU)*	*Amounts recognised in Entity A's financial statements for the identifiable assets (in CU)*
Property, plant and equipment	108	35%	143
Intangible assets (excl. goodwill)	50	16%	66
Accounts receivable	84	27%	111
Inventory	70	22%	90
Total	312	100%	410

B14. Entity A incurred total costs of CU350 to acquire shares in identifiable assets and liabilities relating to its interest in the joint operation of CU252. To allocate the difference of CU98 to the identifiable assets based on their relative fair values, Entity A adds this amount to the sum of the fair values of its shares in the identifiable assets of CU312 and allocates CU410 to its shares in the identifiable assets based on their relative fair values.

B15. Deferred taxes are not recognised because of the initial recognition exceptions in paragraphs 15 and 24 of IAS 12.

B16. Consequently, Entity A recognises the following amounts in its financial statements on the acquisition of its interest in Joint Operation C when applying the cost approach:

	Amounts recognised in Entity A's financial statements (in CU)
Property, plant and equipment	143
Intangible assets (excluding goodwill)	66
Accounts receivable	111
Inventory	90
Retirement benefit obligation	(12)
Accounts payable	(48)
Total	350

Combination approach

B17. Entity A measures the identifiable assets and liabilities at fair value, with very few exceptions, and the residual is recognised as a separate asset, ie goodwill. However, Entity A recognises, in relation to its interest in the joint operation, only its share in each of the assets jointly held and each of the liabilities incurred jointly and not the shares of the other parties to the joint operation in these assets and liabilities.

B18. Deferred taxes are not recognised because of the initial recognition exceptions in paragraphs 15 and 24 of IAS 12.

B19. Consequently, Entity A recognises the following amounts for identifiable assets and liabilities in its financial statements on the acquisition of the interest in Joint Operation C:

	Amounts recognised in Entity A's financial statements for identifiable assets and liabilities (in CU)
Property, plant and equipment	108
Intangible assets (excluding goodwill)	50
Accounts receivable	84
Inventory	70
Retirement benefit obligation	(12)
Accounts payable	(48)
Total	252

B20. Goodwill is the difference between total costs and the fair value of the net assets.

B21. The total costs of CU350 consist of the fixed payment of CU300 and transactions costs of CU50 that are part of total costs (see for example paragraph 20 of IAS 40).

B22. Entity recognises the residual as goodwill:

Total cost	CU350
Entity A’s share in the identifiable assets and liabilities relating to its interest in the joint operation (CU630 x 40%)	CU252
Goodwill	CU98

B23. This calculation shows that transactions costs increase the goodwill recognised by Entity A.

B24. Consequently, Entity A recognises the following amounts in its financial statements on the acquisition of its interest in Joint Operation C when applying the combination approach:

	Amounts recognised in Entity A's financial statements (in CU)
Property, plant and equipment	108
Intangible assets (excluding goodwill)	50
Goodwill	98
Accounts receivable	84
Inventory	70
Retirement benefit obligation	(12)
Accounts payable	(48)
Total	350

Comparison

B25. The following table compares the results of the different approaches:

	IFRS 3 approach	*Cost approach*	*Combination approach*
Property, plant and equipment	108	143	108
Intangible assets (excluding goodwill)	50	66	50
Goodwill	72	0	98
Accounts receivable	84	111	84
Inventory	70	90	70
Retirement benefit obligation	(12)	(12)	(12)
Accounts payable	(48)	(48)	(48)
Deferred tax liability	(24)	0	0
Total	300	350	350