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Issue 48/December 2012

IFRS Developments

Exposure drafts issued on narrow amendments to IFRS 10, IFRS 11 and IAS 28

What you need to know

- The proposed amendment to IFRS 11 clarifies how to account for an acquisition of an interest in a joint operation that is a business as defined in IFRS 3.
- The proposed amendments to IAS 28 (2011) and IFRS 10 clarify how to account for the sale/contribution of assets by an investor to its associate or joint venture. The accounting will depend on whether or not the asset being contributed is a business as defined in IFRS 3.
- The proposed amendments are to be applied prospectively from the effective dates.
- The comment period for both exposure drafts ends on 23 April 2013.

Highlights

In December 2012, the International Accounting Standards Board (IASB) issued two exposure drafts, as follows:

- Acquisition of an Interest in a Joint Operation (proposed amendment to IFRS 11)
- Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (proposed amendments to IFRS 10 and IAS 28)

The comment period for both exposure drafts closes on 23 April 2013.

We discuss the proposals for each of these exposure drafts below.

Acquisition of an interest in a joint operation (proposed amendment to IFRS 11)

Neither IFRS 11 *Joint Arrangements* nor IAS 31 *Interest in Joint Ventures* (IFRS 11 replaces IAS 31 effective 1 January 2013) provide guidance on how a joint operator should account for the acquisition of an interest in a joint operation, when the activity of that joint operation constitutes a business as defined in IFRS 3 *Business Combinations.*[1]

The issue came to the attention of the IFRS Interpretations Committee (the Committee) during 2011, as a result of the significant diversity that has arisen in practice under IAS 31. The IASB was concerned that significant diversity would continue under IFRS 11, so it is proposing to amend IFRS 11 such that a joint operator will apply the relevant principles for business combination accounting in IFRS 3 (and other relevant IFRSs) when acquiring an interest in a joint operation, and will disclose the information required for business combinations.

[1] A business is defined in IFRS 3 as "an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants."

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The principles for business combination accounting include:

- Measuring relevant identifiable assets and liabilities at fair value
- Recognising acquisition-related costs as expenses in the periods in which the costs are incurred and the services received
- Recognising deferred tax assets and liabilities that arise from the initial recognition of assets or liabilities
- Recognising goodwill where the consideration transferred is greater than the acquisition date net fair value

The proposed amendment will apply to the acquisition of an interest in:

- An existing joint operation
- A joint operation on its formation, provided that an existing business is contributed to the joint operation at that time

Transition

The amendment would be applied prospectively on or after the effective date. Therefore, amounts recognised for acquisitions of interests in joint operations in prior periods will not be adjusted.

Sale or contribution of assets between an investor and its associate or joint venture (proposed amendments to IFRS 10 and IAS 28)

There is a conflict between IAS 27 *Consolidated and Separate Financial Statements* and SIC 13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*, in accounting for the loss of control of a subsidiary that is contributed to a jointly controlled entity (JCE)/joint venture (JV) or an associate, in exchange for an equity interest in that JCE/JV or associate.

Paragraph 34 of IAS 27 requires full profit or loss recognition on the loss of control of a subsidiary. SIC 13, however, limits gains and losses arising from contributions of non-monetary assets to a JCE to the extent of the interests held by other equity holders in the JCE.

As a result of the conflict between the two standards there is diversity in practice, and the issue was brought to the attention of the Committee in May 2011. Since then, the Committee has been working with the IASB to find a proposed solution. The exposure draft proposes that all contributions of businesses as defined in IFRS 3[1] (whether in a subsidiary or not) would follow the existing principles in IAS 27 – that is, full gain or loss recognition. All other contributions would be accounted for in accordance with the rationale in SIC 13, that is, partial gain or loss recognition.

On 1 January 2013, IFRS 10 will replace the consolidation principles currently in IAS 27, and the amended IAS 28 (2011) will supersede both IAS 28 *Investments in Associates* (as issued in 2003) and SIC 13. The IASB noted, however, that the conflict mentioned above will remain under IFRS 10 and IAS 28 (2011), because the requirements for the loss of control of a subsidiary will be much the same in the new standards as they are in the existing ones. Therefore, the IASB decided to amend both IAS 28 (2011) and IFRS 10, as described below.

Amendment to IAS 28 (2011)

- Any gain or loss resulting from the sale or contribution of an asset that does not constitute a business between an investor and its associate or joint venture should be partially recognised
- Any gain or loss arising from the sale or contribution of an asset that does constitute a business between an investor and its associate or joint venture should be fully recognised

Amendment to IFRS 10

- Any gain or loss resulting from the sale or contribution of a subsidiary that does not constitute a business between an investor and its associate or joint venture should be partially recognised, to the extent of the unrelated investor's interests in the associate or joint venture

The consequence of the proposed amendments to IFRS 10 and IAS 28 is that a full gain or loss would be recognised on the loss of control of a subsidiary that constitutes a business, even if the investor retains joint control or significant influence over the investee.

Transition

The proposed amendments are to be applied prospectively to the sale or contribution of assets occurring in annual periods beginning on or after the effective date of the amendment.

How we see it

With respect to both of the exposure drafts discussed in this publication, we support the IASB's efforts to attempt to reduce diversity in accounting for these issues by clarifying the principles in the relevant standards.

We note, however, that there is a history of difficulty in practice in applying the definition of a business in IFRS 3. As a result, the Committee has suggested that the IASB address the definition of a business as part of its post-implementation review of IFRS 3. Increased reliance on the definition in the meantime may result in further diversity of application.

On the amendment to IFRS 11, we believe that it should also provide guidance related to increases in interest in a joint operation following the initial acquisition, as well as guidance on the acquisition of an interest in a joint operation that is a not a business.

We will be preparing our views for our comment letter on these proposals over the next few months.

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EYG no. AU1347

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