CHANGES TO IFRS 11 *JOINT ARRANGEMENTS* – ACCOUNTING FOR ACQUISITIONS OF INTERESTS IN JOINT OPERATIONS

Background

A previous submission to the IFRS Interpretations Committee identified diversity in practice regarding the accounting for acquisitions of interests in joint operations that constitute a business under IFRS 3 *Business Combinations*. Three approaches were identified in practice:

- **IFRS 3 approach** – Measure identifiable assets and liabilities at fair value, residual allocated to goodwill, acquisition costs expensed and deferred taxes recognised on initial recognition of assets and liabilities.
- **Cost approach** – Total cost of acquiring interest in joint operation allocated to individual identifiable assets and liabilities on basis of their relative fair values (Premium allocated to individual assets rather than goodwill). No deferred tax recognised and acquisition costs capitalised.
- **Hybrid approach** – Identifiable assets and liabilities measured at fair value and residual recognised as goodwill. Acquisition costs capitalised. Contingent liabilities and deferred tax not recognised.

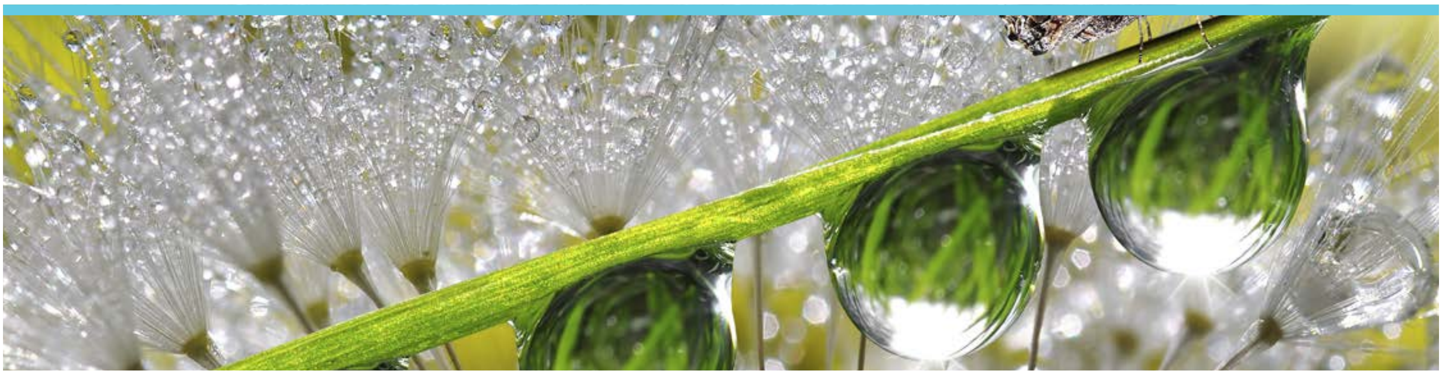
This diversity resulted in the International Accounting Standards Board (IASB) issuing an Exposure Draft in December 2012 to clarify the appropriate accounting treatment, and now a final standard, IASB amending document, *Accounting for Acquisitions of Interests in Joint Operations – Amendments to IFRS 11*. At the time of writing, these amendments had not been approved as local amendments by the Australian Accounting Standards Board (AASB).

Accounting for joint operations

Prior to these amendments, the only accounting guidance for joint operators was included in AASB 11, paragraph 20, which basically requires joint operators to account for what belongs to them, i.e. **its** assets, **its** liabilities, **its** revenue and **its** expenses, including its share of anything held or incurred jointly.

What are the changes?

The amendments expand on this guidance by adding paragraph 21A to



IFRS 11. Paragraph 21A requires that when an entity acquires an interest in a joint operation whose activities constitutes a **business**, it must apply all the principles of IFRS 3 *Business Combinations*, and other IFRSs, as long as these principles do not conflict with the guidance in IFRS 11.

The changes apply to:

- The acquisition of the initial interest in a joint operation
- The acquisition of additional interests in a joint operation
- Cases where an existing business is contributed to a joint operation on formation by one of the parties that participate in the joint operation.

What will this mean in practice?

In practice, this means that we will see the following where interests in joint operations constitute a business:

- Identifiable assets and liabilities to be measured at fair value (unless exception in IFRS 3 or other IFRSs)
- Acquisition costs to be expensed, unless they relate to the costs of issuing debt or equity, which are to be accounted for under IAS 32 *Financial Instruments: Presentation*
- Deferred tax assets and liabilities that arise on initial recognition of an asset or liability (except for goodwill) to be recognised
- Residual consideration to be recognised as goodwill
- Annual goodwill impairment testing of cash-generating units to which goodwill relates, or whenever there is an indication of impairment under IAS 36 I*mpairment of Assets*.

This 'business combination accounting' will not be required where an interest is acquired in a joint operation that is a business from another entity that is under common control of the ultimate controlling party.

Acquiring additional interests

Where a joint operator acquires an additional interest in a joint operation that constitutes a business, previously held interests are not remeasured if the joint operator retains joint control.

Example

Example 7 has been added to IFRS 11. We have adapted Example 7 to illustrate how the accounting process works.

Companies A, B and C have joint control over Joint Operation D, whose activity constitutes a business.

Company E acquires Company A's 40% ownership interest in Joint Operation D for $300 and incurs further acquisition costs of $50.

The contractual agreement between the three parties specifies that Company's E share in several assets and liabilities differs from its 40% ownership interest. Column B in table below shows Company E's specified percentage interest in assets and liabilities per the contractual agreement.

Four step process

When accounting for its 40% interest in Joint Operation D, Company E needs to:

- Firstly determine its percentage entitlement and obligation for each asset and liability of Joint Operation D (Column B)
- Secondly, determine IFRS 3 fair value or other measures of Joint Operation D (Column A),
- Thirdly, determine the amounts to be recognised in its financial statements (Column C)
- Lastly, calculate goodwill (consideration less Column C).

	COLUMN A	COLUMN B	COLUMN C (COLUMN A X COLUMN B)
	Fair value or other measure specified by IFRS 3 for Joint Operation D's assets and liabilities $	Company E's share in these assets and liabilities $	Amounts recognised in Company E's financial statements $
PPE	288	48%	138
Intangible assets (excluding goodwill)	80	90%	72
Accounts receivable	210	40%	84
Inventory	175	40%	70
Retirement benefit obligations	(80)	15%	(12)
Accounts payable	(120)	40%	(48)
Contingent liabilities	(93)	56%	(52)
Deferred tax liability **(assume includes deferred tax liability on fair value of intangible assets of $80)**	(60)	40%	(24)
NET ASSETS	**400**		**228**

The net assets of Joint Operation D are $400 and Company E's share is $228. You can see that Company E's share of $228 does not equate to 40% (its ownership interest) of $400.

Goodwill is calculated as follows:

	$
Consideration	300
Company E's share of identifiable assets and liabilities	(228)
Goodwill	**72**

Acquisition-related costs of $50 are expensed in profit or loss when incurred.

Effective date

These amendments apply prospectively to annual periods beginning on or after 1 January 2016 and can be adopted early. This means that the new requirements must be applied to acquisitions of interests in joint operations (that constitute a business) occurring on or after the beginning of the first period in which the amendment applies (e.g. 1 January 2016 for entities with a 31 December year end and 1 July 2016 for entities with a 30 June year end).

Acquisitions occurring in prior periods are not adjusted retrospectively.

Action point

In theory, new and amended accounting standards cannot be adopted until approved by the AASB. However, these amendments are merely clarifying common practice, and we therefore recommend that you adopt these practices for acquisition of interests in joint operations from 1 July 2013.