EFRAG

European Financial Reporting Advisory Group

The costs and benefits of implementing the Amendments to IFRS 11 Accounting for Acquisitions of Interests in Joint Operations

Introduction

1 Following discussions between the various parties involved in the EU endorsement process, the European Commission decided in 2007 that more extensive information than hitherto needs to be gathered on the costs and benefits of all new or revised Standards and Interpretations as part of the endorsement process. It has further been agreed that EFRAG will gather that information in the case of the Amendments to IFRS 11 *Accounting for Acquisitions of Interests in Joint Operations* ('the Amendments').

2 EFRAG first considered how extensive the work would need to be. For some Standards or Interpretations, it might be necessary to carry out some fairly extensive work in order to understand fully the cost and benefit implications of the Standard or Interpretation being assessed. However, in the case of the Amendments, EFRAG's view is that the cost and benefit implications can be assessed by carrying out a more modest amount of work. The results of the consultations that EFRAG has carried out seem to confirm this. Therefore, as explained more fully in the main sections of this report, the approach that EFRAG has adopted has been to carry out detailed initial assessments of the likely costs and benefits of implementing the Amendments in the EU, to consult on the results of those initial assessments, and to finalise those assessments in the light of the comments received.

EFRAG's endorsement advice

3 EFRAG also carries out a technical assessment of all new and revised Standards and Interpretations issued by the IASB against the so-called endorsement criteria and provides the results of those technical assessments to the European Commission in the form of recommendations as to whether or not the Standard or Interpretation assessed should be endorsed for use in the EU. As part of those technical assessments, EFRAG gives consideration to the costs and benefits that would arise from implementing the new or revised Standard or Interpretation in the EU. EFRAG has therefore taken the conclusion at the end of this report into account in finalising its endorsement advice.

A summary of the Amendments

Background

4 IAS 31 *Interests in Joint Ventures* did not provide guidance on how joint operators should account for the acquisition of an interest in a jointly controlled operation when the activity of the jointly controlled operation constituted a business, as defined in IFRS 3 *Business Combinations*.

5 The lack of guidance in IFRSs caused diversity in practice which was likely to continue with IFRS 11 *Joint Arrangements* (which superseded IAS 31), in relation to the accounting for acquisitions of joint arrangements that are classified as joint operations in which the activity of the joint operation constitutes a business as defined in IFRS 3, as the Standard does not provide any specific guidance on the accounting for such acquisitions.

6 The objective of the Amendments is to introduce guidance into IFRS 11 on the accounting for such transactions.

What has changed?

7 The guidance amends IFRS 11 so that the acquirer of an interest in a joint operation in which the activity constitutes a business, as defined in IFRS 3:

(a) applies all of the principles of business combinations accounting in IFRS 3 and other IFRSs except for those principles that conflict with the guidance in IFRS 11; and

(b) discloses the information required by IFRS 3 and other IFRSs for business combinations.

8 The Amendments apply to both the consolidated financial statements, and separate financial statements of the investors. They apply to the acquisition of the initial interest and to any additional interests in a joint operation in which the activity of the joint operation constitutes a business. They do not apply, however, if the formation of the joint operation coincides with the formation of the business.

9 The principles of business combinations accounting that do not conflict with the guidance in the Amendments include, but are not limited to:

(a) measuring the joint operator's share of identifiable assets and liabilities at fair value, other than items for which exceptions are 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 *Financial Instruments: Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*;

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

(d) recognising the excess of the consideration transferred over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed, if any, as goodwill; and

(e) testing for impairment a cash-generating unit to which goodwill has been allocated at least annually, and whenever there is an indication that the unit may be impaired, as required by IAS 36 *Impairment of Assets* for goodwill acquired in a business combination.

10 Two illustrative examples have been introduced to provide guidance on how to apply the Amendments in the following situations:

(a) acquisition of interests in joint operations in which the activity constitutes a business (Illustrative Example 7); and

(b) contributing the right to use know-how to a joint operation in which the activity constitutes a business (Illustrative Example 8).

Effective date

11 The Amendments should be applied prospectively for annual periods beginning on or after 1 January 2016, with early application permitted.

EFRAG's initial analysis of the costs and benefits of the Amendments

12 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users from implementing the Amendments, both in year one and in subsequent years. The results of EFRAG's initial assessment can be summarised as follows:

(a) *Costs* – EFRAG's initial assessment was that the Amendments might result in increased one-off and ongoing costs for some preparers while they are likely to result in insignificant one-off or ongoing costs for users.

(b) *Benefits* – EFRAG's initial assessment was that preparers and users are likely to benefit from the Amendments. In areas where current IFRSs were silent or contained limited guidance, the new requirements should enhance consistency of application by preparers and increase comparability for users.

13 EFRAG published its initial assessment and supporting analysis on 16 June 2014. It invited comments on the material by 16 July 2014. In response, EFRAG received five comment letters. Two respondents agreed with EFRAG's assessment of the benefits of implementing the Amendments and the associated costs involved for users and preparers. The other respondents did not comment specifically on EFRAG's initial assessment of the costs and benefits of implementing the Amendments in the EU, but supported EFRAG's recommendation that the Amendments be adopted for use in Europe.

EFRAG's final analysis of the costs and benefits of the Amendments

14 Based on its initial analysis and stakeholders' views on that analysis, EFRAG's detailed final analysis of the costs and benefits of the Amendments is presented in the paragraphs below.

Cost for preparers

15 EFRAG has carried out an assessment of the cost implications for preparers resulting from the Amendments.

16 The Amendments require that principles of business combinations in IFRS 3 *Business Combinations* and other relevant Standards are applied to account for the acquisitions of Interests in joint operations that constitute a business, to the extent that they do not conflict with the guidance in IFRS 11 *Joint Arrangements*.

17 This implies that, under the affected transactions, all the joint operation assets and liabilities are initially measured at fair value (with certain exceptions), deferred taxation is recognised, goodwill is separately recognised and tested for impairment and all the required disclosures are provided. As a consequence more information may need to be collected and processed by preparers.

18 Therefore, in EFRAG's view, it is likely that the Amendments would result in higher costs for some preparers in any industry where acquisitions and exchanges of interests in joint operations that constitute businesses are frequent.

19 We believe that the cost of implementing the new requirements will be mitigated by the following factors:

(a) The Amendments do not introduce new accounting principles but extend, to the accounting of acquisition of interests in joint operations in which the activity constitute a business, current requirements that are already applicable to associates and joint ventures using the equity method; and

(b) The prospective application of the Amendments will reduce one-off costs of implementing the new requirements by not requiring restatement of previous acquisitions.

20 Overall, EFRAG's assessment is that the Amendments might result in increased one-off or ongoing costs for some preparers.

Costs for users

21 EFRAG has carried out an assessment of the cost implications for users resulting from the Amendments.

22 EFRAG believes that there will be some insignificant one-off costs for users to familiarise with the new requirements in the Amendments.

23 EFRAG believes that the Amendments are not likely to result in increased ongoing costs for users as they will result in information that is more readily usable and comparable than cost allocation, and consistently applied to new transactions entered into by entities.

24 Overall, EFRAG's assessment is that the Amendments are likely to result in insignificant one-off or ongoing costs for users.

Benefits for preparers and users

25 EFRAG has carried out an assessment of the benefits for users and preparers resulting from the Amendments.

26 The Amendments address diversity in practice on the accounting for acquisitions of interests in joint operations due to the lack of specific guidance in current standards.

27 EFRAG believes that both users and preparers are likely to benefit from the outcomes of these Amendments as they are likely to result in information that is comparable and understandable without adding undue complexity.

28 Users are likely to benefit, as the information resulting from the implementation of the Amendments has greater predictive value and is more comparable between entities and therefore will enhance users' analysis.

29 The Amendments will provide clarification to preparers in selecting the appropriate accounting treatment and introduce a comprehensive and consistent set of accounting principles for the acquisition of an interest in a 'business' irrespective of the form the investor's interest takes.

30 Overall, EFRAG's assessment is that preparers and users are likely to benefit from the Amendments. In areas where current IFRSs were silent or contained limited guidance, the new requirements should enhance consistency of application by preparers and increase comparability for users.

Conclusion

31 EFRAG's overall assessment is that, on balance, the benefits that are expected to arise from the implementation of the *Amendments to IFRS 11 Accounting for Acquisitions of Interests in Joint Operations* in the EU will exceed the costs expected to be incurred.

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