EFRAG
European Financial Reporting Advisory Group

Jonathan Faull
Director General, Internal Market and Services
European Commission
1049 Brussels

24 July 2014

Dear Mr Faull

Adoption of Amendments to IFRS 11 Accounting for Acquisitions of Interests in Joint Operations

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards we are pleased to provide our opinion on the Amendments to IFRS 11 *Accounting for Acquisitions of Interests in Joint Operations* ('the Amendments'), which were issued by the IASB on 6 May 2014. They were issued as an Exposure Draft in December 2012 and EFRAG commented on that draft.

The objective of the Amendments is to introduce guidance into IFRS 11 on the accounting for acquisition of interests in joint operations in which the activity constitutes a business. The guidance amends IFRS 11 so that the acquirer of an interest in a joint operation in which the activity constitutes a business, applies all of the principles on business combinations accounting in IFRS 3 and other IFRSs except for those principles that conflict with the guidance in IFRS 11.

The Amendments become effective for annual periods beginning on or after 1 January 2016. Earlier application is permitted, however entities shall disclose that fact.

The Amendments include references to IFRS 9 *Financial Instruments*, which has not yet been endorsed in the European Union. These references to IFRS 9 are not addressed in this Endorsement Advice and will be considered together with the related requirements in IFRS 9.

EFRAG has carried out an evaluation of the Amendments. As part of that process, EFRAG issued its initial assessment for public comment and, when finalising its advice and the content of this letter, it took the comments received in response into account. EFRAG's evaluation is based on input from standard setters, market participants and other interested parties, and its discussions of technical matters are open to the public.

EFRAG supports the Amendments and has concluded that they meet the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards in that they:

- are not contrary to the principle of 'true and fair view' set out in Article 4(3) of Council Directive 2013/34/EU; and
- meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

For the reasons given above, EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt the Amendments and, accordingly, *Amendments to IFRS 11 Accounting for Acquisitions of Interests in Joint Operations*

EFRAG recommends their adoption. EFRAG's reasoning is explained in the attached 'Appendix - Basis for Conclusions'.

On behalf of EFRAG, I would be happy to discuss our advice with you, other officials of the European Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely

Françoise Flores

EFRAG Chairman

APPENDIX

BASIS FOR CONCLUSIONS

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on the Amendments to IFRS 11 *Accounting for Acquisitions of Interests in Joint Operations* ('the Amendments').

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity of contributing to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS in the European Union and European Economic Area.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the technical criteria for the European endorsement, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

Does the accounting that results from the application of the Amendments meet the technical criteria for EU endorsement?

1 EFRAG has considered whether the Amendments meet the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002, in other words that the Amendments:

(a) are not contrary to the principle of 'true and fair view' set out in Article4(3) of Council Directive 2013/34/EU; and

(b) meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

2 EFRAG also considered, based only on evidence brought to its attention by constituents, whether it would be not conducive to the European public good to adopt the Amendments.

Relevance

3 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.

4 EFRAG considered whether the Amendments would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

5 EFRAG acknowledges that the acquisition of an interest in a joint operation in which the activity of that joint operation constitutes a business does not imply the acquisition of control and therefore does not meet the definition of a business combination under IFRS 3. However, applying the guidance in IFRS 3 and other

IFRSs gives a consistent set of accounting principles for the different components of all transactions involving the acquisition of a business.

6 EFRAG notes that the application of business combination principles to situations where control is not obtained is already required under IAS 28 which states that '*the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of interests in associates and joint ventures*' (paragraph 26 of IAS 28).

7 EFRAG believes that information provided by IFRS 3 and other relevant IFRSs on business combinations accounting, including the disclosures required by those Standards, is relevant for the acquisitions of interests in a joint operation in which the activity constitutes a business.

8 Measuring the joint operator's share of identifiable assets and liabilities at fair value and separately recognising goodwill, when present, generally provides relevant information about the amount at which the interests in the assets and liabilities would have been recognised if they had been acquired separately. The Amendments will enable the joint operator to reflect the expected synergies that stem from the acquisition of a joint operation where the activities constitute a business. However, EFRAG acknowledges that, in the case of acquisitions of interests in joint operations achieved in stages while maintaining joint control, the Amendments may not always result in enhanced relevance of information as each tranche of an interest in the joint operation is recognised separately on acquisition and the previously held interest is not remeasured.

9 On balance, EFRAG's overall assessment is that the Amendments would result in the provision of relevant information and, therefore, they satisfy the relevance criterion.

Reliability

10 EFRAG also considered the reliability of the information that will be provided by applying the Amendments. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

11 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation and completeness.

12 The Amendments require that the definition of a business in IFRS 3 be applied in determining which acquisitions are within the scope of the Amendments. This may require significant judgement by preparers, and the Amendments include examples to illustrate certain of the requirements to assist in this respect.

13 As mentioned in the assessment of the 'relevance' criterion above, the Amendments will require greater use of fair value than hitherto. Use of estimates is an essential part of the financial statements and does not undermine their reliability as long as the estimates used can be reasonably determined. Therefore, EFRAG believes that the Amendments are likely to result in financial information that is reliable as they will be based on the application of the well understood principles of business combinations, contained in IFRS 3 and other applicable IFRSs, to new transactions entered into by all entities.

14 Finally, the Amendments shall be applied prospectively. In EFRAG's view, prospective application of the Amendments results in information that is unbiased because it prevents the undue use of hindsight. Therefore, the Amendments ensure a minimum level of reliability.

15 EFRAG's overall assessment is that the Amendments would raise no concerns about risk of error or bias and, therefore, they satisfy the reliability criterion.

Comparability

16 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

17 EFRAG has considered whether the Amendments result in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

18 EFRAG acknowledges that diversity in practice existed on how joint operators accounted for the acquisition of an interest in a jointly controlled operation under IAS 31 *Interests in Joint Ventures*, when the activity of the jointly controlled operation constituted a business. In providing guidance in an area where little or none existed, the amendments will help reduce diversity in practice that was otherwise likely to continue with IFRS 11 (which superseded IAS 31) in relation to the accounting for joint arrangements that are classified as joint operations, and therefore contribute to increased comparability. This is the case even though, due to their scope, the Amendments cover a limited set of circumstances and do not provide guidance on all aspects of acquisitions of interest in joint operations by joint operators.

19 Furthermore, EFRAG believes that the Amendments will require an entity to account for transactions involving the acquisition of an interest in a 'business' similarly, irrespective of the form that the investor's interest takes (subsidiary, joint venture, associate or joint operation). We note, in this respect, that applying the principles of business combinations to acquisitions of interests in joint operations is consistent with the current requirements applicable to the equity method under IAS 28.

20 However, EFRAG also notes that each tranche of an interest in a joint operation in which the activities constitute a business is recognised separately on acquisition if joint control is maintained. Therefore, comparability between an interest acquired in a single transaction and a similar interest acquired through more than one transaction could, in certain circumstances, be hindered.

21 Finally, the Amendments apply prospectively for transactions occurring in annual periods beginning on or after 1 January 2016. In EFRAG's view, prospective application of the Amendments could also hinder comparability between acquisitions of interests in joint operations entered into before or after the date of application. However, EFRAG acknowledges that it may not always be practicable for an entity to retrospectively determine the fair value of the identifiable assets and liabilities without use of hindsight and, as mentioned in the assessment of the

'reliability' criterion, the need for reliable information commands prospective application.

22 Overall and on balance, EFRAG's assessment is that the Amendments satisfy the comparability criterion.

Understandability

23 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.

24 Although there are a number of aspects to the notion of 'understandability', EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.

25 As a result, EFRAG believes that the main additional issue it needs to consider, in assessing whether the information resulting from the application of the Amendments are understandable, is whether that information will be unduly complex.

26 In EFRAG's view, applying the principles of business combination accounting in IFRS 3 and other IFRSs to acquisitions of interests in a joint operation in which the activity constitutes a business results in financial information that is understandable. This is because the Amendments do not introduce new principles but apply existing accounting principles to the transactions within the scope of the Amendments.

27 EFRAG's overall assessment is that the Amendments satisfy the understandability criterion in all material respects.

True and Fair

28 EFRAG's assessment is that the information resulting from the application of the Amendments would not be contrary to the true and fair view principle.

European public good

29 EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt the Amendments.

Conclusion

30 For the reasons set out above, EFRAG's assessment is that the Amendments satisfy the technical criteria for EU endorsement and EFRAG should therefore recommend their endorsement.