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HKFRS / IFRS UPDATE 2014/10

ACCOUNTING FOR ACQUISITIONS OF INTERESTS IN JOINT OPERATIONS (AMENDMENTS TO HKFRS/IFRS 11)

STATUS
Final

EFFECTIVE DATE
1 January 2016, with earlier application permitted

ACCOUNTING IMPACT
Clarification of the treatment of acquisitions of interests in joint operations that meet the definition of a business in HKFRS/IFRS 3

Background

IFRS 11 *Joint Arrangements* was released in 2011 with an effective date of 1 January 2013, and superseded IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities - Non-Monetary Contributions by Venturers*.

Neither IAS 31 *Interests in Joint Ventures* nor IFRS 11 provided guidance on the accounting by a joint operator for the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business as defined by IFRS 3 *Business Combinations*.

As a result, diversity arose in practice in the accounting for the acquisition of interests in jointly controlled operations that meet the definition of a business, such as:

- The premium paid above the fair value of the identifiable net assets being either recognised as a separate asset (ie goodwill), or proportionally allocated to other identifiable assets
- Deferred tax assets and deferred tax liabilities that arise from the initial recognition of assets and liabilities (except for goodwill) being either recognised or not recognised by virtue of the initial recognition exemption in paragraphs 15 and 24 of IAS 12 *Income Taxes*
- Acquisition costs either being capitalised or expensed.

In 2012 the IFRS Interpretations Committee (IFRS IC) received several requests from a number of constituents regarding this diversity. The IFRS IC then referred the issue to the International Accounting Standards Board (IASB), suggesting that an amendment be made to IFRS 11 to clarify the approach which should be followed.

In December 2012 the IASB published Exposure Draft *ED/2012/7 Acquisition of an Interest in a Joint Operation*, that proposed to incorporate the principles of IFRS 3 for the purposes of a transaction in which the interest in a joint operation which is acquired meets the definition of a business in IFRS 3, with a deadline on comments of April 2013.

The IASB deliberated the comments received from constituents and subsequently released the final amendment to IFRS 11 in May 2014. Following its convergence policy with IFRS, the HKICPA also released equivalent amendments to HKFRS in June 2014.

Summary

The amendments require an entity to apply all of the principles of HKFRS/IFRS 3 when it acquires an interest in a joint operation that constitutes a business as defined by HKFRS/IFRS 3.

The amendment also includes two new *Illustrative Examples*:

- Example 7: *Accounting for acquisitions of interests in joint operations in which the activity constitutes a business*
- Example 8: *Contributing the right to use know-how to a joint operation in which the activity constitutes a business*.

A consequential amendment to HKFRS/IFRS 1 *First-time Adoption of International Financial Reporting Standards* has also been made, to clarify that the exemption from applying HKFRS/IFRS 3 to past business combinations upon adoption of HKFRS/IFRS also applies to past acquisitions of interests in joint operations in which the activity of the joint operation constitutes a business, as defined in HKFRS/IFRS 3.

Amendments to HKFRS/IFRS 11

Paragraph 21A has been added to HKFRS/IFRS 11 to clarify that when an entity acquires an interest in a joint operation that constitutes a business as defined by HKFRS/IFRS 3, the entity must:

- Apply the principles of business combination accounting as prescribed in HKFRS/IFRS 3
- Disclose the information regarding business combinations as prescribed in HKFRS/IFRS 3

Paragraphs B33A – B33D have been added to the *Application Guidance* of HKFRS/IFRS 11, to clarify:

i. The nature of some of the principles of business combination accounting that may apply to the acquisition of an interest in a joint operation that constitutes a business, including:
   - Fair value measurement of identifiable assets and liabilities (other than those that have exemptions under HKFRS/IFRS 3)
   - Recognition of acquisition related costs in profit or loss as they are incurred
   - Recognition of deferred tax
   - Recognition of goodwill (or gain on bargain purchase)
   - Subsequent annual impairment testing of cash generating units to which goodwill arising in the business combination has been attributed to, in accordance with HKAS/IAS 36 *Impairment of Assets*.

ii. The principles of HKFRS/IFRS 3 are also to be applied upon the formation of a joint operation if an existing business as defined by HKFRS/IFRS 3 is contributed by at least one of the parties.

iii. HKFRS/IFRS 3 is not applied where a joint operator increases its interest in a joint operation that meets the definition of a business as defined by HKFRS/IFRS 3, if that joint operator retains joint control over the joint operation.

iv. Consistent with the scope of HKFRS/IFRS 3, the requirement to apply HKFRS/IFRS 3 to the acquisition of an interest in a joint operation that constitutes a business as defined by HKFRS/IFRS 3 does not apply where there is common control between the joint parties of the joint operation both before and after the acquisition, and control is not transitory.

Disclosures

The amendment does not introduce any additional disclosures.

Effective date and transition

The effective date for the amendments is for acquisitions in annual periods beginning on or after 1 January 2016, and is to be applied prospectively.

Therefore the amendments will apply to acquisitions of interests in joint operations that constitute a business as defined by HKFRS/IFRS 3 where the acquisition date is on or after the start of an entity's first annual period beginning on or after 1 January 2016.

Early application is permitted. If the amendments are adopted early, this is required to be disclosed.

BDO's support and assistance on HKFRS/IFRS

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