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Subject	**Accounting treatment for acquisition of additional stake in a joint venture without change in joint control**		
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This Paper has been prepared for discussion at a meeting of the Emerging Economies Group and it represents the views of the author and not necessarily those of the Malaysian Accounting Standards Board.

Background

1. Currently, guidance is provided for changes in a parent's ownership interest in a subsidiary that does not result in the parent losing control[1] as well as for circumstances in which an associate becomes a joint venture or vice versa[2].

   However, there is <u>no guidance</u> provided for circumstances in which an acquisition of an additional stake in an existing joint venture does not result in a change in joint control. A case scenario for illustration,

   - Company XYZ owns 40% equity interest in Company A, which is its joint venture entity in accordance with IFRS 11 *Joint Arrangements*
   - During the year, Company XYZ acquired an additional 5% equity interest in Company A
   - Company A remains a joint venture entity of Company XYZ after the acquisition.

   Issue: How to account for the acquisition of the additional 5% stake?

Proposal

2. We suggest that the IASB consider examining the appropriate accounting treatment for the acquisition of an additional stake in an existing joint venture which does not result in a change in joint control as part of the Post-implementation Review (PIR) on IFRS 11 *Joint Arrangements.*

   We are aware that the IASB does not plan to review IAS 28 *Investments in Associates and Joint Ventures* during the PIR but consider that this interaction between IFRS 11 and IAS 28 merits attention.

[1] IFRS 10 *Consolidated Financial Statements*, paragraphs 23-24. Paragraph 23 states, *"Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (ie transactions with owners in their capacity as owners)."*

[2] IAS 28.24. That paragraph states, *"If an investment in an associate becomes an investment in a joint venture or an investment in a joint venture becomes an investment in an associate, the entity continues to apply the equity method and does not remeasure the retained interest."*

Alternatively, if the issue is not within PIR for IFRS 11, we suggest the issue be taken up in the IASB project on Equity Method, as discussed by the Board at its October 2020 Meeting [Agenda paper 13].

Issue

3. There are currently divergent practices in accounting for the acquisition of an additional stake in an existing joint venture which does not result in a change in control.

<table>
<tr><th>View 1</th><th>View 2</th></tr>
<tr><td>The increase in the investor's share of net assets arising from acquisition of an additional stake is recognised in the investor's equity.

There is no requirement to recognise the additional share of net assets at net fair value, and any difference between the additional cost of investment and additional share of the investee's net assets is recognised in the investor's equity (such as retained earnings).</td><td>On acquisition of the additional stake, any difference between the cost of the additional stake and the entity's share of the additional net fair value of the investee's identifiable net assets is accounted for either as
(i) goodwill (included in the carrying amount of the investment); or
(ii) the excess of the entity's share of net fair value of the investee's identifiable net assets over the cost of investment included as income in profit or loss.

The share of net assets on the existing stake is not revalued.</td></tr>
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4. Proponents of View 1 refer to IAS 28.26, which stipulates that the concepts underlying the procedures in accounting for acquisition of a subsidiary are also adopted in the accounting for the acquisition of an investment in an associate or joint venture.

   IAS 28.26 states,

   > *Many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in IFRS 10. Furthermore, the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate or a joint venture.*

   IFRS 10.B96 prescribes that, when the proportion of the equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent.

The proponents of View 1 note that the accounting treatment is also consistent with the thinking in the proposed amendments to IAS 28 *Investment in Associates and Joint Ventures* in the IASB Exposure Draft ED/2012/3 *Equity Method: Share of Other Net Asset Changes*.

Proponents of View 1 have also identified the following supporting arguments.

(i) In reality, it is sometimes difficult to obtain information required to prepare the fair value adjustments when applying the equity method of accounting since the investor does not control the investee and, consequently, does not have unrestricted access to information.

Although they note the requirement to measure the share of the investee's identified assets and liabilities at fair value on acquisition is prescribed in IAS 28.32, they query the rationale for applicability of this requirement, particularly when:

(a) the unit of account is the investment in the joint venture as a whole, because under the equity method the interest in the joint venture is recognised as a single asset; and

(b) the investor has neither separately recognised the individual assets and liabilities, nor does it separately disclose goodwill attributable to the investment.

(ii) Apart from the impracticality mentioned in paragraph (i) above, the proponents of View 1 also note the following.

(a) The application of IAS 28.32 may result in a misleading representation of the joint venture's performance[3] by recognising income when the entity's share of the net fair value of the investee's identifiable assets and liabilities exceeds the cost of the investment.

(b) Although IAS 28.32 does not specify that *on acquisition date* means *on initial acquisition date* (rather than *on initial and subsequent acquisition dates*), the thinking in the revised accounting for a 'step acquisition' in IFRS 3 *Business Combinations* (2008 version) indicates there is only one acquisition date.

IFRS 3 (2004 version) required the fair value of every asset and liability to be measured at each step for the purposes of calculating a portion of goodwill and this requirement was removed from IFRS 3 (2008 version) whereby, goodwill is measured as the difference at acquisition date between the fair value of any investment in the business held before the acquisition, the consideration transferred and the net assets acquired.

5. Proponents of View 2 believe that an entity (investor) should apply IAS 28.32. However, the share of net assets on the existing stake is not revalued.

[3] because the additional stake in the joint venture is not performance related.

IAS 28.32 states,

> *An investment is accounted for using the equity method from the date on which it becomes an associate or a joint venture. On acquisition of the investment, any difference between the cost of the investment and the entity's share of the net fair value of the investee's identifiable assets and liabilities is accounted for as follows:*
>
> *(a) Goodwill relating to an associate or a joint venture is included in the carrying amount of the investment. Amortisation of that goodwill is not permitted.*
>
> *(b) Any excess of the entity's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is included as income in the determination of the entity's share of the associate or joint venture's profit or loss in the period in which the investment is acquired.*
>
> *Appropriate adjustments to the entity's share of the associate's or joint venture's profit or loss after acquisition are made in order to account, for example, for depreciation of the depreciable assets based on their fair values at the acquisition date. Similarly, appropriate adjustments to the entity's share of the associate's or joint venture's profit or loss after acquisition are made for impairment losses such as for goodwill or property, plant and equipment.*

Proponents of View 2 opine that IAS 28.32 is not limited to the initial acquisition of the joint venture but should also be applied to each additional acquisition of an interest in the joint venture. That is, IAS 28.32 applies to an investment in a joint venture using the equity method of accounting.

In addition, proponents of View 2 believe that IAS 28.26 is not intended to apply to changes in ownership interests, particularly given the different nature of a subsidiary in which an entity has unilateral control compared with an associate or joint venture, in which an entity only has significant influence or joint control.

6. Implications of View 1 and View 2

Using the case scenario in paragraph 1, say:

- Company XYZ owns 40% equity interest in Company A, which is its joint venture entity in accordance with IFRS 11 *Joint Arrangements*

  The cost of investment of this 40% equity interest was CU500 million and the share of net book value which was also the fair value of Company A's net identifiable assets at the acquisition date of 1 July 2015 was CU400 million.

- During the year, Company XYZ acquired an additional 5% equity interest in Company A

  The cost of investment of this additional 5% equity interest was CU70 million. Company XYZ's share of net book value and the share of the estimated fair value of Company A's net identifiable assets at the date of acquisition of 1 February 2019 was CU115 million and CU125 million respectively.

- Company A remains a joint venture for Company XYZ after the acquisition.

The fact pattern is not necessarily intended to be commercially realistic, and has been designed to demonstrate the differing accounting implications of View 1 versus View 2.

	Original stake (40%) CU million	Additional stake (5%) CU million
Cost of investment	500	70
Share of net assets, at fair value	400	125
Goodwill on acquisition	100	-
Excess of the Company XYZ's share of net assets of Company A over the cost of the investment	-	(55)

The accounting implications of View 1 vs. View 2

	Dr CU' million	Cr CU' million
On acquisition of the 40% stake		
Investment in JV	500	
Bank		500
The additional 5% stake		
View 1:		
Investment in JV	115	
Bank		70
Retained earnings		45
View 2		
Investment in JV	125	
Bank		70
Profit & Loss		55

~ END ~