Project **Joint Ventures**

Topic **Transactions between a party and a joint arrangement: consequential amendments to IAS 28**

1. **This Agenda Paper discusses the accounting for transactions (ie sales, purchases or contributions of non-monetary assets, etc) between a party and a joint arrangement, for the purpose of redeliberating any modifications to be incorporated in this section.**

2. This Agenda Paper is divided into two sections:

   (a) accounting requirements proposed by ED 9 and summary of the comments received [paragraphs 3-6];

   (b) analysis performed and modifications proposed [paragraphs 7-16]

Accounting requirements proposed by ED 9 and summary of the comments received

3. ED 9 includes the following accounting requirements for transactions between the parties and the joint arrangement:

   > 27. When a venturer enters into a transaction with a joint venture, it recognises gains or losses resulting from the transaction in accordance with paragraph 22 of IAS 28.[1] Those transactions would include, for example, the sale, purchase or contribution of assets, including the contribution of a non-monetary asset to a joint venture in exchange for an equity interest in the joint venture.

4. We summarise below the comments received from respondents to ED 9 in relation to this section of the draft standard.

[1] IAS 28.22 states: 'Profits and losses resulting from 'upstream' and 'downstream' transactions between an investor (including its consolidated subsidiaries) and an associate are recognised in the investor's financial statements only to the extent of unrelated investors' interests in the associate. […].'

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

Observations raised in the comment letters

5. Some respondents to ED 9 stated that they did not believe that the reference to IAS 28.22 in paragraph 27 of ED 9 was sufficient guidance to cover the following matters that are addressed specifically in IAS 31 and SIC-13:

   (a) SIC-13 specifies a number of conditions that need to be met (SIC-13.5(a)-(c), included in the Appendix to this Agenda Paper) to enable gains or losses to be regarded as realised, and therefore to be recognised by a venturer when carrying out non-monetary contributions to a jointly controlled entity (JCE) in exchange for an equity interest. There is no such requirement in paragraph 22 of IAS 28.

   (b) Paragraphs 48-50 of IAS 31 (included in the Appendix to this Agenda Paper) include the requirement for recognition of losses representing a reduction in the net realisable value of current assets or an impairment loss. There is no such requirement in paragraph 22 of IAS 28.

6. Additionally, we note that ED 9 specifies the requirements to account for transactions, including the contribution of non-monetary assets, between a party and a 'joint venture'. It does not, however, specify the requirements to account for transactions between a party and a 'joint operation'.

Analysis of comments received and modifications proposed

Exceptions stated in paragraph 5(a)-(c) of SIC-13

7. Paragraph 5 of SIC-13 details circumstances in which it is not appropriate for a venturer to recognise a portion of a gain or loss resulting from non-monetary contributions to a JCE. SIC-13 establishes that it is not appropriate to recognise gains or losses when:

   (a) the significant risks and rewards of ownership of the non-monetary asset have not been transferred; or

   (b) the gain or loss on the non-monetary contribution cannot be measured reliably; or

   (c) the transaction lacks commercial substance.

The significant risks and rewards of ownership of the contributed non-monetary asset(s) have not been transferred to the JCE

8. The references to risks and rewards used in SIC-13 are not consistent with the control model we are now using. We therefore think that this exception for the recognition of gains and losses resulting from contributions of non-monetary assets into joint arrangements is no longer appropriate because it is not consistent with the model proposed in the new standard. We consider that there is therefore no need to keep this SIC-13 requirement in the final standard.

The gain or loss on the non-monetary contribution cannot be measured reliably

9. This exception is an application of the conditions the Framework requires for an item to meet the definition of an element of the financial statements:

> 83. An item that meets the definition of an element should be recognised if:
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> (a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and
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> (b) the item has a cost or value that can be measured with reliability.

10. In the Business Combinations project the Board decided that it was unnecessary to repeat statements from the Framework when discussing recognition. We think that carrying these words forward into the new Standard is also unnecessary.

The contribution transaction lacks commercial substance

11. SIC-13 requires that a transaction should not be treated as realised when, among other things, it lacks commercial substance as defined in IAS 16 *Property, Plant and Equipment*. Paragraph 25 of IAS 16 states that an exchange transaction has ‘commercial substance’ if:

    (a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or
    (b) the entity-specific value of the portion of the entity’s operations affected by the transaction changes as a result of the exchange; and
    (c) the difference in (a) and (b) is significant relative to the fair value of the assets exchanged.

12. IAS 16’s ‘commercial substance’ test is designed to enable an entity to measure, with reasonable objectivity, whether the asset that is acquired in a non-monetary

exchange is different to the asset that it has given up. In essence, these rules are designed to prevent the recognition of gains where an entity enters into an artificial transaction with the intention of 'manufacturing' a gain by attributing inflated values to the assets exchanged, when in fact the exchange of assets that are similar is not expected to change the configuration of the entity's cash flows. This would therefore leave the entity in the same position as it was before the transaction.

13. We think that the final standard should keep such a requirement in the case of non-monetary transactions in exchange for an equity interest in an arrangement.

Requirement of recognition of losses representing a reduction in the net realisable value of current assets or an impairment loss [Described in paragraph 5(b) of this Agenda Paper]

14. We think that the requirements in paragraphs 48-50 of IAS 31 for recognising the full amount of any loss when the contribution, sale or purchase provides evidence of a reduction in the net realisable value or recoverable amounts of the assets sold, purchased or contributed should be kept in the final standard for the following reasons:

    - ED 9 did not aim to change the current accounting practice of these transactions; and
    - IAS 28 does not specifically cover this circumstance.

Requirements for joint operations [Described in paragraph 6 of this Agenda Paper]

15. The majority of the arrangements that will be classified as 'joint operations' in accordance with the new standard are currently classified as *jointly controlled operations* or *jointly controlled assets* in IAS 31. However, there might also be arrangements that are *JCEs* according to IAS 31 that will be 'joint operations' under the new standard.

16. The fact that the 'joint operation' is housed in an entity[2] (ie the arrangement would be a 'joint operation' under the new standard and a JCE under IAS 31) should not change the accounting obtained when this type of arrangement is not structured through a separate entity, ie in essence a party in this type of arrangement is transacting with the other parties to the arrangement, even if the arrangement is structured through an entity. We propose to include this clarification in the final standard.

Question 1
Does the Board agree that the final requirements should: (a) not include the exceptions for recognition of profits or losses stated in SIC-13.5(a)-(b) relating to the transfer of significant risks and rewards to the JCE and the requirement that gains or losses should be measured reliably? [Paragraphs 7-10] (b) include the guidance relating to 'commercial substance' in SIC-13? [Paragraphs 11-13] (c) include the guidance relating to full recognition of losses when transactions provide evidence of a reduction in the net realisable value or recoverable amount of the assets transacted or contributed? [Paragraphs 14] (d) clarify the accounting for transactions between the parties and 'joint operations'? [Paragraphs 15-16]

[2] Please note that IAS 31.13 states: 'The operation of some joint ventures involves the use of the assets and other resources of the venturers rather than the establishment of a corporation, partnership or other entity, or a *financial structure that is separate from the venturers* themselves'. The term 'entity' in this paragraph has the same connotations as when it is used in arrangements called 'jointly controlled entities' in IAS 31 (ie a separate financial structure from the venturers themselves).

Appendix - Relevant paragraphs of SIC-13 and IAS 31 referred to in the Agenda Paper

SIC-13

5. In applying IAS 31.48 to non-monetary contributions to a JCE in exchange for an equity interest in the JCE, a venturer shall recognise in profit or loss for the period the portion of a gain or loss attributable to the equity interests of the other venturers except when:

(a) the significant risks and rewards of ownership of the contributed non-monetary asset(s) have not been transferred to the JCE; or

(b) the gain or loss on the non-monetary contribution cannot be measured reliably; or

(c) the contribution transaction lacks commercial substance, as that term is described in IAS 16.

If exception (a), (b) or (c) applies, the gain or loss is regarded as unrealised and therefore is not recognised in profit or loss unless paragraph 6 also applies.

6. If, in addition to receiving an equity interest in the JCE, a venturer receives monetary or non-monetary assets, an appropriate portion of gain or loss on the transaction shall be recognised by the venturer in profit or loss.

7. Unrealised gains or losses on non-monetary assets contributed to JCEs shall be eliminated against the underlying assets under the proportionate consolidation method or against the investment under the equity method. Such unrealised gains or losses shall not be presented as deferred gains or losses in the venturer's consolidated statement of financial position.

IAS 31

48. When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction shall reflect the substance of the transaction. While the assets are retained by the joint venture, and provided the venturer has transferred the significant risks and rewards of ownership, the venturer shall recognise only that portion of the gain or loss that is attributable to the interests of the other venturers. The venturer shall recognise the full amount of any loss when the contribution or sale provides evidence of a reduction in the net realisable value of current assets or an impairment loss.

49. When a venturer purchases assets from a joint venture, the venturer shall not recognise its share of the profits of the joint venture from the transaction until it resells the assets to an independent party. A venturer shall recognise its share of the losses resulting from these transactions in the same way as profits except that losses shall be recognised immediately when they represent a reduction in the net realisable value of current assets or an impairment loss.

50. To assess whether a transaction between a venturer and a joint venture provides evidence of impairment of an asset, the venturer determines the recoverable amount of the asset in accordance with IAS 36 Impairment of Assets. In determining value in use, the venturer estimates future cash flows from the asset on the basis of continuing use of the asset and its ultimate disposal by the joint venture.