Project: **New items for initial consideration**

Topic: **IFRS 11 *Joint Arrangements*—Acquisition of interest in joint arrangement**

Introduction

1. The IFRS Interpretations Committee (the Committee) received a request to clarify the accounting for the acquisition of an (undivided) interest in a joint arrangement.
2. The submission is reproduced in full in Appendix C to this paper.

Purpose of the paper

3. This paper:
   - (a) provides background information on the issue;
   - (b) analyses the issue within the context of IFRSs;
   - (c) assesses the issue against the Committee's agenda criteria;
   - (d) includes the staff recommendation not to add this issue to the Committee's agenda;
   - (e) asks questions of the Committee.

Background information

The issue

4. Neither IAS 31 *Interests in Joint Ventures* nor IFRS 11 *Joint Arrangements* gives comprehensive guidance on accounting for the case when an entity acquires an interest in a joint venture (IAS 31) or in a joint arrangement (IFRS 11). Both standards only address the acquisition accounting for one type of joint venture (IAS 31) or for one type of joint arrangement (IFRS 11), ie

interests in jointly controlled entities (IAS 31) or interests in joint ventures (IFRS 11).

5. When applying the equity method in accounting for the acquisition of an interest in a joint venture as defined in Appendix A to IFRS 11, paragraph 24 of IFRS 11 and paragraph 26 of IAS 28 *Investments in Associates and Joint Ventures* (revised 2011) require an entity to adopt the concepts underlying the procedures used in accounting for the acquisition of a subsidiary, ie including the concepts underlying IFRS 3 *Business Combinations*. Furthermore, paragraph 32 of IAS 28 (revised 2011) gives guidance for the recognition of (negative) goodwill when applying the equity method.

6. The same analysis applies if an entity uses the equity method in accounting for the acquisition of an interest in a jointly controlled entity as specified in IAS 31 (see paragraph 30 of IAS 31 and paragraphs 20 and 23 of IAS 28 *Investment in Associates*, revised 2003).

7. Furthermore, paragraph 33 of IAS 31 and paragraph 18 of IAS 27 *Consolidated and Separate Financial Statements* (amended 2008) require the adoption of the same concepts for the acquisition of the interest in the jointly controlled entity when using proportionate consolidation.

8. However, there is no explicit guidance in IFRS 11 on the accounting for the acquisition of interests in joint operations as defined in IFRS 11 or the acquisition of interests in jointly controlled operations or assets as specified in IAS 31. We have been informed that this lack of guidance in IAS 31 has resulted in diversity in practice when the activity of the jointly controlled operations or assets constitutes a business, as defined in IFRS 3, in the oil and gas industry. The submitter expects that the diversity in practice will continue under IFRS 11 unless the Committee provides some kind of clarification.

9. Applying the concepts underlying IFRS 3 is especially relevant for the recognition of goodwill and deferred taxes.

Summary analysis presented in the submission

10. It is explained in the submission that many oil and natural gas producing fields are business as defined in IFRS 3. However, they are not controlled by one entity but worked through some type of joint venture with a number of participants which often have an undivided interest in the assets of the producing field, a right to a specific percentage of the production of the producing field and a joint obligation for decommissioning.

11. The submitter notes that such joint ventures are usually classified as jointly controlled operations or assets as specified in IAS 31 with each participant recognising its share of the assets, liabilities, revenues and expenses of the jointly controlled operations or assets in its financial statements.

12. Because such undivided interests in oil and natural gas producing fields are frequently sold, exchanged, expanded or disposed, the submitter identified two divergent views on whether IFRS 3 has to be applied when venturers account for the acquisition of their undivided interests in jointly controlled operations or assets or in joint operations:

    (a) **View 1:** the venturer/joint operator does not apply IFRS 3. Even if the activity of the jointly controlled operations or assets or the joint operation and related assets represents a business, the venture/joint operator acquiring the interest does not obtain control of that business. Instead, the venturer/joint operator accounts for the transaction as the acquisition of a group of assets or the initial investment in a joint arrangement.

    (b) **View 2:** the venturer/joint operator applies IFRS 3. The unit of account to determine control is not the activity of the jointly controlled operations or assets or the joint operation and related assets, but the acquired interest, which is controlled by the venturer/joint operator.

13. The submitter states that the issue is widespread in the oil and gas industry.

Current IFRS literature

14. We reproduce for ease of reference in Appendix B the paragraphs from the standards that we used to perform our analysis.

Staff analysis

15. The following analysis first addresses the issue in the light of IFRS 11 before it asks whether the analysis differs in the light of IAS 31.

IFRS 11

16. Paragraph 20 of IFRS 11 requires a joint operator to recognise, in relation to its interest in a joint operation, amongst other things:

    (a) its assets, including its share of any assets held jointly; and

    (b) its liabilities, including its share of any liabilities incurred jointly.

17. In addition, paragraph 21 of IFRS 11 specifies that a joint operator shall account for these assets and liabilities in accordance with the IFRSs applicable to the particular assets and liabilities.

18. We believe that accounting for these assets and liabilities 'in accordance with the IFRSs applicable to the particular assets and liabilities' requires the application of IFRS 3 if these assets and liabilities are acquired by the joint operator as part of a business of the joint operation. IFRS 3 gives guidance on the accounting for assets and liabilities acquired as part of a business.

19. In our opinion, the fact that a joint operator does not control the business of the joint operation is not relevant for this analysis. Paragraph 21 of IFRS 11 requires a joint operator to ignore the fact that it does not control a jointly held asset when applying the guidance in other IFRSs to the jointly held asset. The fact that it does not control the jointly held asset is reflected in the financial statements of the joint operator by recognising only the joint operator's share of that asset instead of the entire asset (see paragraph 20(a) of IFRS 11).

20. This may be illustrated by the example of an aircraft jointly held in a joint operation. The contractual arrangement entitles each joint operator to use the

aircraft for its own business to a specified extent. Paragraph 21 of IFRS 11 requires the joint operators to apply IAS 16 *Property, Plant and Equipment* in accounting for their entitlement to the aircraft and classify these entitlements as property, plant and equipment. The fact that each joint operator does not control the aircraft but only its right to use the aircraft and perhaps its investment in the aircraft does not affect the classification of the aircraft as property, plant and equipment or the need to apply IAS 16. Each joint operator does not, for example, recognise an intangible asset in its financial statements for its right to use the aircraft. The fact that each joint operator does not control the aircraft affects the joint operators' accounting for the jointly held aircraft only insofar as neither of them recognises the value of the entire aircraft under IAS 16, but each operator recognises only a share of it.

21. Consequently, we believe that the fact the joint operator does not control the business of the joint operation and the assets related to it is not an argument against the application of IFRS 3. The joint operator identifies the assets and liabilities related to the business of the joint operation in accordance with IFRS 3 and in a further step it recognises only a share of these assets and liabilities because it does not control them.

22. This conclusion is supported by paragraph C7 of IFRS 11. If the transition from IAS 31 to IFRS 11 results in a change from the equity method to accounting for assets and liabilities in respect of the interest in the joint operation, the entity derecognises the investment in the jointly controlled entity that was previously accounted for using the equity method and recognises instead 'its share of each of the assets and the liabilities in respect of its interest in the joint operation, including any goodwill that might have formed part of the carrying amount of the investment'.

23. Paragraph BC65 of IFRS 11 indicates that recognising goodwill in respect of an interest in a joint operation is not a pure transition requirement or transition relief, ie the recognition of goodwill under paragraph C7 of IFRS 11 is not accepted only because it formed part of the carrying amount of the investment that was previously accounted for using the equity method. Instead, the

goodwill had to arise from the acquisition of the interest in the joint operation to be recognised under paragraph C7 of IFRS 11.

24. This explanation corresponds with the requirement in paragraph C8 of IFRS 11 that an entity has to determine its interest in the assets and liabilities relating to the joint operation on the basis of its rights and obligations in the specified proportion in accordance with the contractual arrangement at the beginning of the earliest period presented. To apply this requirement, an entity needs to perform a new assessment of the assets and the liabilities related to the joint operation at the date of transition from IAS 31 to IFRS 11, instead of merely continuing with the earlier assessment of the assets and liabilities that formed part of the carrying amount of the investment when it was accounted for in accordance with IAS 31 using the equity method.

25. Paragraph C8 of IFRS 11 provides only a transition relief for the measurement of the assets and liabilities that have to be recognised in relation to the interest in a joint arrangement.

26. Consequently, goodwill, if any, is recognised under paragraph C7 of IFRS 11 because it is an asset that is related to the interest in the joint operation and not because of the specific transition situation addressed in paragraphs C7-C11 of IFRS 11.

27. If the assets and liabilities of a joint operation do not form part of a business as defined in IFRS 3, we believe that paragraph 2(b) of IFRS 3 is the guidance applicable to the particular assets, liabilities, revenues and expenses in terms of paragraph 21 of IFRS 11. This means that a joint operator acquiring an interest in such a joint operation, that does not represent a business, identifies all the identifiable assets acquired (which does not include goodwill) and liabilities assumed and allocates the cost of its interest to these assets and liabilities on the basis of their relative fair values (see paragraph 20(a) and (b) of IFRS 11).

IAS 31

28. A venturer in jointly controlled operations has to recognise in respect of its interests in jointly controlled operations the assets that it controls and the liabilities that it incurs (see paragraph 15 of IAS 31).

29. Paragraph 21 of IAS 31 requires a venturer of jointly controlled assets to recognise, amongst other things:

    (a) its share of jointly controlled assets, classified according to the nature of the assets;

    (b) any liabilities that it has incurred; and

    (c) its share of any liabilities incurred jointly with the other venturers in relation to the joint venture.

30. Paragraph 22 of IAS 31 illustrates the requirement that the venturer must recognise its share of jointly controlled assets, classified according to the nature of the assets by giving an example: A share of a jointly controlled oil pipeline is classified as property, plant and equipment.

31. IAS 31 does not give further guidance on the accounting for assets and liabilities related to jointly controlled operations or jointly controlled assets; in particular, it gives no guidance on the acquisition of interests in jointly controlled operations or assets.

32. Venturers in jointly controlled operations or in jointly controlled assets are therefore required to determine an appropriate accounting policy based on the requirements in paragraphs 10-12 of IAS 8. In making the judgement required, an entity shall refer to, and consider the applicability of, the requirements in IFRSs dealing with similar and related issues. We believe that this leads once again to the application of IFRS 3 if the assets and liabilities that venturers have to recognise are part of the business of a jointly controlled operation or assets and the venturers have acquired interests in such jointly controlled operations or assets.

US GAAP comparison

33. Paragraph 4.100 of AICPA Audit and Accounting Guide *Entities With Oil and Gas Producing Activities,* prepared by the ENTITIES WITH OIL AND GAS PRODUCING ACTIVITIES TASK FORCE (updated as of 1 August 2010) explains that the acquisition of a mineral interest in a proved property with oil and gas production activities that are already in place would generally be considered a business combination.

34. We understand from this non-authoritative guidance that entities in the oil and gas industry, where acquisitions of undivided interests in jointly controlled operations or assets are a prevalent type of transaction, typically recognise goodwill when they account for the acquisition of these undivided interests under US GAAP.

Agenda criteria assessment

35. The staff's assessment of the Interpretations Committee's agenda criteria is as follows:

    (a) *The issue is widespread and has practical relevance.*

    Yes. Acquisitions of undivided interests in jointly controlled operations or assets frequently occur in the oil and gas industry.

    (b) *The issue indicates that there are significantly divergent interpretations (either emerging or already existing in practice). The Committee will not add an item to its agenda if IFRSs are clear, with the result that divergent interpretations are not expected in practice.*

    Yes. There are currently differing views as to whether the venturer in jointly controlled operations or in jointly controlled assets should apply IFRS 3 if the activity of those jointly controlled operations or assets constitutes a business as defined in IFRS 3.

    (c) *Financial reporting would be improved through elimination of the diverse reporting methods.*

    Yes. The different views lead in some cases to the recognition of goodwill in the financial statements of the venturer or joint operator and in some cases not.

    (d) *The issue can be resolved efficiently within the confines of existing IFRSs and the Framework, and the demands of the interpretation process.*

No. We think IFRS 11 is clear that IFRS 3 has to be applied when accounting for the interest of a joint operator in a joint arrangement. Further clarification could only be achieved by listing IFRSs, like IFRS 3, for example in paragraphs 21 of IFRS 11.

On the other hand, the lack of guidance on the issue in IAS 31 cannot be resolved efficiently because IFRS 11, which replaces IAS 31, has to be applied for annual periods beginning on or after 1 January 2013. Neither an amendment to IAS 31 nor an interpretation on this issue for entities applying IAS 31 would become effective earlier than 1 January 2013.

(e) *It is probable that the Committee will be able to reach a consensus on the issue on a timely basis.*

No. For the lack of guidance in IAS 31 see the previous subparagraph 35(d).

(f) *If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project? (The IFRIC will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the IFRIC would require to complete its due process.)*

No. Equity method accounting is a suggested project for the Board's future agenda. However, this project would only relate to joint ventures as defined in IFRS 11 and not to joint operations as defined in IFRS 11.

Staff recommendation

36. Based on the assessment of the agenda criteria, we recommend that the Committee should not take the issue onto its agenda.

37. We propose a draft wording for a tentative agenda decision in Appendix A to this paper.

Questions to the Interpretations Committee

Questions for the Committee
1. Does the Committee agree with the staff's analysis in paragraphs 15-34?
2. Does the Committee agree with the staff's recommendation not to take the issue onto its agenda?
3. Does the Committee have any comments on the proposed wording for the tentative agenda decision in Appendix A?

Appendix A—proposed wording for tentative agenda decision

A.1 We propose the following wording for the tentative agenda decision:

> The Committee received a request to clarify the accounting by venturers for the acquisition of interests in jointly controlled operations or assets as specified in IAS 31 and the accounting by joint operators for the acquisition of interests in joint operations as defined in IFRS 11, when the activities and assets underlying the jointly controlled operations or assets, or the joint operation, constitute a business.
>
> The Committee noted that paragraph 21 of IFRS 11 requires joint operators to account for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the IFRSs applicable to the particular assets, liabilities, revenues and expenses. The Committee also noted that IFRS 3 is the applicable IFRS for the recognition of goodwill. In addition, the Committee noted that IAS 31 does not give guidance on the accounting by venturers for acquisitions of interests in jointly controlled operations or assets. However, any amendment to IAS 31 or interpretation on this issue that the Committee might develop to clarify the accounting in accordance with IAS 31would not become effective before 1 January 2013 when IFRS 11 replaces IAS 31.
>
> Consequently, the Committee [decided] not to add this issue to its agenda.

Appendix B—relevant IFRS literature

Extracts from IFRS 3 *Business Combinations*

2 This IFRS applies to a transaction or other event that meets the definition of a business combination. This IFRS does not apply to:

(a) the formation of a joint venture.

(b) the acquisition of an asset or a group of assets that does not constitute a *business*. In such cases the acquirer shall identify and recognise the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, *intangible assets* in IAS 38 *Intangible Assets*) and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative *fair values* at the date of purchase. Such a transaction or event does not give rise to goodwill.

(c) a combination of entities or businesses under common control (paragraphs B1–B4 provide related application guidance).

Extracts from IFRS 11 *Joint Arrangements*

20 A joint operator shall recognise in relation to its interest in a joint operation:

(a) its assets, including its share of any assets held jointly;

(b) its liabilities, including its share of any liabilities incurred jointly;

(c) its revenue from the sale of its share of the output arising from the joint operation;

(d) its share of the revenue from the sale of the output by the joint operation; and

(e) its expenses, including its share of any expenses incurred jointly.

21 A joint operator shall account for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the IFRSs applicable to the particular assets, liabilities, revenues and expenses.

24 **A joint venturer shall recognise its interest in a joint venture as an investment and shall account for that investment using the equity method in accordance with IAS 28 *Investments in Associates and Joint Ventures* unless the entity is exempted from applying the equity method as specified in that standard**.

Appendix A A **joint arrangement** whereby the parties that have **joint control** of the arrangement have rights to the net assets of the arrangement.

C7 When changing from the equity method to accounting for assets and liabilities in respect of its interest in a joint operation, an entity shall, at the beginning of the earliest period presented, derecognise the investment that was previously accounted for using the equity method and any other items that formed part of the entity's net investment in the arrangement in accordance with paragraph 38 of IAS 28 (as amended in 2011) and recognise its share of each of the assets and the liabilities in respect of its interest in the joint operation, including any goodwill that might have formed part of the carrying amount of the investment.

C8 An entity shall determine its interest in the assets and liabilities relating to the joint operation on the basis of its rights and obligations in a specified proportion in accordance with the contractual arrangement. An entity measures the initial carrying amounts of the assets and liabilities by disaggregating them from the carrying amount of the investment at the beginning of the earliest period presented on the basis of the information used by the entity in applying the equity method.

BC65 The Board redeliberated the transition requirements for entities changing from the equity method to accounting for assets and liabilities in respect of their interest in a joint operation. The Board decided to require an entity to recognise each of the assets, including any goodwill arising from acquisition, and the liabilities relating to its interest in the joint operation at its carrying amount on the basis of the information used by the entity in applying the equity method, instead of requiring the entity to remeasure its share of each of those assets and liabilities at the date of transition. The Board did not believe that the costs of requiring entities to remeasure the assets and liabilities relating to the joint operation as a result of the accounting change would outweigh the benefits.

Extracts from IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (revised 2003)

10 **In the absence of an IFRS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:**

- **(a) relevant to the economic decision-making needs of users; and**
- **(b) reliable, in that the financial statements:**
  - **(i) represent faithfully the financial position, financial performance and cash flows of the entity;**
  - **(ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;**
  - **(iii) are neutral, ie free from bias;**
  - **(iv) are prudent; and**
  - **(v) are complete in all material respects**.

11 **In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:**

- **(a) the requirements in IFRSs dealing with similar and related issues; and**

(b) **the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Framework*.**

12 **In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11.**

Extracts from IAS 27 *Consolidated and Separate Financial Statements* (amended 2010)

18 In preparing consolidated financial statements, an entity combines the financial statements of the parent and its subsidiaries line by line by adding together like items of assets, liabilities, equity, income and expenses. In order that the consolidated financial statements present financial information about the group as that of a single economic entity, the following steps are then taken:

(a) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary are eliminated (see IFRS 3, which describes the treatment of any resultant goodwill);

(b) non-controlling interests in the profit or loss of consolidated subsidiaries for the reporting period are identified; and

(c) non-controlling interests in the net assets of consolidated subsidiaries are identified separately from the parent's ownership interests in them. Non-controlling interests in the net assets consist of:

(i) the amount of those non-controlling interests at the date of the original combination calculated in accordance with IFRS 3; and

(ii) the non-controlling interests' share of changes in equity since the date of the combination.

Extracts from IAS 28 *Investments in Associates and Joint Ventures* (revised 2011)

26 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.

32 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.

Extracts from IAS 28 *Investments in Associates* (revised 2003)

20 Many of the procedures appropriate for the application of the equity method are similar to the consolidation procedures described in IAS 27. 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.

23 An investment in an associate is accounted for using the equity method from the date on which it becomes an associate. On acquisition of the investment any difference between the cost of the investment and the investor's share of the net fair value of the associate's identifiable assets and liabilities is accounted for as follows:

(a) goodwill relating to an associate is included in the carrying amount of the investment. Amortisation of that goodwill is not permitted.

(b) any excess of the investor's share of the net fair value of the associate's identifiable assets and liabilities over the cost of the investment is included as income in the determination of the investor's share of the associate's profit or loss in the period in which the investment is acquired.

Appropriate adjustments to the investor's share of the associate's profits or losses after acquisition are also made to account, for example, for depreciation of the depreciable assets based on their fair values at the acquisition date. Similarly, appropriate adjustments to the investor's share of the associate's profits or losses after acquisition are made for impairment losses recognised by the associate, such as for goodwill or property, plant and equipment.

Extracts from IAS 31 *Interests in Joint Ventures*

15 **In respect of its interests in jointly controlled operations, a venturer shall recognise in its financial statements:**

(a) the assets that it controls and the liabilities that it incurs; and

(b) the expenses that it incurs and its share of the income that it earns from the sale of goods or services by the joint venture.

21 **In respect of its interest in jointly controlled assets, a venturer shall recognise in its financial statements:**

(a) **its share of the jointly controlled assets, classified according to the nature of the assets;**

(b) **any liabilities that it has incurred;**

(c) **its share of any liabilities incurred jointly with the other venturers in relation to the joint venture;**

(d) **any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and**

(e) **any expenses that it has incurred in respect of its interest in the joint venture.**

22 In respect of its interest in jointly controlled assets, each venturer includes in its accounting records and recognises in its financial statements:

(a) its share of the jointly controlled assets, classified according to the nature of the assets rather than as an investment. For example, a share of a jointly controlled oil pipeline is classified as property, plant and equipment.

(b) any liabilities that it has incurred, for example those incurred in financing its share of the assets.

(c) its share of any liabilities incurred jointly with other venturers in relation to the joint venture.

(d) any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture.

(e) any expenses that it has incurred in respect of its interest in the joint venture, for example those related to financing the venturer's interest in the assets and selling its share of the output.

30 **A venturer shall recognise its interest in a jointly controlled entity using proportionate consolidation or the alternative method described in paragraph 38. When proportionate consolidation is used, one of the two reporting formats identified below shall be used.**

33 The application of proportionate consolidation means that the statement of financial position of the venturer includes its share of the assets that it controls jointly and its share of the liabilities for which it is jointly responsible. The statement of comprehensive income of the venturer includes its share of the income and expenses of the jointly controlled entity. Many of the procedures appropriate for the application of proportionate consolidation are similar to the procedures for the consolidation of investments in subsidiaries, which are set out in IAS 27.

BC10 The IFRIC rejected this argument, concluding that a stated intention to participate in a market during a future measurement period does not create a constructive obligation for future waste management costs. In accordance with paragraph 19 of IAS 37, a provision can be recognised only in respect of an obligation that arises independently of the entity's future actions. For historical household equipment the obligation is created only by the future actions of the entity. If an entity has no market share in a measurement period, it has no obligation for the waste management costs relating to the products of that type which it had previously manufactured or sold and which otherwise would have created an obligation in that measurement period. This differentiates waste

management costs, for example, from warranties (see Example 1 in the guidance on implementing IAS 37), which represent a legal obligation even if the entity exits the market. Consequently, no obligation exists for the future waste management costs until the entity participates in the market during the measurement period.

Appendix C—Interpretations Committee potential agenda item request

C1. The staff received the following request. All information has been copied without modification, except for details that would identify the submitter of the request and details that are subject to confidentiality.

Issue:

C2. Is the acquisition of an undivided interest in a joint arrangement a business combination?

C3. Most oil and natural gas fields are worked through some type of joint arrangement (JA) with a number of participants in the JA. The participants will often have an undivided interest in the assets, a right to a specified percentage of the production of the field and be jointly obligated for decommissioning. One of the participants to the JA or a third party will function as the operator of the field. The participants may vary in their rights; some may have joint control, often through membership on the joint operating committee. These joint arrangements are usually accounted for as joint assets or joint operations under IAS 31; each participant reflects their share of assets, liabilities, revenue and costs directly. It is expected that most of these arrangements would be classified as 'joint operations' under IFRS 11 'Joint arrangements'.

C4. A producing field might include a number of wells, plus loading platforms and related infrastructure. It will often meet the definition of a business in IFRS 3; it has inputs (fixed assets, natural resources, intellectual property), processes (extraction and dispatch of oil, maintenance and monitoring activities) and outputs being crude oil and other by-products.

C5. The undivided interests in the JA are frequently sold, exchanged, expanded or disposed. A company might acquire an interest in a major producing field of approximately 20%. The company obtains a seat on the joint operating committee and has joint control as a result of the transaction. There is no

corporate shell and no other assets included in the transaction. Is the acquisition of an interest in the JA a business combination?

Current practice:

C6. Two views are seen in practice.

C7. View 1: The acquisition of an undivided interest in the JA does not represent a business combination. The field may represent a business but the entity does not obtain control of the business. The transaction should be accounted for as a group of acquired assets or the initial investment in a joint arrangement; being the additional proportionate undivided interest in the fixed assets of the field plus the amount allocated to proved and probable reserves.

C8. View 2: Obtaining an equity interest in a producing field through a joint arrangement is a business combination. The unit of account to determine control is the acquired interest, not the entire producing field. Control over a specific portion of the output of the field is acquired and that unit represents a business. Inputs and processes exist; the acquirer will fund its share of the operating costs of those processes and take its share of the output.

Reasons for the IFRS IC / IASB to address the issue:

C9. There are divergent views on whether obtaining an undivided interest in a producing field through a joint arrangement is a business combination. This type of transaction is relatively widespread. [The submitter] believe[s] that an interpretation, amendment or agenda decision from the IFRS IC could reduce or eliminate this diversity.