STAFF PAPER

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IFRS Interpretations Committee Meeting

Project	IFRS 11 *Joint Arrangements*		
Paper topic	Analysis of implementation issues		
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Introduction

1. The IFRS Interpretations Committee (the 'Interpretations Committee') received several requests with regard to the application of the requirements of IFRS 11 *Joint Arrangements*.

2. At its November 2013 meeting, the Interpretations Committee was presented with a summary of the results of the outreach that was conducted on implementation issues arising from IFRS 11. The summary of the result of the outreach included (1) views from respondents on the several issues identified in the outreach request and (2) additional issues raised through the feedback from the outreach request.

3. In the discussion at its November 2013 meeting, the Interpretations Committee identified the following priority issues for further consideration:

   (a) whether an assessment of 'other facts and circumstances' should take into account facts and circumstances that do not involve contractual and (legal) enforceable terms; and

   (b) how the parties to a joint operation should recognise assets, liabilities, revenues and expenses, especially if the parties' interests in the assets and liabilities differ from their ownership interest in the joint operation.

4. The Interpretations Committee also asked the staff to identify the issues that would require further guidance and the issues that can be resolved within the context of the current Standards.

Purpose of this paper

5. This paper addresses the issues with regard to paragraph 3(a) of this paper. Other issues will be addressed in a future meeting.

6. In the paper presented to the November 2013 Interpretations Committee meeting, we classified issues into categories. The summary of issues by category is reproduced in **Appendix A** of this paper.

7. In response to the request at the November 2013 Interpretations Committee meeting, we identified the following issues[1] with regard to paragraph 3(a) of this paper to discuss at this meeting. We also identified that Issue 1 is a primary issue and Issues 2 to 5 are supplementary related issues.

Primary issue

(a) **(Issue 1)** Should the assessment of 'other facts and circumstances' be based only on contractual (and legal) enforceable terms?

Supplementary related issues

(b) **(Issue 2)** does the fact that the output is sold at a market price prevent the joint arrangement from being classified as a joint operation, when assessing 'other facts and circumstances'?

(c) **(Issue 3)** does financing from a third party prevent an arrangement from being classified as a joint operation?

[1] In this paper, we use a different notation (including numbering) from the one used in our agenda paper (Agenda paper 10) for the November 2013 Interpretations Committee meeting. Issues 1, 2, 3, 4 and 5 in this paper correspond to Question 1, Question 2, Question 3, Additional issue 2 and Additional issue 3, respectively, in the November agenda paper. The notations used in the November 2013 Interpretations Committee meeting can be found in Appendix A of this paper.

(d) **(Issue 4)** does the nature of output sold determine the classification of a joint arrangement when assessing 'other facts and circumstances'?

(e) **(Issue5)** when assessing 'other facts and circumstances' in the case where parties are taking substantially all of the output, is the assessment based on volumes or monetary values?

8. **Issue 1** relates to the issue of whether an assessment of 'other facts and circumstances' should take into account facts and circumstances that do not involve contractual and (legal) enforceable terms. **Issues 2, 3, 4 and 5** relate to specific considerations in the assessment of 'other facts and circumstances'.

9. In the following paragraphs, we will perform an analysis on Issue 1 (**Analysis 1**) and then address Issues 2, 3, 4 and 5 as a group (**Analysis 2**).

Staff analysis

Analysis 1: Analysis of Issue 1

10. In this section, we perform an analysis on Issue 1[2], which is as follows:

> **(Issue 1)** Should the assessment of 'other facts and circumstances' be based only on contractual (and legal) enforceable terms?

11. The relevant requirements relating to the classification of the joint arrangement and the assessment of 'other facts and circumstances' in IFRS 11 are as follows:

> 14 An entity shall determine the type of joint arrangement in which it is involved. The classification of a joint arrangement as a joint operation or a joint venture depends upon the **rights and obligations** of the parties to the arrangement.

[2] Specifically, the submitter of this issue asked whether the parties to the joint arrangement require a contract (ie legally enforceable rights and obligations) to purchase substantially all of the output of the arrangement in order to be classified as a joint operation.

B2 Contractual arrangements can be evidenced in several ways. An **enforceable** contractual arrangement is often, but not always, in writing, usually in the form of a contract or documented discussions between the parties. Statutory mechanisms can also create **enforceable** arrangements, either on their own or in conjunction with contracts between the parties.

B14 The classification of joint arrangements required by this IFRS depends upon the parties' rights and obligations arising from the arrangement **in the normal course of business**. This IFRS classifies joint arrangements as either joint operations or joint ventures. When an entity has rights to the assets, and obligations for the liabilities, relating to the arrangement, the arrangement is a joint operation. When an entity has rights to the net assets of the arrangement, the arrangement is a joint venture. Paragraphs B16–B33 set out the assessment an entity carries out to determine whether it has an interest in a joint operation or an interest in a joint venture.

B15 As stated in paragraph B14, the classification of joint arrangements requires the parties to assess their **rights and obligations** arising from the arrangement. When making that assessment, an entity shall consider the following:

(a) the structure of the joint arrangement (see paragraphs B16–B21).

(b) when the joint arrangement is structured through a separate vehicle:

(i) the legal form of the separate vehicle (see paragraphs B22–B24);

(ii) the terms of the contractual arrangement (see paragraphs B25–B28); and

(iii) when relevant, other facts and circumstances (see paragraphs B29–B33).

B29 **When the terms of the contractual arrangement do not specify that the parties have rights to the assets, and obligations for the liabilities**, relating to the arrangement, the parties shall consider other facts and circumstances to assess whether the arrangement is a joint operation or a joint venture.

B30 A joint arrangement might be structured in a separate vehicle whose legal form confers separation between the parties and the separate vehicle. The contractual terms agreed among the parties might not specify the parties' rights to the assets and obligations for the liabilities, yet consideration of other facts and circumstances can lead to such an arrangement being classified as a joint operation. This will be the case when other facts and circumstances give the parties **rights to the assets**, **and obligations for the liabilities**, relating to the arrangement.

B31 When the activities of an arrangement are primarily **designed for the provision of output to the parties**, this **indicates** that the parties have **rights to substantially all the economic benefits of the assets** of the arrangement. The parties to such arrangements often ensure their access to the outputs provided by the arrangement by preventing the arrangement from selling output to third parties.

B32 The effect of an arrangement **with such a design and purpose** is that the liabilities incurred by the arrangement are, in substance, **satisfied by the cash flows received from the parties through their purchases of the output**. When the parties are substantially the **only source of cash flows contributing to the continuity of the operations of the arrangement**, this indicates that the parties have an obligation for the liabilities relating to the arrangement. (emphasis added)

Application example
Example 5 … However, the parties also consider the following aspects of the arrangement: • The parties **agreed to purchase all the output** produced by entity C in a ratio of 50:50. … • … From the fact pattern above, the following facts and circumstances are relevant: • The obligation of t**he parties to purchase all the output produced by entity C** reflects the exclusive dependence of entity C upon the parties for the generation of cash flows and, thus**, the parties have an obligation to fund the settlement of the liabilities of entity C**. • The fact that **the parties have rights to all the output produced by entity C** means that the parties are consuming, and therefore **have rights to, all the economic benefits of the assets of entity C**. …

12. We note that two different views relating to this issue can be summarised as follows:

    (a) **(View A)** the assessment of other facts and circumstances should be based on enforceable rights and obligations that arise from contractual or other legal terms; and

    (b) **(View B)** the assessment of other facts and circumstances does **not** need to be based on enforceable rights and obligations that arise from contractual or other legal terms (ie the assessment also includes intent (design), business needs and practice).

13. **View A** is based on the notion that a right or an obligation that is not enforceable is not a right or an obligation. In this sense, when the terms of the contractual arrangement do not specify that the parties have rights to the assets, and obligations for the liabilities, relating to the joint arrangement, an assessment of 'other facts and circumstances' should examine **all relevant enforceable terms.** Enforceable terms would include:

    (a) the terms of the contractual arrangement agreed by the parties (ie a contractual arrangement that is enforceable by law). The contractual arrangement includes the articles, charter or by-laws of the separate vehicle and any other contract setting out the terms of the joint arrangement; and

    (b) other contractual and legal terms that create (enforceable) rights and obligations. This could be, for example, side agreements, purchase commitments and statutory mechanisms that create (enforceable) rights and obligations, either on their own or in conjunction with contracts between the parties.

14. Enforceable terms may not directly specify that the parties have rights to the assets, and obligations for the liabilities, relating to the joint arrangement. However, suppose that there is a purchase agreement that gives the parties to the joint arrangement an obligation to purchase all the output produced by the joint arrangement. This would indicate that the parties have rights to substantially all the economic benefits of the assets of the joint arrangement according to paragraph B31 of IFRS 11 and therefore have rights to the assets of the joint arrangement. If the pricing of the purchase agreement was such that it ensured that all the cash flow needs of the arrangement set up in a separate vehicle were met through the parties' obligations to purchase the output, this would indicate that according to paragraph B32 of IFRS 11, the parties also had, in substance, the obligations for the liabilities of the separate entity.

15. The conclusion of the classification assessment under **View B** is not different from View A when there are enforceable terms that give the parties to the joint arrangement an obligation to purchase all the output produced by the joint arrangement and the pricing of the output purchase ensures that the cash flow needs of the separate vehicle are met from the cash flows arising from the purchase of output by the parties. However, the conclusion of the classification assessment under View B could be different from View A when there are no enforceable terms that give the parties to the joint arrangement an obligation to purchase all the output produced by the joint arrangement. In such a case, according to View B, the assessment of 'other facts and circumstances' is **not limited to enforceable terms**.

16. Suppose that:

    (a) the parties to the joint arrangement have an option contract to buy all the output produced by the joint arrangement; and

    (b) it is highly probable that:

        (i) the parties exercise the option;

        (ii) the pricing of the purchase of the output was such that it ensured all the cash flow needs of the separate entity were met if the parties were to purchase all of the output; and

        (iii) established practice of the parties shows that they have purchased all of the output.

17. According to View B, this also indicates that the parties have rights to the assets of the joint arrangement and the obligations for the liabilities of it according to paragraphs B31 and B32 of IFRS 11.

18. In this section, we will analyse the relevant literature in IFRS 11 and consider whether we think it lends support to View A and/or View B.

Examination 1: Paragraphs 14 and B2 of IFRS 11

19. We note that paragraph 14 of IFRS 11 sets out principles as to the classification of the joint arrangement as a joint operation or a joint venture. Paragraph 14 of IFRS 11 states that:

> 14 An entity shall determine the type of joint arrangement in which it is involved. The classification of a joint arrangement as a joint operation or a joint venture depends upon the **rights and obligations** of the parties to the arrangement. (emphasis added)

20. We think that **View A** is more in line with the requirements in paragraph 14 of IFRS 11. This is because paragraph 14 of IFRS 11 states that the classification of a joint arrangement depends on the rights and obligations of the parties to the arrangement. In other words, paragraph 14 of IFRS 11 implies that when assessing 'other facts and circumstances' in order to determine the classification of a joint arrangement, such assessment should depend on enforceable terms because rights and obligations, by nature, are enforceable.

21. We note that paragraph B2 of IFRS 11 also supports that rights and obligations of the parties to the joint arrangement should be enforceable because it describes contractual arrangement as 'enforceable'. Paragraph B2 of IFRS 11 is as follows:

> B2 Contractual arrangements can be evidenced in several ways. An **enforceable** contractual arrangement is often, but not always, in writing, usually in the form of a contract or documented discussions between the parties. Statutory mechanisms can also create **enforceable** arrangements, either on their own or in conjunction with contracts between the parties. (emphasis added)

Examination 2: Paragraphs B14 and B15 of IFRS 11

22. We note that paragraphs B14 and B15 of IFRS 11 describe that the classification of joint arrangement depends upon the parties' rights and obligations. Paragraphs B14 and B15 of IFRS 11 are as follows:

B14 The classification of joint arrangements required by this IFRS depends upon the parties' **rights and obligations** arising from the arrangement **in the normal course of business**. This IFRS classifies joint arrangements as either joint operations or joint ventures. When an entity has rights to the assets, and obligations for the liabilities, relating to the arrangement, the arrangement is a joint operation. When an entity has rights to the net assets of the arrangement, the arrangement is a joint venture. Paragraphs B16–B33 set out the assessment an entity carries out to determine whether it has an interest in a joint operation or an interest in a joint venture. (emphasis added)

B15 As stated in paragraph B14, the classification of joint arrangements requires the parties to assess their **rights and obligations** arising from the arrangement. When making that assessment, an entity shall consider the following:

(a) the structure of the joint arrangement (see paragraphs B16–B21).

(b) when the joint arrangement is structured through a separate vehicle:

(i) the legal form of the separate vehicle (see paragraphs B22–B24);

(ii) the terms of the contractual arrangement (see paragraphs B25–B28); and

(iii) when relevant, other facts and circumstances (see paragraphs B29–B33).

23. We think that paragraphs 14 and 15 of IFRS 11 are consistent with **View A**. This is because these paragraphs imply that when assessing 'other facts and circumstances', the assessment should be:

(a) based on (enforceable) rights and obligations; and

(b) whether such (enforceable) rights and obligations are effective 'in the normal course of business'.

24. If View B is taken, the assessment of 'other facts and circumstances' would not need to be based on (enforceable) rights and obligations and would just consider all facts and circumstances including intent (design), business needs and also practice.

Examination 3: Paragraph B31 of IFRS 11

25. We examine paragraph B31 of IFRS 11, which is as follows:

> B31 When the activities of an arrangement are primarily **designed** for the provision of output to the parties, this **indicates** that the parties have **rights** to **substantially all the economic benefits** of the assets of the arrangement. The parties to such arrangements often ensure their access to the outputs provided by the arrangement by preventing the arrangement from selling output to third parties. (emphasis added)

26. We think that paragraph B31 of IFRS 11 could be read in support of either View A or View B.

27. We note that if there are enforceable terms which specify that all output is purchased by the parties, it would be 'equivalent' to parties having the '(enforceable) rights to substantially all the economic benefits'. In this sense, paragraph B31 would support View A.

28. We also note that paragraph B31 uses the terms 'design' and 'indicate'. We think that 'design' of the arrangement on its own is an indicator and not sufficient to establish rights and obligations. This interpretation would also support View A.

29. On the other hand, View B argues that further assessment may be needed when there are no such enforceable terms. More specifically, it argues that paragraph B31 accommodates a situation when the provision of output to the parties is not enforceable but, for example, **highly probable**. The argument is

particularly based on the terms ‘designed for’ and ‘indicates’ in paragraph B31. This is because:

(a) the expression ‘designed for’ can be interpreted as having a wider context than legally enforceable one;

(b) the term ‘indicates’ implies that if any (non-contractual) facts and circumstances can ‘indicate’ that the parties have rights to substantially all the economic benefits of the assets of the arrangement, it would also be accommodated by paragraph B31; and

(c) Although the term ‘indicate’ suggests that ‘design’ on its own is not sufficient, paragraph B31 implies that consideration of ‘design’ should affect the assessment.

30. Additionally, the requirements in paragraph B32 of IFRS 11 support the argument for View B with regard to paragraph B31 of IFRS 11 because the assessment required by paragraph B32 is not based on enforceable terms, as our examination below shows.

Examination 4: Paragraph B32 of IFRS 11

31. We note that paragraph B32 of IFRS 11 provides support for **View B**. Paragraph B32 of IFRS 11 states that:

> B32 The effect of an arrangement **with such a design and purpose** is that the liabilities incurred by the arrangement are, in substance, satisfied by the cash flows received from the parties through their purchases of the output. When the parties are substantially the only source of cash flows contributing to the continuity of the operations of the arrangement, this indicates that the parties have an obligation for the liabilities relating to the arrangement. (emphasis added)

32. Paragraph B32 is not independent of paragraph B31. The description ‘with such a design and purpose’ relates to the description ‘designed for the provision of output to the parties’ and ‘preventing the arrangement from selling output to third parties’ as in paragraph B31. This leads to a circumstance

where 'the cash flows received from the parties through their purchases of the output' satisfies the liabilities of the joint arrangement. Based on this (non-contractual) circumstance, paragraph B32 prescribes that such a circumstance indicates that the parties have an obligation for the liabilities to the joint arrangement.

33. We also note the second sentence of paragraph B32. It is conditioned on the parties being substantially the only source of cash flows. This suggests that being the only source of cash flows is sufficient to give the parties the obligation to the liabilities of the joint arrangement. In other words, it is not necessary for the parties to have the (enforceable) obligation for being the only source of cash flows; it is sufficient for the parties to be the only source of cash flows based on practice.

34. We think that if we apply View A to paragraph B32, there should be enforceable terms in which the parties to the joint arrangement have obligations to provide substantially all cash flows that satisfy the liabilities of the joint arrangement. However, as noted above, paragraph B32 of IFRS 11 does not require any contractual terms relating to the parties' obligations for the liabilities.

35. Based on this examination of paragraph B32, we think that the argument of View B made for paragraph B31 is supported. This is because consideration of facts and circumstances that are not based on enforceable rights and obligations in applying paragraph B31 would be consistent with the guidance in paragraph B32.

Examination 5: Consideration of other Standards

36. We note that the term 'facts and circumstances' are used in many other Standards[3]. However, we note that IFRIC 4 *Determining whether an*

[3] Specifically, we examined the Standards including the following paragraphs (the list is not exhaustive): paragraph B45 of IFRS 2 *Share-based payment*; paragraph 45 of IFRS 3 *Business Combination*; paragraph 20 of IFRS 6 *Exploration for and Evaluation of Mineral Resources*; paragraphs 8 and B23 of IFRS 10 *Consolidated Financial Statements*; paragraph 8 of IAS 28 *Investments in Associates and Joint Ventures*; paragraphs 9 and 10 of IFRIC 4 *Determining whether an*

Arrangement contains a Lease would only be relevant to our discussion because IFRIC 4 uses the term 'facts and circumstances' in a context similar to the one in IFRS 11.

37. We note that IFRIC 4 *Determining whether an Arrangement contains a Lease* describes how the assessment of 'facts and circumstances' be made when determining whether and how an entity has substantially all the economic benefits of the assets when another entity has (legal) ownership of the assets and therefore may be helpful in our analysis.

38. IFRIC 4 relates to an arrangement, comprising a transaction or a series of related transactions, that does not take the legal form of a lease but conveys a right to use an asset in return for a payment or series of payments. IFRIC 4 provides guidance for how to determine whether an arrangement is, or contains, a lease as defined in IAS 17 *Leases*. Paragraph 9 of IFRIC 4 states that:

> 9 An arrangement conveys the right to use the asset if the arrangement conveys to the purchaser (lessee) the right to control the use of the underlying asset. The right to control the use of the underlying asset is conveyed if any one of the following conditions is met:
>
> (a) The purchaser has the ability or right to operate the asset or direct others to operate the asset in a manner it determines while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.
>
> (b) The purchaser has the ability or right to control physical access to the underlying asset while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.
>
> (c) **Facts and circumstances** indicate that **it is remote that one or more parties other than the purchaser will take more than an insignificant amount of the output or other utility that will be produced or generated by the asset during the term of the**

Arrangement contains a Lease; paragraph 10 of IFRIC 18 *Transfers of Assets from Customers*; paragraph 8 of SIC 27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

> **arrangemen**t, and the price that the purchaser will pay for the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output. (emphasis added)

39. We think that IFRIC 4 is consistent with View A. This is because the assessment in paragraph 9(c) of IFRIC 4 is based on contractual obligations for the purchaser to make payments[4]. In other words, paragraph 9(c) of IFRIC 4 describes a circumstance in which a purchaser is committed to take the output or other utility of the asset; and requires whether (other) facts and circumstances indicate that third parties will take more than an insignificant amount of the output or other utility of the asset.

40. On the basis of this observation, we think that IFRIC 4 is more consistent with View A than View B.

Summary of Analysis 1

41. We noted in our analysis above that:

(a) Paragraphs 14 and B2 of IFRS 11 can be read to support View A (see **Examination 1**);

(b) Paragraphs B14 and B15 of IFRS provide support for View A (see **Examination 2**);

(c) Paragraph B31 of IFRS 11 may support either View A or View B (see **Examination 3**);

(d) Paragraph B32 of IFRS 11 supports View B (see **Examination 4**); and

(e) IFRIC 4 is consistent with View A. (see **Examination 5**)

[4] Paragraph 1 of IFRIC 4 states that:

> (…) Examples of arrangements in which one entity (the supplier) may convey such a right to use an asset to another entity (the purchase), often together with related services, include:
>
> - (…)
> - take-or-pay and similar contracts, in which purchasers must make specified payments regardless of whether they take delivery of the contracted products or services (eg a take-or-pay contract to acquire substantially all of the output of a supplier's power generator).

42. On the basis of our analysis above, we note that there may be a **potential conflict** between the requirements in IFRS 11. This is because:

(a) we think that the principle for the classification of the joint arrangement supports View A. According to this principle, the classification of the joint arrangement should depend upon enforceable rights and obligations of the parties to the joint arrangement;

(b) on the other hand, the specific guidance for the assessment of 'other facts and circumstances' can support View B. According to the guidance, the assessment of 'other facts and circumstances' may depend on facts and circumstances that are not based on enforceable terms. In other words, these 'other facts and circumstances' include intent (design), business needs and practice.

43. Consequently, we understand how arguments can be made from the current literature to support either View A or View B. We therefore understand that there could be diversity in practice. We think that it is important to reduce diversity because conclusions of other IFRS 11 issues may depend on which view (ie View A or View B) is taken for this issue. Given this, we think that the Interpretations Committee should make clear which view should be applied in order to address diversity in practice[5].

Analysis 2: Analysis of Issues 2, 3, 4 and 5

44. In this section, we perform an analysis on Issues 2, 3, 4 and 5, which are as follows:

> **(Issue 2)** does the fact that the output is sold at a market price prevent the joint arrangement from being classified as a joint operation, when assessing 'other facts and circumstances'?
>
> **(Issue 3)** does financing from a third party prevent an arrangement from being classified as a joint operation?

[5] Some staff who were consulted when developing this paper suggested that when all of the guidance in IFRS 11 is read together, only View A can be applied.

(Issue 4) does the nature of output sold determine the classification of a joint arrangement when assessing 'other facts and circumstances'?

(Issue 5) when assessing 'other facts and circumstances' in the case where parties are taking substantially all of the output, is the assessment based on volumes or monetary values?

45. We note that the first three issues (ie Issues 2, 3 and 4) are examples of particular conditions that are not referred to or illustrated in IFRS 11 in the context of the classification of the joint arrangement, but which we considered to be reasonably common. We note that Issue 5 relates to which criterion should be used in assessing 'other facts and circumstances'.

Examination 1: Issues 2, 3 and 4

46. With regard to Issues 2, 3 and 4, we think that the following questions, for example, would need to be answered to determine whether a joint arrangement should be classified as a joint operation.

(a) Taking the case of Issue 2, we note that paragraph B32 of IFRS 11 provides guidance for assessing whether the parties have an obligation for the liabilities relating to the arrangement. We first note that the liabilities incurred by the arrangement should be, in substance, satisfied by the cash flows received from the parties through their purchases of the output (the first sentence of paragraph B32 of IFRS 11). We also note that the cash flows from the parties should be substantially the only source of cash flows contributing to the continuity of the operations of the arrangement (the second sentence of paragraph B32 of IFRS 11). Accordingly, in a situation where it is reasonably possible that market price would fall and cause the entity to incur losses, the following questions arise.

(i) can we say that the liabilities incurred by the arrangement are, in substance, satisfied by the cash flows received from the parties through their purchases of the output?; and

(ii) can we also say that the parties are substantially the only source of cash flows required for the continuity of the operation of the joint arrangement?

(b) As for Issue 3, we think that an assessment should be made on whether third party financing would prevent the parties from being substantially the only source of cash flows contributing to the continuity of the operation of the joint arrangement, assuming that all output of the joint arrangement is provided to the parties to the joint arrangement. Two further questions arise.

(i) if third party financing exists only during the pre-production phase[6], does this indicate that the parties are still substantially the only source of cash flows contributing to the continuity of the operation of the joint arrangement for the purposes of classifying the joint arrangement as a joint operation?

(ii) if the parties to the joint arrangement guarantee the third party financing, how would this affect the assessment? Is a guarantee necessary to indicate that the parties are substantially the only source of cash flows contributing to the continuity of the operation of the joint arrangement?

(c) With regard to Issue 4, we note that nature of the output may be an important factor in assessing whether the provision of output to the parties indicates that the parties have rights to substantially all the economic benefits of the assets of the joint arrangement. Suppose that the output is a specific product that can only be used in the manufacturing processes of the parties. In this situation,

(i) does this provide evidence that it is highly probable that output will be purchased by the parties?

(ii) if there are other sources from which the parties can purchase the specific output, how does that affect the classification of the

[6] Example 6 of IFRS 11 addresses a case of third party financing. However, that example does not assume that all output of the joint arrangement is provided to the parties to the joint arrangement.

joint arrangement when the parties are not contractually obliged to purchase the output from the joint arrangement?

47. We note that answers to the questions raised above can be dependent on whether View A or View B is taken regarding Issue 1 (ie with regard to Analysis 1). Examination under View A and View B for each issue (ie Issues 2, 3 and 4) is as follows.

Issue 2(ie sale of output at market price)

48. If View A is taken, the assessment would focus on whether market price of the output prevents:

(a) the liabilities of the arrangement from being, in substance, satisfied by the cash flows received from the parties through their purchases of the output; and

(b) the parties to the joint arrangement from being substantially the only source of cash flows for the continuity of the operation of the joint arrangement.

49. If it is reasonably possible that market price would fall and cause the entity to incur losses, the parties still might be ‘the only source of cash flows’ for the continuity of the operation of the joint arrangement. However, if the cash flows from the parties through their purchases of the output are not sufficient to enable the arrangement to meet its liabilities, it would be questionable whether the cash flows from the parties ensure the continuity of the operation of the joint arrangement. Consequently, if it is reasonably possible that market price would fall and cause the entity to incur losses, we think that it could prevent the joint arrangement from being classified as a joint operation.

50. If View B is taken, the assessment would not only focus the market price factor, but also other facts and circumstances. Accordingly, the same fact (ie a decline of market price) alone would not necessarily prevent the joint arrangement from being classified as a joint operation because other non-contractual facts and circumstances need to be considered together.

51. Consequently, we think that the conclusion on Issue 2 would likely depend on whether View A or View B is taken.

Issue 3 (ie third party financing)

52. The assessment relates to whether the parties to the joint arrangement from being substantially the only source of cash flows for the continuity of the operation of the joint arrangement (the second sentence of paragraph B32 of IFRS 11). We think that there would be no difference whether View A or View B is taken. This is because if the cash flows from operations would be expected to fund the repayment of finance, it would not matter whether the financing was provided by third parties or by the parties to the joint arrangement.

53. Consequently, the conclusion on Issue 3 would **not** depend on whether View A or View B is taken.

Issue 4 (ie nature of output)

54. If View A is taken, the type of output would not affect the assessment. This is because provision of the output to the parties would rely on enforceable rights and obligations. Consequently, the assessment only focuses on whether the liabilities of the arrangement are, in substance, satisfied by the cash flows received from the parties through their purchases of the output (the first sentence of paragraph B32 of IFRS 11) and whether cash flows received from the parties through their purchase of the output would be substantially the only source of cash flows to the continuity of the operation of the joint arrangement (the second sentence of paragraph B32 of IFRS 11).

55. If View B is taken, we think that the type of output would affect the assessment. For example, if the output is a specific product that can only be used in the manufacturing processes of the parties, answers to the questions raised above (ie paragraph 46 (c)) would influence the conclusion reached on the classification of the joint arrangement.

56. Consequently, we think that the conclusion on Issue 4 would depend on whether View A or View B is taken.

Examination 2: Issue 5

57. Issue 5 relates to a situation in which by-products or joint products are generated by the joint arrangement; for example, product A, having a higher value, is produced in small quantity whereas product B, having a lower value, is produced in large quantity.

58. We note that to classify the joint arrangement as a joint operation on the basis of the guidance in paragraph B32 of IFRS 11, cash flows received from the parties through their purchase of output need to be substantially the only source of cash flows contributing to the continuity of the operations of the joint arrangement. In other words, paragraph B32 of IFRS 11 focuses on 'cash flows' of the joint arrangement in terms of the classification. In this sense, when assessing whether the parties have rights to substantially all the economic benefits of the assets of the joint arrangement through the purchase of output, we think that such 'economic benefits' relates to cash flows. Consequently, we think that it would be appropriate to make the assessment based on monetary value of the output rather than based on physical quantities.

Summary of Analysis 2

59. On the basis of the analysis above, with regard to **Issues 2, 3 and 4**, we noted that:

(a) an entity should apply **judgement** when determining whether a joint arrangement is a joint operation or a joint venture in accordance with paragraph 17 of IFRS 11[7]; and

(b) for Issues 2 and 4, conclusions can vary depending on which view (ie View A or View B) is taken for Issue 1:

[7] Particular conditions in Issue 4 under the assumption of taking View A and in Issue 3 would not affect the classification of the joint arrangement.

(i) for issue 2, if View A is taken, the condition that output is sold at market price could prevent the joint arrangement from being classified as a joint operation when it is reasonably possible that market price would fall and cause the entity to incur a loss. On the other hand, if View B is taken, we think that the same condition alone would not necessarily prevent the joint arrangement from being classified as a joint operation;

(ii) for issue 4, if View A is taken, the type of output would not affect the assessment of 'other facts and circumstances', whereas if View B is taken, the type of output would affect the assessment.

(c) for Issue 3, the conclusion does not depend on which view (ie View A or view B) is taken for Issue 1. That is, we think that the assessment of whether the parties are substantially the only source of cash flows to the continuity of the operation of the joint arrangement does not depend on whether the financing was provided by third parties or by the parties to the joint arrangement.

60. With regard to **Issue 5**, we think it is clear that the assessment should be based on monetary value. Also, we think that this conclusion does not depend on which view (ie View A or View B) is taken for Issue 1.

61. In conclusion, we think that the current Standards provide **sufficient guidance** for Issues 2, 3, 4 and 5.

Staff Recommendation

62. On the basis of Analysis 1 above, we think that the Interpretations Committee should take Issue 1 onto its agenda. This is because:

(a) we understand how the current Standards could be read to support either View A or View B;

(b) the issue is a significant one among the implementation issues relating to IFRS 11 raised in practice. The conclusion on this issue may affect discussions on other issues;

(c) the feedback from outreach activity to stakeholders suggest that there are divergent interpretations; and

(d) therefore, it is necessary to clarify the requirements regarding this issue.

63. The staff's assessment of the agenda criteria[8] for this issue is as follows:

Source of issue	
Issues could include: the identification of divergent practices that have emerged for accounting for particular transactions, cases of doubt about the appropriate accounting treatment for a particular circumstance or concerns expressed by investors about poorly specified disclosure requirements (5.14).	
Criteria	
We should address issues(5.16):	
that have widespread effect and have, or are expected to have, a material effect on those affected;	**Yes.** Whether the assessment of 'other facts and circumstances' should be based on contractual (and legal) enforceable terms is a significant issue among many implementation issues relating to IFRS 11. Other issues can be affected by the conclusion on this issue.
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and	**Yes.** The feedback from outreach activity to stakeholders indicates that there are divergent views in practice. Considering the nature of this issue, we think that financial reporting would be improved if diversity is eliminated or reduced.
that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial*	**Yes.** This issue can be resolved efficiently within the confined of existing IFRSs and the *Conceptual Framework*

[8] These criteria can be found in the IASB and IFRS Interpretations Committee Due Process Handbook as indicated in the paragraphs below.

Reporting.	*for Financial Reporting*.
In addition:	
Is the issue sufficiently narrow in scope that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process that would be required when making changes to IFRSs (5.17)?	**Yes.** We think that this issue is sufficiently narrow in scope because it relates to whether the assessment of 'other facts and circumstances' should be based on enforceable rights and obligations that arise from contractual or other legal terms.
Will the solution developed by the Interpretations Committee be effective for a reasonable time period (5.21)? (The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified).	**Yes.** Considering that IFRS 11 became effective recently, the solution of this issue will be effective for a reasonable time period.

64. On the other hand, we think that the Interpretations Committee should **not** take Issues 2, 3, 4 and 5. This is because:

(a) Issues 2, 3 and 4 relate to whether and how particular conditions that are not referred to or illustrated in IFRS 11 affect the classification of a joint arrangement;

(b) it would require judgement in accordance with paragraph 17 of IFRS 11 when assessing whether and how such particular conditions affect the classification of a joint arrangement[9];

(c) consequently, we think that the current Standards provide sufficient guidance; and

(d) as for the issue relating to Issue 5, we think it is clear that when assessing 'other facts and circumstances' and in a circumstance where

[9] For Issues 2 and 4, conclusions can vary depending on which view (ie View A or View B) is taken for Issue 1, whereas for Issue 3, conclusion does not depend on which view is taken for Issue 1.

the parties are taking substantially all the economic benefits of the assets of the joint arrangement, the assessment would be made based on monetary value of the output.

Question for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff analysis that: (a) (Issue 1) the current Standards could be read to support either View A or View B; (b) (Issues 2, 3 and 4) the current Standards provide sufficient guidance because: (i) an entity should apply judgement with paragraph 17 of IFRS 11 when determining whether a joint arrangement is a joint operation or a joint venture in accordance; and (ii) for Issues 2 and 4, conclusions can vary depending on which view (ie View A or View B) is taken for Issue 1, whereas for Issue 3, conclusion does not depend on which view is taken for Issue 1. (c) (Issues 5) in assessing whether the parties are taking substantially all the economic benefits of the assets, the assessment would be made based on monetary value of the output rather than volume of the output. 2. Does the Interpretations Committee agree with the staff recommendation that: (a) Issue 1 should be taken onto the Interpretations Committee's agenda; and (b) Issues 2, 3, 4 and 5 should not be taken onto the Interpretations Committee's agenda[10].

[10] If the Interpretations Committee decides not to take these issues onto its agenda, (tentative) agenda decision for those issues will be published for comments when we have completed our assessment of other IFRS 11 issues that will be addressed at future Interpretations Committee's meetings.

Appendix A—Summary of issues by category

The table below is the reproduction of the summary of issues that was presented in the agenda paper (Agenda Paper 10) for the November 2013 Interpretations Committee meeting.

Categories	Summary of Issues
Category A1: Classification of joint arrangements – issues relating to unclear wording	
Category A1 (Question 1)	Should the assessment of 'other facts and circumstances' be based only on contractual (and legal) enforceable terms?
Category A1 (Question 2)	When the parties have an obligation to purchase substantially all the output produced by the arrangement, does the fact that the output is sold at a market price prevent the arrangement from being classified as a joint operation?
Category A1 (Question 3)	When assessing 'other facts and circumstances', does financing from a third party prevent an arrangement from being classified as a joint operation?
Category A1 (Question 4)	When assessing 'other facts and circumstances', should the assessment be made at the level of the parties as a group or by each party in isolation?
Category A1 (Additional Issue 1)	Are the parties required to have both 'rights and obligations' or either of them, in order for a joint arrangement to be classified as a joint operation?
Category A2: Classification of joint arrangements – issues relating to lack of guidance	
Category A2 (Additional Issue 2)	When assessing 'other facts and circumstances', how does the nature of output sold affect the classification of the joint arrangement?
Category A2 (Additional Issue 3)	When assessing 'other facts and circumstances' and in a circumstance where the parties are taking substantially all of the output, should the assessment be based on volumes or monetary values of the output?
Category A2 (Additional Issue 4)	In order for a joint operator to have obligations for the liabilities, what should be the nature of the obligation be?

Categories	Summary of Issues
Category A2 (Additional Issue 5)	How should a joint arrangement that is a limited-life entity be classified?
Category A2 (Additional Issue 6)	How should a joint arrangement with Limited liability structures be classified?
Category B: Classification of joint arrangements – changes in classification	
Category B (Additional Issue 7)	Should the classification of a joint arrangement in a circumstance when investors agree to buy the product that is produced by an asset for less than the useful life of the asset?
Category B (Additional Issue 8)	Should the classification of a joint arrangement change when different rights and obligations arise in different phases (eg pre-production and production)?
Category C: Recognition and measurement of joint arrangements	
Category C (Question 5)	How should a party to a joint operation account for their share of assets and liabilities when the share of output purchased by the parties from the arrangement differs from the parties' ownership interest in the arrangement?
Category C (Additional Issue 9)	How should a party to a joint arrangement measure a joint arrangement when there is a change in classification of a joint arrangement?
Category C (Additional Issue 10)	How should a party to a joint arrangement measure a joint arrangement when there is a so-called 'Hidden' partner?
Category D1: Recognition and measurement of interests in a joint operation: acquiring control over a joint operation	
Category D1 (Additional Issue 11)	How should an investor account for a transaction in which the investor obtains a control of a joint operation through a step-acquisition (adding to previously held interest) when joint control ceases to exist but other investors or interest holders remain?
Category D1	How should an investor account for a transaction in which the

Categories	Summary of Issues
(Additional Issue 12)	investor obtains a control of a joint operation through a single purchase?
Category D2: Recognition and measurement of interests in a joint operation: acquiring an interest whilst obtaining or retaining joint control	
Category D2 (Additional Issue 13)	How should an investor recognise and measure its interest when the investor initially acquires its interest in a joint operation?
Category D2 (Additional Issue 14)	How should an investor recognise and measure its interest when the investor acquires additional interest in a joint operation without obtaining control?
Category D2 (Additional Issue 15)	How should an investor recognise and measure its interest in a business or assets contributed by other parties to the joint arrangement when the investor contributes a business to a joint operation at the formation of the joint arrangement?
Category E: Other issues	
Category E (Additional Issue 16)	How should separate financial statements of the joint operation be prepared?
Category E (Additional Issue 17)	How should a joint operator account for an investment in subsidiary held by the joint operation in its separate financial statements?
Category E (Additional Issue 18)	Should it be necessary to amend IAS 23 *Borrowing costs* to allow the capitalisation of borrowing costs incurred for investments accounted for using the equity method?
Category E (Additional Issue 19)	Two transition items when changing from proportionate consolidation to the equity method: (1) can the transition requirement to allocate goodwill on a 'relative carrying value basis' be superseded by a more relevant allocation methodology?; and (2) does the transition guidance in IFRS 11 (using carrying value as 'cost basis') supersede the guidance in IAS 28 (revised 2011) when conflict arises?
Category E	First time application issue: Can a first-time adopter recognise a

Categories	Summary of Issues
(Additional Issue 20)	reversal of impairment for its investment when changing from proportionate consolidation to the equity method?
Category E (Additional Issue 21)	How should a joint arrangement (generally called an SCCV) in the real estate industry be classified?