

STAFF PAPER

July 2014

IFRS Interpretations Committee Meeting

Project	IFRS 11 <i>Joint Arrangements</i>		
Paper topic	Consideration of next steps		
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Introduction

1. At its May 2014 meeting, the IFRS Interpretations Committee (the Interpretations Committee) considered the next steps with regard to issues relating to the classification of joint arrangements. It noted that an issue (ie the classification of a common joint arrangement structure, so-called ‘project entity’), is scheduled to be discussed at its July 2014 meeting and this discussion could affect the consideration of the next steps. Consequently, the Interpretations Committee noted that it will make a decision on the next steps after that discussion. In addition, the Interpretations Committee noted that it plans to discuss an issue relating to the recognition and measurement of joint operations when the parties’ interests in the assets and liabilities differ from their ownership interest in the joint operation at its July 2014 meeting.
2. Following the May 2014 meeting, at this Interpretations Committee meeting, we have presented papers for analysis of ‘project entity’ (Agenda Paper 2B) and of the issue relating to the accounting when the parties’ interest in the assets and liabilities differ from their ownership interest in the joint operation (Agenda Paper 2C). Accordingly, we bring this paper to consider next steps.
3. In order to identify the next steps, this paper proposes some options the Interpretations Committee can take relating to the priority issues, which the

Interpretations Committee identified at its November 2013 meeting and has discussed at its subsequent meetings. In addition, this paper asks the Interpretations Committee about how the remaining issues other than the priority issues¹ should be treated.

Where we stand

The issues discussed at previous Interpretations Committee’s meetings

4. The Interpretations Committee identified two priority issues for further consideration at its November 2013 meeting. The two priority issues are:
 - (a) **(Issue 1)** 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) **(Issue 2)** 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.

5. In the past meetings, the Interpretations Committee has dealt with only Issue 1 by discussing five sub-issues.
 - (a) Issue 1A—Should the assessment of ‘other facts and circumstances’ be based only on contractual (and legal) enforceable terms?
 - (b) Issue 1B—Does the fact that the output from the joint arrangement 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 1C—Does financing from a third party prevent an arrangement from being classified as a joint operation?

¹ Agenda Paper 10 (http://AP10_Nov2013.pdf) for the November 2013 Interpretations Committee meeting provided a list of summary of issues identified relating to the implementation of IFRS 11.

- (d) Issue 1D—Does the nature of the output produced by the joint arrangement determine the classification of a joint arrangement when assessing ‘other facts and circumstances’?
- (e) Issue 1E—When assessing ‘other facts and circumstances’ in the case in which parties are taking substantially all of the output, is the assessment based on volumes or monetary values?

Issue 1A

- 6. The Interpretations Committee tentatively decided not to add Issue 1A to its agenda at its January 2014 meeting, noting that the assessment of ‘other facts and circumstances’ should be focused on whether those facts and circumstances create enforceable rights to the assets and obligations for the liabilities. At its May 2014 meeting, the Interpretations Committee finalised the agenda decision.
- 7. Meanwhile, the Interpretations Committee continued discussion about the issue of how to assess ‘other facts and circumstances’ and it consulted IASB members on how the concept of ‘substance over form’ should be applied to this matter before progressing this matter further. At its May 2014 meeting, the Interpretations Committee noted that the IASB members consulted generally agree with the Interpretations Committee’s view that the assessment of ‘other facts and circumstances’ should focus on whether the parties to the joint arrangement have rights and obligations that can be identified to be, in substance, direct rights to the assets and direct obligations for the liabilities of the joint arrangement.
- 8. We also have presented an analysis of the so-called ‘project entity’ issue in Agenda Paper 2B for this meeting. We conclude that the assessment of the classification of the ‘project entity’ would depend on specific contractual terms and conditions and requires a full analysis of features involving the joint arrangement. We also think that the requirements in IFRS 11 are consistent in providing the principles for the assessment of the classification of such a joint arrangement and therefore, additional guidance would not be necessary.

Issues 1B-1E

9. The Interpretations Committee considered an analysis of various examples (relating to Issues 1B–1E) aimed at illustrating the application of the related guidance in IFRS 11 and noted that the analysis can be useful in understanding the guidance in IFRS 11². However, the Interpretations Committee noted that the examples are fact-specific and thought that adding illustrative examples to IFRS 11 might not be the most effective way of clarifying the issues raised.

Issue 2

10. In Agenda Paper 2C for this meeting, we have presented an analysis of Issue 2. We think that the joint operators should account for the assets, liabilities, revenues and expenses of the joint operation consistently with the requirements for classification in IFRS 11. We also think that the accounting for the difference arising from the ‘share of the output purchased’ and the ‘share of the ownership interest’ should reflect the reason for the difference and that judgement will be needed to determine the appropriate accounting.

Other issue

11. The Interpretations Committee also discussed the issue of how to prepare the (separate) financial statements of the joint operation (ie separate vehicle) at its May 2014 meeting. It noted that even if the same financial statement items are presented in more than one reporting entity (ie the joint operators and the joint operation), it could be appropriate from a financial reporting perspective. However, it requested the staff to consult IASB members on whether its conclusion would be consistent with the *Conceptual Framework for Financial Reporting* and the Standards.
12. We think that the feedback from consultation with IASB members is consistent with the discussions at previous Interpretations Committee meetings, as noted in Agenda Paper 2A for this meeting.

² Refer to Agenda Paper 5A for the March 2014 Interpretations Committee meeting (<http://www.ifrs.org/Meetings/AP5A>)

The issues to be discussed at this meeting

13. The Interpretations Committee will address the following issues at this meeting:
- (a) Feedback from consultation with IASB members on the issue of how to prepare the (separate) financial statements of the joint operation (ie separate vehicle) (Agenda Paper 2A);
 - (b) an issue relating to common joint arrangement structure (so-called ‘project entities) (Agenda Paper 2B); and
 - (c) an issue relating to the accounting treatment when the joint operators’ share of output purchased differs from their share of ownership interest in the joint operation (Agenda Paper 2C).

Consideration of the next steps

14. We think that the Interpretations Committee has reached a consensus on how to apply the assessment of ‘other facts and circumstances’ (ie **Issue 1**) through the past meetings, and its view was documented in the March 2014 IFRIC *Update* and the May 2014 IFRIC *Update*. Specifically, the view of the Interpretations Committee was that:
- (a) the assessment of ‘other facts and circumstances’ should be based on a narrow view (ie an assessment based on ‘indirect’ rights and ‘indirect’ obligations, relating to the joint arrangement) rather than a broader one (for example, a view that also considers design, economic compulsion and business needs); and
 - (b) adding illustrative examples to the Standard might not be appropriate to clarify the issue.
15. We also think that the Interpretations Committee should not take onto its agenda the issue of how the joint operators should account for the assets, liabilities, revenues and expenses of the joint operation (ie **Issue 2**) because of the reasons mentioned above.

16. We think that the following circumstantial factors might help the Interpretations committee to consider the next steps:
- (a) Many jurisdictions are in the second year of applying IFRS 11, with EU countries in the process of implementation this year.
 - (b) Informal feedback received from stakeholders who are in the second year of applying IFRS 11 suggests that the narrow view (ie an assessment based on ‘indirect’ rights and ‘indirect’ obligations, relating to the joint arrangement) is prevalent in their jurisdictions.
 - (c) A Post-implementation Review (PiR) of IFRS 11 is expected to start towards the end of 2015.
17. Taking into account the consensus of the Interpretations Committee on Issue 1, the staff recommendation for Issue 2 and the circumstantial factors noted above, we think that the Interpretations Committee could consider the following two main alternatives.
- (a) (**Alternative 1**) Wait for practice to continue to develop over the next 18 months and allow the PiR of IFRS 11 to consider whether any further standard-setting action is required; or
 - (b) (**Alternative 2**) Convert the Interpretations Committee’s conclusions from this and previous meetings into guidance by:
 - (i) Issuing an Interpretation; or
 - (ii) Adding to the application guidance (ie to Appendix B) of IFRS 11.
18. Finally, we note that at the start of the Interpretations Committee’s work on IFRS 11, we presented the results of some targeted outreach that we had performed to understand the range of issues that were being encountered in practice. All of these issues were identified in the paper (ie Agenda Paper 10) presented to the November 2013 Interpretations Committee meeting (See also **Appendix A** of this paper). At that meeting the Interpretations Committee identified the two priority issues from among the feedback on which it thought

it should focus its discussions. These two priority issues have been the focus of the Interpretations Committee's discussions since then.

19. We think that it would be appropriate for the Interpretation Committee not to discuss the other issues that were presented to the Interpretations Committee in November 2013. This is because we think that the Interpretations Committee appropriately prioritised the issues to focus on those that were likely to have greatest applicability. In particular we note that in respect of Issue 1 (whether an assessment of 'other facts and circumstances' should take into account facts and circumstances that do not involve contractual and (legal) enforceable terms) the Interpretations Committee's discussions have encompassed several of the other issues that had been raised. We also note that particular consideration has been given to the accounting requirements in separate financial statements when considering issue 1. Consequently we think that we can wait for practice to continue to develop, with the benefit of the Interpretations Committee's discussions on the two priority issues, and then allow the PiR of IFRS 11 to consider whether any further action is required.

Staff recommendation and question for the Interpretations Committee

20. We note that:
- (a) the informal feedback that we have received recently in respect of Issue 1 suggests that practice has so far developed in a manner consistent with the Interpretations Committee's conclusions relating to that issue;
 - (b) IFRS 11 provides consistent guidance for Issue 2 (ie how the joint operators should account for the assets, liabilities, revenues and expenses of the joint operation); and
 - (c) we expect that practice will develop in a manner consistent with the Interpretations Committee's discussions on issues 1 and 2 on how to deal with the other implementation issues.

21. Our recommendation, therefore, is that the Interpretations Committee follows **Alternative 1** described above and does not discuss the other implementation issues presented in November 2013.

Question for Interpretations Committee

1. Does the Interpretations Committee agree with the staff recommendation on the next steps in respect of its work on Issue 1, Issue 2 and the other issues presented in November 2013?

Appendix A—Summary of Issues (that were identified in 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?

Categories	Summary of Issues
Category D1 (Additional Issue 12)	How should an investor account for a transaction in which the 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 <i>Borrowing costs</i> 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

Categories	Summary of Issues
	conflict arises?
Category E (Additional Issue 20)	First time application issue: Can a first-time adopter recognise a 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?