IFRS

STAFF PAPER

September 2014

IFRS Interpretations Committee Meeting

Project	**IFRS 11 *Joint Arrangements***		
Paper topic	Summary of discussion		
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Introduction

1. At its meeting in July 2014, the IFRS Interpretations Committee (the Interpretations Committee) considered its next steps with regard to various issues that it had identified at its November 2013 meetings.

2. The Interpretations Committee noted that its discussion on joint arrangements in its meetings since November 2013 would help stakeholders address implementation issues relating to IFRS 11 *Joint Arrangements*. The Interpretations Committee therefore decided to discuss, at its next meeting, how it can best document its conclusions and observations from this work so that it will be helpful for stakeholders.

3. This Agenda Paper aims to address the Interpretations Committee's request at its July 2014 meeting, and the structure of this paper is as follows:

   (a) Brief overview of the topics discussed

   (b) Exploring the ways of documenting the work of the Interpretations Committee from those meetings

   (c) Proposed wordings for documentation of the work of the Interpretations Committee

   (d) Appendix A—Summary of the discussion by chronological order

(e) Appendix B—Summary of the discussion by topics

(f) Appendix C—Summary of the discussion in a table

Brief overview of the topic discussed[1]

4. The Interpretations Committee considered the following issues relating to the implementation of IFRS 11.

   (a) **Issue 1**—classification of the joint arrangement (with regard to the assessment of 'other facts and circumstances');

   (b) **Issue 2**—accounting by the joint operators; and

   (c) **Issue 3**—accounting within the separate financial statements.

5. With regard to **Issue 1**(ie classification of the joint arrangement, especially with regard to the assessment of 'other facts and circumstances'), the Interpretations Committee first examined conceptual aspects of the requirements for assessing 'other facts and circumstances'. Specifically, it dealt with the following issues:

   (a) **Issue 1A**—Whether or not the assessment of 'other facts and circumstances' should be based only on contractual (and legal) enforceable terms;

   (b) **Issue 1AA**—How and why 'other facts and circumstances' create rights and obligations that result in a joint arrangement being classified as a joint operation.

6. On the basis of the conclusions and observations from Issue 1A and 1AA, the Interpretations Committee discussed how specific fact patterns affect the assessment of 'other facts and circumstances'. The specific issues it considered were:

   (a) **Issue 1B**—Does the fact that the output from the joint arrangement is sold at a market price prevent the joint arrangement from being

[1] Refer to Appendices A–C of this paper for more information about the summary of discussions.

classified as a joint operation, when assessing ‘other facts and circumstances’?

(b) **Issue 1C**—Does financing from a third party prevent an arrangement from being classified as a joint operation?

(c) **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’?

(d) **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?

(e) **Issue IF**— How should the assessment of ‘other facts and circumstances’ be applied to a specific type of joint arrangement structure (so-called ‘project entity’)?

7. With regard to **Issue 2** (ie accounting by the joint operators), the Interpretations Committee discussed this issue by considering a circumstance in which the joint arrangement is classified as a joint operation following the assessment of ‘other facts and circumstances’ which shows that:

(a) the parties to the joint arrangement purchase all output from the joint arrangement; and

(b) this fact, in addition to other facts, indicates that the parties have rights to the assets and obligations for the liabilities relating to the joint arrangement.

8. In that circumstance, the Interpretations Committee addressed how the joint operators should recognise assets, liabilities, revenues and expenses in relation to their interest in the joint operation by:

(a) **Issue 2A**—clarifying the requirements of paragraph 20 of IFRS 11; and

(b) **Issue 2B**—considering the accounting when the joint operators’ share of output purchased differs from their share of ownership interest in the joint operation.

9. With regard to **Issue 3** (ie accounting within the separate financial statements), the Interpretations Committee discussed:

   (a) **Issue 3A**—the accounting by the joint operator in its separate financial statements; and

   (b) **Issue 3B**—the accounting by the joint operation in its (separate) financial statements.

Exploring the ways of documenting the work of the Interpretations Committee

10. At its July 2014 meeting, the Interpretations Committee decided to discuss how it can best document its conclusions and observations from the discussion over IFRS 11 issues so that it can be helpful for stakeholders. We note that the reason behind this decision can be summarised that:

    (a) the discussions involved many different issues over several meetings and thus stakeholders may find it difficult to understand the whole picture of the work of the Interpretations Committee; and

    (b) the Interpretations Committee agree that the discussions at its meetings were useful in understanding the guidance in IFRS 11.

11. We think that basically, there would be two options for documenting the work of the Interpretations Committee:

    (a) (Option 1) publishing in IFRIC Update; or

    (b) (Option 2) publishing as another form of educational material, under the banner of the IASB Education Initiative.

12. We compared Option 1 and Option 2 based on some criteria as follows.

Scope of the documentation

13. If the documentation was merely to aggregate the outcome of the discussions, it would be achieved by the collection of the previous IFRIC *Updates*, as is documented in **Appendix A** (ie summary of discussion by chronological

order) and **Appendix B** (ie summary of discussion by topics) of this paper. However, taking into account the two reasons noted above, we think that the document of the work of the Interpretations Committee should provide an integrated summary that brings the Interpretations Committee's conclusions and observations together in a way that sets them in context not only with the Standard but also with each other, to the extent that this is relevant. For example, we think that the summary could include some analyses that were included in the agenda papers presented to the Interpretations Committee meetings, if the analyses were discussed and agreed at those meetings.

14. Having said that, we also think that the summary should not provide more analysis of the issues beyond what was addressed and agreed at the Interpretations Committee's meeting.

15. We think that these objectives can be achieved through Option 1. The steps required under Option 1 would be to agree the wording of the summary, publish in draft in IFRIC Update with comments requested (60 day comment period), and then finalise at a future meeting (January 2015) after consideration of the comments received.

16. If we were to take Option 2 we would apply a different due process. We would follow the due process applicable for Education Initiative materials (for example, paragraph 6.44(c) of the IASB and IFRS Interpretations Committee *Due Process Handbook* states that educational material accompanying an IFRS must be reviewed by at least three IASB members). This would not include any public comment period.

17. If we follow Option 1, we note that the style of the summary would be different from that used in the normal IFRIC *Update*. This is because we would be providing an integrated summary of the package of issues discussed by the Interpretations Committee.

Timing of the documentation

18. Another consideration would be that the summary should be made available on a timely basis so that it can be useful for stakeholders. We note that some

stakeholders have requested that the Interpretations Committee make the summary available before the end of 2014.

19. Applying Option 1 would allow for the draft summary to be available before the end of 2014, although finalisation would be dependent on the Interpretations Committee's analysis of any comments received. Finalisation would therefore not happen until January 2015, based on our current meeting schedule.

20. Applying Option 2 might allow quicker publication, as review by at least three IASB members should be achievable in time for publication before the end of 2014.

Other considerations

21. Option 1 follows a well-tested process that results in an output (ie the Agenda Decision) that stakeholders are familiar with, and which preparers, auditors and securities regulators are used to taking notice of. We understand from some securities regulators that Agenda Decisions are useful in reducing diversity in practice, notwithstanding the fact that Agenda Decisions do not change the requirements of IFRS.

22. Although the IASB routinely publishes education material alongside new Standards, much of the non-routine education materials published by the IASB Education Initiative are principally aimed at teachers and students of IFRS. If Option 2 is followed, thought will need to be given to publicising the existence of this education material to ensure that it reaches those for whom it will be relevant.

Recommendation

23. We think either Option 1 or Option 2 could be used to achieve the objective of communicating the Interpretations Committee's conclusions and observations from its discussions on IFRS 11. On the basis of the comparison of Option 1 and Option 2 above, we think that the greater familiarity and previous use of

Agenda Decisions for similar communications makes Option 1 preferable to Option 2, however we note that this would not be as timely as Option 2 could potentially be. On balance, we recommend that the Interpretations Committee document its discussions relating to IFRS 11 issues through the September 2014 IFRIC *Update*, as proposed in the following section of this paper.

Question for Interpretations Committee
1. Does the Interpretations Committee agree with the staff recommendation that: (a) the IFRIC *Update* is the preferable way of documenting its work relating to IFRS 11 issues?; and (b) if so, the summary is published in draft the September IFRIC *Update,* as proposed in the following section of this paper, with comments open for 60 days?

Proposed wording for the documentation

24. As recommended in the previous section of this paper, we have proposed wording for the documentation of the observations and conclusions made in the Interpretations Committee's meeting since November 2013.

25. The proposed wording is as follows.

IFRS 11 *Joint Arrangements*—Implementation issues

Introduction

IFRS 11 *Joint Arrangements* was issued in 2011 and was effective from 2013. IFRS 11 provides guidance on the classification of, and accounting for, joint arrangements. The accounting for an interest in a joint arrangement flows from its classification.

At its meetings from November 2013 to July 2014, the IFRS Interpretations Committee (Interpretations Committee) discussed a collection of issues relating to the implementation of IFRS 11. These discussions covered issues relating to the classification of joint arrangements, in particular the role of 'other facts and circumstances'. The discussions also covered issues relating to the accounting for and by a joint operation, including accounting by a joint operator when the joint operator's share of output purchased differs from its ownership interest in the joint operation. The Interpretations Committee also considered the accounting in the separate financial statements of a joint operator and a joint operation.

This summary describes the Interpretations Committee's observations in respect of these issues.

Classification of joint arrangements

Background

IFRS 11 introduced a new way of classifying joint arrangements compared with the previous Standard, IAS 31 *Interests in Joint Ventures*. Joint arrangements are classified as either joint operations or as joint ventures. A joint operation is a joint arrangement in which the parties sharing control have (direct) rights to the assets of the joint arrangement and (direct) obligations for the liabilities of the joint arrangement. A joint venture is a joint arrangement in which the parties sharing control have a net interest, that is, they have an interest in the net assets and the net income of the joint arrangement.

IFRS 11 provides guidance for parties to a joint arrangement in assessing their rights and obligations relating to the joint arrangement. This guidance requires consideration of the role that the legal form of the arrangement plays in establishing the parties' rights and obligations and the effect that the contractual agreement that establishes joint control has in establishing rights and obligations. The party also considers the effect that 'other facts and circumstances' have in establishing rights and obligations, including the effect that 'other facts and circumstances' have on the rights and obligations established by the other sources.

The importance of structure

The use of an entity with separate legal personality to house the joint arrangement can affect the rights and obligations that the parties have and, consequently, affect the classification of the joint arrangement. An entity with separate legal personality, such as a limited liability company, will lead in the first instance to the parties having rights to the net assets of the joint arrangement, rather than rights to the assets and obligations for the liabilities of the joint arrangement. The Interpretations Committee observed that such is the significance of the effect of the entity on the rights and obligations of the parties to the joint arrangement that two joint arrangements that are otherwise structured identically, except for the use of an entity by one joint arrangement, could result in different classifications.

Because of the effect that an entity with separate legal personality has on the parties' rights and obligations, IFRS 11 concludes that a joint arrangement housed in such an entity will be a joint venture, unless the effects of the entity are overcome, either through the terms of the joint arrangement agreement, or as a consequence of other facts and circumstances.

The Interpretations Committee noted that the notion of 'overcoming the effects of the entity' is sometimes referred to as 'piercing the corporate veil'. When the corporate veil is pierced, the assets and liabilities of the entity become the assets and liabilities of the parties, and consequently the joint arrangement is classified as a joint operation.

The role of 'other facts and circumstances'

The focus on the rights and obligations of the parties to the joint arrangement when making the classification assessment has posed a challenge in the implementation of IFRS 11. In particular, understanding how 'other facts and circumstances' affect the classification, has been difficult.

One of the key principles of IFRS 11 is that the classification of a joint arrangement as a joint operation or a joint venture depends on rights to assets and obligations for liabilities. The Interpretations Committee noted that rights and obligations, by nature, are enforceable. It follows therefore that when assessing the effect of 'other facts and circumstances' on the classification of a joint arrangement, it is only facts and circumstances that involve contractual and (legal) enforceable terms that should be considered. Facts and circumstances that do not involve contractual and (legal) enforceable terms, such as the entity's past practices, design and purpose of the joint arrangement and the entity's business needs, do not affect the classification of the joint arrangement.

The assessment of 'other facts and circumstances' when classifying a joint arrangement is relevant when the parties to a joint arrangement do not have (direct) rights to the assets and (direct) obligations for the liabilities of the joint arrangement. The Interpretations Committee noted that the assessment of 'other facts and circumstances' thus focuses on whether the parties to the joint arrangement have other rights to the assets and other obligations for the liabilities, that can be considered to be, in substance, 'direct' rights to the assets and in substance 'direct' obligations for the liabilities, relating to the joint arrangement.

Understanding 'in substance direct rights to the assets and in substance direct obligations for the liabilities' of the joint arrangement

The Interpretations Committee observed that parties to the joint arrangement have, in substance, direct rights to the assets of the joint arrangement when they:

- have rights to the economic benefits (for example, 'output') of the assets of the arrangement; and
- have obligations to acquire those economic benefits and thus assume the risks relating to those economic benefits (for example, the risks relating to the 'output').

The Interpretations Committee also observed that parties to the joint arrangement have, in substance, direct obligations for the liabilities of the joint arrangement when they:

- settle the liabilities of the joint arrangement through cash flows cascading from the parties to the joint arrangement as a consequence of the parties' rights and obligations for the assets; and
- settlement of the liabilities of the joint arrangement occurs in this

manner on a continuous basis.

When the parties to a joint arrangement have, in substance, direct rights to the assets of the joint arrangement and, in substance, direct obligations for the liabilities of the joint arrangement, that joint arrangement is classified as a joint operation.

Application to some common questions

Example 5 of the application guidance to IFRS 11 provides an example fact pattern in which the 'other facts and circumstances' are sufficient to overcome the effects of the legal entity, resulting in classification of the joint arrangement as a joint operation. The 'other facts and circumstances' in that example include the purchase of substantially all of the output by the parties from the joint arrangement. The price of the output that is charged to the parties is set at a level designed to cover the costs of production and administrative expenses incurred by the joint arrangement, ie the price is set to achieve a break-even result.

Application Example 5 in IFRS 11 triggered some questions that were considered by the Interpretations Committee. Applying the observations above to these questions led the Interpretations Committee to the following conclusions:

- The sale of output from the joint arrangement to the parties at market price is not a determinative factor for the classification of the joint arrangement. A key consequence of setting the price to achieve a break-even result, is that cash flows from the parties will result in the exclusive dependence of the joint arrangement on the parties for the generation of cash flows that will be used to settle the liabilities of the joint arrangement on a continuous basis. Changing the price at which the parties purchase substantially all of the output from a break-even price to the market price could break the link to the provision of cash flows on a continuous basis. Judgement is therefore needed to determine if joint operation classification is achieved.
- The provision of financing by third parties, rather than by the parties to

the joint arrangement, would not necessarily affect the classification of the joint arrangement. The key is that the cash flows from operations are generated from the parties on a continuous basis through their purchase of the output produced. These cash flows are then used by the joint arrangement to settle liabilities, including the financing liabilities, thus maintaining the link between the parties and the settlement of the joint arrangement's liabilities.

- The nature of the output that is produced by the joint arrangement and purchased by the parties is not a determinative factor for classification of the joint arrangement. The focus in IFRS 11 is on the cash flows between the parties and the joint operation, rather than the nature of the product. Consequently whether the output is fungible (eg crude oil) or whether it is bespoke to the parties' operational needs (eg specialised manufacturing parts) does not itself affect classification.
- When assessing whether the parties are purchasing substantially all of the output from the joint arrangement, that assessment is based on the monetary value of the output, rather than on physical quantities.
- The sale of the output to third parties rather than to the parties to the joint arrangement breaks the cash flow link between the parties and the joint arrangement. Consequently the sale of more than an insignificant amount of output to third parties would fail to give the parties in substance rights to the assets and in substance obligations for the liabilities of the joint arrangement. Such an arrangement would therefore be classified as a joint venture.

Accounting by a joint operator

A party to a joint arrangement is required to account for its rights and obligations. In the case of a party to a joint operation, this means accounting for the assets to which it has rights, including its share of assets held jointly, and accounting for the liabilities for which it has obligations, including its share of any liabilities incurred jointly. In contrast, a party to a joint venture accounts for its interest in the joint venture using the equity method.

IFRS 11 gives guidance on the accounting by a joint operator. This is general guidance irrespective of whether the joint operation is structured in an entity or not.

Recognition of revenue

Paragraph 20(c)-(d) of IFRS 11 states that:

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

...

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

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

...

The Interpretations Committee observed that if the joint operators purchase the output from the joint operation, they recognise 'their revenue' when they sell the output to third parties (in accordance with paragraph 20(c)). If the joint arrangement does not sell output to third parties, the joint operators would not recognise any revenue under paragraph 20(d) of IFRS 11. This is because the joint operators would not recognise revenue in relation to the 'share of the revenue from the sale of the output by the joint operation' because the share of the revenue from the sale of the output to the joint operators by the joint operation would be eliminated against the share of the output purchased by the joint operators.

Accounting by a joint operator when the joint operator's share of output purchased differs from its share of ownership interest in the joint operation

A joint arrangement that is housed in a separate vehicle and for which the parties to the joint arrangement have committed to purchase substantially all of the output produced at a price designed to achieve a break-even result, the parties to the joint arrangement would be considered to have, in substance, direct rights to the assets and, in substance, direct obligations for the liabilities. Such a joint arrangement is presented in Example 5 of the application guidance to IFRS 11 and is classified as a joint operation. A variation of such a fact pattern could (and does) arise in which the parties' percentage ownership interest in the separate vehicle differs from the percentage share of the output produced that each party is obliged to purchase.

The joint operators for such a joint operation would account for their assets, liabilities, revenues and expenses in accordance with the shares specified in the contractual arrangement. However, if there is no explicit contractual agreement between the joint operators about how to allocate their 'share of assets', 'share of liabilities', 'share of revenue' and 'share of expenses' relating to the joint operation the question arises about what share of assets, liabilities, revenue and expenses each joint operator should recognise. Specifically, should the share of assets, liabilities, revenue and expenses recognised reflect the percentage ownership of the legal entity, or should it reflect the percentage of output purchased by each joint operator?

The basis for classifying a joint arrangement as a joint operation (as noted above) is that the parties to the joint arrangement have, in substance, direct rights to the assets and direct obligations for the liabilities. This is achieved through the parties' commitment to purchase the output from the joint arrangement. Thus the basis for the parties to recognise the assets of the joint arrangement is their access to the economic benefits of the assets. Similarly the basis for the parties to recognise liabilities of the joint arrangement is that they settle the liabilities of the joint arrangement through cash flows cascading from the parties to the joint arrangement as a consequence of the parties' rights and obligations to purchase the output.

If measuring the share of assets and liabilities of the joint operation was based on the same concept as the basis for recognising those assets and liabilities, the Interpretations Committee observed that a joint operator would account for its share of assets of the joint operation on the basis of the share of output produced by those assets and purchased by the joint operator. The ‘share of output purchased’ corresponds proportionately to the ‘gross’ economic benefits of the assets of the joint operation and therefore also corresponds proportionately to the joint operators’ (in substance) direct rights to the assets of the joint arrangement.

However, the variations in fact patterns could require modifications to this general approach. A variation noted by the Interpretations Committee was one in which the share of output purchased by each party varies frequently over the life of the joint arrangement. The question arising in this situation is over what time horizon should the share of output be based? In this and other circumstances where the share of output purchased is different from the ownership interest in the entity, the Interpretations Committee noted that it is important to understand why this difference exists.

Notwithstanding the analysis above, the Interpretations Committee noted the practical challenges associated with this issue. Consequently the Interpretations Committee concluded that accounting for the share of assets and liabilities of the joint operation based on the share of the ownership interest in the separate vehicle should be the default approach, however, if contractual agreements involving the joint arrangement indicate otherwise, the accounting should reflect the economics of the factors that cause the difference between the share of the ownership interest and the share of the output.

Accounting in separate financial statements

Accounting by the joint operator in its separate financial statements

The requirement to prepare separate financial statements is common in many jurisdictions. Questions were raised about the accounting by a joint operator in its separate financial statements for its share of assets and liabilities of a joint operation when that joint operation is structured through a separate vehicle.

The accounting required by IFRS 11 is different from the proportionate consolidation method which was required by IAS 31. IFRS 11 requires the joint operator to account for all of its rights and obligations in relation to the joint operation. Those rights and obligations are the same whether separate or consolidated financial statements are prepared. Consequently the same accounting is required in the consolidated financial statements and in the separate financial statements of the joint operator.

IFRS 11 requires the joint operator to account for its rights and obligations, which are its share in the assets held by the entity and its share of the liabilities incurred by it. Accordingly, the Interpretations Committee observed that the joint operator would not additionally account for its shareholding in the separate vehicle, whether at cost in accordance with IAS 27 *Separate Financial Statements* or at fair value in accordance with IFRS 9 *Financial Instruments*.

Accounting by the joint operation in its financial statements

The recognition by joint operators in both consolidated and separate financial statements of their share of assets and liabilities held by the joint operation leads to the question of whether those same assets and liabilities should also be recognised in the financial statements of the joint operation itself.

The Interpretations Committee noted that IFRS 11 applies only to the accounting by the joint operators and not to the accounting by the separate vehicle that is a joint operation. The financial statements of the separate vehicle would therefore be prepared in accordance with applicable IFRS standards.

Company law typically requires a legal entity/separate vehicle to prepare financial statements; therefore, the reporting entity for the (separate) financial statements would encompass the assets, liabilities, income and expense of that legal entity/separate vehicle.

However, when identifying the assets and liabilities of the separate vehicle it is necessary to understand the joint operators’ rights and obligations relating to those assets and liabilities and how those rights and obligations affect those assets and liabilities. The Interpretations Committee noted that the joint operator should, where appropriate, reflect the effects of the rights and obligations in the accounting for the assets and liabilities.

The following example illustrates the way that different rights and obligations could affect the accounting:

- If the joint operators agree to use the asset in the joint operation without a contractual agreement with the joint operation, the accounting by the joint operation would not be affected because the contract is between the shareholders of the joint operation only; however
- If the joint operators enter into a lease agreement with the joint operation to use the asset in the joint operation, the accounting by the joint operation would be affected and thus the asset in the joint operation might be derecognised.

Appendix A—A summary of discussion by chronological order

A1 The Interpretations Committee received several requests with regard to the application of the requirements of IFRS 11 *Joint Arrangements*. The Interpretations Committee has discussed relevant issues at its meetings in November 2013, January 2014, March 2014, May 2014 and July 2014.

Discussion at the Interpretations Committee meeting in November 2013

A2 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 results of the outreach included (1) views from respondents on the various issues identified in the outreach request and (2) additional issues raised through the feedback from the outreach request.

A3 The Interpretations Committee identified the following priority issues for further consideration:

(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 joint operators should recognise assets, liabilities, revenues and expenses in relation to their interests in the joint operation, especially if their interests in the assets and liabilities differ from their ownership interest in the joint operation.

A4 In addition, the Interpretations Committee discussed the joint operator's accounting in its separate IFRS-financial statements for an interest in a joint operation that is housed in a separate entity (ie **Issue 3A**). This was within the context of a consultation by the IASB to help the IASB assess the magnitude of accounting issues in the separate IFRS-financial statements of the joint operator when the joint operation is housed in a separate vehicle. The Interpretations Committee noted that:

(a) the issue is prevalent in practice because separate IFRS-financial statements are common in many jurisdictions, and, in addition, joint arrangements structured through separate vehicles are more often classified as joint operations in practice than was originally expected;

(b) it is clear and consistent that IFRS 11 requires the same accounting for joint operations in the consolidated IFRS-financial statements and the separate IFRS-financial statements because it requires the joint operator to account for all of its rights and obligations;

(c) in order to be classified as a joint operation, the parties to the joint arrangement must have sufficient rights to and obligations for the assets and liabilities held in the entity such that these rights and obligations pierce the veil of incorporation. In this case, IFRS 11 requires that the joint operator does not account for its shareholding in the entity that houses the joint operation at cost in accordance with IAS 27 Separate Financial Statements or at fair value in accordance with IFRS 9 Financial Instruments. Instead, the joint operator accounts for its rights and obligations, which are its shares in the assets held by the entity and its shares in the liabilities incurred by it; and

(d) the classification of a joint arrangement as a joint operation depends on the rights and obligations that the parties have. Consequently, the assessment of those rights and obligations is critical to making this classification.

Discussion at the Interpretations Committee meeting in January 2014

A5 The staff presented an analysis of Issue 1, covering the following 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?

(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?

A6 The Interpretations Committee discussed **Issue 1A** and tentatively decided not to add this issue to its agenda. The Interpretations Committee considered whether the assessment of ‘other facts and circumstances’ should be undertaken with a view only towards whether those facts and circumstances create enforceable rights to the assets and obligations for the liabilities or whether that assessment should also consider the design and purpose of the joint arrangement, the entity’s business needs and the entity’s past practices.

A7 The Interpretations Committee noted that paragraph 14 of IFRS 11 requires the classification of a joint arrangement as a joint operation or a joint venture to depend on rights to the assets and obligations for the liabilities of the parties to the arrangement, and that rights and obligations, by nature, are enforceable. The Interpretations Committee noted that paragraph B30 of IFRS 11 describes that when ‘other facts and circumstances’ give the parties rights to the assets, and obligations for the liabilities, relating to the arrangement, the assessment of ‘other facts and circumstances’ would lead to the joint arrangement being classified as a joint operation. Consequently, the Interpretations Committee noted 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.

A8 With regard to the other issues (including **Issues 1B–1E**) that were considered, the Interpretations Committee noted that it is important to understand how and why particular facts and circumstances create rights and obligations that result in the joint arrangement being classified as a joint operation. The Interpretations Committee asked the staff to develop examples to analyse this matter. It also noted that these examples should include fact patterns illustrating Issues 1B–1E and consider the application of IFRS 11 to a specific type of joint arrangement structure.

A9 The Interpretations Committee also asked for this analysis to consider the implications for accounting within separate financial statements. The Interpretations Committee's discussion led it to say that after it had considered this further analysis, it would decide whether to recommend adding examples or other guidance to the Standard.

A10 For the convenience of understanding, we denote the subsequent issues that were raised in this meeting as follows:

(a) **Issue 1AA**— How and why do particular facts and circumstances create rights and obligations that result in the joint arrangement being classified as a joint operation?

(b) **Issue 1F**[2]—How should the assessment of 'other facts and circumstances' be applied to a specific type of joint arrangement structure?; and

(c) **Issue 3B**—Accounting within the separate financial statements

Discussion at the Interpretations Committee meeting in March 2014

A11 The Interpretations Committee discussed Issue 1AA (ie how and why 'other facts and circumstances' create rights and obligations that result in a joint arrangement being classified as a joint operation). It noted that the assessment of 'other facts and circumstances' focus on whether the parties to the joint arrangement have 'indirect' rights and 'indirect' obligations, relating to the

[2] This issue relates to 'project entities', the joint arrangement structures found in real estate industry.

joint arrangement, that can be identified to be, in substance, direct rights to the assets and direct obligations for the liabilities, relating to the joint arrangement. It therefore noted that if a party to the joint arrangement has such 'indirect' rights and obligations, the joint arrangement would be classified as a joint operation.

A12 The Interpretations Committee considered a staff 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 11. 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.

A13 The Interpretations Committee noted that 'other facts and circumstances' need to be assessed when the joint arrangement is structured through a separate vehicle, but neither the legal form of that vehicle nor the contractual agreement result in the parties having direct rights to the assets and direct obligations for the liabilities of the joint arrangement. It noted that the purpose of assessing 'other facts and circumstances' is to consider whether the substance of the joint arrangement gives the parties rights to the assets and obligations for the liabilities relating to the joint arrangement. Some members of the Interpretations Committee described this as a 'substance over form' approach. The Interpretations Committee noted that the concept of 'substance over form' may not be consistently understood or applied in practice. Consequently, the Interpretations Committee decided to consult the IASB on this matter before progressing this issue further.

A14 Addressing **Issue 1F** (ie how should the assessment of 'other facts and circumstances' be applied to a specific type of joint arrangement structure?), the Interpretations Committee asked the staff to provide an analysis of a specific joint structure, which includes types of joint arrangement structures that have different features from the ones that were identified in Agenda Paper 5B for this meeting.

Discussion at the Interpretations Committee meeting in May 2014

A15 The Interpretations Committee finalised its agenda decision on **Issue 1A** (ie should the assessment of ‘other facts and circumstances’ be based only on contractual (and legal) enforceable terms) on the basis of the same reasons as noted for its tentative agenda decision made in the January 2014 meeting. Consequently, the Interpretations Committee noted 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.

A16 Addressing **Issue 1AA** (ie how and why ‘other facts and circumstances’ create rights and obligations that result in a joint arrangement being classified as a joint operation), the Interpretations Committee discussed feedback from the informal consultation with IASB members on the issue of how to apply the concept of ‘substance over form’ when assessing ‘other facts and circumstances.’ 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.

A17 The Interpretations Committee also discussed **Issue 3B** (ie accounting within the separate financial statements) by considering the (separate) financial statements of the joint operation that is a separate vehicle and decided to consult IASB members on its observations that:

(a) IFRS 11 applies only to the accounting by the joint operators but not to the accounting by the separate vehicle that is a joint operation;

(b) therefore, the financial statements of the separate vehicle would be prepared in accordance with applicable Standards;

(c) it will be important to focus on the nature of the reporting entity when preparing the financial statements of the separate vehicle; and

(d) when preparing these financial statements, it will be necessary to understand the joint operators' rights and obligations and account for the effects of those rights and obligations on the assets and liabilities of the separate vehicle.

A18 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 specific type of 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.

A19 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 (ie Issue 2) at its July 2014 meeting.

Discussion at the Interpretations Committee meeting in July 2014

A20 The Interpretations Committee discussed **Issue 1F** (ie how to apply the assessment of 'other facts and circumstances' to a specific type of joint arrangement structure). It considered a joint arrangement which is normally established for a bespoke construction project for delivery of a single product or service to a single customer. The Interpretations Committee, by examining the features included in the paper for this meeting (ie Agenda Paper 2B), noted that :

(a) dealing with whether the parties to the joint arrangement have, in substance, direct rights to the assets of the joint arrangement, the Interpretations Committee observed that the features of the joint arrangement do not show that the parties to the joint arrangement have substantially all economic benefits of the assets of the joint arrangement, although they may have some economic benefits of those assets. Accordingly, the Interpretations Committee thought that the parties to the joint arrangement would not have, in substance, direct rights to the assets of the joint arrangement.; and

(b) on the other hand, the Interpretations Committee observed that the features could indicate that the parties to the joint arrangement have, in substance, direct obligations for the liabilities of the joint arrangement, depending on the nature of the parties' obligations. This is because, for example, the feature involving cash calls, might or might not indicate that the parties to the joint arrangement could be required to settle the liabilities of the joint arrangement on a continuous basis.

A21 Consequently, the Interpretations Committee noted that the joint arrangement having the features in the example would not be classified as a joint operation. This is because in order to classify a joint arrangement as a joint operation, IFRS 11 requires that the parties to the joint arrangement have, in substance, both direct rights to the assets and direct obligations for the liabilities, relating to the joint arrangement.

A22 The Interpretations Committee also noted that two joint arrangements with similar features can be classified differently depending on whether the joint arrangement is structured through a separate vehicle or not. This is because unless specific 'other facts and circumstances' overcome the legal form of a separate vehicle, a joint arrangement that is structured through a separate vehicle would be classified as a joint venture. The Interpretations Committee noted that this reflects the approach adopted in IFRS 11, which places importance on:

(a) reflecting the rights and obligations of the parties to the joint arrangement; and

(b) the presence of a separate vehicle affecting those rights and obligations.

A23 The Interpretations Committee discussed **Issue 2** (ie accounting by the joint operator). The discussion of Issue 2 particularly related to how to account for when the joint operators' share of the output purchase differs from their share of ownership interest in the joint operation. It addressed this issue by considering a circumstance in which the joint arrangement that is a separate vehicle is classified as a joint operation because the assessment of 'other facts and circumstances' shows that:

(a) the parties to the joint arrangement purchase all output from the joint arrangement; and

(b) this fact, in addition to other facts, indicates that the parties have rights to the assets and obligations for the liabilities relating to the joint arrangement.

A24 The Interpretations Committee noted that the joint operators would not recognise any amount in relation to 'share of the revenue from the sale of the output by the joint operation' (paragraph 20(d) of IFRS 11). This is because the share of the revenue from the sale of the output to the joint operators by the joint operation would be eliminated against the share of the output purchased by the joint operators.

A25 The Interpretations Committee discussed the accounting by the joint operators when the joint operators' share of the output purchased differs from their ownership interests in the joint operation. The Interpretations Committee noted that it is important to understand why the share of the output purchased differs from the ownership interests in the joint operation. The Interpretations Committee also noted that the accounting for the difference arising between the share of the output purchased and the ownership interest can vary depending on the details of the contractual agreement. Judgement will therefore be needed to determine the appropriate accounting.

A26 The Interpretations Committee also considered feedback from the informal consultation with individual IASB members on **Issue 3B** (ie how to prepare the (separate) financial statements of a joint operation that is a separate vehicle). The Interpretations Committee noted that the feedback is consistent with its conclusion reached in its May 2014 meeting that:

(a) IFRS 11 applies only to the accounting by the joint operators but not to the accounting by the separate vehicle that is a joint operation;

(b) therefore, the financial statements of the separate vehicle would be prepared in accordance with applicable Standards;

(c) it will be important to focus on the nature of the reporting entity when preparing the financial statements of the separate vehicle; and

(d) when preparing these financial statements, it will be necessary to understand the joint operators' rights and obligations and account for the effects of those rights and obligations on the assets and liabilities of the separate vehicle.

Appendix B—A summary of the discussion by topics

Overview of the topics discussed

B1 The Interpretations Committee addressed the following issues relating to the implementation of IFRS 11.

(a) **Issue 1**—classification of the joint arrangement (with regard to the assessment of 'other facts and circumstances');

(b) **Issue 2**—accounting by the joint operators; and

(c) **Issue 3**—accounting within the separate financial statements.

B2 With regard to **Issue 1**(ie classification of the joint arrangement, especially with regard to the assessment of 'other facts and circumstances'), the Interpretations Committee first examined conceptual aspects of the requirements for assessing 'other facts and circumstances'. Specifically, it dealt with the following issues:

(a) **Issue 1A**—Whether or not the assessment of 'other facts and circumstances' should be based only on contractual (and legal) enforceable terms;

(b) **Issue 1AA**—How and why 'other facts and circumstances' create rights and obligations that result in a joint arrangement being classified as a joint operation.

B3 On the basis of the conclusions and observations from Issue 1A and 1AA, the Interpretations Committee discussed how specific fact patterns affect the assessment of 'other facts and circumstances'. The specific issues it considered were:

(a) **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’?

(b) **Issue 1C**—Does financing from a third party prevent an arrangement from being classified as a joint operation?

(c) **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’?

(d) **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?

(e) **Issue IF**— How should the assessment of ‘other facts and circumstances’ be applied to a specific type of joint arrangement structure (so-called ‘project entity’)?

B4 With regard to **Issue 2** (ie accounting by the joint operators), the Interpretations Committee discussed this issue by considering a circumstance in which the joint arrangement is classified as a joint operation following the assessment of ‘other facts and circumstances’ which shows that:

(a) the parties to the joint arrangement purchase all output from the joint arrangement; and

(b) this fact, in addition to other facts, indicates that the parties have rights to the assets and obligations for the liabilities relating to the joint arrangement.

B5 In that circumstance, the Interpretations Committee addressed how the joint operators should recognise assets, liabilities, revenues and expenses in relation to their interest in the joint operation by:

(a) **Issue 2A**—clarifying the requirements of paragraph 20 of IFRS 11; and

(b) **Issue 2B**—considering the accounting when the joint operators’ share of output purchased differs from their share of ownership interest in the joint operation.

B6 With regard to **Issue 3** (ie accounting within the separate financial statements), the Interpretations Committee discussed:

(a) **Issue 3A**—the accounting by the joint operator in its separate financial statements; and

(b) **Issue 3B**—the accounting by the joint operation in its (separate) financial statements.

Issue 1: summary of the discussion

Discussion of Issue 1A[3]

B7 The Interpretations Committee addressed Issue 1 (ie the classification of the joint arrangement with regard to the assessment of 'other facts and circumstances').

B8 The Interpretations Committee first discussed **Issue 1A** (ie whether an assessment of 'other facts and circumstances' should take into account fact and circumstances do not involve contractual and (legal) enforceable terms). Addressing Issue 1A, the Interpretations Committee noted that two different views 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).

[3] Refer to:

January 2014 Interpretations Committee meeting (January 2014 IFRIC Update (January 2014 IFRIC Update) and Agenda Paper 11(Agenda Paper 11_January 2014)); and

May 2014 Interpretations Committee meeting (May 2014 IFRIC Update (May2014 IFRIC Update) and Agenda Paper Agenda Paper 13_May 2014)).

B9 **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 arrangements agreed by the parties (ie a contractual arrangement that is enforceable by law). A 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.

B10 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.

B11 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**.

B12 Using an example to illustrate View B, the Interpretations Committee considered 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.

B13 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.

B14 The Interpretations Committee noted that paragraph 14 of IFRS 11 requires the classification of a joint arrangement as a joint operation or a joint venture to depend on rights to the assets and obligations for the liabilities of the parties to the arrangement, and that rights and obligations, by nature, are enforceable.

B15 The Interpretations Committee also noted that paragraph B30 of IFRS 11 describes that when ‘other facts and circumstances’ give the parties rights to the assets, and obligations for the liabilities, relating to the arrangement, the assessment of 'other facts and circumstances' would lead to the joint arrangement being classified as a joint operation.

B16 On the basis of the observations above, the Interpretations Committee noted that the assessment of 'other facts and circumstances' could not be only based on intent (design), business needs and practice (ie View B) and therefore **supported View A** that the assessment of 'other facts and circumstances' should be based on enforceable rights and obligations that arise from contractual or other legal terms. More specifically, it noted 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. Consequently, the Interpretations Committee noted that it is important to understand how and why particular facts and circumstances create rights and obligations that result in the joint arrangement being classified as a joint operation (ie **Issue 1AA**).

Discussion of Issue 1AA [4]

B17 Addressing **Issue 1AA** (ie how and why particular facts and circumstances create rights and obligations that result in the joint arrangement being classified as a joint operation), the Interpretations Committee noted that the assessment of 'other facts and circumstances' is performed when the parties to the joint arrangement do not have (direct) rights to the assets, and (direct) obligations for the liabilities, relating to the joint arrangement. The assessment of 'other facts and circumstances' thus focuses on whether the parties to the joint arrangement have other rights to the assets and other obligations for the liabilities, which can be considered to be, in substance,

[4] Refer to:

January 2014 Interpretations Committee meeting (January 2014 IFRIC Update (January 2014 IFRIC Update) and Agenda Paper 11(Agenda Paper 11_January 2014));

March 2014 Interpretations Committee meeting (Marcy 2014 IFRIC Update (March2014 IFRIC Update) and Agenda Paper 5A (Agenda Paper 5A_March 2014)); and

May 2014 Interpretations Committee meeting (May 2014 IFRIC Update (May2014 IFRIC Update) and Agenda Paper 2A (Agenda Paper 2A_May 2014)).

‘direct’ rights to the assets, and ‘direct’ obligations for the liabilities, relating to the joint arrangement.

Parties’ rights to the assets of the joint arrangement

B18 The Interpretations Committee noted that the parties to the joint arrangement have, in substance, direct rights to the assets of the joint arrangement when they:

(a) have **rights** to economic **benefits** (for example, ‘output’) of the assets of the joint arrangement ; and

(b) have **obligations** to acquire those economic benefits and therefore assume **risks** relating to those economic benefits (for example, the risks relating to the ‘output’).

B19 To understand more clearly the observation above, the Interpretations Committee compared two scenarios. Suppose two scenarios assuming there are two parties (Party A and Party B) that set up a joint arrangement structured through a separate vehicle (Entity C) in which Party A owns 40 per cent of the shares of Entity C and Party B owns 60 per cent of the shares of Entity C.

(a) (**Scenario 1**) Parties A and B are obligated to purchase their shares of output of the assets of Entity C. Parties A and B can then choose to sell their shares of the output to third parties or to use it themselves; and

(b) (**Scenario 2**) Entity C sells all the output to third parties and Parties A and B have rights to the net profits generated by those sales in proportion to their shares of Entity C.

B20 **In Scenario 1**, Parties A and B have, in substance, direct rights to the assets of Entity C because:

(a) each party acquires its share of the economic benefits of the assets; and

(b) their obligation to purchase the output means that they assume the risks involving their shares of the economic benefits (ie risks involving the output).

B21 In other words, Party A has 40 per cent of the economic benefits generated by the assets of the arrangement and it assumes 40 per cent of the total risks as a consequence of being obliged to purchase the output; and Party B has 60 per cent of the economic benefits generated by the assets of the arrangement and it assumes 60 per cent of the total risks as a consequence of being obliged to purchase the output.

B22 **In Scenario 2**, Parties A and B do not have rights associated with the output, but they have rights to the net profits from the sale of the output. This may indicate that they have rights to their shares of the economic benefits generated by the assets of Entity C, although in this case, the economic benefits are not 'output' but net profits. However, the Interpretations Committee thought that the economic benefits that the parties have are different from the economic benefits of the assets of the joint arrangement. This is because IFRS 11 requires in substance, direct rights to be created for the parties. In other words, IFRS 11 requires 'gross' economic benefits of the 'assets' of the joint arrangement in order to establish in substance, direct rights to the assets.

B23 Similarly, Parties A and B do not assume the same risks to the economic benefits of the assets because IFRS 11 requires as a condition to create in substance, direct rights. In Scenario 2, Parties A and B assume 'net' risks relating to the economic benefits because they are only entitled to the net economic benefits (ie the net profits obtained), whereas the Interpretations Committee think IFRS 11 requires the parties to the joint arrangement to have 'gross' risks relating to the economic benefits.

B24 The Interpretations Committee highlighted the term 'gross' here for economic benefits and risks because it thought that IFRS 11 requires the parties to have rights to the assets and obligations for the liabilities, rather than rights and obligations for the net of the assets and liabilities.

B25 Accordingly, the Interpretations Committee thought that in Scenario 2, Parties A and B do not have, in substance, direct rights to the assets of Entity C.

Parties' obligation for the liabilities of the joint arrangement

B26 The Interpretations Committee also note that the parties to the joint arrangement have, in substance, direct obligations for the liabilities of the joint arrangement when they:

(a) are, through such rights to the assets of the joint arrangement as noted above, substantially the only source of cash flows that:

(i) can ensure the settlement of the liabilities of the joint arrangement; and

(ii) can continue the operation of the arrangement; and

(b) settle the liabilities of the joint arrangement **on a continuous basis**.

B27 The Interpretations Committee thought that the guidance in paragraph B32 is described more generally in the diagram following paragraph B33 of IFRS 11. The diagram illustrates that one of the criteria for the classification of joint operation is that "[the joint arrangement] depends on the parties **on a continuous basis** for settling the liabilities relating to the activity conducted through the arrangement".

B28 The Interpretations Committee thought that the meaning of 'continuous basis' is that the cash flows from the parties to the joint arrangement to settle the liabilities of the separate vehicle **'in the normal course of business'** as described in paragraph B14 of IFRS 11. In this sense, if the parties to the joint arrangement have a secondary obligation (for example, a guarantee obligation) for the liabilities of the separate vehicle, it would not meet the criterion above because such an obligation would not require the parties to the joint arrangement to settle the liabilities 'on a continuous basis' (ie a guarantee would only represent an obligation for the parties when a specific event occurs).

B29 The Interpretations Committee noted that according to the first bullet point of the analyses included in Example 5 in paragraph B32 of IFRS 11, "The obligation of the parties to purchase all the output produced by entity C" would create the parties', in substance, direct rights to the assets. This obligation to purchase would also create the parties', in substance, direct obligations for the liabilities when it leads to "fund the settlement of the liabilities of entity C". In this sense, the assessment of parties', in substance, direct obligation would **not be independent** of the assessment of parties', in substance, direct rights.

Implication of 'substance over form'

B30 On the basis of the observations above, the Interpretations Committee noted that if a party to the joint arrangement has, in substance, direct rights to the assets and direct obligations for the liabilities, relating the joint arrangement, as described above, the joint arrangement would be classified as a joint operation. The Interpretations Committee understand this to mean that it is necessary to demonstrate that cash cascades from the parties through legal or contractual obligations to pay the liabilities of the joint arrangement.

B31 More generally, the Interpretations Committee observed that when there is a combination of rights and obligations that gives rise to, in substance, direct rights to assets and direct obligations for liabilities, that combination involves a cascading of rights or obligations. It observed that in order for 'other facts and circumstances' to result in the parties having obligations for the liabilities of a joint arrangement, it is necessary to demonstrate that cash cascades from the parties through legal or contractual obligations to ensure the settlement of the liabilities of the joint arrangement on a continuous basis.

B32 The Interpretations Committee also noted that the concept of 'piercing the veil of incorporation' was used in the context of describing the relationship between the joint operator and the joint operation when the joint operation is housed in a separate legal entity, such as a limited liability company.

B33 The phrase 'piercing the veil of incorporation' is one that has been used in some jurisdictions to describe the circumstance in which the boundaries of a legal entity (eg a company) are 'overcome', resulting in another party having access to the assets of the legal entity and exposure to the liabilities of that legal entity. When a joint arrangement is classified as a joint operation, the assets and liabilities of the joint operation are/become the assets and liabilities of the joint operators. The Interpretations Committee thought that the notion of cascading contractual or legal rights and obligations can be used as an explanation of how the 'veil of incorporation' is pierced.

B34 Notwithstanding this understanding, some members of the Interpretations Committee observed that the concept of 'substance over form' may not be consistently understood or applied in practice. The Interpretations Committee noted that there is an alternative view that is broader than the Interpretations Committee's view in terms of considering what can give rise to, in substance, direct rights to the assets and direct obligations for the liabilities, relating to the joint arrangement. Proponents of this alternative view would argue that if features of the joint arrangement (or the parties' rights and obligations relating to the joint arrangement) indicate that the parties to the joint arrangement are closely or fully involved with the operation of the separate vehicle, classifying the joint arrangement as a joint operation would faithfully reflect the economic substance of the arrangement.

B35 The Interpretations Committee therefore carried out informal consultations with IASB members on this matter of 'substance over from'. The Interpretations Committee noted that 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.

Conclusion of Issues 1A and 1AA

B36 On the basis of the discussion over Issues 1A and 1AA, the Interpretations Committee concluded that:

(a) the assessment of 'other facts and circumstances' should be based on contractual (and legal) enforceable terms;

(b) 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;

(c) if the assessment of 'other facts and circumstances' indicate that a party to the joint arrangement has, in substance, direct rights to the assets and direct obligations for the liabilities, relating to the joint arrangement, the joint arrangement would be classified as a joint operation; and

(d) IFRS 11 provides criteria for how to assess whether the parties to the joint arrangement has, in substance, direct rights to the assets and direct obligations for the liabilities, relating to the joint arrangement.

Discussion of Issues 1B–1F[5]

B37 The Interpretations Committee further examined how and why particular facts and circumstances create rights and obligations (ie Issue 1AA) by considering different specific fact patterns. The different specific fact patterns are:

(a) **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'?

(b) **Issue 1C**—Does financing from a third party prevent an arrangement from being classified as a joint operation?

[5] Refer to:

January 2014 Interpretations Committee meeting (January 2014 IFRIC Update (January 2014 IFRIC Update) and Agenda Paper 11(Agenda Paper 11_January 2014));

March 2014 Interpretations Committee meeting (March 2014 IFRIC Update (March 2014 IFRIC Update), Agenda Paper 5A (Agenda Paper 5A_March 2014) and Agenda Paper 5B (Agenda Paper 5B_March 2014)); and

July 2014 Interpretations Committee meeting (July 2014 IFRIC Update (July 2014 IFRIC Update) and Agenda Paper 2B (Agenda Paper 2B_July 2014))

(c) **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’?

(d) **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?

(e) **Issue IF**— How should the assessment of ‘other facts and circumstances’ be applied to a specific type of joint arrangement structure (so-called ‘project entity’)?

B38 With regard to **Issues 1B–1E**, the Interpretations Committee considered an analysis of various examples illustrating those issues and noted that the analysis can be useful in understanding the guidance in IFRS 11. However, it 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.

B39 With regard to **Issue 1F** (ie How should the assessment of ‘other facts and circumstances’ be applied to a specific type of joint arrangement structure?) , the Interpretations Committee considered an analysis of examples of a specific type of joint arrangement structure that is established for a bespoke construction project for delivery of a construction product or service to a (single) customer(s). It noted that the features in the examples:

(a) would not indicate that the parties to the joint arrangement have, in substance, direct rights to the assets of the joint arrangement; but

(b) could indicate that the parties to the joint arrangement have, in substance, direct obligations for the liabilities of the joint arrangement, depending on the nature of the parties’ obligations.

B40 Consequently, the Interpretations Committee noted that the joint arrangement having the features in the examples would not be classified as a joint operation. This is because in order to classify a joint arrangement as a joint operation, IFRS 11 requires that the parties to the joint arrangement have, in substance, both direct rights to the assets and direct obligations for the liabilities relating to the joint arrangement.

B41 The Interpretations Committee also noted that two joint arrangements with similar features can be classified differently depending on whether or not the joint arrangement is structured through a separate vehicle (in circumstances in which the legal form confers separation between the parties and the separate vehicle). This is because:

(a) in the case of a joint arrangement that is structured through a separate vehicle, the legal form of the vehicle must be overcome by other contractual arrangements or specific 'other facts and circumstances' in order for the joint arrangement to be classified as a joint operation; but

(b) in the case of a joint arrangement that is not structured through a separate vehicle, it is classified as a joint operation as a default.

B42 The Interpretations Committee noted that this reflects the approach adopted in IFRS 11, which places importance on:

(a) reflecting the rights and obligations of the parties to the joint arrangement; and

(b) the presence of a separate vehicle affecting those rights and obligations.

B43 The Interpretations Committee noted that the assessment of the classification of a joint arrangement depends on specific contractual terms and conditions and requires a full analysis of the features of the joint arrangement structure.

Issue 2: summary of the discussion

B44 With regard to Issue 2 (ie accounting by the joint operator), the Interpretations Committee addressed the following two sub issues:

(a) **Issue 2A**—the implication of 'share of the revenue from the sale of the output by the joint operation' (paragraph 20(d) of IFRS 11); and

(b) **Issue 2B**—accounting treatment when the joint operator's share of output purchased differs from their share of ownership interest in the joint operation.

B45 In addressing these issues as above, the Interpretations Committee considered a circumstance in which the joint arrangement that is a separate vehicle is classified as a joint operation because the assessment of 'other facts and circumstances' shows that:

(a) the parties to the joint arrangement purchase all output from the joint arrangement; and

(b) this fact, in addition to other facts, indicates that the parties have rights to the assets and obligations for the liabilities relating to the joint arrangement.

Discussion of Issue 2A[6]

B46 The Interpretations Committee discussed **Issue 2A** (ie the implication of 'share of the revenue from the sale of the output by the joint operation') and noted that the joint operators would not recognise any amount in relation to 'share of the revenue from the sale of the output by the joint operation' (paragraph 20(d) of IFRS 11. This is because the share of the revenue from the sale of the output to the joint operators by the joint operation would be eliminated against the share of the output purchased by the joint operators. The Interpretations Committee noted that the joint operators would recognise revenue for the share of the output purchased from the joint operation when they sell those output to a third party.

B47 The Interpretations Committee noted that paragraph 20(d) of IFRS 11 would be applicable when: (a) the joint arrangement are not structured through a separate vehicle; or (b) the joint arrangements are structured through a separate vehicle and the contractual arrangement to reverse or modify the rights and obligations are conferred by the legal form of the separate vehicle.

[6] Refer to July 2014 Interpretations Committee meeting (July 2014 IFRIC Update (July 2014 IFRIC Update) and Agenda Paper 2C (Agenda Paper 2C_July 2014)).

This is because in the two cases noted above, the joint arrangement is classified as a joint operation regardless of whether the joint operation sells its output to third parties or the joint operators.

Discussion of Issue 2B[7]

B48 The Interpretations Committee discussed **Issue 2B** (ie accounting treatment when the joint operator's share of output purchased differs from their share of ownership interest in the joint operation) and noted that there could be two views on the accounting treatment when the joint operator's share of output purchased differs from their share of ownership interest in the joint operation:

(a) **View 1**—the accounting treatment by the joint operator when the joint operator's share of output purchased differs from their share of ownership interest in the joint operation, should be based on the share of the output purchased by the joint operators from the joint operation;

(b) **View 2**—the accounting treatment should be based on the joint operators' share of the ownership interest in the joint operation.

B49 To address this issue, the Interpretations committee first considered its observations and conclusions made in the discussion of Issue 1AA. When discussing Issue 1AA, the Interpretations Committee highlighted the difference between 'gross' risk relating to the economic benefits and 'net' risk relating to the economic benefits. In other words, when the joint arrangement sells its output to third parties, the parties to the joint arrangement do not have, in substance, direct rights to the assets of the joint arrangement because they would have only 'net' economic benefits (and 'net' risks relating to the economic benefits) of the assets of the joint arrangement; IFRS 11 requires the parties to the joint arrangement to have 'gross' economic benefits and 'gross' risks relating to the economic benefits) of the assets of the joint arrangement.

B50 Accordingly, to be consistent with the conclusion made for Issue 1AA, the Interpretations Committee thought that the accounting for 'share of assets'

[7] Refer to July 2014 Interpretations Committee meeting (July 2014 IFRIC Update (July 2014 IFRIC Update) and Agenda Paper 2C (Agenda Paper 2C_July 2014)).

needs to be based on the concept of 'gross' economic benefits. In that case, the Interpretations Committee noted that the joint operators should account for their 'share of assets [of the joint operation]' on the basis of the 'share of output [produced by those assets and] purchased [by the joint operators]'. This is because:

(a) the 'share of output purchased' corresponds proportionately to the 'gross' economic benefits of the assets of the joint operation and therefore also corresponds proportionately to the joint operators' (in substance) direct rights to the assets of the joint arrangement; and

(b) the 'share of ownership interest' per se would not give the joint operators rights to the 'gross' economic benefits of the joint operation but the 'net' economic benefits of it because 'share of ownership interest' only relates to the joint operators' rights to the 'net assets' of the joint operation.

B51 Similarly, the Interpretations Committee noted that the accounting for 'share of liabilities' and 'share of expenses' would also be based on 'share of output purchased'. As mentioned in the discussion of Issue 1AA, cascading of cash flows from the parties to the joint arrangement to the arrangement to settle the liabilities of the joint arrangement was highlighted as a condition for the classification of the joint arrangement as a joint operation. In other words, the 'share of output purchased' needs to correspond proportionately to the amount of cash outflows of the joint operation. Consequently, if the accounting of 'share of liabilities' and 'share of expenses', which relate to cash outflows of the joint operation is based on 'share of output purchased', it would be consistent with the conclusions made in Issue 1AA.

B52 Although the Interpretations Committee agreed that an analysis of this issue based on the conclusions made for Issue 1AA would bring consistency with the classification requirements of IFRS 11, it noted that IFRS 11 does not link the accounting by the joint operator with the classification requirements. It also questioned whether it would be applicable to specific fact patterns. For example, it noted that there could be a situation where 'the share of output purchased' may vary frequently over the life-cycle of the output. In that situation, a question, for example, would arise over what horizon the 'share of output purchased' should be based.

B53 It also noted that when taking into account how to account for the difference between the share of output purchased and the share of ownership interest, it would be difficult to provide general guidance because the nature of such difference can vary depending on the details of the contractual agreement.

B54 The Interpretations Committee therefore highlighted that it is important to understand why the share of the output purchased differs from the ownership interest in the joint operation. It noted that the accounting based on the share of the ownership interest would be a rebuttable presumption; accordingly, if contractual agreements involving the joint arrangement indicate otherwise, the accounting should reflect the economics of the factors that cause the difference between the share of the ownership interest and the share of the output.

Issue 3: summary of the discussion

B55 With regard to Issue 3 (ie accounting within the separate financial statements), the Interpretations Committee discussed:

(a) **Issue 3A**—the accounting by the joint operator in its separate financial statements; and

(b) **Issue 3B**—the accounting by the joint operation that is a separate vehicle in its (separate) financial statements.

Discussion of Issue 3A[8]

B56 The Interpretations Committee discussed **Issue 3A** (ie the joint operator's accounting in its separate IFRS-financial statements for an interest in a joint

[8] Refer to November 2013 Interpretations Committee meeting (November 2013 IFRIC Update (November 2013 IFRIC Update), Agenda Paper 11 (Agenda Paper 11_November 2013), Agenda Paper 11A (Agenda Paper 11A_November 2013)).

operation that is housed in a separate entity). This was within the context of a consultation by the IASB to help the IASB assess the magnitude of accounting issues in the separate IFRS-financial statements of the joint operator when the joint operation is housed in a separate vehicle. The Interpretations Committee noted that:

(a) the issue is prevalent in practice because separate IFRS-financial statements are common in many jurisdictions, and, in addition, joint arrangements structured through separate vehicles are more often classified as joint operations in practice than was originally expected;

(b) it is clear and consistent that IFRS 11 requires the same accounting for joint operations in the consolidated IFRS-financial statements and the separate IFRS-financial statements because it requires the joint operator to account for all of its rights and obligations;

(c) in order to be classified as a joint operation, the parties to the joint arrangement must have sufficient rights to and obligations for the assets and liabilities held in the entity such that these rights and obligations pierce the veil of incorporation. In this case, IFRS 11 requires that the joint operator does not account for its shareholding in the entity that houses the joint operation at cost in accordance with IAS 27 Separate Financial Statements or at fair value in accordance with IFRS 9 Financial Instruments. Instead, the joint operator accounts for its rights and obligations, which are its shares in the assets held by the entity and its shares in the liabilities incurred by it; and

(d) the classification of a joint arrangement as a joint operation depends on the rights and obligations that the parties have. Consequently, the assessment of those rights and obligations is critical to making this classification.

Discussion of Issue 3B[9]

B57 The Interpretations Committee discussed Issue 3B (ie the accounting by the joint operation that is a separate vehicle in its (separate) financial statements) and noted that:

(a) IFRS 11 applies only to the accounting by the joint operators but not to the accounting by the separate vehicle that is a joint operation;

(b) therefore, the financial statements of the separate vehicle would be prepared in accordance with applicable Standards;

(c) it will be important to focus on the nature of the reporting entity when preparing the financial statements of the separate vehicle; and

(d) when preparing these financial statements, it will be necessary to understand the joint operators' rights and obligations and account for the effects of those rights and obligations on the assets and liabilities of the separate vehicle.

B58 The Interpretations Committee also consulted individual IASB members on this issue and confirmed that the views of the IASB members that it consulted were consistent with its view.

[9] Refer to:

May 2014 Interpretations Committee meeting (May 2014 IFRIC Update (May2014 IFRIC Update) and Agenda Paper 2B (Agenda Paper 2B_May 2014)); and

July 2014 Interpretations Committee meeting (July 2014 IFRIC Update (July 2014 IFRIC Update) and Agenda Paper 2A (Agenda Paper 2A_July 2014)).

Appendix C—Summary of the discussion in a table

Type of issue		November 2013	January 2014	March 2014	April 2014	May 2014	June 2014	July 2014
Classification (assessment of 'other facts and circumstances')	Issue 1A[1]	Identified Issue 1as a priority issue	Tentatively decided to reject Issue 1A			Finalised Agenda decision		
	Issue 1AA[2]		Requested the staff to analyse Issue 1AA	Discussed and decided to consult IASB members	Consulted individual IASB members	Noted that feedback from the consultation is consistent with the conclusion of the Interpretations Committee on Issues 1A and 1AA		
	Issues 1B–1E[3]		Discussed and requested the staff to further analyse the issues using examples	Discussed and decided not to add Illustrative Examples to IFRS 11				
	Issue 1F[4]		Requested the staff to examine a case of 'project entity'	Discussed and requested the staff to bring a variation case				Discussed and noted that IFRS 11 is consistent

Type of issue		November 2013	January 2014	March 2014	April 2014	May 2014	June 2014	July 2014
Recognition	Issue 2[5)]	Identified Issue 2 as a priority issue						Discussed and noted that the accounting depends on situations
Other issue	Issue 3[6)]	Discussed Issue 3A within a consultation from the IASB	Requested the staff to address issues relating to the issue of separate financial statements (Issue 3B)			Discussed Issue 3B (ie the accounting by the joint operation) and decided to consult IASB members	Informally consulted individual IASB members	Noted that feedback from the informal consultation is consistent with the conclusion of the Interpretations Committee

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

2) Issue 1AA: How and why 'other facts and circumstances' create rights and obligations that result in a joint arrangement being classified as a joint operation?

3) Issues 1B–1E: See paragraphs 33(a)–(d) of this paper.

4) Issue 1F: How should the assessment of 'other facts and circumstances' be applied to a specific type of a joint arrangement structure, ie 'project entity'?

5) Issue 2: How should the joint operators recognise financial statement items in relation to their interest in a joint operation?

6) Issue 3: Accounting within the separate financial statements (Issue 3A–accounting by the joint operator; Issue 3B–accounting by the joint operation)