

STAFF PAPER

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IFRS Interpretations Committee Meeting

Project	IFRS 11 <i>Joint Arrangements</i>		
Paper topic	Tentative agenda decision comment letter analysis		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in *IFRIC Update*. The approval of a final Interpretation by the Board is reported in *IASB Update*.

Introduction

1. At its meeting in November 2013, the IFRS Interpretations Committee ('the Interpretations Committee') started its discussion related to various topics on joint arrangements. The Interpretations Committee continued its discussion through several meetings until the meeting in July 2014.
2. At its meeting in September 2014, the Interpretations Committee decided that the most appropriate way of documenting its discussion on joint arrangements in its meetings since November 2013 would be to publish it in *IFRIC Update*. Consequently, the Interpretations Committee published a series of the agenda decisions related to IFRS 11 topics in November 2014 *IFRIC Update*¹ as follows:
 - (a) **(Agenda Decision A)** Classification of joint arrangements: the assessment of 'other facts and circumstances';
 - (b) **(Agenda Decision B)** Classification of joint arrangements: application of 'other facts and circumstances' to specific fact patterns;
 - (c) **(Agenda Decision C)** Classification of joint arrangements: consideration of two joint arrangements with similar features that are classified differently;

¹ *IFRIC Update* (November 2014)

<http://media.ifrs.org/2014/IFRIC/November/IFRIC-Update-November-2014.html>

- (d) **(Agenda Decision D)** Accounting by the joint operator: recognition of revenue by a joint operator;
- (e) **(Agenda Decision E)** Accounting by the joint operator: the accounting treatment when the joint operator's share of output purchased differs from its share of ownership interest in the joint operation;
- (f) **(Agenda Decision F)** Accounting in separate financial statements: accounting by the joint operator in its separate financial statements; and
- (g) **(Agenda Decision G)** Accounting in separate financial statements: accounting by the joint operation in its financial statements.

3. In addition to these agenda decisions, at its meeting in November 2014 the Interpretations Committee discussed a potential tentative agenda decision related to classification of joint arrangements involving an industry-specific case. However, the Interpretations Committee decided not to publish a tentative agenda decision on the topic, because it was too industry- and structure-specific. The Interpretations Committee also noted that this was an extension of the discussion related to agenda decisions A and B to see whether the decisions reached in these agenda decisions would change under a specific fact pattern.

4. The purpose of this paper is to:

- (a) provide an analysis of the comments received on the tentative agenda decisions; and
- (b) set out the wording for the proposed final agenda decisions.

5. After considering the comments on the tentative agenda decisions, we recommend that the Interpretations Committee should finalise the agenda decisions with changes to the wording of the tentative agenda decisions, as follows:

- (a) in the agenda decision A we propose to make modifications so that:
 - (i) the agenda decision can avoid confusion by the words 'the parties' as to whether parties together, not individually, should have rights to the assets and obligations for the liabilities of the joint arrangement; and

- (ii) it becomes clear that an obligation referred to in the agenda decision includes a constructive obligation.
- (b) in the agenda decision B we propose to modify the wording so that:
 - (i) the agenda decision under the section ‘output sold at a market price’ clarifies that the cash flows from the purchase of output are not the only source of cash flows that can be considered;
 - (ii) the agenda decision under the section ‘nature of output (ie fungible or bespoke output)’ covers the cash flows between the parties to the joint arrangement and the counterparties of the joint operation’s liabilities;
 - (iii) the agenda decision under the section ‘financing from a third party’ highlights that cash flows from the parties to the joint arrangement, in substance, should satisfy the liabilities of the joint arrangement; and
 - (iv) the meaning of the term ‘obligations for assets’ can be clarified under the section ‘determining the basis for “substantially all of the output”’.
- (c) in the agenda decision D we propose to add clarifications regarding revenue recognition when the parties to the joint operation purchase all the output from the joint operation;
- (d) in the agenda decision E we propose to acknowledge that the issue considered is too broad an issue for the Interpretations Committee to address in an efficient manner; and
- (e) in the agenda decision G we propose to modify the wording so as to clarify that it is not the intention of the Interpretations Committee to imply that financial statements of a joint operation would not necessarily have to recognise the same assets and liabilities to which joint operators have rights and for which they have obligations.

6. We also recommend that the Interpretations Committee should retain its decision not to publish a separate agenda decision relating to classification of joint arrangement involving an industry-specific case.

Paper structure

7. The paper is organised as follows:
- (a) comment letter summary;
 - (b) staff analysis; and
 - (c) staff recommendation.
8. The proposed final agenda decisions are included as a separate agenda paper, ‘Appendix A–Final agenda decisions’.
9. The comment letters received on the tentative agenda decisions published in *IFRIC Update* in November 2014 are included as a separate agenda paper, ‘Appendix B–Comment letters received’.

Comment letter summary

10. The comment period for the tentative agenda decisions ended on 20 January 2015. We received eight² comment letters on the tentative agenda decisions.
11. The following table shows the number of comments we received for each agenda decision, including the agenda decision that the Interpretations Committee decided not to publish (designated as ‘Other’):

Agenda decisions	Overall	A	B	C	D	E	F	G	Other
Number of comments	5	3	4	1	2	2	0	2	3

² European Securities and Markets Authority (ESMA), European Financial Reporting Advisory Group (EFRAG), Accounting Standards Committee of Germany (ASCG), Organismo Italiano di Contabilità (OIC), the Italian standard-setter, Deloitte, KPMG, EY, and BP

Overall comments

12. Five respondents (EFRAG, OIC, ASCG, DTT, and EY) made an overall comment. EFRAG commented that:

Given the significant practical difficulties reported by constituents, we believe that this information will provide useful educational material that illustrates aspects of the application of IFRS.

13. OIC stated that it agreed with the technical conclusions reached by the Interpretations Committee. Deloitte also agreed in general with the Interpretations Committee's decision not to add these issues onto its agenda for the reasons set out in the tentative agenda decisions.

14. On the contrary, ASCG, and EY expressed a general concern about the Interpretations Committee's decision not to take all or some of the issues onto its agenda. ASCG commented:

We appreciate and support the substance of the IFRS IC's tentative agenda decisions and the clarifications they comprise. However, we have concerns about not developing any formal clarification of the standard, but declaring that sufficient guidance would exist and neither a clarification nor an interpretation is needed.

15. ASCG noted that in the light of the importance of the clarifications made in the tentative agenda decisions, it would not be appropriate merely to publish the clarifications through agenda decisions. It suggested amending IFRS 11 as noted below:

we urge the IFRS IC to hold onto its views, but to revise the tentative agenda decision by proposing a narrow-scope amendment which would add guidance to IFRS 11, based on the wording of the current tentative agenda decisions. Only if this is not deemed feasible, we would encourage the IFRS IC to publish the clarifications as agenda decisions, but in this case to also earmark these issues for

future due process steps, i.e. the post-implementation review of IFRS 11.

16. EY commented:

We believe most of the tentative agenda decisions provide helpful clarifications, which will assist the preparers in addressing a number of implementation issues relating to IFRS 11 and result in a more consistent application of the standard.

However, we do not agree that, absent the clarifications provided in most of the tentative agenda decisions, sufficient guidance exists in IFRS 11 for the issues considered, as stated at the end of each of those tentative agenda decisions.

17. Considering that there are other issues in relation to IFRS 11, EY recommended that the IASB should consider undertaking a more comprehensive review project for IFRS 11, noting that:

Due to the fact that there are other issues with IFRS 11 which still remain unclear, we believe the tentative agenda decisions, if finalised, would only provide piecemeal guidance for constituents. ...

Therefore, we recommend that the Board considers undertaking a more comprehensive review project on the principles in and implementation of IFRS 11. We believe that this could be done in the form of a Post-implementation Review (PiR). However, if the Board decides to implement such a project in the form of a PiR, we believe the timing of the PiR of IFRS 11 should be brought forward from its originally planned date and commence as soon as possible.

Agenda decision A—Classification of joint arrangements: the assessment of ‘other facts and circumstances’

18. Two respondents (OIC and EY) agreed with the technical discussion in the agenda decision, but they also made the following comments:
- (a) OIC does not think that there is sufficient guidance in IFRS 11 to reach the same conclusion included in the agenda decision. In the light of significant impacts this may have on practice, it suggests that the clarification should be made by amending the Standard (ie by the Annual Improvement Process).
 - (b) EY suggested addressing the following aspects of the assessment of the classification in the agenda decision to make it more helpful:
 - (i) the period over which the enforceable rights need to exist as a part of condition of a joint arrangement to be classified as a joint operation; and
 - (ii) whether a reassessment of the classification is required when such a period elapses.
 - (c) While acknowledging that the following aspects were outside the scope of the discussion in developing this agenda decision, EY suggested that the Interpretations Committee should refer the following questions to the IASB for further consideration as a part of a more comprehensive review project on IFRS 11, because there is diversity in practice in these respects:
 - (i) ‘does a constructive obligation lead to enforceable rights and obligations?’; and
 - (ii) ‘could the purpose and design of a joint arrangement potentially create enforceable rights to the assets and obligations for the liabilities that should be considered for the purpose of the assessment of other facts and circumstances?’
19. Another respondent (BP) disagreed with the Interpretations Committee’s decision not to take the issue onto its agenda. It stated that:

We believe that the design and purpose of a joint arrangement, the entity's business needs and the entity's past practices are all important factors in determining the classification of a joint arrangement because they indicate whether, in practice, the parties will be substantially the only source of cash flows received by the joint arrangement. We do not agree that the assessment of 'other facts and circumstances' should consider only facts and circumstances which create enforceable rights and obligations.

20. We also learnt about a further concern during a follow-up discussion with a stakeholder relating to the tentative agenda decision. The stakeholder expressed a concern over the words 'the parties' to the joint arrangement used in the agenda decision A. The concern relates to whether the use of the words 'the parties' was intended to mean that it requires these parties together, not individually, have to have rights to the assets and obligations for the liabilities, relating to the joint arrangement, in order to achieve a joint operation classification.

Agenda decision B—Classification of joint arrangements: application of 'other facts and circumstances' to specific fact patterns

21. On the agenda decision B, four respondents (KPMG, DTT, EY, and BP) made comments. The comments on this agenda decision referred to four aspects of the application of 'other facts and circumstances' as follows:
 - (a) output sold at a market price;
 - (b) financing from a third party;
 - (c) nature of output (ie fungible or bespoke output); and
 - (d) determining the basis for 'substantially all of the output'.

Output sold at a market price

22. One respondent (KPMG) expressed a concern about the clarity of the tentative agenda decision. It noted:

[...] the tentative agenda decision notes that the parties would need to consider whether the cash flows provided by the parties to the arrangement through the purchase of the output at market price would be sufficient to enable the arrangement to settle its liabilities on a continuous basis.

This may imply that an assessment is required of how likely it is that the cash flows from the purchase of output by the joint arrangement parties will be sufficient to repay the existing and future liabilities. It is not clear that this is the intention of the IFRS Interpretations Committee.

An assessment of sufficiency is not part of the current requirements under IFRS 11, which are about exclusivity. IFRS 11.B32 indicates that the 'other facts and circumstances' test should consider whether the parties are substantially the only source of cash flow contributing to the continuity of the operations of the arrangement. Therefore, we believe that classification of the arrangement as a joint operation is not precluded even if the cash flow from the purchase of the output can potentially generate insufficient cash flows to cover the arrangement's liabilities – the parties can either voluntarily advance more funding to the arrangement or the operations will not continue [...]

23. Another respondent (BP) disagrees with the Interpretations Committee's decision not to add the issue to its agenda. It notes that the pricing of the output of a joint arrangement does not have substantive effects on either the parties to the joint arrangement or the joint arrangement itself and therefore, it should not necessarily be relevant to the classification of a joint arrangement.

Financing from a third party

24. One respondent (KPMG) agreed that third party financing does not preclude classification as a joint operation. It also suggested changing the current wording of the tentative agenda decision to address its concern as follows:

the tentative decision appears narrowly drafted to refer only to repayment, whereas the issue, as shared earlier in the draft and in the Staff Paper, is third party finance more generally. We believe that the decision should address that broader circumstance, i.e. including when the arrangement has the facility to draw down such finance, and note that the Staff Paper was accepting of this (March 2014, agenda reference 5A, paragraphs 51 and 52).

Nature of output (ie fungible or bespoke output)

25. One respondent (BP) disagreed with the Interpretations Committee's decision not to add this issue to its agenda, because it thought that the nature of the output could be a strong indicator when assessing whether the parties are substantially the only source of cash flows to the joint arrangement.
26. Another respondent (Deloitte) suggested modifying the current wording of the tentative agenda decision, referring to the focus of obligations for liabilities being on the existence of cash flows between the parties and the joint operation. It recommended modifying the wording to acknowledge that such obligations can also exist when the parties make payments directly to the counterparties of the joint operation's liabilities.
27. Another respondent (EY) generally agreed with the tentative agenda decision, but pointed out that production of bespoke output may lead to a creation of constructive obligations. This respondent also made the, more general, comments about constructive obligations, which are set out in paragraph 18 (c) of this paper.

Determining the basis for 'substantially all of the output'

28. While one respondent (EY) generally agreed with the discussion in the tentative agenda decision, it suggested clarifying the meaning of the phrase 'obligations for the assets' used in the following paragraph in the tentative agenda decision because its meaning was not clear:

The Interpretations Committee therefore noted that the economic benefits of the assets of the joint arrangement

would relate to the cash flows arising from the parties' rights and *obligations for the assets*. (emphasis added)

Agenda decision C—Classification of joint arrangements: consideration of two joint arrangements with similar features that are classified differently

29. One respondent (EY) specifically commented that it agreed with the Interpretations Committee's decision not to add the issue to its agenda.
30. Another respondent (BP), on the other hand, disagreed with the tentative agenda decision noting:

The Interpretations Committee noted that IFRS 11 could lead to two joint arrangements being classified differently if one is structured through a separate vehicle and the other is not, but in other respects they have apparently similar features. This appears to represent a legal form over substance approach.

Agenda decision D—Accounting by the joint operator: recognition of revenue by a joint operator

31. One respondent (KPMG) generally agreed with the tentative agenda decision that a joint operator recognises revenue in accordance with paragraph 20(d) of IFRS 11 only when the joint operation sells its output to third parties. However, it also noted that it may not be true in some cases, explaining as follows:

when the purchase of output is not proportionate and at market price, we believe that it is appropriate for the party taking proportionally less output to recognise the rest of its ownership share as a sale to the other party to the arrangement. This is because in that case, that party is in substance selling some of its output to the other party of the arrangement, which is considered a third party to the selling party.

32. Another respondent (EY) also generally agreed with the tentative agenda decision. At the same time, it expressed a concern that the term 'the other parties to the joint

operation' used in the fourth paragraph of the tentative agenda decision was not clear, explaining as follows:

The term 'other parties to the joint operation' is not defined in IFRS. We presume the Committee refers to other joint operators. However, the current wording might also be read as referring to entities that participate in a joint operation, but do not have joint control over that joint operation. If so, it is unclear why such entities are excluded from the notion of 'third parties'. We therefore recommend that the Committee clarifies the sentence.

Agenda decision E—Accounting by the joint operator: the accounting treatment when the joint operator's share of output purchased differs from its share of ownership interest in the joint operation

33. Deloitte and EY commented on this agenda decision and both disagreed with the Interpretations Committee's conclusion that sufficient guidance existed in the existing IFRS requirements. They suggested that the Interpretations Committee should take the issue to its agenda or refer the issue to the IASB. Deloitte noted:

In respect of the tentative agenda decision on the accounting treatment when the joint operator's share of output purchased differs from its share of ownership of the joint operation, we agree with the analysis that an approach should be adopted that results in an appropriate reflection of the economic share of each party in the joint operation. However, in the absence of any guidance in IFRS 11 and given the related issues arising (for example, how to address any difference between ownership interest and share of assets and liabilities on acquisition of an interest in a joint operation) we do not agree with a conclusion that sufficient guidance exists. We believe that there is diversity in practice on the accounting for such arrangements that, therefore, standard-setting activity is required in this area and recommend that the Committee refer the issue to the IASB for further consideration.

34. Citing some examples of a situation that caused or may cause diversity in practice, EY commented:

we have seen diversity in practice where the joint operator's share of output purchased differs from its share of the ownership interest. We believe the current wording of the tentative agenda decision provides some insight, however, it is not sufficient to address the issue. We therefore recommend the Committee either add this issue to its agenda or escalate it to the Board for further consideration.

Agenda decision F—Accounting in separate financial statements: accounting by the joint operator in its separate financial statements

35. Only one respondent (EY) referred specifically to this agenda decision; it stated that it agreed with the discussion in the tentative agenda decision.

Agenda decision G—Accounting in separate financial statements: accounting by the joint operation in its financial statements

36. One respondent (EY) noted that the current wording of the tentative agenda decision seemed to suggest a narrow view of what the reporting entity is. It thought that the current wording may be read as suggesting that the joint operation would not necessarily reflect the assets and liabilities to which joint operators have rights and for which they have obligations. It also noted:

We understand that the definition of the reporting entity is not specifically an IFRS 11 issue. However, we are aware that this is a difficult area in practice and we recommend that the Committee escalates the issue to the Board for further consideration.

37. Another respondent (Deloitte) recommended modifying the current wording of the tentative agenda decision to include a reference to ‘contractual arrangements with the joint operators’, giving its reason as follows:

We believe that a reference to “contractual arrangements with the joint operators” would more clearly illustrate that, for example, a finance lease agreement with a joint operator could lead to derecognition of the leased asset and recognition of a receivable by the joint operation.

Other—Classification of joint arrangements: consideration of an industry-specific case

38. Three respondents (ESMA, EFRAG, and EY) commented on the Interpretations Committee’s decision not to publish a tentative agenda decision relating to classification of joint arrangements involving an industry-specific case. They suggested that the Interpretations Committee should publish an agenda decision on this topic, citing that the tentative agenda decision:
- (a) ‘can be useful for preparers, users, auditors and regulators’ (ESMA);
 - (b) ‘would provide constituents useful educational material that can be applied to similar situations’ (EFRAG); and
 - (c) ‘contained a very useful discussion on identifying the primary obligor and which party has the rights to the assets and the obligations for the liabilities of a joint arrangement’ (EY).
39. ESMA also made a comment from a process point of view, noting that it might create confusion if an agenda decision was not published on this topic. This is because the Interpretations Committee decided not to issue an agenda decision even though it discussed this topic at its previous meetings and the summary of the discussion was included in the *IFRIC Update* in July 2014 (ESMA).

Staff analysis

Overall comments

40. After receiving comments from respondents, we understand that some of them think that clarifications of IFRS 11 should not be dealt with through agenda decisions, but they should lead to amendments to IFRS 11 by narrow-scope

amendments or being considered in a Post-implementation Review (PIR) of IFRS 11.

41. On the basis of the analysis in the sections that follow, we are of the view that the Interpretations Committee should retain its decisions not to add the issues onto its agenda because IFRS 11 provide sufficient guidance, except for the agenda decision E (non-proportionate interest), which is further discussed in the respective section of this paper.

42. We note that finalisation of the tentative agenda decisions would bring benefit to the stakeholders because as noted by three respondents, they provide helpful clarifications to IFRS 11 and thereby, supporting the consistent implementation of IFRS 11. We also note that two other respondents agreed in general with the technical discussions included in the tentative agenda decisions.

43. We further note that finalisation of the issues addressed in the tentative agenda decisions does not mean that they cannot be revisited in the future. For example, if feedback from other sources (eg through the PIR of IFRS 11, or the next Agenda Consultation, both of which are expected to start within a year) indicates that there still is diversity surrounding these issues, we can revisit the issues then.

44. On the basis of the analysis above, we recommend that the Interpretations Committee should finalise the tentative agenda decisions by retaining its decisions not to add the issues to its agenda.

Agenda decision A—Classification of joint arrangements: the assessment of ‘other facts and circumstances’

45. Two respondents disagreed with the tentative agenda decision. One of them disagreed that there was enough guidance, and the other disagreed that the assessment of other facts and circumstances should not consider the design and purpose of the joint arrangement, the entity’s business needs and the entity’s past practices.

46. In response to these comments, we note that the tentative agenda decision A published in November 2014³ added clarifications to and did not change the observations noted in the agenda decision published in May 2014⁴, which states:

...the Interpretations Committee noted that the assessment of 'other facts and circumstances' should focus on whether those facts and circumstances create rights to the assets and obligations for the liabilities.

47. This was a result of extensive discussion as to whether the assessment of other facts and circumstances should be undertaken with a view only towards whether those facts and circumstances create 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.
48. We think that these comments did not present any relevant argument that the Interpretations Committee had not considered in its previous discussions. Accordingly, we do not think that clarifications should be made by amending the Standard (ie by the Annual Improvement Process), nor do we think Interpretations Committee should reopen the discussion.

Meaning of the words 'the parties' in this agenda decision

49. During a follow-up discussion with a stakeholder, the stakeholder expressed a concern about the words 'the parties', whether they meant that the parties together, not individually, had to have rights to the assets and obligations for the liabilities of a joint arrangement to classify it as a joint operation.
50. We note that the references to the words 'the parties' used in this agenda decision are used in the same context as those in paragraph 14 of IFRS 11, which is as follows:

An entity shall determine the type of joint arrangement in which it is involved. The classification of a joint

³ IFRIC Update (November 2014)

<http://media.ifrs.org/2014/IFRIC/November/IFRIC-Update-November-2014.html>

⁴ IFRIC Update (May 2014)

<http://media.ifrs.org/2014/IFRIC/May/IFRIC-Update-May-2014.html>

arrangement as a joint operation or a joint venture depends upon the rights and obligations of the parties to the arrangement.

51. We note that the term ‘the parties’ in the above sentence does not indicate entities have to assess the type of joint arrangement on the basis of their rights and obligations combined together. This is evident from paragraph 17 of IFRS 11 as follows [emphasis added]:

An entity applies judgement when assessing whether a joint arrangement is a joint operation or a joint venture. *An entity* shall determine the type of joint arrangement in which it is involved by considering *its* rights and obligations arising from the arrangement.

52. We think that the application requirement in this respect is clear from IFRS 11, but we also share the concern expressed by the stakeholder. We think that we can respond to the concern raised by making the wording clearer. Accordingly, we propose to replace the words ‘the parties’ used in some parts of the agenda decision with ‘a party’, as shown in the Appendix A—Final agenda decisions.

Other matters raised

53. In its comment, EY raised a question regarding the period over which the enforceable rights need to exist in order for a joint arrangement to be classified as a joint operation and the requirement for reassessment after such period elapses. Specifically, it asked whether such period should exist until:

- (a) any financing of the joint arrangement is expected to be repaid;
- (b) the underlying assets are expected to cease to be used by the joint arrangement; or
- (c) the end of the joint arrangement

54. We note that according to paragraph 15 of IFRS 11 the joint operation classification requires that a party to a joint arrangement has to have both rights to the assets and obligations for the liabilities of the joint arrangement. We also note that paragraph 19 of IFRS 11 sets out a reassessment requirement, in which a party to the joint arrangement has to reassess its classification of the joint

arrangement when facts and circumstances change. In other words, we think that the party to the joint arrangement can classify the joint arrangement as a joint operation as long as it has both rights and obligations. If the party ceases to have either rights or obligations before the end of the life of the joint arrangement, we think that this would trigger the reassessment requirement and the party would need to make a classification assessment based on the new facts and circumstances.

55. If we were to add a clarification to the current wording to address the concern raised, we would propose to add the following paragraph before the penultimate paragraph of the agenda decision A:

The Interpretations Committee, referring to paragraph 19 of IFRS 11, also noted that when facts and circumstances change such that the party's rights and/or obligations change, the party would need to reassess the classification of the joint arrangement. In other words, the joint arrangement can be classified as a joint operation as long as the party has rights to the assets and obligations for the liabilities of the joint arrangement.

56. However, we think that this is clear from the principal requirements of IFRS 11, which are that:

- (a) according to paragraph 15 of IFRS 11, a party to a joint arrangement has to have both rights to the assets and obligations for the liabilities, relating to the joint arrangement in order to classify the joint arrangement as a joint operation; and
- (b) according to paragraph 19 of IFRS 11, the party to a joint arrangement has to reassess the classification of the joint arrangement when facts and circumstances change.

57. Accordingly, we do not propose adding clarifications in this respect in the agenda decision.

Should constructive obligations be considered in assessing the type of classification of a joint arrangement?

58. EY also raised the question of whether a constructive obligation leads to enforceable rights and obligations. It went on to express the concern that some may regard the wording of the tentative agenda decision as suggesting that a party to a joint arrangement should not consider constructive obligations for the purpose of classification of the joint arrangement. It noted that the agenda decision asserted that rights and obligations are enforceable.
59. In response to the concern, we think that it was not the intention of the Interpretations Committee to suggest the exclusion of constructive obligations from the scope of a classification assessment. We think that IFRS 11 does not exclude constructive obligations because there is no specific reference to constructive obligations in IFRS 11. Rather it includes the word ‘obligations’ in general. We note from IAS 37 that a constructive obligation is an obligation. Therefore, we think that it is not the intention of IFRS 11 and the tentative agenda decision published in the *IFRIC Update* in November 2014⁵ to exclude constructive obligations from an assessment of a classification of a joint arrangement.
60. That said, we would like to highlight that apart from arising from past events one of the features of obligations, including constructive obligations, is that an entity has no realistic alternative to settling the obligation⁶. We are of the view that this does not mean that the design and purpose of the joint arrangement, the entity’s business needs and the entity’s past practices should not be included in the assessment at all. We think that they should be included in such assessment to the extent that they affect the existence of obligations, including constructive obligations. We, however, think that it is not these factors themselves, but it is the

⁵ *IFRIC Update* (November 2014)

<http://media.ifrs.org/2014/IFRIC/November/IFRIC-Update-November-2014.html>

⁶ Paragraph 10 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, defines an obligating event as an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

obligations, legal or constructive, that a party ultimately has to look to in determining the classification of the joint arrangement.

61. We understood from the comments received that there is a view that constructive obligations are not enforceable. We disagree with this view. Although we acknowledge that constructive obligations are not contractual, we think that constructive obligations can be enforceable. As stated above, we think that it was not the intention of the Interpretations Committee to exclude constructive obligations from the scope of IFRS 11 by including the word ‘enforceable’.
62. On the basis of the analysis above, we think that constructive obligations should be considered along with legal obligations when assessing the classification of a joint arrangement on the basis of other facts and circumstances. Notwithstanding this analysis, we understand the concern raised and in order to avoid possible confusion we propose to modify the wording to the tentative agenda decision. We propose to do so by deleting the word ‘enforceable’ and clarifying that an obligation referred to in the agenda decision includes a constructive obligation.

Agenda decision B—Classification of joint arrangements: application of ‘other facts and circumstances’ to specific fact patterns

Output sold at a market price

63. KPMG raised a concern about sources of cash flows from the parties to a joint arrangement when assessing a classification of the joint arrangement. It thought that the wording in the tentative agenda decision could be read as implying that an entity has to assess how likely it is that the cash flows from the purchase of output by the parties will be sufficient to cover the joint arrangement’s liabilities. It further noted that insufficient cash flows arising from purchase of output by the parties to cover the joint arrangement’s liabilities, by itself, does not preclude a joint operation classification. It also noted that ‘an assessment of sufficiency is not part of the current requirements under IFRS 11, which are about exclusivity.’
64. We disagree that the current requirement of IFRS 11 is only about exclusivity. We think that it is about both exclusivity and sufficiency. Paragraph B32 of IFRS 11 states;

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

65. We note that the second sentence above refers to ‘only source of cash flows’, which indicates exclusivity. In our view, the sentences above also touch on the aspect of sufficiency because they deal with an arrangement in which cash flows from the parties to the joint arrangement, in substance, satisfy the joint arrangement’s liabilities. We think this indicates that cash flows from the parties have to be sufficient to cover the joint arrangement’s liabilities in full.
66. On the contrary, we agree with KPMG that the fact that cash flows from purchase of output might not cover the joint arrangement’s liabilities, by itself, does not preclude a joint operation classification. This is because there could be other means by which the parties to the joint arrangement can, in substance, satisfy the joint arrangement’s liabilities (eg if there are ‘cash call’ arrangements for the parties’ to finance the joint arrangement). We note from paragraph B32 of IFRS 11 above that the second sentence refers to cash flows in general, and it does not limit such cash flows to those arising from purchase of output by the parties to the joint arrangement.
67. On the basis of the analysis, we propose to modify the wording of the tentative agenda decision, as shown in Appendix A—Final agenda decisions, to clarify that cash flows arising from purchase of output need not be the only source of cash flows that can be considered.
68. Another respondent (BP) made a comment that the pricing of the output of a joint arrangement does not have substantive effects on either the parties to the joint arrangement or the joint arrangement itself and therefore, it should not necessarily be relevant to the classification of a joint arrangement. We agree with its comment to the extent that the pricing of the output alone is not a determining

factor for the classification of the joint arrangement. This is because the pricing of the output as a factor, by itself, is not sufficient to conclude a classification of a joint arrangement.

69. However, we think that the pricing of the output becomes relevant when assessing whether cash flows from the parties to the joint arrangement enable the joint arrangement to settle its liabilities on a continuous basis. This is because the parties would have to consider, among other things, whether the cash flows provided to the joint arrangement through the parties' purchase of the output from the joint arrangement would be sufficient to satisfy the joint arrangement's liabilities, and this can be affected by the pricing of the output.
70. On the basis of the analysis above, we think that the pricing of output is relevant when assessing a classification of a joint arrangement. Therefore, we propose no modification to the wording in this section of the agenda decision.

Financing from a third party

71. KPMG expressed the concern that the current wording of the tentative agenda decision appeared narrowly drafted to refer only to repayment. It suggested addressing a broader circumstance.
72. We agree with the comment. We think that the wording does not have to relate only to the repayment through cash flows from purchase of output by the parties to the joint arrangement. We think that wording that refers more generally to cash flows satisfying the joint arrangement's liabilities would be better. This is because this way it can highlight that cash flows from the parties to the joint arrangement, in substance, should satisfy the liabilities of the joint arrangement.
73. On the basis of the analysis, we propose to change the wording to the tentative agenda decision, as shown in Appendix A—Final agenda decisions.

Nature of output (ie fungible or bespoke output)

74. BP made a comment that the nature of the output could be a strong indicator when assessing whether the parties are substantially the only source of cash flows to the joint arrangement. We think that this comment arose because the tentative agenda decision states in part:

The Interpretations Committee noted that whether the output that is produced by the joint arrangement and purchased by the parties is fungible or bespoke is not a determinative factor for the classification of the joint arrangement.

75. We note that the tentative agenda decision above merely says that the nature of output alone as a factor is not sufficient to conclude that a joint arrangement is a joint operation. This is because the nature of the product does not, by itself, convey to the parties the rights to the assets and obligations for the liabilities of the joint arrangement. Consistent with the tentative agenda decision A, the classification of a joint arrangement should be based on the parties' rights and obligations.
76. On the basis of the analysis, we think that we do not need to modify the wording of the agenda decision.
77. Another respondent, Deloitte, made a suggestion relating to the parties to which cash from the parties to the joint arrangement flows. It suggested modifying the wording to acknowledge that the parties' obligations for liabilities can also exist when the parties make payments directly to the counterparties of the joint operation's liabilities.
78. We think that it was not the intention of the Interpretations Committee to limit the cash flows only to those between the parties and the joint operation. We note that the focus of obligations for liabilities is on whether the liabilities of the joint operation are, in substance, satisfied by the cash flows from the parties on a continuous basis. We note that this can also be achieved when the parties pay directly to the counterparties of the joint operation's liabilities.
79. Accordingly, in order to make it clearer in this aspect, we propose to modify the wording of the agenda decision to clarify this point as shown in Appendix A—Final agenda decisions.
80. In relation to our response to the comment by EY that bespoke output may lead to a constructive obligation, please see the discussion in paragraphs 58–62 of this paper.

Determining the basis for ‘substantially all of the output’

81. EY expressed the concern that the meaning of the term ‘obligations for assets’ used in the agenda decision B is not clear. We can understand the concern because obligations are normally associated with liabilities, not with assets.
82. We note that this term comes from the discussion in agenda decision A, in which the Interpretations Committee notes that for the parties to the joint arrangement to have rights to the assets of the joint operation through the assessment of other facts and circumstances, they have to:
 - (a) have rights to substantially all of the economic benefits (for example, ‘output’) of assets of the arrangement; and
 - (b) 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).
83. We note that the same term ‘obligations for assets’ is used in the tentative agenda decision A, but that the same concern was not raised. We think that this may indicate that the term was not unclear in the agenda decision A. We think that this may be because the term ‘obligations for assets’ used in the agenda decision A followed logical discussions included in that agenda decision. On the contrary, the agenda decision B does not include as much discussion leading to the use of the term ‘obligations for assets’ as the agenda decision A, and we think that this has contributed to the lack of clarity.
84. Because each agenda decision should be understandable on its own, we propose to address the concern about the term ‘obligations for assets’ used in the agenda decision B by replacing it with the term ‘assumed risks from the assets’.

Agenda decision C—Classification of joint arrangements: consideration of two joint arrangements with similar features that are classified differently

85. BP disagree with the Interpretations Committee’s decision not to add the issue onto its agenda because it thought that the clarification included in the agenda decision C appears to reflect a legal form over substance approach.

86. We disagree with the BP's observation because we do not think that the conclusion reached in this agenda decision conflicts with the concept of economic substance as noted in the IFRIC *Update*⁷ as follows:

The Interpretations Committee noted that IFRS 11 could lead to two joint arrangements being classified differently if one is structured through a separate vehicle and the other is not, but in other respects they have apparently similar features. This is because the legal form of the separate vehicle affects the rights and obligations of the parties to the joint arrangement when assessing the type of joint arrangement, as noted, for example, in paragraphs B22 and BC43 of IFRS 11.

The Interpretations Committee thought that such different accounting would not conflict with the concept of economic substance. This is because, according to the approach adopted in IFRS 11, the concept of economic substance means that the classification of the joint arrangement should reflect the rights and obligations of the parties to the joint arrangement and the presence of a separate vehicle plays a significant role in determining the nature of those rights and obligations.

87. While the Interpretations Committee acknowledges that the presence of a separate vehicle can affect the rights and obligations when assessing a classification of a joint arrangement, it notes that it is still those rights and obligations that the joint arrangement accounting should reflect.
88. We think that the analysis given by the Interpretations Committee appropriately reflects the substance of the arrangement. Accordingly, we propose the Interpretations Committee should finalise the agenda decision without modification.

⁷ IFRIC *Update* (November 2014)

<http://media.ifrs.org/2014/IFRIC/November/IFRIC-Update-November-2014.html>

Agenda decision D—Accounting by the joint operator: recognition of revenue by a joint operator

The meaning of the term ‘the other parties to the joint operation’

89. EY raised the concern that the meaning of the term ‘other parties to the joint operation’ used in the following context in the agenda decision D was not clear:

Accordingly, paragraph 20(d) of IFRS 11 would result in the recognition of revenue by a joint operator only when the joint operation sells its output to third parties. For this purpose, third parties do not include other parties to the joint operation.

90. We think that the parties who should be excluded from the ‘third parties’ in this context include joint operators and the parties that:

- (a) participate in the joint operation; and
- (b) have rights to the assets, and obligations for liabilities relating to the joint operation; but
- (c) do not have joint control of the joint operation.

91. This is because, as in the case of the sale of output by the joint operation to the joint operators, selling output to these parties means selling output to themselves because they, too, have rights to the assets of the joint operation. Paragraph 23 of IFRS 11 confirms that such a party shall apply the same accounting as a joint operator. We note that these parties, whether they have a joint control or not, are parties to the joint operation, and that they are captured by the term ‘other parties to the joint operation’ in the agenda decision. Accordingly, we propose no modification to the wording in this respect.

Case involving non-proportionate sale at market price

92. KPMG expressed the concern that some may regard the current tentative agenda decision as setting out a blanket rule that would be applicable in any circumstance. The tentative agenda decision D published in November 2014 states in part:

Examining paragraph 20(d) of IFRS 11, the Interpretations Committee noted that if the joint arrangement is structured through a separate vehicle and the assessment of other facts and circumstances results in the joint arrangement being classified as a joint operation, because the parties take all the output of the joint arrangement, the application of paragraph 20(d) of IFRS 11 would not result in the recognition of revenue by the parties.

93. It commented that it could be a case in which parties to the joint operation would recognise revenue even when they purchase all the output from the joint operation. It explains that it could happen when:

- (a) the joint operation sells its output to the parties to the joint operation at market price; and
- (b) the sale of output by the joint operation is not proportional to their ownership interest.

In such a case, KPMG explains that the party to the joint operation taking proportionally less output, in substance, sells some of its share of output to the other parties to the joint operation.

94. We agree with the concern raised and the analysis provided in the comment letter. We note that when the party to the joint operation recognises revenue in the situation described above, it recognises revenue in accordance with paragraph 20(c) rather than paragraph 20(d) of IFRS 11. We note that the output that is, in substance, sold by the party that is purchasing proportionally less output, and consequently would initially be recognised as its inventory before being sold to the other party. We therefore agree that it would record revenue in accordance with paragraph 20(c) of IFRS 11 when that inventory is sold to the other party.

95. We further note that the above case results in revenue recognition by the party in accordance with paragraph 20(c) of IFRS 11 when the allocation of rights to the assets between the parties matches their ownership interest through contractual agreement or as a result of an assessment of other facts and circumstances. In other words, we think that it is the allocation of parties'

rights to the output rather than their ownership interest that should be compared with the allocation of output to be purchased. The parties purchasing proportionally less output would recognise revenue because they, in substance, sell to the other parties the output to which they have rights, and not because their purchase of output is not proportional to their ownership interest, which can be different from the proportion of their rights to the output.

96. On the basis of the analysis, we propose to add clarifications to this effect before the penultimate paragraph of the agenda decision D, as shown in Appendix A—Final agenda decisions.

Agenda decision E—Accounting by the joint operator: the accounting treatment when the joint operator's share of output purchased differs from its share of ownership interest in the joint operation

97. Two respondents (Deloitte and EY) disagreed with the Interpretations Committee's decision not to add the issue onto its agenda because they thought that there was not enough guidance in IFRS 11 in respect of the issue considered.
98. 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 at its meeting in July 2014.
99. At the meeting, staff presented a paper with one scenario in which parties to the joint arrangement account for the imbalance at the inception between the ownership share and their share of output purchased by recognising 'due to party A' and 'due from party B'. There were mixed views among the Interpretations Committee members on this treatment. Further, although one of the members also raised the concern about the accounting treatment in the circumstance in which the share of output purchased varies over the life cycle of the output, the Interpretations Committee decided not to go further than acknowledging the accounting issue.

100. As a result of the discussion, the Interpretations Committee noted in the IFRIC *Update* in July 2014⁸ that:
- (a) it is important to understand why the share of the output purchased differs from the ownership interests in the joint operation;
 - (b) 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; and
 - (c) Judgement will therefore be needed to determine the appropriate accounting.
101. We note that factors causing the difference between the share of the output purchased and the ownership interest can arise from a variety of reasons. We are of the view that this issue is too broad for the Interpretations Committee to address a general principle that would result in reflecting the economics of the factors causing the difference.
102. As discussed in paragraphs 40–44 of this paper, we think that it would be efficient to consider the issue considered here together with other possible issues relating to IFRS 11 comprehensively through the PIR of IFRS 11.
103. Notwithstanding our observations about the breadth of this issue, we think that the discussion included in the tentative agenda decision is useful. This is because it acknowledges that 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 by understanding the difference and exercising judgement. Accordingly, we suggest that the Interpretations Committee should retain the discussion included in the tentative agenda decision.
104. On the basis of the analysis, we propose that the Interpretations Committee should modify the wording of the tentative agenda decision to delete reference to IFRS 11 containing sufficient guidance. We think that we should acknowledge the

⁸ IFRIC *Update* (July 2014)

<http://media.ifrs.org/2014/IFRIC/July/IFRIC-Update-July-2014.html>

breadth of the issue. The proposed revised wording is shown in Appendix A—
Final agenda decisions.

***Agenda decision F—Accounting in separate financial statements:
accounting by the joint operator in its separate financial statements***

105. We received a comment from only one respondent (EY) relating to this agenda decision, which stated that it agreed with the discussion in the tentative agenda decision. Accordingly, we recommend that the Interpretations Committee should finalise agenda decision F without modification.

***Agenda decision G—Accounting in separate financial statements:
accounting by the joint operation in its financial statements***

106. EY expressed the concern that the current wording of the tentative agenda decision could be read as implying that financial statements of a joint operation would not necessarily have to recognise the same assets and liabilities to which joint operators have rights and for which they have obligations. It thought that the tentative agenda decision seemed to suggest a narrow view of what the reporting entity is.
107. Deloitte also made a suggestion to include a reference to ‘contractual arrangements with the joint operators’. It noted that this would clearly illustrate situations involving derecognition of finance lease assets and recognition of a receivable by the joint operation.
108. While acknowledging the EY’s concern, we do not think that it was the intention of the Interpretations Committee to take a narrow view of the reporting entity, as can be seen in staff paper 2A at its discussion in July 2014⁹, as follows [emphasis added]:

⁹ Agenda Paper 2A of the July 2014 meeting

<http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2014/July/AP02A-IFRS%2011%20Joint%20arrangements%20-%20consultation%20with%20IASB%20members.pdf>

As for the effect of the joint operators' rights and obligations, we noted the Interpretations Committee's conclusion that:

(a) the financial statement items of the joint operators could *appear not only on the (separate) financial statements of the joint operators but also on the (separate) financial statements of the separate vehicle*, depending on the type of agreements between the joint operators and the separate vehicle;

(b) the two sets of the financial statements (ie the joint operators' and the separate vehicle's) portray different reporting entities; and

(c) consequently, even if the same financial statement items are presented in more than one reporting entity, it could be appropriate from a financial reporting perspective.

109. The Interpretations Committee also noted that there could be cases in which it would be appropriate for joint operators and the joint operation to account for the same item differently, on the basis of contractual agreements between them (eg in the case of a finance lease agreement).
110. We think that the current wording could more clearly illustrate the point above by including a reference to 'contractual arrangements with the joint operators', as suggested by Deloitte. Accordingly, we would like to propose a revision to the wording of the agenda decision as shown in Appendix A—Final agenda decisions.

Other—Classification of joint arrangements: consideration of an industry-specific case

111. At its meeting in November 2014, the Interpretations Committee discussed, among other things, specifically whether to publish a potential separate tentative agenda decision relating to classification of joint arrangement involving an industry-specific case. As a result of the discussion, the Interpretations Committee decided not to publish this particular agenda decision for the following

reasons while acknowledging that the clarification included in the wording could be useful:

- (a) it is too industry- and structure-specific; and
- (b) it was an extension of the discussion related to the agenda Decisions A and B to see whether the decisions reached in these agenda decisions would change under a specific fact pattern, which was not the case.

112. One respondent pointed out a potential issue related to due process because this discussion had previously included in the *IFRIC Update*¹⁰ but it is not followed by a finalisation (ie in the form of an agenda decision). We think that there is no due process issue surrounding the decision not to publish an agenda decision relating to this topic. This is because as noted in paragraph 111, the discussion was an extension of the observations in the agenda decisions A and B and these agenda decisions note those observations.
113. Furthermore, we note that no new information has been put forward to convince us to change the conclusion reached at the Interpretations Committee's meeting in November 2014. Accordingly, we recommend that the Interpretations Committee should retain its decision not to publish a separate agenda decision relating to classification of joint arrangement involving an industry-specific case.

Staff recommendation

114. On the basis of the analysis of the comments, we recommend that the Interpretations Committee should finalise the agenda decisions with changes to the wording of the tentative agenda decisions, as follows:
- (a) in the agenda decision A we propose to make modifications so that:
 - (i) the agenda decision can avoid confusion by the words 'the parties' as to whether parties together, not individually,

¹⁰ *IFRIC Update* (July 2014)

<http://media.ifrs.org/2014/IFRIC/July/IFRIC-Update-July-2014.html>

- should have rights to the assets and obligations for the liabilities of the joint arrangement; and
- (ii) it becomes clear that an obligation referred to in the agenda decision includes a constructive obligation.
- (b) in the agenda decision B we propose to modify the wording so that:
- (i) the agenda decision under the section ‘output sold at a market price’ clarifies that the cash flows from the purchase of output are not the only source of cash flows that can be considered;
 - (ii) the agenda decision under the section ‘nature of output (ie fungible or bespoke output)’ covers the cash flows between the parties to the joint arrangement and the counterparties of the joint operation’s liabilities;
 - (iii) the agenda decision under the section ‘financing from a third party’ highlights that cash flows from the parties to the joint arrangement, in substance, should satisfy the liabilities of the joint arrangement; and
 - (iv) the meaning of the term ‘obligations for assets’ can be clarified under the section ‘determining the basis for “substantially all of the output”’.
- (c) in the agenda decision D we propose to add clarifications regarding revenue recognition when the parties to the joint operation purchase all the output from the joint operation;
- (d) in the agenda decision E we propose to acknowledge that the issue considered is too broad an issue for the Interpretations Committee to address in an efficient manner; and
- (e) in the agenda decision G we propose to modify the wording so as to clarify that it is not the intention of the Interpretations Committee to imply that financial statements of a joint operation would not

necessarily have to recognise the same assets and liabilities to which joint operators have rights and for which they have obligations.

115. We also recommend that the Interpretations Committee should retain its decision not to publish a separate agenda decision relating to classification of joint arrangement involving an industry-specific case.
116. The wording of the proposed final agenda decisions is included in the Appendix A—Final agenda decisions.

Questions for the Interpretations Committee

1. Does the Interpretations Committee agree with the staff's recommendation that the Interpretations Committee should finalise its decision not to add this issue to its agenda?
2. Does the Interpretations Committee have any comments on the proposed wording in Appendix A for the final agenda decisions?