



STAFF PAPER

September 2018

IFRS® Interpretations Committee meeting

Project	IFRS 11 <i>Joint Arrangements</i> –Joint Operations		
Paper topic	Initial Consideration		
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Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about the recognition of lease liabilities by a party to an unincorporated joint operation when applying IFRS 11 *Joint Arrangements*.
2. The objective of this paper is to:
 - (a) provide the Committee with background information on the matter;
 - (b) present our research and analysis; and
 - (c) ask the Committee whether it agrees with our recommendation not to add the matter to its standard-setting agenda.

Structure of the paper

3. This paper includes:
 - (a) background information;
 - (b) outreach;
 - (c) staff analysis; and
 - (d) staff recommendation.

4. There are four appendices to this paper:
 - (a) Appendix A—proposed wording of the tentative agenda decision.
 - (b) Appendix B—submission.
 - (c) Appendix C—glossary of contractual terms.
 - (d) Appendix D—extract from Appendix A to Agenda Paper 24F to the April 2016 Board meeting (2015 Agenda Consultation Feedback).

Background information

The fact pattern

5. Appendix B to this paper includes the submission. Below we have reproduced the main facts we considered in our analysis, supplemented by additional research undertaken:
 - (a) A number of parties establish a joint arrangement by entering into a joint operating agreement (JOA)—the JOA gives the parties joint control of the arrangement. Each of the parties is a joint operator as defined in IFRS 11.
 - (b) The joint arrangement is unincorporated, ie it is not structured through a separate vehicle. Accordingly, applying IFRS 11 the joint arrangement is classified as a joint operation—paragraph B16 of IFRS 11 states that ‘a joint arrangement that is not structured through a separate vehicle is a joint operation’.
 - (c) The JOA sets out the terms upon which the joint operators participate in the activity that is the subject of the arrangement. The JOA (or ancillary agreements signed by the joint operators) outlines among other things the following:
 - (i) The relevant activities of the joint operation.
 - (ii) That one of the joint operators is the operator (referred to as the ‘lead operator’ hereafter). The lead operator manages the day-to-day activities of the joint operation in accordance with

the JOA. The lead operator also enters into contracts with third parties for goods or services to be used in the joint operation.

- (iii) The work programme, budgets, authorisation for expenditure, procurement and insurance.
 - (iv) The capital and other contributions required of the joint operators.
 - (v) How the joint operators share the assets and liabilities, and revenue and expenses, relating to the joint operation, and the nature of those assets, liabilities, revenue and expenses. The JOA specifies (a) each joint operator's share of the rights and benefits arising from the activities of the joint operation, including its share of any joint assets; and (b) that the joint operators are primarily liable pro-rata to each other, and secondarily jointly and severally liable for all liabilities and costs relating to the joint operation¹. (See Appendix C for further information about the legal terms.)
- (d) The lead operator enters into a lease², as the sole signatory, for an item of property, plant and equipment to be used as part of the relevant activities of the joint operation throughout the term of the lease. The lead operator has primary responsibility for the liability towards the third-party supplier (lessor) and, in accordance with the JOA, has the right to recover a share of the lease costs from the other joint operators. Depending on the particular clauses in the lease contract or other related agreements, the lessor may have recourse against the other joint operators in the event of non-payment by the lead operator. (See Appendix C for further information about default clauses.)

¹ In this respect, both 'pro-rata' and 'jointly and severally' liable are interpreted as the common law concepts.

² We have assumed that the contract with the third-party supplier contains a lease, as defined in IFRS 16 *Leases*.

The submission

6. Paragraph 20(b) of IFRS 11 states:

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

 - (a) ...
 - (b) its liabilities, including its share of any liabilities incurred jointly;...
7. The submitter asks whether, in applying paragraph 20(b) of IFRS 11, the lead operator recognises the entire lease liability or only its share of that liability. The submission outlines arguments in support of each of those views.
8. The submission uses a lease contract as an example of the type of contract that a joint operator enters into relating to a joint operation's activities. The question, however, could apply to any contract entered into by a joint operator that gives rise to a liability. We understand that, at least for some entities, this question has not arisen before now because (i) these leases have been classified as operating leases applying IAS 17 *Leases* (and thus did not give rise to the recognition of assets and liabilities), and (ii) other contracts that might give rise to a liability are typically not of such significance that they have been material for those entities.

Outreach

9. We decided not to perform outreach on this request for two reasons:
 - (a) Through informal research and feedback from the latest agenda consultation in 2015 (see Appendix D to this paper), we are aware that entities, particularly in the extractives industry, enter into unincorporated joint arrangements with related lease contracts that involve very significant lease payments. Consequently, we are already aware that the fact pattern is widespread and that the differing reporting methods could have a material effect on those affected.

- (b) Although the question relates to the application of IFRS 11, it is very much linked to the application of IFRS 16 *Leases*. For this reason, we considered it to be urgent in nature and thus proceeded to bring it to the Committee’s September 2018 meeting. In addition, in the light of the effective date of IFRS 16 (annual financial statements for periods beginning on or after 1 January 2019), there is likely to be little observable practice at this time.

Staff analysis

What does IFRS 11 say?

10. IFRS 11 establishes principles for financial reporting by entities that have an interest in joint arrangements (paragraph 1 of IFRS 11). In developing IFRS 11, the Board was of the view that ‘the accounting for joint arrangements should reflect the rights and obligations that the parties have as a result of their interests in the arrangements, regardless of those arrangements’ structure or legal form’ (paragraph BC9 of IFRS 11).
11. A joint operation is defined as ‘a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement’ (Appendix A to IFRS 11).
12. Paragraph 20 of IFRS 11 specifies the requirements for the recognition of assets, liabilities, revenue and expenses in relation to a joint operator’s interest in a joint operation:

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

- (a) its assets, including its share of any assets held jointly;
- (b) its liabilities, including its share of any liabilities incurred jointly;
- (c) its revenue from the sale of its share of the output arising from the joint operation;

- (d) its share of the revenue from the sale of the output by the joint operation; and
- (e) its expenses, including its share of any expenses incurred jointly.

13. Paragraph 21 of IFRS 11 requires a joint operator to account for the items recognised (applying paragraph 20) in accordance with the IFRS Standards applicable to the particular assets, liabilities, revenue and expenses. Specifically in relation to a joint operation similar to the one described in the submission (ie a joint operation not structured through a separate vehicle, the relevant activities of which involves operating an asset jointly), paragraph B18 states:

...the parties to a joint arrangement might agree, for example, to share and operate an asset together. In such a case, the contractual arrangement establishes the parties' rights to the asset that is operated jointly, and how output or revenue from the asset and operating costs are shared among the parties. Each joint operator accounts for its share of the joint asset and its agreed share of any liabilities, and recognises its share of the output, revenues and expenses in accordance with the contractual arrangement.

14. The recognition requirements in paragraph 20 of IFRS 11 remain largely unchanged from those previously in IAS 31 *Interests in Joint Ventures* for jointly controlled assets. In our view, the joint arrangement described in the submission would have been a jointly controlled asset applying IAS 31. That aspect of IAS 31 was not reconsidered by the Board when it developed IFRS 11—accordingly, there are no further requirements or explanation in IFRS 11 or its basis for conclusions regarding how to apply the requirement in paragraph 20(b) to recognise 'liabilities, including its share of any liabilities incurred jointly'.

15. Nonetheless, paragraph BC43 explains the Board's objective in developing IFRS 11 (*emphasis added*):

The Board believes that the accounting for joint arrangements *should faithfully reflect the rights and obligations that the parties have in respect of the assets*

and liabilities relating to the arrangement. In that respect, the Board observes that the activities that are the subject of different joint arrangements might be operationally very similar, but that the contractual terms agreed by the parties to these joint arrangements might confer on the parties very different rights to the assets, and obligations for the liabilities, relating to such activities. Consequently, the Board believes that the economic substance of the arrangements does not depend exclusively on whether the activities undertaken through joint arrangements are closely related to the activities undertaken by the parties on their own, or on whether the parties are closely involved in the operations of the arrangements. Instead, the *economic substance of the arrangements depends on the rights and obligations assumed by the parties when carrying out such activities. It is those rights and obligations that the accounting for joint arrangements should reflect.*

Application of paragraph 20(b) of IFRS 11

16. The submitter asks only about the recognition of liabilities by the lead operator. In analysing the matter, however, we think it is helpful to discuss the application of paragraph 20(b) of IFRS 11 by both the lead operator as well as the other joint operators.
17. Paragraph 20(b) requires the recognition of a joint operator's 'liabilities, including its share of any liabilities incurred jointly'. Accordingly, this includes both:
 - (a) liabilities *incurred by a joint operator* in relation to its interest in a joint operation; and
 - (b) the joint operator's share of any *liabilities incurred jointly* in relation to its interest in the joint operation.
18. For jointly controlled assets, IAS 31 had also required a joint operator to recognise the liabilities that it had incurred as well as its share of any liabilities incurred jointly.
19. Paragraph B18 of IFRS 11 includes application guidance in relation to a joint operation in which the joint operators operate an asset jointly. It refers to a circumstance in which the contractual arrangement establishes the joint operators' rights to the asset operated jointly, and how output or revenue from the asset and

operating costs are shared among the parties. In that circumstance, paragraph B18 states that each joint operator accounts for its agreed share of any liabilities in accordance with the contractual arrangement (which, in the fact pattern described in the submission, is the JOA). We think ‘its agreed share of any liabilities’ in paragraph B18 refers to any liabilities that arise from the JOA.

20. The identification of a joint operator’s liabilities and any liabilities incurred jointly depends on the terms and conditions of all the contractual arrangements or agreements relating to the joint operation. This includes the JOA; any ancillary agreements signed by the joint operators; the lease contract (for joint operations that use leased assets); guarantee, indemnity or surety contracts; the articles, charter or by-laws of the separate vehicle (for joint operations structured through a separate vehicle); etc. Each joint operator would also need to consider the applicable legislation pertaining to those contracts. Accordingly, the identification of liabilities very much depends on the particular contractual agreements in place, which we would expect to be different for each joint operation. That identification also requires a detailed assessment and understanding of those agreements.

21. In circumstances in which there is alignment between a joint operator’s obligations that arise from each of the relevant contractual agreements, the identification of liabilities is likely to be more straight-forward than in the fact pattern described in the submission. For example, assume a joint operation uses a leased asset for the entire lease term. The JOA states that the joint operators are primarily liable pro-rata to each other for all liabilities and costs relating to the joint operation, and that they are secondarily jointly and severally liable. The lease contract is signed by all the joint operators—the terms and conditions of the lease are such that each joint operator has primary responsibility for a proportionate share of the liability (severally liable³) towards the lessor; in the event of non-payment by one of the signatories, the lessor has recourse against the other signatories. In this case, we think each joint operator’s lease liability would be its proportionate share of the overall lease liability. Each joint

³ See Appendix C.

operator would also account for any liabilities that might arise from its obligation to pay the lessor in the event of non-payment by the other joint operators.

22. In addition, in situations in which the joint operation itself signs contracts with third-party suppliers, the identification of some liabilities is likely to be more straightforward. For example, assume the same facts as in the example in paragraph 21 above, except as follows: the joint operation is incorporated and signs the lease contract; the joint operation therefore has primary responsibility for the liability towards the lessor. In the event of non-payment by the joint operation, the lessor has recourse against the joint operators. In this case, the lease liability would appear to be a liability incurred jointly, as described in paragraph 20(b) of IFRS 11. Accordingly, each joint operator would recognise its agreed share of that liability in accordance with the JOA. The joint operators would again also account for any liabilities that might arise from its obligation to pay the lessor in the event of non-payment by the joint operation.
23. In our view, in the fact pattern described in the submission, the identification of the joint operators' liabilities, and in particular the lead operator's liability, in relation to the lease is more difficult than in the circumstances described in paragraphs 21-22 above. This is because the lead operator's obligation arising from the lease contract is not aligned with its obligations as specified in the JOA. In the lease contract, the lead operator has primary responsibility for the *entire* liability towards the lessor; in contrast, in the JOA the lead operator is liable towards the other parties only for its pro-rata share of the liabilities and costs relating to the joint operation.
24. So, in this circumstance, how does each of the joint operators, including the lead operator, identify 'its liabilities' in relation to the joint operation as required by paragraph 20(b) of IFRS 11?

The identification of liabilities incurred by each joint operator

25. Paragraph 21 of IFRS 11 requires a joint operator to account for the assets and liabilities relating to its interest in a joint operation in accordance with the IFRS Standards applicable to the particular assets and liabilities. So a joint operator looks to and applies other applicable Standards in identifying its assets and liabilities.

26. In the fact pattern described in the submission, it is assumed that the contract with the third-party supplier contains a lease applying IFRS 16. The joint operators would consider the rights and obligations created by the JOA, and in particular in this instance the rights and obligations relating to the leased asset. They would also consider any contractual clause that means they provide a guarantee or indemnity in the event of non-payment of lease liabilities by the lead operator.
27. So, in the fact pattern described in the submission we think each of the joint operators would identify the following contractual rights and obligations in relation to the leased asset used in the joint operation’s activities:

Right / obligation arises from:	Lead operator		Other joint operators	
	Rights	Obligations	Rights	Obligations
Lease contract / indemnity clause	<ul style="list-style-type: none"> • Right to use the leased asset 	<ul style="list-style-type: none"> • Obligation to pay lessor all lease payments 		<ul style="list-style-type: none"> • Obligation to pay lessor on non-payment by lead operator
JOA	<ul style="list-style-type: none"> • Right to recover share of lease costs from other operators • Share of right-of-use (ROU) asset 		<ul style="list-style-type: none"> • Share of ROU asset 	<ul style="list-style-type: none"> • Obligation to pay lead operator pro-rata share of lease costs

28. In considering the applicable Standards for each of these contractual rights and obligations, we think each joint operator recognises as its assets and its liabilities (applying paragraph 20(a) and 20(b) of IFRS 11) the following:

Lead operator

DR ROU asset

CR Lease liability (obligation to pay the lessor)

DR Net investment in sublease (right to recover share of lease costs)

CR ROU asset (the share representing the rights of the other joint operators)

Each of the other joint operators

DR ROU asset (its share)

CR Lease liability (obligation to pay share of lease costs)⁴

29. For the lead operator:

- (a) the lease creates a liability, ie the lead operator has a present obligation to transfer an economic resource (cash) as a result of a past event (signing the contract and the leased asset being made available for use)⁵. That liability represents the entire lease liability, for which it has primary responsibility. Although the lessor has recourse against the other joint operators, that recourse is conditional upon non-payment by the lead operator. In addition, although the JOA gives the lead operator the right to recover a share of the lease costs from the other joint operators, the JOA does not extinguish any part of the lead operator's obligation towards the lessor.
- (b) the JOA creates a right to recover some of the lease costs. The JOA, in effect, creates a sublease between the lead operator and the joint operation—in the fact pattern described in the submission, we would expect the lead operator to recognise that right as a net investment in the sublease (ie we think the sublease would be classified as a finance lease applying IFRS 16 because, among other factors, the sublease is for the entire term of the head lease).
- (c) the lease creates a ROU asset, which after accounting for the sublease results in the lead operator recognising its share of the ROU asset operated jointly by the joint operators.

⁴ The other joint operators would also account for any additional liability that might arise from providing, for example, an indemnity in the event of non-payment by the lead operator.

⁵ The definition of a liability in the *Conceptual Framework for Financial Reporting* published in March 2018.

30. For each other joint operator:
- (a) the JOA creates a right to its share of the ROU asset (the leased asset is held and operated jointly).
 - (b) the JOA creates an obligation to pay its share of the total lease costs to the lead operator, recognised as a lease liability under the sublease.
 - (c) the lease or other contracts may create an additional liability, such as a financial guarantee contract for its obligation to pay the lessor on non-payment by the lead operator.
31. To illustrate, assume parties A, B, C and D participate in a joint operation, the JOA of which states that A acts as the lead operator and each of the operators have equal rights to the assets, and are primarily liable pro-rata to each other, and secondarily jointly and severally liable for the liabilities and costs relating to the joint operation. A enters into a lease for an asset that will be used in the joint operation's activities for the entire lease term. Applying IFRS 16, the ROU asset and lease liability at lease commencement are CU216 million. The net investment in the sublease reflects lease payments receivable by A from B, C and D (for simplicity, we have assumed that all joint operators apply the same discount rate to the lease receivable (A) and lease liabilities (A, B, C and D)).
32. A recognises the following at lease commencement and in accounting for its rights and obligations arising from the JOA:

		CU'000	CU,000
DR	Right-of-use asset – (100%)	216,000	
CR	Lease Liability – (100%)		216,000
DR	Net investment in sublease – (75%)	162,000	
CR	Right-of-use asset – (75%)		162,000

This results in A recognising its share of the right-of-use asset of CU54 million.

33. B, C and D each recognise the following in accounting for their rights and obligations arising from the JOA:

		CU'000	CU,000
DR	Right-of-use asset – (25%)	54,000	
CR	Lease Liability – (25%)		54,000

B, C and D would also account for any additional liability that might arise from providing, for example, an indemnity.

34. As previously explained, in our view this situation is different from the circumstance described in paragraph 21 of this paper, in which all the joint operators sign the lease. In that case each joint operator, including the lead operator, has primary responsibility for only its proportionate share of the liability towards the lessor. In contrast in the fact pattern described in the submission, the lead operator has primary responsibility for all the liability towards the lessor.

Alignment with other requirements

35. Our analysis above in identifying each joint operator's liabilities focuses on (i) identifying liabilities for which the joint operator has primary responsibility (either under the lease or the JOA); and (ii) distinguishing those from liabilities that arise because a joint operator provides a guarantee or indemnity in the event of non-payment of the operator that has primary responsibility.
36. In relation to the lease in the fact pattern described in the submission, the lead operator has primary responsibility to make payments to the lessor. The lessor may have recourse to the other joint operators in the event of the lead operator's non-payment. We note that IFRS 9 *Financial Instruments* distinguishes between liabilities for which an entity is primarily responsible and those for which it provides guarantees. This is set out in the derecognition requirements in IFRS 9, which apply to lease liabilities (paragraph 2.1(b)(ii) of IFRS 9).
37. Applying IFRS 9, an entity derecognises a financial liability (or a part of it) only when it is extinguished, ie when the entity discharges the liability or *is legally released from primary responsibility for the liability either by process of law or by the creditor*. An entity can be legally released from primary responsibility even if it has given a guarantee (paragraphs 3.3.1 and B3.3.1 of IFRS 9). We note that if the entity

has been released from its primary responsibility to make payments but assumes a guarantee obligation to pay if the party assuming the primary responsibility defaults, paragraph B3.3.7 of IFRS 9 requires an entity to derecognise the original financial liability and recognise a new financial liability based on the fair value of its obligation for the guarantee.

38. We think our views regarding the liabilities identified and recognised by each joint operator in the fact pattern described in the submission aligns with these requirements. This is because we think each of the joint operators, including the lead operator, would recognise the liabilities for which they respectively have primary responsibility. In addition, they would each recognise a liability for any financial guarantees. This enables the difference in the primary responsibility of the lead operator described in paragraph 34 above to be reflected.
39. In addition, we think our view aligns with the Board’s thinking when it developed IFRS 16, and in particular the requirements for subleases. Some had suggested that, when entering into a sublease, an intermediate lessor should be able to offset sublease payments against some or all of its lease liability arising from the related head lease. This is because the cash inflows and outflows relate to payments for use of the same underlying asset, and for some contracts those cash inflows and outflows might exactly match for a period of time. The Board decided, however, to require an intermediate lessor to account for a sublease and the related head lease as two separate contracts. Paragraph BC232 of IFRS 16 explains the Board’s decision (*emphasis added*):

The IASB concluded that this approach is appropriate because in general each contract is negotiated separately, with the counterparty to the sublease being a different entity from the counterparty to the head lease. Accordingly, for an intermediate lessor, *the obligations that arise from the head lease are generally not extinguished by the terms and conditions of the sublease.*

Does IFRS 16 affect a joint operator’s assessment of its lease liabilities?

40. The submission mentions paragraph B11 of IFRS 16. It implies that some think the requirements in that paragraph might influence a joint operator’s assessment of its lease liabilities applying paragraph 20(b) of IFRS 11.

41. Paragraph B11 of IFRS 16 states:

A contract to receive goods or services may be entered into by a joint arrangement, or on behalf of a joint arrangement, as defined in IFRS 11 *Joint Arrangements*. In this case, the joint arrangement is considered to be the customer in the contract. Accordingly, in assessing whether such a contract contains a lease, an entity shall assess whether the joint arrangement has the right to control the use of an identified asset throughout the period of use.

42. Paragraph B11 is part of IFRS 16’s application guidance, and is included within the section titled ‘identifying a lease’. That section of the application guidance supplements the requirements in paragraphs 9-11 of IFRS 16 by specifying requirements to help assess whether a contract contains a lease.

43. Paragraph BC126 of IFRS 16 explains why the Board included the requirements in paragraph B11 (*emphasis added*):

...The IASB decided to clarify that an entity should consider the joint arrangement to be the customer *when assessing whether the contract contains a lease applying paragraphs 9–11 of IFRS 16*—ie the parties to the joint arrangement should not each be considered to be a customer. Accordingly, if the parties to the joint arrangement collectively have the right to control the use of an identified asset throughout the period of use through their joint control of the arrangement, the contract contains a lease. In that scenario, it would be inappropriate to conclude that a contract does not contain a lease on the grounds that each of the parties to the joint arrangement either obtains only a portion of the economic benefits from use of the underlying asset or does not unilaterally direct the use of the underlying asset.

44. Accordingly, we think it is clear that the Board developed the requirements in paragraph B11 to apply only when assessing whether a contract contains a lease. Consequently, we think paragraph B11 of IFRS 16 has no further effect on the required accounting for the lease or the joint arrangement.

Staff Conclusion

45. In relation to its interest in a joint operation, paragraph 20(b) of IFRS 11 requires a joint operator to recognise both liabilities that it has incurred and its share of any liabilities incurred jointly.
46. Identifying the liabilities that it has incurred and those incurred jointly depends on the terms and conditions of all the contractual arrangements and agreements relating to the joint operation, including the law pertaining to those contracts. The contractual agreements relating to each joint operation are likely to differ.
47. A joint operator's liabilities include those for which it has primary responsibility, eg liabilities for which the joint operator has a present obligation to make payments. They also include any liabilities for guarantees or indemnities provided in the event of non-payment by another party that has primary responsibility for a liability.
48. We think this approach reflects the Board's views outlined in paragraph BC43 about the accounting required by IFRS 11—ie we think it faithfully reflects the rights and obligations that joint operators have in respect of the assets and liabilities relating to the arrangement. Paragraph BC43 states the following:

The Board believes that the accounting for joint arrangements should faithfully reflect the rights and obligations that the parties have in respect of the assets and liabilities relating to the arrangement...the economic substance of the arrangements depends on the rights and obligations assumed by the parties when carrying out such activities. It is those rights and obligations that the accounting for joint arrangements should reflect.

49. Our analysis would reflect that, in the fact pattern described in the submission, the lead operator has a present obligation to pay to the lessor the lease payments in full,

and a right to recover from the other joint operators their proportion of those lease payments.

50. We also think it is important to disclose information about each of these major joint operations that is sufficient for a user of financial statements to understand the activities of the joint operation, and a joint operator’s interest in (and risks associated with) that operation. Paragraph 20(a) of IFRS 12 *Disclosure of Interests in Other Entities* requires a joint operator to ‘disclose information that enables users of its financial statements to evaluate the nature, extent and financial effects of its interests in joint arrangements..., including the nature and effects of its contractual relationship with the other investors with joint control of...joint arrangements’.

Question 1 for the Committee

Does the Committee agree with the staff’s analysis of the requirements in paragraph 20(b) of IFRS 11 outlined in paragraphs 16-50 of this paper?

Should the Committee add this matter to its standard-setting agenda?

***Is it necessary to add to or change IFRS Standards to improve financial reporting?*⁶**

51. Based on our analysis, we think that the requirements in existing IFRS Standards provide an adequate basis for a joint operator to identify and recognise its liabilities, including its share of any liabilities incurred jointly, in relation to its interest in a joint operation as described in the submission. That assessment depends on the particular terms and conditions of all contractual arrangements and agreements that relate to the joint operation’s activities.

⁶ Paragraph 5.16(b) of the *Due Process Handbook*.

Staff recommendation

52. Based on our assessment of the Committee’s agenda criteria in paragraphs 5.16-5.17 of the Due Process Handbook (discussed in paragraph 51 above), we recommend that the Committee does not add this matter to its standard-setting agenda. Instead we recommend publishing a tentative agenda decision that outlines how a joint operator applies the requirements in IFRS Standards in identifying its liabilities in relation to its interests in a joint operation.
53. Appendix A to this paper sets out the proposed wording of the tentative agenda decision.
54. We note that a number of respondents to the Board’s 2015 Agenda Consultation suggested that the Board consider adding a project on joint operation accounting in IFRS 11—the matters raised by those respondents include the matter discussed in this paper (see Appendix D to this paper). Accordingly, the Board has already identified this matter as one for its consideration when it undertakes the post-implementation review (PIR) of IFRS 11.

Questions 2 and 3 for the Committee

2. Does the Committee agree with our recommendation not to add this matter to its standard-setting agenda?
3. Does the Committee have any comments on the proposed wording of the tentative agenda decision set out in Appendix A to this paper?

Appendix A—proposed wording of the tentative agenda decision**Liabilities in relation to a joint operator's interest in a joint operation (IFRS 11 *Joint Arrangements*)**

The Committee received a request about the recognition of liabilities by a joint operator in relation to its interest in a joint operation (as defined in IFRS 11). In the fact pattern described in the request, the joint operation is not structured through a separate vehicle. One of the joint operators, as the sole signatory, enters into a lease contract with a third-party supplier (lessor) for an item of property, plant and equipment that will be operated jointly as part of the joint operation's activities. The joint operator that signed the lease contract (hereafter, lead operator) has the right to recover a share of the lease costs from the other joint operators in accordance with the contractual arrangement to the joint operation.

In relation to its interest in a joint operation, paragraph 20(b) of IFRS 11 requires a joint operator to recognise its liabilities, including its share of any liabilities incurred jointly. Accordingly, a joint operator identifies and recognises both (a) liabilities that it incurs in relation to its interest in the joint operation, and (b) its share of any liabilities incurred jointly with other parties to the joint arrangement.

Identifying the liabilities that a joint operator incurs and those incurred jointly requires an assessment of the terms and conditions in all contractual agreements that relate to the joint operation, including consideration of the laws pertaining to those agreements.

The Committee observed that the liabilities that a joint operator incurs include those for which it has primary responsibility, including for example liabilities for which it has a present obligation to make payments.

The Committee highlighted the importance of disclosing information about joint operations that is sufficient for a user of financial statements to understand the activities of the joint operation, and a joint operator's interest in that operation. The Committee noted that, applying paragraph 20(a) of IFRS 12 *Disclosure of Interests in Other Entities*, a joint operator is required disclose information that enables users of its financial statements to evaluate the nature, extent and financial effects of its interests in a joint

operation, including the nature and effects of its contractual relationship with the other investors with joint control of that joint operation.

The Committee concluded that the requirements in existing IFRS Standards provide an adequate basis for a joint operator to identify its liabilities in relation to its interest in a joint operation. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Appendix B—submission

B1. We have reproduced the submission below, and in doing so deleted details that would identify the submitter of this request.

Suggested agenda item: Recognition of lease liabilities by the operators in an unincorporated joint operation

It has come to our attention that there are diverse views on the application of the term ‘liabilities incurred jointly’ in IFRS 11.20(b) to lease liabilities recognised under IFRS 16. We are seeking clarification by the Committee of the issue detailed below.

Background

In unincorporated joint operations, it is common for one of the joint operators (often referred to as the ‘lead operator’) to enter into necessary contractual arrangements with third parties and, as a result to assume the primary responsibility for making payments to those parties (including, when necessary, lessors for assets to be used in the joint operation’s activities). The lead operator will then recover a share of those costs from the other operators (typically, either in cash or by taking a higher share of the joint operation’s output). Although there will often be an agreement between the joint operators specifying the asset to be leased and the supplier to be used and/or a joint operating agreement (JOA) between the operators stating that they are jointly and severally liable for amounts owed in respect of the operation’s activities, the lead operator typically retains the primary contractual relationship with the lessor.

Unincorporated joint operations are a common feature of the mining and oil and gas industries and often involve the lease of particularly large and expensive items of property, plant and equipment. As such, recognition by the lead operator of 100 per cent of the lease liability or only (for example) 50 per cent of that contractual obligation can have a highly material effect on its financial statements.

Question – Should the lead operator in an unincorporated joint operation recognise in full the lease liability for a contract into which it alone has the primary obligation to make payments to the lessor?

View 1 – Yes.

As the primary obligor under the lease contract, the lead operator should recognise its liability to the lessor in full. As the lessor does not have a direct primary claim against the other parties to the joint operation, this liability has not been ‘incurred jointly’ and to recognise only a portion of that liability would be to understate the contractually enforceable claims against the lead operator’s assets. Under this view, the reference in IFRS 16.B11 to a joint operation being ‘considered to be the customer in the contract’ is (as explained in IFRS 16.BC126) included in the guidance on applying the definition of a lease only because “it would be inappropriate to conclude that a contract does not contain a lease on the grounds that each of the parties to the joint arrangement either obtains only a portion of the economic benefits from use of the underlying asset or does not unilaterally direct the use of the underlying asset.” As such, this guidance can be seen as relevant only to the identification of a lease, not to the recognition or measurement of lease liabilities once they are determined to exist.

View 2 – No.

Under this view, a lease liability can be considered to be ‘incurred jointly’ even if the lessor has a contractual relationship only with the lead operator. Notwithstanding the primary obligation for lease payments being the lead operator’s, proponents of this view consider that (for example) an agreement between the joint operators specifying the asset to be leased and the supplier to be used or a joint operating agreement (JOA) between the operators stating that they are jointly and severally liable for amounts owed in respect of the operation’s activities can justify a conclusion that the lead operator should recognise only a portion of that liability.

This view would be consistent with a position that IFRS 16.B11 has an effect beyond the identification of a lease and means that lease liabilities should (unlike other liabilities incurred solely by one party to a joint operation) be treated as ‘incurred jointly’ because the joint operation is deemed to be ‘the customer in the contract’.

Reasons for the Committee to address the issue

We are concerned that the two views observed in practice reflect fundamentally different approaches to the definition of a liability and, given the significance of leased assets to many joint arrangements in the extractives industries, can lead to material differences in the gearing ratios of parties to such arrangements. As such, diversity in this respect would undermine the comparability of financial statements in the sector upon adoption of IFRS 16.

Appendix C—glossary of contractual terms

C1. This appendix includes definitions of common legal terms used in lease and joint operating agreements. Please note that in a number of cases, although the terms themselves remain the same, the meaning can differ based on the particular jurisdiction as each jurisdiction has its own individual laws and regulations as well as case law. For the sake of simplicity and because such terms originated in common law, the definitions refer specifically to common law concepts. We have then included a short discussion on how these definitions would apply in the context of joint operations:

A. Liability clauses commonly used in agreements (ie Joint, several, pro-rata and joint and several liability)

(Source: [Thompson Reuters Practical Law website: Glossary](#))

Term	Definition	Example in the context of a Joint Operation
Joint Liability	Joint liability under a contract or trust deed arises when two or more persons jointly promise to do the same thing for another person. There is one obligation. If parties have joint liability, then they are each fully liable for the performance of the relevant obligation. Performance by one discharges the other.	For example, joint operators A and B agree in the joint operating agreement that they are jointly liable for all obligations arising by virtue of the joint operation’s activities. This means that either joint operator A or B would be liable for the total liabilities arising from the joint operation’s relevant activities.

Term	Definition	Example in the context of a Joint Operation
Several Liability	Several liability (the word several is an archaic word for separate) arises when two or more persons make separate promises to another. Common examples of contracts with several liability are syndicated loan agreements and insurance contracts with multiple insurers. With several liability, each party is liable only for its own specified obligations. If a party is unable to satisfy his obligation, the responsibility does not pass to other parties.	For example, joint operators A and B agree in the joint operating agreement that they are severally liable for all obligations arising by virtue of the joint operation’s activities. This means that either joint operator A or B would be liable for only their agreed share or proportion of the total liabilities (not necessarily equal to their participating interest) arising from the joint operation’s relevant activities.
Joint and Several liability	Joint and several liability arises in contract when two or more persons jointly promise to do the same thing and also severally make separate promises to do the same thing. Joint and several liability is thus a hybrid of joint liability and several liability. In the case of joint and several liability, the claimant may enforce the relevant contractual obligation, in full, against either of the jointly liable parties.	For example, joint operators A and B agree in the joint operating agreement that they are jointly and severally liable for all obligations arising by virtue of the joint operation’s activities. This means that either joint operator A or B could be liable for their agreed share or proportion of the total liabilities or alternatively the total liabilities arising from the joint operation’s relevant activities. The agreement may specify at what point the joint operators become joint and severally liable but if not explicitly stated, then it is from inception of the contract. The joint operators are often primarily liable to one other on a pro rata basis, and secondarily jointly and severally liable for all obligations arising by virtue of the joint operation's activities. In addition, the joint and several liability will be subject to either (individually or in combination): <ol style="list-style-type: none"> 1. the default clauses of the agreement; 2. the lead operator’s indemnity clause; and 3. any other relevant clauses of the agreement tailoring the basic concept.

Term	Definition	Example in the context of a Joint Operation
Pro-rata	<p>A term meaning proportionately allocated. For example, if two lenders each contribute 50% of a loan to a borrower, a pro rata distribution of a principal repayment made by the borrower would mean that each lender would receive 50% of the principal repayment.</p>	<p>If joint operators are liable pro-rata, it means that they are liable for all obligations arising by virtue of the joint operation’s activities based on their participating interest in the joint operation.</p> <p>In many instances as noted above, joint operators are primarily liable to one other on a pro rata basis, and secondarily jointly and severally liable for all obligations arising by virtue of the joint operation's activities. This means that they are liable for their share of the liability and, only in the event of default, will they be required to cover the liability of the defaulting joint operator. Their liability for any default amount depends on the terms of the contract (ie default clauses)</p>

B. Default clauses

(Source: [Thompson Reuters Practical Law website](#): *Guarantees and indemnities: a quick guide*)

Default clauses protect the parties of the agreement against non-performance (such as non-payment) by the other party or parties to the agreement. These clauses are tailored specifically for the contract but could include the following legal remedies:

Term	Definition	Example in the context of a Joint Operation
Guarantee	<p>A guarantee is a contractual promise to:</p> <ul style="list-style-type: none"> • ensure that a third party fulfils its obligations (pure guarantee); and/or • pay an amount owed by a third party if it fails to do so itself (conditional payment guarantee). <p>A guarantee is a secondary obligation because it is contingent on the obligation of the third party (principal) to the beneficiary of the guarantee (beneficiary).</p> <p>A guarantee is distinct from a demand guarantee (also called an on-demand bond). The latter is a guarantee that imposes a primary obligation on the guarantor to pay the beneficiary on its first demand for payment, where the principal fails to perform the contract.</p>	<p>The guarantees commonly used in the context of a joint operation will be a demand guarantee. In this case, all remaining joint operators (excluding the defaulting party) would be liable for the total amount of a liability but only once one of the joint operators has defaulted.</p> <p>The demand guarantee in a joint operating agreement would specify the liability of each of the remaining joint operators.</p>
Indemnity	<p>An indemnity is a contractual promise to accept liability for another's loss. It is a primary obligation because it is independent of the obligation of a third party (principal) to the beneficiary of the indemnity (beneficiary) under which the loss arose.</p>	<p>An on-demand indemnity clause is a common feature of a joint operating agreement and is preferred to a guarantee as the burden of proof is lower. It operates in the same manner as the demand guarantee described above in the context of a joint operating agreement.</p>

Appendix D—extract from Appendix A to Agenda Paper 24F to the April 2016 Board meeting (2015 Agenda Consultation Feedback)

D1. As part of the 2015 Agenda Consultation process, respondents made suggestions for new projects to be added to the Board’s work plan. Appendix A to [Agenda Paper 24F](#) to the April 2016 Board meeting summarised the suggestions and included staff comments on next steps that the Board approved. The following extract from that appendix relates to the joint operation accounting matter described in the submission (*emphasis added*):

<i>Ref</i>	<i>Topic</i>	<i>Feedback received</i>	<i>Possible next steps</i>
New transactions			
A16	Joint operation accounting (EY 41, CBN/CNC Belgian Standard Setter CL96)	<p>Joint operation accounting is difficult to apply in certain situations.(CL96)</p> <p>We recommend adding a project on joint operation accounting under IFRS 11 Joint Arrangements. Joint operation accounting is difficult to apply in certain situations. However, the IFRS Interpretations Committee rejected the request to deal with some of these situations because they were too broad to be analysed. Other situations we encounter are: <i>joint operations in which the partners are jointly and severally liable for the obligations; and the interaction between the expected lease standard and joint operation accounting</i>. These situations should be addressed in illustrative examples. There may be a link with the project on the equity method, although it is not specifically included in paragraphs A22 and A23 of the request for views. Joint operation accounting should also be specifically addressed in the post implementation review of IFRS 10-12.</p> <p>It would be beneficial to work on the projects of risk sharing and joint operation accounting together, as there may be some overlap in the concepts and the appropriate accounting. (CL41)</p>	<p>Two aspects of the accounting by a joint operator were among the Agenda Decisions published by the Interpretations Committee in March 2015. The Interpretations Committee noted in the case of one of these issues, the accounting treatment when the joint operator’s share of output purchased differs from its share of ownership interest in the joint operation, the matter was too broad for it to develop additional guidance.</p> <p>We think that the first step, however, should be to investigate this issue in the forthcoming PIR of IFRS 11. Consequently we do not propose to conduct any further analysis as part of the agenda consultation.</p>