IFRS

STAFF PAPER

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IASB® Meeting

Project	**Comprehensive review of the *IFRS for SMEs®* Standard**
Paper topic	Previous Board decisions—IFRS 11 *Joint Arrangements*

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Purpose

1. At the September 2019 Board meeting, the staff presented a paper summarising the potential consequences of the Board's tentative decision to seek views on aligning Section 9 *Consolidated and Separate Financial Statements* of the *IFRS for SMEs* Standard with IFRS 10 *Consolidated Financial Statements* while seeking views on not aligning Section 15 *Investments in Joint Ventures* with IFRS 11 *Joint Arrangements*.

2. At that meeting, the Board requested that the staff prepare a paper addressing:

   (a) the potential consequences of aligning the definition of 'control' in Section 9 with that in IFRS 10 while not aligning the definition of 'joint control' in Section 15 with that in IFRS 11;

   (b) the potential implications of aligning Section 15 with IFRS 11 with regard only to the definition of 'joint control' but retaining the accounting requirements of Section 15; and

   (c) the potential implications of waiting until the post-implementation review of IFRS 10 and IFRS 11 are completed before considering aligning the *IFRS for SMEs* Standard with IFRS 10 and IFRS 11.

Structure of this paper

3. This paper is structured as follows:

   (a) background (paragraphs 5–7);

   (b) applying IFRS 11 and Section 15 (paragraphs 8–17);

   (c) aligning the definition of ‘control’ but not the definition of ‘joint control’ (paragraphs 18–21);

   (d) aligning Section 15 with IFRS 11 with regard only to the definition of ‘joint control’ (paragraphs 22–29);

   (e) waiting until the post-implementation review of IFRS 10 and IFRS 11 is complete (paragraphs 30–34);

   (f) staff recommendation (paragraphs 35–38); and

   (g) question for the Board.

4. An overview of the requirements of Section 15 and IFRS 11 is set out in Appendix A of this Agenda paper.

Background

5. At its July 2019 meeting, the Board tentatively decided it would seek views on not aligning Section 15 with IFRS 11 in the Request for Information to be issued as part of the 2019 Comprehensive Review of the *IFRS for SMEs* Standard (2019 Review). The Board made this tentative decision because:

   (a) in the view of some Board members, IFRS 11 has proven challenging for entities to apply in practice; and

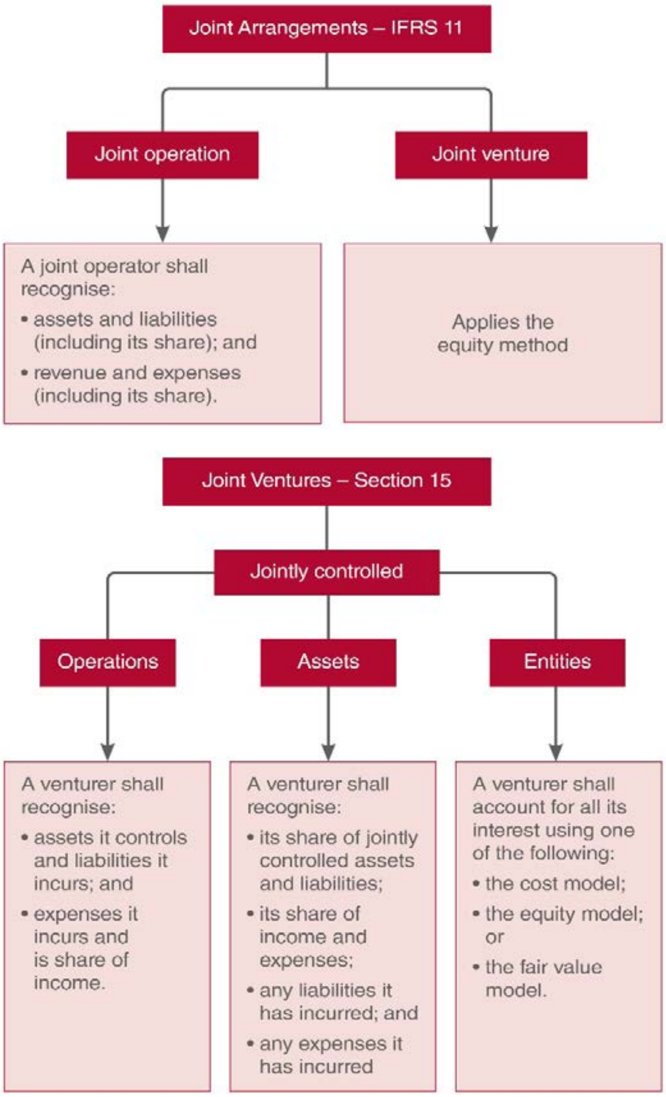
   (b) the Board has insufficient information to ascertain whether and how Section 15 should be aligned with IFRS 11, since the post-implementation review of IFRS 11 is only in its initial phase.

6. At the September 2019 Board meeting, the staff emphasised the link between the definitions of ‘control’ and ‘joint control’, and summarised the potential consequences arising from the Board’s decision at the July 2019 meeting.

7. This agenda paper addresses the three main concerns raised by the Board at the September 2019 meeting as noted in paragraph 2.

Applying IFRS 11 and Section 15

8. The diagram below summarises the requirements for classifying joint arrangements in IFRS 11 and joint ventures in Section 15:[1]



9. The staff notes that Section 15 does not require the use of proportional consolidation in the accounting for joint ventures. In contrast, prior to the issue of IFRS 11, full IFRS Standards permitted the use of proportionate consolidation. The *IFRS for SMEs* Standard pre-empted the changes introduced by IFRS 11 eliminating the option to use proportionate consolidation.

[1] Source: *Effect Analysis on IFRS 11 and IFRS 12* page 18.

10. Applying IFRS 11 an entity determines, firstly, whether the contractual arrangement gives all the parties, or group of parties, control of an arrangement collectively.

11. After concluding that a party, or a group of parties, has collective control of the arrangement, the entity assesses whether it has joint control of the arrangement.

12. IFRS 10 defines control of an investee as follows:

> An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

13. IFRS 11 defines joint control as follows:

> The contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

14. IFRS 10 defines power as 'existing rights that give the current ability to direct the *relevant activities* [emphasis added]' and defines relevant activities as 'activities of the investee that significantly affect the investee's returns'.

15. Section 15 of the *IFRS for SMEs* Standard states that:

> **Joint control** is the contractually agreed sharing of **control** over the economic activity and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).

16. The glossary of the *IFRS for SMEs* Standard defines control as 'the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities'.

17. IFRS 11 and Section 15 require an entity to determine if it has joint control by reference to the definition of control.

Aligning the definition of ‘control’ but not the definition of ‘joint control’

18. Agenda Paper 30F from the September 2019 Board meeting set out the potential consequences of aligning the definition of ‘control’ in the *IFRS for SMEs* Standard with the definition in IFRS 10 while not aligning the definition of ‘joint control’ in the *IFRS for SMEs* Standard with the definition in IFRS 11. In Agenda Paper 30F, the staff expressed the view that:

    (a) a relationship exists in IFRS Standards between ‘control of an investee’ and ‘joint control’; specifically, the Basis for Conclusions to IFRS 11 notes the alignment between IFRS 11 and IFRS 10. That is, IFRS 11 directs parties to an arrangement to first assess whether all the parties control the arrangement collectively, on the basis of the definition of control and corresponding guidance in IFRS 10;[2] and

    (b) the inconsistencies that may arise by not aligning Section 15 with IFRS 11 contradict the principle of simplicity that underpins the *IFRS for SMEs* Standard.

19. The staff notes that if the definitions are not aligned, an entity applying the *IFRS for SMEs* Standard will need to determine whether it ‘controls’ an entity assessing if it has the ability to direct relevant activities (power). The entity would then need to determine whether it has joint control by assessing if it has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

20. The staff takes the view that an entity might encounter difficulties if the relevant activities used to determine whether an entity has control are not the same as those that govern the entity’s financial and operating policies.

21. An alternative approach would be to have two definitions of control within the *IFRS for SMEs* Standard. Section 15 could carry forward the definition of control from the *IFRS for SMEs* Standard; whereas the definition of control in Section 9 could be aligned with IFRS 10. In the staff’s view, using two definitions of control

[2] Basis for Conclusions on IFRS 11 paragraph BC21.

would introduce complexity to the Standard and therefore does not recommend this alternative approach.

Aligning Section 15 with IFRS 11 with regard only to the definition of 'joint control'

22. At the September 2019 Board meeting the staff were asked to consider whether it would be possible to align Section 15 with the IFRS 11 definition of 'joint control' while retaining the accounting requirements of Section 15.

23. IFRS 11 requires that an entity first apply judgement to assess whether all the parties, or a group of parties, have joint control of an arrangement. The entity then determines the type of joint arrangement to which it is party—whether a joint operation or a joint venture—depending upon the rights and obligations of the parties to the arrangement.

24. Section 15 requires that a venture determine the type of joint venture to which it is party. Section 15 describes three types of joint ventures—jointly controlled operations, jointly controlled assets and jointly controlled entities.

25. The differences between the way an entity classifies joint arrangements and the way it classifies joint ventures arise from the form of the arrangement or the rights and obligations of the parties to the arrangement rather than from the definition of joint control. Therefore, the staff thinks it would be possible to retain the three types of joint ventures and the corresponding accounting requirements in Section 15.

26. However, the staff takes the view that retaining the accounting requirements of Section 15 would contradict the principle of simplicity that underpins the *IFRS for SMEs* Standard. Section 15 requires an entity to distinguish between jointly controlled assets, jointly controlled operations and jointly controlled entities, whereas IFRS 11 requires an entity to distinguish between only joint operations and joint ventures.

27. Furthermore, as noted in Agenda Paper 30C from the July 2019 Board meeting, in developing IFRS 11, the Board observed:

> … that in some instances it might be difficult to assess whether an arrangement is a 'joint operation' or a 'joint

> asset'. This is because elements from both types of joint arrangement are sometimes present (in many arrangements joint assets are also jointly operated, and therefore such arrangements could be viewed as a 'joint asset' or as a 'joint operation'). Additionally, both types of joint arrangement result in the same accounting outcome …

28. Some Board members expressed the view that this difficulty may arise from the requirement in IFRS 11 paragraph 12 that an entity consider all facts and circumstances when assessing whether all the parties, or a group of parties have joint control.

29. The staff acknowledges that the requirement to assess all facts and circumstances has proven burdensome in some instances. The staff takes the view that the Board could address this concern by requiring that an entity assess 'facts and circumstances', rather than '*all* facts and circumstances'. This simplification would ease the burden on entities applying the *IFRS for SMEs* Standard.

Waiting until the post-implementation review of IFRS 10 and IFRS 11 is complete

30. At the September 2019 meeting the Board asked the staff to consider whether it should wait until the post-implementation review of IFRS 10 and IFRS 11 is completed before seeking views on whether to align Section 15 with IFRS 11.

31. In the 2012 Comprehensive Review of the *IFRS for SMEs* Standard (2012 Review) the Board developed a framework to address new and amended IFRS Standards that would fall within the scope of future reviews. The Board stated that:[3]

> (a) …
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> (b) new and revised full IFRS Standards should not be considered until they have been issued. However, it would not be necessary to wait until their Post-

[3] *IFRS for SMEs* Standard paragraph BC188.

implementation Reviews (PIRs) have been completed.

32. The staff believes that this framework remains the appropriate basis on which to develop the request for information. The staff notes that if the Board decides to defer seeking views on IFRS 10 and IFRS 11 during the 2019 Review, the Board's next opportunity to seek views on that Standard is unlikely to arise before 2025.

33. At previous meetings, the Board has raised concerns about the breadth of the 2019 Review. Deferring seeking views on aligning the *IFRS for SMEs* Standard with IFRS 10 and IFRS 11 would, most likely, widen the scope of the next review of the *IFRS for SMEs* Standard.

34. Finally, the staff notes that using the request for information to gather evidence does not preclude the Board from deciding against aligning Section 15 and IFRS 11 at a later date. Evidence gathered from stakeholder responses to the request for information could be used to identify challenges entities face in applying Section 15 and IFRS 11.

Staff recommendation

35. At its July 2019 meeting, the staff recommended that the Board seek views on:

  (a) requiring an entity that is party to a joint arrangement to assess its rights and obligations considering the type of joint arrangement (joint venture or joint operation) to which it is party;

  (b) retaining the accounting policy election in Section 15, whereby an entity that is a venturer elects to apply one of the following:

    (i) the cost model;
    (ii) the equity method; or
    (iii) the fair value model;

  (c) an entity that is a venturer in a joint operation recognising:

    (i) its assets, including its share of any assets held jointly;

    (ii) its liabilities, including its share of any liabilities held jointly;

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

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

(v) its expenses, including its share of any expenses incurred jointly.

36. The Board’s response is described in paragraph 5 of this agenda paper. At the September 2019 meeting the staff highlighted the consequences that would arise following the Board’s tentative decision at the July 2019 meeting. At the September 2019 meeting the Board directed the staff to address the three concerns set out in paragraph 2.

37. In this agenda paper the staff has attempted to address these three concerns. The staff:

(a) takes the view that if the definitions of control and joint control are not aligned then complexity will be introduced to the *IFRS for SMEs* Standard. That is, an entity would determine if it has control by first assessing whether it has the ability to direct relevant activities (power). The entity would then determine whether it has joint control by assessing if it has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

(b) takes the view that the differences between the way an entity classifies joint arrangements and the way it classifies joint ventures do not arise from the definition of ‘joint control’ and that, therefore, the Board can retain the accounting requirements in Section 15. The staff notes that:

(i) retaining the Section 15 requirements requires an entity to distinguish between jointly controlled assets, jointly controlled operations and jointly controlled entities, whereas IFRS 11 requires an entity to distinguish between only joint operations and joint ventures.

(ii) in developing IFRS 11, the Board said it might sometimes be difficult to assess whether an arrangement is a joint operation or a joint asset.

(c) takes the view that it would be possible to defer seeking views on aligning the *IFRS for SMEs* Standard with IFRS 10 and IFRS 11 until the completion of the post-implementation review, but that doing so would, most likely, widen the scope of any future review of the *IFRS for SMEs* Standard. Also, seeking views as part of the request for information does not preclude the Board from deciding against aligning Section 15 and IFRS 11 at a later date.

38. The staff recommends, therefore, that the Board seek views on aligning the *IFRS for SMEs* Standard with IFRS 11 in the manner set out in paragraph 35.

Question for the Board

Does the Board wish to:

(i) seek views in the request for information on aligning the *IFRS for SMEs* Standard with IFRS 11 in the manner set out in paragraph 35;

(ii) seek views in the request for information on aligning the definition of ‘control’ but not the definition of ‘joint control’ in the *IFRS for SMEs* Standard, as set out in paragraphs 18–21; or

(iii) seek views on not aligning Section 15 of the *IFRS for SMEs* Standard with IFRS 11; that is wait until the completion of the post-implementation review of IFRS 11 is completed?

Appendix A—Overview of the requirements of Section 15 of the *IFRS for SMEs* Standard and IFRS 11

Overview of Section 15

A1. Section 15 states that a joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint ventures can take the form of jointly controlled operations, jointly controlled assets or jointly controlled entities.

A2. Section 15 of the *IFRS for SMEs* Standard states that:

(a) *jointly controlled operations* are joint ventures that involve the use of the assets and other resources of the venturers instead of the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves;[4]

(b) *jointly controlled assets* are joint ventures that feature the joint ownership of one or more assets contributed to, or acquired for the purpose of, the joint venture and dedicated to the purposes of the joint venture;[5] and

(c) *jointly controlled entities* are joint ventures that involve the establishment of a corporation, partnership or other entity in which each venturer has an interest.[6]

A3. A venturer, in relation to its interests in jointly controlled operations, recognises in its financial statements:[7]

(a) the assets it controls and the liabilities it incurs; and

(b) the expenses it incurs and its share of the income it earns from the sale of goods or services by the joint venture.

[4] *IFRS for SMEs* Standard paragraph 15.4.

[5] *IFRS for SMEs* Standard paragraph 15.6.

[6] *IFRS for SMEs* Standard paragraph 15.8.

[7] *IFRS for SMEs* Standard paragraph 15.5.

A4. A venturer, in relation to its interest in *jointly controlled assets*, recognises in its financial statements:[8]

(a) its share of the jointly controlled assets, classified according to the nature of the assets;

(b) any liabilities it has incurred;

(c) its share of any liabilities incurred jointly with the other venturers in relation to the joint venture;

(d) any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and

(e) any expenses it has incurred in respect of its interest in the joint venture.

A5. A venturer accounts for all of its interests in jointly controlled entities using one of the following:[9]

(a) the cost model;
(b) the equity method; or
(c) the fair value model.

Overview of IFRS 11

A6. IFRS 11 applies to entities that are a party to a *joint arrangement*.[10] A joint arrangement is an arrangement of which two or more parties have *joint control*. Joint control is defined as ‘the contractually agreed sharing of control of an arrangement, which exists only when decisions about relevant activities require the unanimous consent of the parties sharing control.’

A7. Applying IFRS 11, a party to a joint arrangement recognises its rights and obligations arising from the arrangement.

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[8] *IFRS for SMEs* Standard paragraph 15.7.

[9] *IFRS for SMEs* Standard paragraph 15.9.

[10] IFRS 11 paragraph 3.

A8. Joint arrangements are classified as either joint operations or joint ventures:

(a) *joint operations* are joint arrangements in which the parties that have joint control (joint operators) have rights to the assets, and obligations for the liabilities, relating to the arrangement; and

(b) *joint ventures* are joint arrangements in which the parties that have joint control (joint venturers) have rights to the net assets of the arrangement.

A9. A joint operator has rights to assets and obligations for liabilities relating to the arrangement and recognises:

(a) its assets, including its share of any assets held jointly;

(b) its liabilities, including its share of any liabilities held 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.

A10. A joint venture recognises its interest in a joint venture as an investment and applies the equity method of accounting.