Classification of joint arrangements: application of ‘other facts and circumstances’ to specific fact patterns (IFRS 11 *Joint Arrangements*)—March 2015

The Interpretations Committee discussed how ‘other facts and circumstances’ should be applied to some specific fact patterns. It identified four different cases and considered how particular features of those fact patterns would affect the classification of the joint arrangement when assessing other facts and circumstances. The observations from the discussions are as follows.

Output sold at a market price
The Interpretations Committee discussed whether the fact that the output from the joint arrangement is sold to the parties of the joint arrangement at a market price prevents the joint arrangement from being classified as a joint operation, when assessing other facts and circumstances.

The Interpretations Committee observed that the sale of output from the joint arrangement to the parties at market price, on its own, is not a determinative factor for the classification of the joint arrangement. It noted that the parties would need 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 at market price, along with any other funding that the parties are obliged to provide, would be sufficient to enable the joint arrangement to settle its liabilities on a continuous basis.

Accordingly, the Interpretations Committee noted that exercising judgement is needed in this situation in order to determine whether the arrangement is a joint operation based on other facts and circumstances.

Financing from a third party
The Interpretations Committee discussed whether financing from a third party prevents a joint arrangement from being classified as a joint operation.

The Interpretations Committee noted that if the cash flows to the joint arrangement from the sale of output to the parties, along with any other funding that the parties are obliged to provide, satisfy the joint arrangement’s liabilities, then third party financing alone would not affect the classification of the joint arrangement, irrespective of whether the financing occurs at inception or during the course of the joint arrangement’s operations. The Interpretations Committee noted that in this situation, the joint arrangement will, or may, settle some of its liabilities using cash flows from third-party financing, but the resulting obligation to the third party finance provider will, in due course, be settled using cash flows that the parties are obliged to provide.

Nature of output (ie fungible or bespoke output)
The Interpretations Committee discussed whether the nature of the output (ie fungible or bespoke output) produced by the joint arrangement determines the classification of a joint arrangement when assessing other facts and circumstances.

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. It also noted that the focus of ‘obligation for the liabilities’ in IFRS 11 is on the existence of cash flows flowing from the parties to satisfy the joint arrangement’s liabilities as a consequence of the parties’ rights to, and obligations for, the assets of the joint arrangement, regardless of the nature of the product (ie fungible or bespoke output).

Determining the basis for ‘substantially all of the output’
The Interpretations Committee discussed whether volumes or monetary values of output should be the basis for determining whether the parties to the joint arrangement are taking ‘substantially all of the output’ from the joint arrangement when assessing other facts and circumstances.

The Interpretations Committee, referring to paragraphs B31–B32 of IFRS 11, observed that parties to the joint arrangement have rights to the assets of the joint arrangement through other facts and circumstances when they:

a. have rights to substantially all of the economic benefits (for example, ‘output’) of the 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).

The Interpretations Committee also noted from paragraphs B31–B32 of IFRS 11 that in order to meet the criteria for classifying the joint arrangement as a joint operation through the assessment of other facts and circumstances:

a. the parties to the joint arrangement should have rights to substantially all the economic benefits of the assets of the joint arrangement; and
b. the joint arrangement should be able to settle its liabilities from the ‘cash flows’ received as a consequence of the parties’ rights to and obligations for the assets of the joint arrangement, along with any other funding that the parties are obliged to provide.

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 to, and obligations for, the assets. Consequently, it noted that the assessment is based on the monetary value of the output, instead of physical quantities.

On the basis of this analysis, the Interpretations Committee determined that, in the light of the existing IFRS requirements, sufficient guidance exists and that neither an Interpretation nor an amendment to a Standard was necessary.

Consequently, the Interpretations Committee decided not to add these issues to its agenda.