



STAFF PAPER

March 2019

IFRS® Interpretations Committee meeting

Project	Liabilities in relation to a joint operator's interest in a joint operation (IFRS 11)		
Paper topic	Comment letters		
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1. For ease of reference, this paper reproduces comment letters received on the tentative agenda decision published by the IFRS Interpretations Committee in September 2018 on 'Liabilities in relation to a joint operator's interest in a joint operation'.

21 November 2018

Sue Lloyd
Chair
IFRS Interpretations Committee
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London
United Kingdom
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Dear Ms Lloyd

Tentative agenda decision – IFRS 11 *Joint Arrangements*: Liabilities in relation to a joint operator’s interest in a joint operation

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee’s publication in the September IFRIC Update of the tentative decision not to take onto the Committee’s agenda the request for clarification on the recognition by a joint operator of liabilities to which it has the primary responsibility.

We agree with the IFRS Interpretations Committee’s decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision. However, we believe that additional clarity could be added by specifying that:

- in the circumstances described in the tentative agenda decision, the lead operator has primary responsibility for the lease liability; and
- the Committee did not opine on the accounting for any contractual arrangements which may exist between joint operators in respect of a leased asset.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely



Veronica Poole
Global IFRS Leader



Ms Sue Lloyd
Chair
IFRS Interpretations Committee
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12 October 2018

Dear Sue,

Tentative agenda decision – IFRS 11 *Joint Arrangements*: Liabilities in relation to a joint operator’s interest in a joint operation

We are commenting on the above tentative agenda decision, published in the September 2018 edition of IFRIC Update on behalf of PricewaterhouseCoopers. Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on the agenda decision. “PricewaterhouseCoopers” refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We agree with the Committee’s decision to address only the accounting by the lead operator for its obligation to the lessor. We agree that the lead operator should recognise its own liabilities including the obligations for which it has primary responsibility. There is sufficient guidance in the IFRS standards to arrive at this conclusion and we therefore agree with the Committee’s decision not to add this issue onto its agenda.

If you have any questions in relation to this letter please do not hesitate to contact Henry Daubeney, PwC Head of Reporting and Chief Accounting (+447841569635) or Jessica Taurae (+447740166459).

Yours sincerely,

A handwritten signature in black ink that reads 'PricewaterhouseCoopers LLP' in a cursive, flowing script.

PricewaterhouseCoopers LLP

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Ms Sue Lloyd
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Our ref BOD/288

20 November 2018

Dear Ms Lloyd

Tentative agenda decision: Liabilities in relation to a joint operator's interest in a joint operation (IFRS 11 Joint Arrangements)

We appreciate the opportunity to comment on the IFRS Interpretations Committee's (the Committee) tentative agenda decision *Liabilities in relation to a joint operator's interest in a joint operation (IFRS 11 Joint Arrangements)* (IFRIC Update September 2018). We have consulted with, and this letter represents the views of, the KPMG network.

The agenda item relates to the recognition of lease liabilities when an underlying asset is operated jointly as part of an unincorporated joint operation's activities. We are concerned that, when considered together with the Committee's agenda paper and discussion, the tentative agenda decision could be read to require a lead operator to recognise the entire lease liability, even in cases when it is not the customer in the contract with the asset owner and does not obtain control of the right to use the underlying asset. We are concerned that such a treatment:

- is not consistent with the guidance on identifying a lease in IFRS 16 and represents an exception to the general principle that a customer in a contract that contains a lease recognises a right-of-use asset and lease liability;
- creates confusion as to the circumstances in which the other members of the joint arrangement recognise a share of the right-of-use asset and lease liability;
- is an inappropriate application of paragraphs 20 and B18 of IFRS 11; and
- has wider consequences for the application of joint operation accounting and the creation of structuring opportunities.

For these reasons, we do not believe the Committee should finalise the draft agenda decision in its current form.

Application of IFRS 16

We are concerned that the Committee's agenda paper is not consistent with the guidance on identifying a lease in IFRS 16 and represents an exception to the general principle that a customer in a contract that contains a lease recognises a right-of-use asset and lease liability

The Committee's agenda paper asserts as part of the "fact pattern" [sic] that "The lead operator **enters into a lease**" [emphasis added]. The subsequent analysis focuses on the application of other IFRSs assuming that the lead operator has primary responsibility for a liability. In our view, this is a fatal flaw in the agenda paper, as the analysis thereby bypasses the central interpretive issues – whether the contract with the asset owner creates a liability and, if so, for whom.

We believe that in order to address these issues, it is first necessary to apply the guidance in IFRS 16 on lease definition to the contract with the asset owner. That guidance includes IFRS 16.B11, which states that in certain circumstances the "joint arrangement is the customer in the contract" and the assessment of whether the arrangement contains a lease depends on "whether **the joint arrangement has the right to control the use of an identified asset...**" [emphasis added].

It is therefore necessary to determine whether the lead operator or the joint arrangement is the customer – as this determines whether the lead operator or the joint arrangement is the candidate lessee, and therefore whether the lead operator or the joint arrangement recognises the right-of-use asset and lease liability. This follows from the definition of a lessee – i.e. the party "that obtains the right to use an underlying asset" (IFRS 16.App A). If the lead operator is a lessee in the contract with the asset owner, it is then necessary to consider whether there is a sub-lease from the lead operator to the joint arrangement – see below.

Further, IFRS 16 explains that the joint arrangement can be a customer, regardless of who signed the contract. Indeed, IFRS 16.BC126 specifically envisages that this may be the case when the joint arrangement is unincorporated and only one party signs the contract with the asset owner: "The contract might be signed by the joint arrangement itself if the joint arrangement has its own legal identity, or it might be signed **by one** or more of the parties to the joint arrangement on behalf of the joint arrangement. **In such cases, ...**" [emphasis added].

We are aware that assessing whether the lead operator has signed "on behalf of" the joint arrangement can be a matter of significant judgement, and a variety of fact patterns arise in practice. In order to promote a consistent approach to recognition of lease liabilities in such cases, we have published our own detailed guidance on how to

make this assessment¹. We are disappointed that the Committee has not yet discussed this central issue.

In contrast, the Committee agenda paper argues that if the lead operator is a “sole signatory”, then it may be required to account for a lease even when it does not obtain the right to use an underlying asset. The suggestion that a paying agent rather than the party identified by IFRS 16 as the lessee may be required to account for the lease would open untold structuring opportunities. As a long-term supporter of the recognition of assets and liabilities arising from lease contracts, we reject such a significant exception to the core principle of IFRS 16.

Accounting at the joint operator level

We are concerned that the Committee's agenda paper and discussion has created confusion as to the circumstances in which the other members of the joint arrangement recognise a share of the right-of-use asset and lease liability.

Prior to the Committee's deliberations, it appeared that if the joint arrangement obtained the right to control the underlying asset in the agreement with the asset owner, then each party to the joint arrangement would account for its share of the right-of-use asset and lease liability. Conversely, if the lead operator obtained the right to use the underlying asset in the agreement with the asset owner, then it was necessary to assess whether there was a sub-lease from the lead operator to the joint arrangement.

However, the Committee's deliberations raise questions over the first scenario. The staff paper relies on the joint operation obtaining (collective) control of the right to use the underlying asset in order to conclude there is a lease from the asset owner to lead operator. This calls into question whether there can be a sub-lease from the lead operator to the joint arrangement. Put simply, if the lead operator does not obtain control of the right to use the underlying asset, then it cannot convey control of the right to use the underlying asset to the joint arrangement.

This is not our view – but it is a view we have heard with increasing frequency since the last Committee meeting.

Our understanding has always been that the Board's intention with IFRS 16.B11 was to require the parties to a joint arrangement to recognise their share of lease assets and liabilities when the parties obtain the right to jointly control the use of an underlying asset. We continue to support that intention and our published guidance requires that

¹ “Joint arrangements in the oil and gas industry: Identifying the customer in a contract for the use of assets” – available at [KPMG.com/ifrs16](https://www.kpmg.com/ifrs16)

accounting. However, we fear that the Committee's deliberations risk frustrating that intention.

We appreciate that the Committee would be reluctant to expand the scope of its deliberations to consider further the accounting by the other parties to the joint arrangement. Such scope creep is not necessary under our analysis. However, in our view, it is an unfortunate necessity under the analysis set out in the Committee's agenda paper.

Application of IFRS 11

Following from the above we have concerns as to what such an outcome would have for the application of IFRS 11. According to paragraph 20 of IFRS 11, a joint operator recognises its share of assets that are held jointly and liabilities that are incurred jointly. B18 also explains that assets and liabilities are recognised on the basis of the contractual arrangement. This is reinforced by BC38 which makes it clear that the contractual arrangement is the basis for recognition and measurement, and that this requirement would override ownership levels.

We read the tentative agenda decision as contrary to the requirements of IFRS 11 as it reads the lease contract in isolation and ignores the existence of a contractual arrangement that the parties have agreed. Consequently, the lead operator would recognise assets and liabilities more than required under IFRS 11 whilst the other parties would not recognise any lease accounting.

The existence of a 'sublease' has been raised but this should be separately assessed according to the contractual arrangements.

Wider implications to joint operation accounting

Under IFRS 11 the consequence of entering a joint arrangement contract is that other contracts should not be read in isolation but under the umbrella of the arrangement. The provisions of IFRS 11 do not distinguish between types of assets or liabilities but apply to all equally.

Based upon the analysis above we have further concern because the tentative agenda decision would have wider consequences for the application of joint operation accounting beyond the lease accounting. It suggests that one party who signs a contract for a joint operation should recognise the entire assets and liabilities, ignoring agreements between the parties. Operators other than a signatory of a contract would under-recognise assets and liabilities. Consequently, all the parties to the joint operation would not recognise their share of assets and liabilities from joint operations in their financial statements. This creates potential for structuring opportunities.

Clarity of intended message

It will be clear from the foregoing that we have serious concerns about the message that the Committee is intending to convey here. As a final observation on the tentative agenda decision, we are concerned that that message is not clear. The text as written is open to broad interpretation and would not reduce diversity.

Next steps

For the reasons above, we believe that the Committee should not finalise the tentative agenda decision in its current form. We believe the central issue in the fact patterns that prompted the submission to the Committee is how to assess whether the lead operator has signed “on behalf of” the joint arrangement. This is a complex and judgemental issue on which we have published detailed guidance in order to promote consistency of approach. We strongly encourage the Committee to focus its discussions on this central issue in order to avoid the unintended consequences and structuring opportunities that in our view would arise if the agenda decision is finalised in its current form.

Conversely, if the Committee believes that there is a public policy imperative for the lead operator to account for a lease liability as a consequence of signing a contract with a third party irrespective of whether the lead operator obtains control of the right to use an underlying asset, then the Committee should recommend to the IASB that the following IFRSs be amended to require this:

- B11 of IFRS 16 should state a joint arrangement is considered when identifying a lease, but accounting is based on who signs the contract.
- B17 and B18 of IFRS 11 should clarify the meaning of “incurred jointly” to consider the contracts with third parties only.
- IFRS 11 should also clarify the meaning of “held jointly” to consider how assets are recognised when assets are transferred between the joint operators, without third party involvement.

Depending on timing, such amendments could be Annual Improvements, a narrow scope standard-setting project, or considered more holistically as part of the overdue post-implementation review of IFRS 11.



KPMG IFRG Limited
*Tentative agenda decision: Liabilities in relation to a joint operator's interest in a joint
operation (IFRS 11 Joint Arrangements)*
20 November 2018

We hope you find this letter helpful. Please contact Brian O'Donovan or Peter Carlson at +44 (0) 20 7694 8871 if you wish to discuss any of the issues raised.

Yours sincerely

KPMG IFRG Limited

KPMG IFRG Limited

International Financial Reporting Standards Interpretations 21 November 2018
Committee
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Dear IFRS Interpretations Committee member

Tentative agenda decision - Liabilities in Relation to a Joint Operator's Interest in a Joint Operation (IFRS 11 *Joint Arrangements*) - Agenda Paper 3 (*IFRIC Update* September 2018)

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on the above tentative agenda decision of the IFRS Interpretations Committee (the Committee) published in the September 2018 *IFRIC Update*.

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). The request asked about the recognition of liabilities by the lead operator.

We agree with the Committee's observation that the lease liabilities a joint operator recognises include those for which it has primary responsibility. However, as explained below, we observe that this only addresses part of the overall accounting for the transaction by a lead operator and the other joint operators in a joint operation which may need further analysis.

The agenda paper illustrates the journal entries from the perspectives of both the lead operator and the other joint operators of a joint operating agreement (JOA) when the lead operator enters into (and is primarily obligated for) a contract with a supplier and also subleases the same asset to the joint operation. The tentative agenda decision addresses only the recognition of the lease liability by the lead operator. In addition, as many JOAs do not convey the right to use an identified asset to the joint operation and, hence, do not create subleases, the rights and obligations of the lead operator and the other joint operators in a joint operation in these situations will often be different from the illustration in the agenda paper. Thus, the accounting treatment will be subject to further evaluation.

It is also observed that the tentative agenda decision may impact entities in other industries such as construction and engineering, as well as those with other arrangements such as employee benefits and pensions, which may have additional accounting questions.

Considering the wider potential impact of the issues beyond the remit of the request, which is limited to the question of whether the lead operator recognises the entire lease liability or only its share of that liability, we therefore recommend the Committee to request the International Accounting Standards Board to add the Post-implementation Review of IFRS 11 to its agenda, perform outreach on the use of joint operations that are not structured through a separate vehicle and assess if IFRS 11 is operating as intended in order to adequately address the ramifications of the tentative agenda decision.

We support the Committee's decision not to take this issue onto its agenda and agree with the tentative agenda decision, as worded in the September 2018 *IFRIC Update*. However, we ask the Committee to articulate in its agenda decision as to when a contract is considered to have been entered into "*on behalf of a joint arrangement*", in accordance with paragraph B11 of IFRS 16 *Leases* (emphasis added), such that the joint operation is the customer in the lease contract. While we believe this evaluation should focus on the enforceable rights and obligations of each party to the contract that provide the right to use an underlying asset, the standard may not be clear as to when a contract is entered into on behalf of a joint arrangement. For example, some stakeholders are of the view that applying the principal-agent guidance in IFRS 15 *Revenue from Contracts with Customers* is also acceptable. Further clarification would help an entity determine which party has the primary responsibility over any of the lease liability.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 [0]20 7951 3152.

Yours faithfully

Ernst + Young Global Limited

Mrs Sue Lloyd

IFRS Interpretations Committee
Columbus Building,
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Paris, November 23, 2018

Tentative Agenda Decisions – IFRIC Update September 2018

Dear Sue,

MAZARS is pleased to comment on the various IFRS Interpretations Committee tentative agenda decisions published in the September 2018 IFRIC Update.

We have gathered all our comments as appendices to this letter, which can be read separately and are meant to be self-explanatory.

We note that the Tentative Agenda Decisions are sometimes based on a strict reading of existing IFRSs without considering the relevance of the financial information resulting from the decision. In our opinion, this is especially the case for the step acquisition issue (IAS 27, see Appendix 4) and the cash flow hedge relationship (IFRS 9 and IAS 39, see Appendix 6). We consider it key to question the relevance of the accounting consequences of an Agenda Decision before finalizing it, to avoid some counterintuitive accounting and to enhance at the same time the credibility of the work undertaken by the Interpretations Committee.

Should you have any questions regarding our comments on the various tentative agenda decisions, please do not hesitate to contact Michel Barbet-Massin (+33 1 49 97 62 27) or Edouard Fossat (+33 1 49 97 65 92).

Yours faithfully



Michel Barbet-Massin

Financial Reporting Advisory



Edouard Fossat

Appendix 2

Liabilities in relation to a joint operator's interest in a joint operation (IFRS 11 Joint Arrangements) — Agenda Paper 3

We agree with the tentative conclusion reached by the Committee that a joint operator recognises both the liabilities it incurs in relation to its interest in a joint operation and its share of any liabilities incurred jointly with other parties to the joint arrangement.

We also agree with the Committee's decision to only deal with the liability issue: we believe that the situation described, on the asset side, is not different from a fact pattern where the joint operator brings to the joint operation an owned asset, of which 100% of the rights and obligations are retained by the joint operator. Addressing the accounting treatment of such assets may lead to wider discussions on the IFRS 11 accounting model that would probably not be resolved on a timely basis.

Nevertheless, we believe that the description of the fact pattern should make clear that the lease contract is not entered into by the joint operator ***on behalf of the joint operation***, as described in IFRS 16.B11. Otherwise, the right of use arising from the lease contract would be that of the joint operation, and the conclusion on the lease liability borne by the joint operator might be different.

In addition, we understand that many issuers did not anticipate the outcome of such lease contracts in relation to their joint operations while conducting their IFRS 16 project, and that the agenda decision might be difficult to implement in the first financial statements with IFRS 16.



Ms. Sue Lloyd
Chair
IFRS Interpretations Committee
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12 November 2018

Submitted via the online upload page

Dear Ms. Lloyd,

We reviewed the tentative agenda decision **“Liabilities in relation to a Joint operator’s interest in a joint operation”** together with the **Staff paper Agenda 3 of the September 2018 IFRIC meeting “IFRS 11 Joint Arrangements – Joint Operations”** which includes the original submission **“Appendix B submission”**. We appreciate the opportunity provided by the Committee to comment on this tentative agenda decision.

We disagree with the tentative agenda decision for the following reasons:

- The fact pattern described in the IFRIC staff paper does not properly reflect the way the operations are conducted in practice and therefore does not reflect the legal substance of the various arrangements that are involved. The tentative agenda decision focuses only on one arrangement which is the lease contract. It fails to address the fact that the key substance and the combined legal effect of the arrangements (the lease contract and the joint operating agreement) result in the lead operator entering into an agreement **on behalf** of the Joint Operations.
- the recognition of the debt corresponding to future lease payment has to be based on the application of the relevant standard IFRS 16 leases and on the control model.

We also disagree with the absence of outreach by the staff. We understand that the deadline for implementing the standard is approaching but a review of relevant facts and circumstances deserve the full attention of the Committee.

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On Behalf of the operator in the Upstream Oil & Gas Industry

In the upstream oil industry when a contract is entered on behalf of a Joint Operation it is common for the contract to detail or to state:

- the lead operator (term used in the Staff Paper but not used in the oil & gas industry. In the oil industry the Operator is the company undertaking the operations on behalf of the Joint Operation)
- the participants (i.e. Joint Operators other than the lead operator): any person with whom the lead operator has entered into a Joint Operating Agreement or other similar arrangements, for the purpose of searching, developing and producing hydrocarbons in the Permit Area.
- the Permit Area where the operations are carried out.
- that the lead operator enters into the contract for itself and for the participants and **on behalf** of all Joint Operators.
- that the lead operator is entitled to assign the contract to any participant without requiring the consent of the service provider (the lessor in this case).

Lessors are aware that the lead operator enters into the contact because it operates on behalf of the Joint Operators and lessors are also aware that operatorship might be transferred to any other participant. There would be no contract with the lessor if there was no Joint Operation.

The fact that the Lessor accepts that the contract is transferable to any participant demonstrates that the customer is the Joint Operation and not the lead operator.

The Joint Operating Agreement

- has clauses for the transfer of operatorship. Generally the transfer clause provides for the automatic removal of the lead operator when it becomes bankrupt.
- has provisions for contract award which includes consultation of all Joint Operators and/or obtaining approval of the major terms of the contract prior to awarding the contract
- may require the lead operator to provide all Joint Operators with executed copies of contracts.
- sets up technical committees and a management committee (Operating Committee) to decide on asset design when necessary and to monitor the performance of the contract.

The Association of International Petroleum Negotiators (AIPN) is an independent not-for-profit professional membership association that supports international energy negotiators around the world and enhances their effectiveness and professionalism in the international energy community. The AIPN has established a model of **Joint Operating Agreement (2012)**.

The model suggests various possible clauses and alternatives that can be used by Joint Operators when they negotiate a Joint Operating Agreement. We have attached the standard provision of a Joint operating agreement for the award of contracts to establish the fact that the lease contract and the Joint Operating Agreement are in substance one agreement. Major Lease contracts such as drilling rigs, FPSO will be subject of Procedure C of Alternative 2.

The fact pattern described in the IFRIC staff paper does not properly reflect the way the operations are conducted in practice and therefore does not reflect the legal substance of the various arrangements that are involved. The tentative agenda decision focuses only on one arrangement which is the lease contract. It fails to address the fact that the substance and the combined legal effect of the arrangements result in the lead operator entering into an agreement **on behalf** of the Joint Operations.

IFRS 16 Leases and the control model establish who is the customer and who has control

IFRS 16 Leases indicates that

Paragraph 9: At inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Paragraphs B9–B31 set out guidance on the assessment of whether a contract is, or contains, a lease.

A contract entered into by a lead operator on behalf of Joint Operation, by definition, cannot be a lease as the asset would be under joint control. The fact that the lead operator might sign the contract is not relevant; what is relevant is “the right to control”.

Paragraph B11 of the Application Guidance provides authoritative guidance on when the joint arrangement (operation) is the customer.

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.

This is further developed in Paragraph BC 126 of Basis for Conclusions, which states the following:

Assessing whether a contract contains a lease when the customer is a joint arrangement

BC126 When two or more parties form a joint arrangement of which they have joint control as defined in IFRS 11 Joint Arrangements, those parties can decide to lease assets to be used in the joint arrangement’s operations. The joint arrangement might be a joint venture or a joint operation. The contract might be signed by the joint arrangement itself if the joint arrangement has its own legal identity, or it might be signed by one or more of the parties to the joint arrangement on behalf of the joint arrangement. In these cases, 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—i.e. 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.

In the first part of our letter we have detailed the provisions incorporated in our contracts (identification of all participants, reference to the existence a joint operating agreement between participants, possible assignment of the contract to any of the participant etc..) as evidence that the operator is acting on behalf of the Joint Operations and to prove that the Joint Operation is in fact the customer.

In our view paragraph 9 of IFRS 16 as well as B11 and BC126 mean that the Joint Operation is the lessee, irrespective of the Joint Operation’s legal form. The gross liability and right-of-use asset under the contract are attributable to the Joint Operation and not to the parties to the Joint Operation.

Therefore each party to the Joint Operation will recognise its share of the right-of-use asset and the lease obligation in relation to its interest in the Joint Operation.

The assumption that the lead operator of the Joint Operation has to account for 100% of the right-of-use asset and related liability because it signs the lease is inconsistent with the provisions of IFRS 16 paragraph 9, B11, BC126 and IFRS 11.

Furthermore the above analysis is consistent with paragraph B18 of IFRS11:

In other cases, 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.

Should the lease arrangement be the sole arrangement considered as it is the case in the current tentative agenda decision, this would mean that the lead operator has control over the asset. However as we have explained, the lead operator has no control over the asset. Instead, there is a joint control from the Joint Operation.

IFRS 11 paragraph 21 states that assets and liabilities should be recorded in accordance with their respective applicable IFRS. If the lead operator has no control, then the conclusion of the tentative agenda decision should paradoxically, in accordance with IFRS 11 paragraph 21, be that there is no liability under IFRS 16. A Right-Of-Use asset and a liability only exist if there is control. Therefore the tentative agenda decision should clarify how to be in agreement with IFRS 11 paragraph 21.

Differences with US GAAP

We are concerned that the tentative agenda decision could create diversity for users of financial statements of lead operators depending on whether US GAAP or IFRS standards are applied to prepare these financial statements. Under US GAAP many leases will be classified as operational leases in the Oil & Gas .

Under US GAAP

- the debt of financial leases and operational leases has to be presented separately whereas under IFRS no such different presentation exists.
- the Right-Of-Use depreciation is limited to recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis whereas the sum of the depreciation and of the interest leads to an "upfronting" of the charge under IFRS.
- The cash flow statement is also different for operating leases and results in the classification of flows under operating (or investing) flows under US GAAP whereas flows are reported under Financial flows under IFRS.

These differences exist at the present time. However there might be greater divergence depending on how and when the recovery from partners (other than the lead operator) is recognized by the lead operator. This could lead, for instance, to the recognition of a result in the statement of profit and loss in different years under IFRS for partners share when there would be no result under US GAAP. As the full liability will be recognized by the lead operator in the financial debt, the tentative agenda decision will increase the divergence in the cash-flow statement (financial flows under IFRS and operating flow under US GAAP).

An outreach on the current practice under IAS 17 as well as on the implementation of IFRS 16 could have brought valuable information to the IFRIC.

When we reviewed the staff paper we noted

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:
 - (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.

We consider that there were lessons to be learned from the application of IAS 17 as far as the interaction with IFRS 11 is concerned. The review of the disclosures would have shown that:

- a) companies disclosed figures for financial leases and for operational leases for their participating interest only
- b) no disclosures were made for subleases for contracts which were entered into on behalf of a specific license

Therefore it was clear that companies were previously reporting leases entered into on behalf of a specific license for their share of participating interest only under IAS 17.

The implementation of IFRS 16 leases requires considerable efforts. Companies established the design of their systems some time ago. In the ERP systems used in the Oil & Gas industry, postings are derived from commitment documents. The posting is made at the time the event occurs but the accounting is prepared well in advance. The documentation of the system was available for review and discussion well in advance of the effective date of the new accounting standard.

We also note that the staff based much of its analysis on IFRS 11 Joint Arrangements. This standard was issued in May 2011 and has applied to annual reporting periods since January 2013. The Post-

Implementation Review is yet to take place. In the absence of the PIR, staff could have conducted limited outreach on Financial Liabilities in unincorporated Joint Operations. This would likely have shown the absence of financial debt in unincorporated Joint Operations because it would require a complex mechanism of indemnity between joint operators and banks. In unincorporated Joint Operations each Joint operator finances its own share of expenditure only and therefore it would be odd for the lead operator to show all joint partners' financing in its financial statement just because there is an embedded lease in a service contract signed by him.

We regret that the IASB staff did not perform outreach on the disclosures of IAS 17 in the context of a Joint Operation (IFRS 11) and on the preparation of the implementation of IFRS 16. There would have been useful information to have been shared between the IFRIC members and the preparers.

Concerns

The tentative agenda decision comes at a time where companies are already well advanced in their plans to implement the standard. Given the expectations of the regulators to have IFRIC agenda decisions complied with there is very little time for the preparers to modify their plans. We also doubt that software providers can propose solutions readily available to manage large numbers of subleases as described in the Staff Paper.

Conclusion

We ask the IFRIC to reconsider its tentative agenda decision. We consider that the analysis should be supplemented before any decision is made.

We recommend that the subject be part of a Post implementation Review and be dealt with through an Interpretation rather than a hasty agenda decision so close to the effective date of the standard.

Yours Faithfully,



Patrick de La Chevardière
Chief Financial Officer

APPENDIX: Extract from **2012 MODEL INTERNATIONAL JOINT OPERATING AGREEMENT**
 Association of International Petroleum Negotiators (AIPN).

6.7 Contract Awards

ALTERNATIVE PROVISION, CHOOSE ONE

ALTERNATIVE #2 (FROM ARTICLE 6.7.A TO 6.7..C)

Subject to the Contract, Operator (*the Lead Operator in the submission*) shall award each contract for Joint Operations on the following basis (the amounts stated are in thousands of U.S. dollars):

	Procedure A	Procedure B	Procedure C
Exploration and Appraisal Operations	0 to ____	____ to ____	> ____
Development Operations	0 to ____	____ to ____	> ____
Production Operations	0 to ____	____ to ____	> ____
Decommissioning Operations	0 to ____	____ to ____	> ____

6.7.A Procedure A

Operator shall award the contract to the best qualified contractor, as determined by cost, quality, and ability to perform the contract properly, on time, within budgeted cost, and in compliance with applicable legal and contractual requirements, without the obligation to tender and without informing or seeking the approval of the Operating Committee, except that before entering into contracts with Affiliates of Operator or of any Non-Operator exceeding [_____] U.S. dollars], Operator shall obtain the approval of the Operating Committee.

6.7.B Procedure B

Operator shall:

- 6.7.B.1 Provide the Parties with a list of the entities whom Operator proposes to invite to tender for the contract;
- 6.7.B.2 Add to the tender list any entity whom a Party reasonably requests to be added within fourteen (14) Days of receipt of such list;
- 6.7.B.3 Complete the tendering process within a reasonable period of time;
- 6.7.B.4 Inform the Parties of the entities to whom the contract has been awarded, provided that before awarding contracts to Affiliates of Operator or of any Non-Operator that exceed [_____] U.S. dollars], Operator shall obtain the approval of the Operating Committee;
- 6.7.B.5 Circulate to the Parties a competitive bid analysis stating the reasons for the choice made; and
- 6.7.B.6 Upon the request of a Party, provide such Party with a copy of the final version of the contract.

6.7.C Procedure C

Operator shall:

- 6.7.C.1 Provide the Parties with a list of the entities whom Operator proposes to invite to tender for the contract;
- 6.7.C.2 Add to such list any entity whom a Party reasonably requests to be added within fourteen (14) Days of receipt of such list;
- 6.7.C.3 Prepare and dispatch the tender documents to the entities on the tender list and to Non-Operators;
- 6.7.C.4 After the expiration of the period allowed for tendering, consider, and analyze the details of all bids received;
- 6.7.C.5 Prepare and circulate to the Parties a competitive bid analysis, stating Operator's recommendation as to the entity to whom the contract should be awarded, the reasons for the recommendation, and the technical, commercial, and contractual terms to be agreed upon;
- 6.7.C.6 Obtain the approval of the Operating Committee to the recommended bid; and
- 6.7.C.7 Upon the request of a Party, provide such Party with a copy of the final version of the contract.

Ms Sue Lloyd
Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
London
E14 4HD

14 November 2018

Dear Ms Lloyd,

Tentative agenda decision – IFRS 11 Joint arrangements: Liabilities in relation to a joint operator's interest in a joint operation

We are writing to you to comment on the above tentative agenda decision published in the September 2018 edition of the IFRIC update from the perspective of an independent mid-cap E&P company. We have read the tentative agenda decision and watched the webcast discussion of the related IFRIC staff paper. Having had the chance to consider the findings and the impact on our group balance sheet, we disagree with the findings reached in the tentative agenda decision and our reasons for this are set out below.

1. Where Premier, as an operator, enters into a lease on behalf of a joint operation, our current accounting policy and practice is to adopt what is known as a 'net approach', where we, and each of our partners in the joint operation, accounts for their respective share of a given asset and related liability. We follow this accounting policy regardless of whether we are the sole signatory of a lease agreement on behalf of our partners in a joint operation or whether we have entered into a lease agreement jointly with our partners. Both situations currently apply to Premier.

The tentative agenda decision will require a change to our existing practice and require us, as operator, to recognise a gross liability where we currently recognise only a net liability. This change, in our view, will be driven by IFRIC's interpretation of IFRS 11 and not the implementation of IFRS 16. This is an issue that relates to a wider question of how joint operation accounting is applied and practice and we believe it is premature for IFRIC to opine on this narrow issue without conducting a full and proper review into joint operation accounting.

The UK's Financial Reporting Council (FRC) have recently reviewed Premier's 2017 annual report and accounts as part of their thematic review, which included a focus on Premier's accounting policies. No concerns were expressed or points noted in relation to our current IFRS 11 policies and our use of the 'net approach'. Furthermore, the absence of clear guidance in relation to an operator's obligations or liabilities may also result in other areas which haven't been applied in accordance with your interpretation of IFRS 11.

This issue is not new and companies are currently accounting for finance leases on a net basis. The real issue is much wider and is reflected in the divergent views on how to account for joint operations by joint operators under IFRS 11. IFRS 11 has been effective for almost 6 years, yet no

post-implementation review of IFRS 11 has been carried out. We believe, therefore, it is inappropriate for IFRIC to attempt to answer this narrow question without the IASB having performed a post-implementation review of IFRS 11, as required by the IFRS Foundation's Due Process Handbook. Such a review could allow this issue to be addressed more holistically with appropriate consultation with the oil and gas industry.

To conclude this point, we do not believe it is correct that the adoption of IFRS 16 should give rise to a change in our IFRS 11 accounting policies, especially as the requirements of IFRS 11 are unchanged.

2. The tentative agenda decision focuses entirely on the requirements of IFRS 11 and appears to ignore some key parts of IFRS 16. In particular, paragraph B11 of IFRS 16, explicitly states that *"a contract to receive goods or services may be entered into by a joint arrangement, or on behalf of a joint arrangement. In this case the joint arrangement is considered to be the customer in the contract."*

Where Premier enters into lease agreements on a sole signatory basis we do so entirely on behalf of a joint operation. We do not as operator have control of the underlying leased asset. The leased asset will be controlled by the various mechanisms established in the provisions of the Joint Operating Agreement (JOA) with our partners.

We note that the IFRIC staff paper addresses that B11 is intended to be read in conjunction with BC126 (i.e. in identifying a lease). However, from discussions we have been having, it is clear that companies such as us have been considering paragraph B11 more broadly during our IFRS 16 implementation work. Unless B11 is changed to clarify that this is only intended to be in relation to lease identification, it could be misleading and is likely to lead to diversity in practice. This is compounded by IFRS 11 paragraph 21 which tells you to refer to other standards. So the natural place to refer to in IFRS 16 when considering IFRS 16 accounting for joint arrangements, is B11 – the joint arrangements paragraph.

In our view, the intention of paragraph IFRS 16:B11 is to allow a joint operation to be the customer of a lease agreement regardless of whether or not the underlying lease agreement was signed by just the operator or by each individual party to the joint operation. On the basis that the joint operation is the customer to the lease agreement we believe that continue to follow the 'net approach' is fully compliant with IFRS 16.

3. If no further clarifications are made by IFRIC, and industry practice is established as a 'gross approach' for situations where the operator of a joint operation is the sole signatory to a lease arrangement, we believe that there is currently a risk that there will be inconsistent treatment adopted in the industry of how to apply sub-lease accounting. Absent further clarifications, this may result in different approaches taken by preparers and diversity in practice which the submitter sought to address by issuing its paper to IFRIC. We understand these inconsistencies exist, notwithstanding the worked example presented in the Staff Paper.

4. In addition to the above, we would also like to provide more guidance on the substance of our joint operation contracting arrangements. Operators enter into contracts on behalf of their unincorporated joint operations. The Operator will be explicitly identified as being an agent contracting on behalf of itself and its partners (the "principals"). As a matter of law, an agent that acts within its authority is effectively a proxy for the principals and so the principals are bound by

the terms of the contracts entered into by the agent, as if they had signed the contract. This applies equally to an operator as it would to any other agent.

A typical oil and gas project will involve hundreds of contracts, from simple confidentiality agreements and service orders to complicated and high value contracts, such as drilling contracts and vessel lease arrangements. It would place an unreasonable administrative burden on the joint operation to have all contracts signed by all partners. As a consequence, the agency principle is key to the proper functioning of our joint operations.

The operator's role as agent is governed under the terms of the relevant JOA. The JOA records the appointment of the operator and sets out the scope of the operator's authority. Typically JOAs require the operator to act as a conduit for claims under the joint operation's contracts by requiring all contractual counterparties to only make claims against the operator and for the operator to then be indemnified under the JOA. This is a standard provision in the vast majority of oil and gas JOAs and, as with the more general agency principle, is key to the proper functioning of the joint operation.

We do not believe that the IFRIC panel had sufficient industry representation to properly understand or appreciate how the JOA mechanism works within our joint operations. Analogous to the principal – agency consideration is the analysis which has recently been performed by all IFRS preparers under IFRS 15. Under this standard, an analysis of control determines whether revenue is accounted for on a gross or net basis. Indicators are provided to help with this IFRS 15 analysis. The legal form of the arrangement is not a determinant as to whether or not we account for the revenue on a gross or net basis. Typically, the operator of a joint operation, would market the oil or gas revenues on behalf of the partners to the joint operation, but would only recognise its net share of the revenues. Having part of joint operations accounting (revenue) driven by substance and presented on a net basis and part driven by legal form (lease obligations) on a gross basis would be confusing.

In our view, the tentative agenda decision reached by IFRIC whereby we as operator would have to recognise 100% of the joint operations liability when we are acting for our partners as an agent does not properly consider the principal-agency relationship set out by law, the practical functioning of the JOA or the substance of our contractual agreements.

5. We believe that the legalistic view reached by the tentative agenda decision will result in companies like us having very different accounting for what are in substance very similar arrangements. For example, our lease agreements which are signed by Premier as a sole signatory (as operator) and those that have multiple signatories (e.g. all parties to the joint operation), are in substance very similar and will be managed internally by us following a consistent process. In substance, these agreements represent essentially the same position to the lessor, operator, non-operator parties and the joint operation itself. In our view, the underlying accounting should be consistent for what are in substance identical arrangements.

6. Finally, we would like to express our disappointment at IFRIC for reaching such a conclusion without any meaningful involvement from the upstream oil and gas industry and also at the timing of this decision. As a company we have expended significant time and resources to the implementation of IFRS 16 given the significant impact this new standard has on our reported financial position and performance. The timing of the tentative agenda decision, being so close to the effective date of IFRS 16, after we have substantially completed our implementation work, is extremely unhelpful. As you will be aware, the FRC have set out its requirement that 2018 annual

reports include disclosures on the impact of IFRS 16. Given the timing of this decision, it has made it significantly harder for us to comply with this requirement in our 2018 annual report and accounts.

We would be very willing to discuss any aspect of our letter and the tentative agenda decision, so please do not hesitate to contact me if you have any questions in relation to this matter.

Yours sincerely,

M Karaiskos

Mike Karaiskos
Group Financial Controller
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November 14, 2018

Tentative agenda decision - Liabilities in relation to a joint operator's interest in a joint operation (IFRS 11 Joint Arrangements)

Dear Ms Lloyd,

Royal Dutch Shell plc is writing to comment on the IFRS Interpretations Committee's (the 'Committee') tentative agenda decision *Liabilities in relation to a joint operator's interest in a joint operation - IFRS 11 Joint Arrangements* ('tentative agenda decision'). We appreciate the opportunity provided by the Committee to comment on this tentative agenda decision.

Question for respondents

The question put to the Committee concerns the recognition of liabilities by the (lead) operator, where the (lead) operator, in a joint operation, enters into a lease as sole signatory of an asset that will be operated on behalf of the partners in the joint operation. Such recognition can be either the recognition of the full lease liability by the (lead) operator or recognition of its share.

In its tentative agenda decision, the Committee observed that the liabilities a joint operator recognises include those for which it has primary responsibility. While the meaning of the term 'primary responsibility' is unclear and therefore open to interpretation, our understanding of the tentative agenda decision is that the (lead) operator should identify and recognise the full liabilities where the (lead) operator is the sole signatory to the lease even if the (lead) operator signs the lease on behalf of the other partners in the joint operation in accordance with the joint operating agreement.

Response

We have serious concerns about the Committee's tentative agenda decision as we believe that the fundamental issue to be considered is how accounting for joint operations is applied under IFRS 11 Joint Arrangements ('IFRS 11'). We do not believe this is solely an IFRS 16 matter, and an interpretation in connection with IFRS 16 Leases ('IFRS 16') should not trigger a change in the accounting for joint operations. The potential implications are much wider and therefore, in our view, it would not be appropriate for the Committee to attempt to answer this narrow question without a more fundamental review of joint operation accounting.

The tentative agenda decision will have an impact on the established and widely applied industry practices in relation to accounting for joint operations on a net basis and have a broader impact on the accounting for assets and liabilities by all partners in joint operations.

We would therefore urge the Committee not to finalise this agenda decision and to defer the matter to a more fundamental review of IFRS 11 with further input from the sector.

The more detailed considerations that lead us to this conclusion are set out in the attachment.

We appreciate your consideration of the concerns raised in this letter. If you have any questions or would like additional information on the recommendations and comments that we have provided, please contact us directly.

Yours sincerely,

/s/ Martin J. ten Brink

Executive Vice President Controller

Attachment

Clarification of terms used

The tentative agenda decision refers to the ‘lead operator’ and ‘joint operator’. In Oil & Gas joint operations the partners together share control through a joint operating agreement. The partner responsible for the day-to-day management is usually referred to as the ‘operator’.

Further analysis

IFRS 16

Focusing on leases entered into by the operator first, it is necessary to refer to the relevant standard dealing with leases, IFRS 16 Leases (‘IFRS 16’). First, we look at paragraph 9, which states the following under the heading ‘Identifying a lease’:

At inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Paragraphs B9–B31 set out guidance on the assessment of whether a contract is, or contains, a lease.

The right to control the use of an asset is further clarified in IFRS 16.B9:

To assess whether a contract conveys the right to control the use of an identified asset (see paragraphs B13–B20) for a period of time, an entity shall assess whether, throughout the period of use, the customer has both of the following:

- a) the right to obtain substantially all of the economic benefits from use of the identified asset; and*
- b) the right to direct the use of the identified asset.*

This means that a contract entered into by an operator on behalf of a joint operation, by definition, cannot be a lease as the asset would be under joint control. The fact that the operator is signatory to the contract is not relevant; what is relevant is ‘the right to control’.

This reality is, in fact, acknowledged both in the standard’s Application Guidance and Basis for Conclusions. IFRS 16.B11 of the Application Guidance 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.

This is further explained in IFRS 16 paragraph BC126 of the Basis for Conclusions, which states:

Assessing whether a contract contains a lease when the customer is a joint arrangement

When two or more parties form a joint arrangement of which they have joint control as defined in IFRS 11 Joint Arrangements, those parties can decide to lease assets to be used in the joint arrangement’s operations. The joint arrangement might be a joint venture or a joint operation. The contract might be signed by the joint arrangement itself if the joint arrangement has its own legal identity, or it might be signed by one or more of the parties to the joint arrangement on behalf of the joint arrangement. In these cases, the LASB 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, i.e., 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.

The above indicates that the IASB found it necessary to insert this clarification in IFRS 16 by virtue of the fact that a contract entered into by an operator cannot, under IFRS 16's own principle of control, contain a lease.

Instead, the combination of the IFRS 16 paragraph 9 control model, IFRS 16.B11 and IFRS 16.BC126 means that the owner of the asset is the lessor and the joint operation is the lessee, irrespective of the joint operation's legal form.

Accounting for 100% of the right of use asset and lease liability by an operator of the joint operation that signed a lease in its own name on behalf of the joint operation, would be inconsistent with the provisions of IFRS 16, as discussed in the above. Lease contracts signed by the operator in its own name, especially for the more significant ones, are subject to the joint operation's Management Committee or any other overarching Committee that exercise control and oversight over the operator. The approval provides the operator with the mandate to lease a specific asset on behalf of the joint operation. Secondly, under the joint operations governance structure, the partners are required to approve the work programme and budgets of the joint operation.

Conceptual framework

We believe that in assessing whether an item meets the definition of an asset, liability or equity, consideration needs to be given to its underlying substance and economic reality and not merely its legal form. This is in line with the IASB's Conceptual Framework (issued March 2018) BC3.26, which states that:

Substance over form is not considered a separate component of faithful representation because it would be redundant. Faithful representation means that financial information represents the substance of an economic phenomenon rather than merely representing its legal form. Representing a legal form that differs from the economic substance of the underlying economic phenomenon could not result in a faithful representation.

Where a lease is entered into on behalf of a joint operation, the joint operation, as the customer, has the rights to the economic benefits of the asset. Assuming that the manner and purpose for which the leased asset is used would require the majority consent of the partners, then 'the substance' of this 'economic phenomenon' would be that the joint operation is the lessee, not the operator and that, from an accounting perspective, the gross lease liability and right of use asset under the contract are attributable to the joint operation and not the operator – even if the operator is the sole signatory to the lease.

Principal versus agent

In our view, what this means is that the operator is acting as an agent for the joint operation. It should be noted that under the law of agency, the principal versus agent relationship can both be contractual and non-contractual, where the authority of the agent can be either express or implied. From this follows that in law a principal versus agent relationship can exist without there being a formal agency contract in

place. The statement in IFRS 16.B11 that ‘the joint arrangement is considered to be the customer in the contract’ can only be made, and the conclusion in IFRS 16.BC126 that ‘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’ can only be reached, on the basis that the operator is acting as an agent for the joint operation in entering into the lease. This argument is strengthened by IFRS 16 paragraph B11’s reference to a contract being entered into ‘on behalf of a joint arrangement’, i.e., through the operator acting as an agent for the joint operation.

From this follows that each party to the joint operation will recognise in relation to its interest in a joint operation its share of the right of use asset and the lease obligation.

This analysis is supported, by analogy, by the principles of principal versus agent guidance set out in IFRS 10 Consolidated Financial Statements (‘IFRS10’). Paragraph B58 of IFRS 10 states:

When an investor with decision-making rights (a decision maker) assesses whether it controls an investee, it shall determine whether it is a principal or an agent. An investor shall also determine whether another entity with decision-making rights is acting as an agent for the investor. An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)) and therefore does not control the investee when it exercises its decision-making authority (see paragraphs 17 and 18). Thus, sometimes a principal’s power may be held and exercisable by an agent, but on behalf of the principal. A decision maker is not an agent simply because other parties can benefit from the decisions that it makes.

It has already been established that the operator does not control the use of the asset, as IFRS 16 stipulates that the joint operation is the customer. It seems clear that, by analogy, the operator is acting as an agent for the joint operator.

IFRS 11

The issue is not new, and companies in the Oil & Gas industry are currently accounting for assets and liabilities that are under joint control on a net basis by consolidating their share to these assets and liabilities. For example, decommissioning obligations in jurisdictions where the operator is liable under legislation and existing financial leases. For decommissioning obligations, based on the joint operation’s work programme and budget approval by all parties to the joint operation, the operator receives the mandate to enter into decommissioning contracts on behalf of the joint operation. Currently, it is custom that each joint operator recognises the decommissioning asset and liability at its share based on the interpretation of paragraph 20(a)(b) of IFRS 11 Joint Arrangements (‘IFRS 11’). When the decommissioning commences the operator will have to pay for the whole decommissioning work performed and the other partners will settle their share of the decommissioning obligation through the operator.

In certain jurisdictions the government requires that each joint operation submits a plan to the government in which it sets out in detail what the decommissioning plan looks like. This plan needs to be signed by all parties to the joint operation. However, the operator will enter into the contracts in its own name as it has the mandate from the other partners to commit to these contracts on behalf of the joint operation.

The current decommissioning obligations are recognised on a net basis, meaning that each partner recognises its share of the obligation, an agenda decision regarding an interpretation of IFRS 16 should in our view not trigger a fundamental change in accounting.

Finally, paragraph BC43 of IFRS 11 sets out the IASB Board's objective when developing IFRS 11:

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.

Our view is that the governance in place and decision-making process of the joint operation establishes the rights and obligations of the joint operators and, therefore, leads to the joint operation having the right to use an asset and incurring the related liabilities, similar as concluded above. As a result, the joint operation should account for those assets and liabilities and the joint operators should report their proportionate share of the assets and liabilities of the joint operation in line with arrangements made between parties based on the joint operating agreement.

Recommendations

As high-lighted at the beginning of this letter, the real issue is how joint operation accounting is applied under IFRS 11. For this reason, we would welcome a Post-Implementation Review ('PIR') of IFRS 11 as expected in accordance with the IFRS Foundation's Due Process Handbook that requires the IASB to conduct a PIR of each new standard. The Handbook states in 6.52 that:

The IASB is required to conduct a PIR of each new Standard or major amendment. A PIR normally begins after the new requirements have been applied internationally for two years, which is generally about 30 to 36 months after the effective date.

IFRS 11 has been applied by IFRS reporters since January 1, 2013 (in the European Union since 2014). We understand that the PIR for IFRS 11 is currently on the list of future PIRs that includes PIRs for IFRS 5, 10 and 12 as well.

If the Committee believes that there should be a change in the status quo, such change should be made as part of a full review of IFRS 11. For this reason, we would like to urge that this PIR takes place sooner rather than later, where this issue can be addressed more holistically and its interaction with IFRS 16. We hereby offer our assistance in an IFRS 11 PIR to provide our views and that of the sector as this topic is highly significant to our company and the Oil & Gas industry.

Additional observation

Some might argue that gross accounting is required as this would be consistent with the financial asset / financial liability off-setting principles in IAS 32 Financial Instruments: Presentation. Whilst, this assumes that the operator would be off-setting a receivable against the lease obligation, the argument cannot apply since, as explained above, there is no receivable under the current tentative agenda decision. Net accounting arises through the mechanics of joint arrangement accounting with the operator accounting for its share of the liabilities incurred jointly with other parties to the joint arrangement, again bearing in mind that the joint operator is the customer from an accounting perspective (under IFRS 16) and that the operator is acting as an agent for the joint operation (by analogy under IFRS 10).

IFRS Interpretations Committee

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UK

16 November 2018

Comment letter regarding tentative IFRIC agenda decision on liabilities in relation to a joint operator's interest in a joint operation (IFRS 11 Joint Arrangements)

Dear Sir or Madam,

Thank you for inviting for comments on the IFRS Interpretations Committee's (IFRIC) tentative agenda decision: *Liabilities in relation to a joint operator's interest in a joint operation – IFRS 11 Joint Arrangements*.

Introduction

As unincorporated joint operations are commonly used in the oil and gas industry, we would like to take this opportunity to express our views regarding the tentative agenda decision. The basis for our concern is that we do not consider that the IFRIC agenda decision faithfully reflects the substance of the arrangements in our industry. In particular, we believe that;

- Contracts entered into by the lead operator for the sole purpose of serving a specific joint operation should be accounted for similarly by all joint operators to that joint operation, because this reflects the economic and commercial substance of the activity
- The proposed interpretation is narrow in scope, and other interpretations could be argued
- There is a perceived conflict between IFRS 11 and IFRS 16 that should be more thoroughly addressed
- A formal outreach should have been performed to establish current accounting practices and interpretations
- Contractual agreements in our industry are often different from and more nuanced than the fact pattern described in the submission

The proposed decision does not reflect the substance of unincorporated joint operation activities in the oil and gas industry

We find it difficult to agree with a view, as communicated in the Staff paper and stated during the IFRIC meeting in September, that an assessment solely based on a legal interpretation of who is primary responsible for a liability better reflects the substance of the liabilities incurred by each party to a joint operation. The use of unincorporated joint operations in the oil and gas industry has a long practice as the method for sharing risks in joint exploration, development and production activities. From an economic point of view, the substance of this setup reflects a common understanding that all joint operators in practice shares the same economic risks and benefits regardless of which party has the primary responsibility for an obligation, when this obligation relates to the lease of an identified asset specifically entered into for the use in the joint operation. We believe the accounting instead should reflect whether all parties to the joint operation in substance carries the same economic risks relating to the contract, also considering any guarantees towards third parties and joint and several responsibilities between the

joint operators. In our view, the operator only acts as an agent in these situations, and the accounting should reflect that the substance of these arrangements is that the customer is the joint arrangement (and for agreements to be reflected proportionally by the parties to that joint arrangement).

We are concerned that if IFRS is interpreted and applied in a way which does not reflect what the industry, including suppliers and lessors, and users of the financial statements view as the economic substance of an arrangement, this could give rise to use of more alternative performance measures, reducing the relevance of IFRS financial reporting.

The proposed interpretation is narrow in scope and other interpretations could be argued

In our view, the IFRIC should not conclude on this topic as we do not agree that the proposed interpretation is evident from existing standards. We think the proposed interpretation and the staff paper which served as the basis for the discussion in IFRIC is too narrow in scope and that a fair presentation of an operator's and joint operators' interests in a joint operation should be evaluated more broadly.

The question raised in the submission to IFRIC would benefit from a thorough analysis of all aspects of how each party to an unincorporated joint operation should account for lease contracts. Particularly, this relates to addressing whether a sublease exists, and how the lead operator and other joint operators should account for their respective rights and obligations under the contract, if the joint operators are not considered to be parties to the "head lease" contract.

We are concerned that the tentative agenda decision could give rise to unintended accounting differences between participants in the same licenses, for which each joint operator, for all practical purposes, carries exactly the same underlying risk and burden of the same obligations, including the risk of non-payments by any of the joint operators. The risk of accounting differences and inconsistent interpretations particularly relate to the uncertainty for how partners' share of costs is to be accounted for by the lead operator, and whether the non-operators should recognize a sublease liability (or some other liability) or not.

We appreciate the IASB staff's effort in proposing a solution to the fact pattern described in the submission, indicating the existence of a financial sublease. However, the discussion in the committee gives rise to significant uncertainty relating the appropriateness of the proposed solution. Alternative solutions include;

- considering the amounts recharged by lead operator to partners to be an income from an operating sublease, or;
- considering the amounts payment for service provided by the lead operator to the joint operation or joint operators.

Both alternatives would gross up costs and revenue in the lead operator's accounts, as well as cash flows from operations. We question the appropriateness of a gross presentation of these transactions, as the operator recharges these costs on a no gain/no loss basis, with reference also to IAS 1 par 34, which requires net presentation of costs and revenues which are incidental to its revenue-generating activities, and where the substance of the transaction requires a net presentation.

Besides leaving the accounting open for further uncertainty and divergence in practice, we trust that the above serves to illustrate how complex the accounting for activities and obligations incurred in the activities of unincorporated joint operations is for each joint operator, including the lead operator. In our view, this supports a view that a broader and more thorough analysis is required.

We understand that these elements and considerations will be assessed as part of the post implementation review of IFRS 11. We are however concerned that the proposed accounting in the tentative agenda decision pre-conclude or limit the scope of this post-implementation review.

Perceived conflict between IFRS 11 and IFRS 16 should be more thoroughly addressed

Based on the Staff paper to the proposed Agenda decision, we believe there may be a conflict between IFRS 11 par 20 (b) and IFRS 16 par B11, and we disagree with Staff that the wording of IFRS 16 par B11, stating that a joint operator can in fact enter into a liability on behalf of a joint arrangement, cannot be extended beyond defining the narrow field of determining the existence of a lease. A narrow interpretation of this paragraph, as currently indicated in the Staff paper, would have been emphasized in the standard IFRS 16 itself or in its Basis for Conclusions, had this narrow interpretation been the intention. Contrary, IFRS 16 BC126 explicitly states that;

"When two or more parties form a joint arrangement of which they have joint control as defined in IFRS 11 Joint Arrangements, those parties can decide to lease assets to be used in the joint arrangement's operations. The joint arrangement might be a joint venture or a joint operation. The contract might be signed by the joint arrangement itself if the joint arrangement has its own legal identity, or it might be signed by one or more of the parties to the joint arrangement on behalf of the joint arrangement..."

Limiting the relevance of an IFRS 16 paragraph to merely apply to the sub-heading under which it is included, also raises the question of whether the same limitation should be applied to other paragraphs in this standard, or in other standards.

A formal outreach should have been performed to establish current accounting practices and interpretations

We believe that the IASB staff paper should have included a formal outreach to ensure a broader review of existing accounting practice in the industry for similar matters. The staff paper states that there is limited practice on the matter, as the matter has not been considered material for companies involved. We do not agree with this statement.

A review of existing industry practice under IAS 17 would, from our experience, have identified a practice of net reporting of financial leases by each joint operator, regardless of whether the lease contract has been signed by all joint operators or entered into solely by a lead operator. The same goes for commitment reporting for operating leases under IAS 17, where each joint operator would report its pro rata share of any lease commitments incurred by the lead operator when a lease is explicitly entered for the use on a specific joint operation (oil or gas license). We would be happy to contribute, should the IASB at this stage determine that further outreach is warranted before the agenda decision is made, or in connection with the post-implementation IFRS 11 review.

Contractual agreements in the industry are often different from or more nuanced than the narrow-scope fact pattern described in the submission

The fact description in the IFRIC submission is narrow in scope and presents a situation which is not necessarily representative for all contracts signed by the lead operator of a joint operation.

We note that the term "primary responsible" is not defined in the tentative agenda decision, and would be open to interpretation. The discussions in the IFRIC meeting supported a view that all parties in the joint operation *could* be considered primary responsible for its pro-rata share of the liability, e.g. in a situation where all joint operators sign the contract and have joint and several liabilities towards a third party.

We agree that a conclusion as to who is the primary responsible for a lease obligation will depend on various facts and circumstances, including applicable laws and regulations surrounding the contract. This includes facts and

circumstances influencing whether a lead operator is legally allowed to commit other joint operators towards external counterparties, thereby making all joint operators primary responsible for a “third party” liability. We also note that some lease contracts used by the industry legally allow for transportation of the contract from the “lead operator” to the licenses for which the asset is being used.

The submission’s narrow scope and description leads to the Staff paper and IFRIC discussion, which address the submission, also inadvertently being relatively narrow. The proposed wording of the tentative agenda decision does state that “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.” This does in some respects counterbalance the limited scope of the submission. However, the issues that the submission did not describe, and the full economic substance of the activities, should be addressed before the IASB makes its final decision.

We believe that, should the proposed tentative agenda decision become final, it will of necessity be applied by financial statement preparers to a broader set of issues than the original submission warranted. This applies to accounting for the activities of non-incorporated joint operations, as have been exemplified in our letter above. Financial statement preparers may refer to the agenda decision and Staff discussion in arriving at accounting solutions that were not sufficiently reflected in the original submission or subsequent discussion. Consequently, all sides of the activities and transactions may not be consistently accounted for between parties to the contracts or throughout the industry. We believe that these issues warrant further attention by the IASB.

Equinor’s recommendation

Given the short time remaining before the implementation date of IFRS 16, and the complexity of the processes which is affected by the tentative agenda decision, we recommend that the committee withdraw its tentative agenda decision and instead refer the conclusion on this topic to the post-implementation review of IFRS 11.

We hope that you find our comments helpful and should you wish to discuss the comments raised any further please contact me (oekev@equinor.com, +47 977 67 514) or Morten Haukaas (mhauka@equinor.com, +47 917 86 483).

Yours sincerely,



Ørjan Kvelvane
Senior Vice President and Chief Accounting Officer
Equinor ASA

Jayne Hodgson

Chief Accounting Officer & Head of Group Control

BP p.l.c.
1 St. James's Square
London
SW1Y 4PD



19 November 2018

Ms S. Lloyd
IFRS Interpretations Committee
7 Westferry Circus,
Canary Wharf,
London E14 4HD

Dear Ms Lloyd,

IFRS Interpretations Committee tentative agenda decisions on IFRS 11 *Joint Arrangements* – September 2018

Direct 020 3401 4041
jayne.hodgson@uk.bp.com
www.bp.com

We welcome the opportunity to comment on the tentative agenda decision made by the IFRS Interpretations Committee at its September meeting in relation to IFRS 11 *Joint Arrangements*. Whilst we do not frequently comment on the agenda decisions of the committee, we do, in this instance, wish to comment as the issue is highly significant to the oil and gas industry.

In summary, we disagree with the conclusion reached by the committee as we do not believe it reflects the economic substance of these arrangements. In our opinion, the committee's tentative agenda decision will result in an accounting outcome that is likely to be difficult for users of the accounts to understand and may, as a consequence, lead to the use of new or amended alternative performance measures in order to adequately explain the economic substance of these arrangements. In particular, the presentation of key metrics such as net debt and gearing will be significantly affected and the resulting presentation of cash flows will adversely affect the ease with which communication can be made to investors of how entities balance their sources and uses of cash.

In our opinion, the committee's tentative agenda decision:

- does not reflect that a joint operation could be a reporting entity;
- is based on legal form rather than the economic substance of the arrangements;
- is based on an inconsistent and counterintuitive application of IFRS 16 B11 as a result of which an operator would report a lease liability without having control of a right-of-use asset; and
- does not reflect that the operator could not enter into a lease 'on behalf of' a joint operation without the unanimous consent of the parties to the joint operation.

We believe that the economic substance of the fact pattern described by the submission can, in certain specific circumstances, be the same as if either the joint operators had all signed a lease agreement or if a joint operation structured through a separate vehicle had signed a lease agreement in its own name.

We also believe that this is a complex issue for which guidance in IFRS 11 and IFRS 16 is not currently sufficiently clear. We believe the lack of clarity and diverse views on this matter mean that the question submitted should not be resolved through a decision to not add the matter to the committee's standard-setting agenda, rather we believe it should be addressed through amendments to IFRS 11 and IFRS 16.

We note that the Board has identified this matter as one for its consideration when it undertakes the post-implementation review of IFRS 11. We question whether in making

an agenda decision on this submission, the outcome of the Board's consideration of the matter is being pre-judged.

Furthermore, in our view, the question submitted is narrow in scope and the committee's response to it does not provide full clarity on the appropriate accounting in these arrangements. We believe that a number of consequential questions remain unanswered but we have restricted our comments to those that relate directly to the tentative agenda decision published by the committee. Whilst we have concerns about parts of the analysis presented in the staff paper that were not addressed by the committee, in particular the existence of a sub-lease, we have not addressed those concerns in our response. We believe that this lack of clarity is likely to lead to diversity in practice upon implementation of IFRS 16.

Our detailed comments are set out in the appendix to this letter. If you wish to discuss any of the comments in this letter, we would be happy to do so.

Yours sincerely,

/s/ Jayne Hodgson

Appendix

Terminology

We note the use of the term 'lead operator' in the committee's agenda decision and the related staff paper. We believe the use of the word 'lead' could be misleading as it could be inferred to denote a greater level of control over decisions than is appropriate. We believe 'the operator' is a more appropriate term as the entity performing this role acts according to the decisions made by the joint operators (as defined by IFRS 11) as they exercise their joint control over the joint arrangement. In our response below, therefore, we have used the term 'operator' rather than 'lead operator'.

Analysis

(a) IFRS 11 and the reporting entity

IFRS 11 requires the partners to account for their share of the assets and liabilities of a joint operation. There is no specific guidance, however, on joint operation accounting relating to unincorporated entities in IFRS 11 and it is not clear whether the standard considers a 'reporting entity' to exist in such arrangements. In our view, even if a joint operation is not an incorporated body, this does not preclude it from being a reporting entity. The conceptual framework confirms that a reporting entity need not be a legal entity. It follows that a joint operation can be a reporting entity and prepare its own balance sheet. In our view, this means that an unincorporated joint operation could incur liabilities, for which the joint operators would then account for their share. IFRS 11 provides no guidance, however, on what is meant by 'liabilities incurred jointly'. It could be inferred into the committee's tentative agenda decision that it is impossible for an unincorporated joint operation to ever have liabilities of its own and, therefore, impossible for a joint operator to ever report a share of liabilities incurred by the joint operation. If this is the case then this should be made clear by amending IFRS 11. Such a conclusion would, however, in our view:

- (a) be counter to the statement in the conceptual framework that a reporting entity need not be a legal entity; and
- (b) represent a significant difference, based on legal form rather than economic substance, from the accounting that would be required if a joint operation structured through a separate vehicle entered into a contract.

We also believe that clear guidance is needed in IFRS 11 on how the operator, acting at the direction of an unincorporated joint operation, should report transactions that it enters into on behalf of the joint operation.

(b) Interaction of IFRS 11 and IFRS 16

We agree with the conclusions in paragraphs 21 and 22 of the staff paper considered by the committee at its September 2018 meeting. We do not, however, agree with the accounting outcome described by the tentative agenda decision with regards to the fact pattern described in the submission and do not believe that such an outcome reflects the economic substance of these arrangements, rather it is conclusion based on legal form.

We support the view that the economic substance of the arrangements can only be established by consideration of both the lease contract and the joint operating agreement together. We believe, therefore, that the economic substance of the fact pattern described by the submission can, in certain specific circumstances (see our alternative proposal below), be the same as if either the joint operators had all signed a lease agreement or if a joint operation structured through a separate vehicle had signed a lease agreement in its own name.

Paragraph BC43 of IFRS 11 explains the board's objective in developing IFRS 11, 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. Our view is that the decision-making process of the joint operation establishes the rights and obligations of the joint operators and, therefore, leads to the joint operation having the right to use an asset and incurring the related liabilities. As a result the joint operation should account for those assets and liabilities and the joint operators should report their shares.

We think it is inconsistent and counterintuitive to conclude that a lease can be entered into on behalf of a joint arrangement, and that the joint arrangement is the customer in such cases, for the purposes of identifying a lease (as described by IFRS 16 B11), but that the lease is not then accounted for as having been entered into by that joint arrangement, rather it is accounted for as having been entered into by the operator.

Having concluded a joint arrangement is the customer in a lease, our view is that an entity should then apply the rest of IFRS 16 in a way that is consistent with that conclusion. We do not believe that paragraph BC126 explicitly supports a conclusion that interpretation of paragraph B11 should be restricted only to the identification of a lease, rather it only clarifies that the joint arrangement can be the customer. In our view, if the intent of IFRS 16 B11 was that a joint arrangement can be a customer in a lease but would not account for that lease as such then this should be clarified in the standard as it is a fundamental concept that has not been adequately explained.

If the lease is entered into on behalf of the joint arrangement, the joint arrangement has the rights to the economic benefits of the asset. If how and for what purpose such assets are used would require the unanimous consent of the joint operators then we believe that the joint arrangement is the lessee, not the operator. As a result of the decision-making processes of the joint arrangement, the joint operators have the right to control the use of the asset throughout the period of use as described by IFRS 16 BC126 even if the operator is the sole signatory to the lease. The operator does not have the right to control the use and, therefore, cannot be the lessee – it must act according to the unanimous consent decisions of the joint operators.

The lease liability is also incurred jointly by all joint operators as the joint arrangement is the customer and, therefore, the lessee – the joint operators incur their share of the lease liability consciously through the decision-making mechanisms of the joint arrangement. The application of IFRS 11, therefore, in our view, would result in each joint operator recognising its share of this liability incurred jointly (otherwise expressed as being incurred by the joint operation 'reporting entity') in accordance with IFRS 11 para 20(b), rather than the operator considering the liability to be its own. In effect, the operator is acting as an agent for the joint operation.

The operator could not enter into significant lease contracts on behalf of a joint arrangement, such as for drilling rigs and floating production, storage and offloading facilities, which would be part of the relevant activities of the joint arrangement, without being directed to do so by the joint operators. The impact on the operator of bringing lease liabilities for such assets, which may be leased for the life of an oil or gas field and are clearly dedicated to that joint arrangement, onto its balance sheet could be highly significant and not reflective of the substance of the arrangements.

(c) Primary responsibility

We note that the conclusion reached by the committee is based on a concept of primary responsibility for the obligation and that this phrase is key to the tentative agenda decision. This would appear to us to be a legal form-based concept. We note the term's use in IFRS 9 in relation to derecognition of financial liabilities and the use of 'primarily responsible' in IFRS 15 in relation to agency arrangements but do not believe this to be a defined or adequately explained term in IFRS and so have concerns that its use will leave the committee's agenda decision open to interpretation.

(d) Alternative approach proposed

In our view, when an operator enters into a lease on behalf of a joint operation, that lease should be accounted for by the joint operation and the joint operators should account for their share of the assets and liabilities of the joint operation. We believe that an operator enters into a lease on behalf of a joint operation if the joint operators are required to unanimously agree on the asset to be leased, the key terms of the lease agreement and any subsequent significant changes in how and for what purposes the asset is used.

Due process

We note that the Board has identified this matter as one for its consideration when it undertakes the post-implementation review of IFRS 11. We question whether in making an agenda decision on this submission, the outcome of the Board's consideration of the matter is being pre-judged. This, together with our view that there is a significant lack of clarity in IFRS 11 and IFRS 16 and the clearly divergent opinions that have been expressed on this topic, even within the IFRS Interpretations Committee, make us question whether a decision not to add this to the committee's standard-setting agenda is the appropriate method of addressing the question submitted. In our view, the tentative agenda decision should not be finalised, rather a more holistic review of joint operation accounting should be undertaken as part of the post-implementation review of IFRS 11.



PETRONAS

Ms Sue Lloyd
Chair
IFRS Interpretations Committee
Columbus Building, 7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

21 November 2018

Dear Ms Lloyd,

Tentative agenda decision – IFRS 11 *Joint Arrangements*: Liabilities in relation to a joint operator’s interest in a joint operation

Reference is made to the above tentative agenda decision by the IFRS Interpretations Committee (“Committee”) which was published in September 2018. Our comments are as follows:

Lead operator should recognise its share of the lease liability

We would like to express our concerns regarding the Committee’s observation that the lead operator should recognise 100% lease liability for the leases that they enter into, on behalf of the joint arrangement. Our view is that the lead operator should only recognise its share of the lease liabilities based on the following justifications:

1. It is common in the oil and gas industry for joint arrangement to be structured as an unincorporated joint arrangement. The lead operator would contract on behalf of the joint arrangement. Nevertheless, their liability at any point in time is limited to their share of the liability as per the intent of the joint operating agreement. To strengthen this point, it is evident that the lead operator will request for advance payments known as “cash call” prior to any expenditure being incurred.

Furthermore, for major contracts (e.g. when the asset is specialised, expensive and of strategic importance), the lead operator would need to obtain joint partners’ consent prior to entering into the contract. In this regard, the non-operators would not allow the lead operator to negotiate independently and will ensure that they are involved in the contracting process. This demonstrates that the lead operator is acting on behalf of the joint arrangement, hence should only recognise its share of liabilities.

2. The financial results of a joint arrangement whether it is incorporated or unincorporated, should not be different as the intent is the same, i.e. to act on behalf of the joint arrangement. It is not intended to create any differences in the economic returns to the parties. In most instances, parties choose to incorporate a joint operating company in order to leverage on the technical strengths of each party or due to regulatory requirements.

3. Typically, Joint Operating Agreements stipulate that all parties are jointly and severally liable for the joint arrangement's obligations. Hence, all parties should record its respective share of liabilities.
4. Lead operator's credit rating may be adversely impacted due to full recognition of liabilities although a portion of these liabilities in substance belongs to non-operators.

Non-operators in unincorporated joint arrangements should recognise its share of the liability as incurred

The non-operators in unincorporated joint arrangements should be given practical expedience to recognise its share of lease liability as and when incurred, compared to full recognition of its share of lease liability and right-of-use asset at the inception of the lease.


Based on Joint Operating Agreements in the oil and gas industry, which are governed by the Association of International Petroleum Negotiators ("AIPN"), non-operators do not have full access to all contracts entered by the lead operator. This hinders the effective application of IFRS 16 *Leases* by non-operators due to lack of relevant information (e.g. contract terms, termination clauses, options to renew, etc.) to make the necessary lease assessments.

Due to the concerns highlighted above, it is not practical for the non-operators to apply IFRS 16 *Leases*.

If you require further clarification, please do not hesitate to contact the undersigned at lizam@petronas.com, or Asrul Sani at asruls@petronas.com.

Thank you.

Yours sincerely,
for **PETRONAS**


LIZA MUSTAPHA
GROUP FINANCIAL CONTROLLER

c.c. Tengku M Taufik Tengku Aziz
Executive Vice President and Group Chief Financial Officer



Madrid, 21 November 2018
Columbus Building, 7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Sir/Madam,

Re: Liabilities in relation to a joint operator's interest in a joint operation (IFRS 11 *Joint Arrangements*)

Repsol is very pleased to provide comments on the tentative agenda 'Liabilities in relation to a joint operator's interest in a joint operation (IFRS 11 *Joint Arrangements*)', raised by the IFRS Interpretations Committee at its September meeting.

Further information about the Repsol Group and its activities is available on our Website: www.repsol.com.

Thank you for your attention.

Yours sincerely,

A handwritten signature in blue ink, reading "Ramiro T.", with a stylized flourish at the end.

Ramiro Tomás Rodríguez

Financial Reporting and Corporation Economic & Administrative Director

TENTATIVE AGENDA DECISION

Liabilities in relation to a joint operator's interest in a joint operation (IFRS 11 Joint Arrangements)—Agenda Paper 3

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 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.

The request asked about the recognition of liabilities by the lead operator.

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 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 a joint operator recognises include those for which it has primary responsibility.

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 to 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 the lead operator to identify and recognise 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.

We agree with the IFRS IC tentative agenda decision. We believe that a joint operator must recognise its liabilities, including its share of any liabilities incurred jointly and those for which it has primary responsibility.

In accordance with the fact pattern described in the request, the 'lead operator', as the sole signatory, enters into a lease contract with a third-party lessor. The 'lead operator' has a primary responsibility in the contract and, as the customer in the lease contract, it should recognise the entire contract liability to third party suppliers. The fact that the other joint operators have an obligation to reimburse a part of the lease costs does not change this conclusion. In this sense, we also agree with the different conclusion stated in Agenda Paper 3 where the lease contract is signed by the other joint operators or is signed by the 'lead operator' on behalf of the joint arrangement, as in these cases the lease liability would be incurred jointly. We agree that in these cases the joint arrangement would be the customer in the lease contract (as described by IFRS 16 B11), and the risks assumed by the parties in these cases with respect to the lessor is consistent with the risks embedded in the fact pattern.

There is another issue not explicitly addressed in the wording of the tentative agenda decision, but referred within Agenda Paper 3, which is the existence of a sublease where the lead operator is the intermediate lessor and the other joint operators are lessees. We do not fully agree with the conclusion in Agenda Paper 3 as regards of the existence of a sublease as we do not believe the fact pattern definitively supports this conclusion. In our view, the determination of who the customer is and who controls the identified asset is critical to the determination of whether a sublease exists and this assessment was not stressed enough in the fact pattern. The conclusion of a sublease based on the fact pattern appears to implicitly rely on joint and several liability existing which is an important but not the exclusive requirement. In our view, a more fulsome, comprehensive assessment of who controls and benefits from the identifiable asset is critical, with joint and several liability being an indicator but not the determining factor of whether a sublease exists. Depending on the conclusion of this assessment, the obligation to reimburse a part of the lease costs by the other joint operators would be considered an executory service contract obligation (create reciprocal obligations between the parties and do not result in the initial recognition of assets and liabilities) or a sublease liability.

We believe that the criteria noted above (i.e. in accordance with the fact pattern described in the request, there would be a lease liability fully recognised by the 'lead operator' and a comprehensive assessment of the potential existence of a sublease based on the control of the use of the identified asset by the other joint operators likely indicated by a contractual arrangement) is consistent with the criteria stated in IFRS 9, IFRS 11 and IFRS 16.

Consequently, we agree with the Committee decision not to add this matter to its standard-setting agenda, although we believe that it would be useful if the final wording of the agenda decision includes a reference to the potential existence of a sublease, based on a comprehensive assessment on the control of the use of the identified asset.



Mrs Sue Lloyd

IFRS Interpretations Committee Chair
7 Westferry Circus, Canary Wharf
London, UK, E14 4HD
United Kingdom

Paris, November 20, 2018

Dear Mrs Lloyd,

Re: September 2018 Committee's proposed agenda decisions- IFRS 11 Joint Operations

We welcome the opportunity to comment on the above-referenced proposed agenda decision.

Why we are commenting

As a capital intensive industry, telecom operators deploy some of their wireline or wireless infrastructure in cooperation with their competitors under various contractual arrangements. The sector being a key economic infrastructure, such sharing arrangements are usually subject to rule-making by sector /competition regulatory bodies that affects the contractual arrangements.

Shared infrastructure covers both wireless and wireline operations:

- e.g. sharing of passive elements like mobile site and pylons (up to sharing more active equipment),
- e.g. sharing of optical fibers (backhaul, transport or distribution network).

The sharing of infrastructure may take the form of open commercial offers or may involve a framework agreement that organizes the joint control over assets or activities; in that case, a usual organization is that each joint operator takes responsibility of a geographic area ensuring reciprocity and equality of contributions.

In some cases, the sharing of the infrastructure under a JOA has been introduced years after the deployment of the infrastructure and its historical contracts, and the design of the joint arrangement must address the interaction between those historical contracts and the newly created rights and obligations; in

other cases, when created at the time of deployment, the sharing of the infrastructure under a JOA is very often built on a complex characterization of the rights and obligations to adapt the legal categories to the regulation's requirements.

Those arrangements typically require an IFRS 11 and IFRS 16 analysis and of their interplay:

- In terms of IFRS 11, unless specifically required by regulation, those arrangements take the form of joint operations rather than joint ventures because the parties are not interested in having control of net assets and more prosaically the latter structuration requires more administrative and contractual steps to transfer assets and contracts or because the regulator imposes a lead operator.
- In terms of IFRS 16, among the often debated questions are determining the existence of identified assets in the arrangement and the "unit of account".
- But the key issue we have been facing is the interplay of IFRS 11 and 16: we are not surprised by the question asked to the Interpretation Committee as we had flagged it as soon as we started our implementation of IFRS 16. Alas, the Board elected not to address the suggested topic A16 made during the 2015 Agenda Consultation process and none of the large audit firms were able to provide us with a clear guidance until now. Therefore, we had to develop an accounting policy based on the economics of the joint arrangement, i.e. a global assessment of the combined rights and obligations of the JOA, the particular contracts, the ancillary agreements, the guarantee, indemnity or surety clauses.

Why the timing of a definitive agenda decision is untimely

First of all, we do not understand why the decision made in April 2016 by the Board to use the forthcoming PIR review of IFRS 11 to investigate the complexities arising from IFRS 11 (including "the interaction between the expected lease standard and joint operation accounting") has not been retained.

More importantly, the implementation of IFRS 16 has been for the industry a significant challenge not only by the volume of leases and the significance of the IT, training, process and internal control deployment, but also by the very short timeline for the implementation.

The proposed decision affects a number of joint operations with a very significant number of leases: it will require the reassessment of the interplay of the lease contracts with the JOA. We expect it will require a complex analysis of the lease and joint arrangement to identify which lease is a joint arrangement lease or one of the joint operator; then when the presence of a head-lease is concluded, a further analysis of how to account for the 'sublease' will be needed (ref also to next section about the classification of the sublease). Those analyses will have to be transcribed into the systems and audited. Finally, the budget and internal targets as well as our guidance to investors will need to be updated. Other dimensions that need consideration are covenants, regulatory accounting, pricing tests under competition regulation, etc.



Therefore, we do not believe that a definitive agenda decision has any chance of being implementable for the January 1, 2019 effective date and most likely not for the first interim financial information to be published in Q1 2019.

Also, we note that until the contemplated IAS 8 amendment regarding agenda decisions acknowledging that an immediate application is finalized by the IASB and endorsed by the European Union, preparers will be exposed to the potential consequences of a strict reading of the application date of agenda decisions.

Why an amendment should be considered rather than an agenda decision

Although we understand the reasoning developed by the staff for IFRS 16.B11 (and BC 126) and IFRS 16.20(b) (and BC43), we note that it is the (mis)understanding of this guidance that led not to consider the applicability of IFRS 9 derecognition rules to lease liabilities scoped in per IFRS 9.2.1 (b) (ii). We believe the past discussions we had with audit firms demonstrates that the common reading of these paragraphs remained obscure until now. This supports the idea that as a minimum a clarification would be more appropriate.

In addition, the tentative agenda decision that has been published emphasizes that the request asked about the recognition of the liabilities by the lead operator. As a consequence it does not include any guidance about the right of use discussed in §25-35 of the AP3. In those paragraphs, the staff assumes that the sublease would be classified as a finance lease enabling derecognition of a portion of the head-lease ROU in favor of a Net Investment in sublease. If that assumption is not met, the right to the payment of the sublease by the other joint operator is not recognized at inception (operating lease accounting).

We have two concerns with this:

First, we note that the guidance in IFRS16 about the sublease classification by an intermediate lessor is extremely limited beyond the fact that the classification is made by reference to the head-lease rather than the underlying asset (B58): the finance lease classification in illustrative examples 20 (IE8) assumes the sublease is for the full surface of the head-lease and the remaining head-lease term. How this alignment of term or the applicability of the other criteria (IFRS 16.61-66) is established is not developed: what is the equivalent of transferring substantially all the risks and rewards incidental to ownership of an underlying asset that is a lease? We believe the determination is likely to be extremely complex or judgmental as the perfect match considered by the standard or the AP will be more representative of pass-through leases.

Secondly, when applied to a sharing of leases, the representation faithfulness and usefulness of an operating sublease classification would also be questionable. As contributions of infrastructure are frequently reciprocal or even equal, the agenda decision could lead to presenting 150% of lease liabilities (100% of joint operator A lease and 50% of joint operator B sublease to joint operator A) and 150% of lease assets (id, when the sublease cannot be characterized as a finance lease of the headlease). Furthermore, this accounting outcome may discourage infrastructure sharing between joint operators in favor of third



party intermediation structures when allowed by regulation, or increase its costs by moving to joint venture type arrangements. Either way, better capital allocation may not be achieved. Finally, a question may arise as to whether operating lease revenue and expense related to the subleases should be recognized if one would consider a similar reasoning to IFRS 15.5 (d) or 6 or 9 (d).

We therefore believe that the original scope of the question should be extended (to the asset side) and further outreach is needed.

If you would like to discuss our comments further, please do not hesitate to contact us at nicolas.depailerets@orange.com and mariececile.lajoie@orange.com.

Yours sincerely,

/s/ Nicolas de Paillerets

Nicolas de Paillerets
Orange
Director of Accounting Principles

/s/ Marie-Cécile Lajoie

Marie-Cécile Lajoie
Orange
Director of IFRS projects

Orange is a European communication services provider that is reporting in accordance with IFRS as adopted by the E.U. and is listed on EuroNext and NYSE.



Association pour la participation des
entreprises françaises à l'harmonisation
comptable internationale



The Chairman of the IFRS IC
Columbus Building, 7
Westferry Circus
Canary Wharf
London E14 4HD.

21 November 2018

Dear Ms Lloyd,

Re : Tentative agenda decision “IFRS 11 : **Liabilities in relation to a Joint operator’s interest in a joint operation**”

We welcome the opportunity to comment on the above tentative agenda decision published in September 2018, since we have two main concerns relating to this tentative decision.

The first concern relates to the **timetable**:

We do not think that it is appropriate to publish an agenda decision that would certainly affect significantly the accounting for some lease contracts, only few weeks before the effective transition date of IFRS 16.

Actually, even though the Committee has decided not to specify how the “primary lessee” will have to account subsequently for its rights to recover some of the lease costs, we understand that the mechanism to be used would be that of a sublease. Sublease mechanisms are quite complex to implement in the context of IFRS 16 restatements and require specific parameters that have not necessarily been anticipated by the entities concerned by the joint operation (JO) lease contracts. The proposed accounting treatment will therefore be quite disruptive and has not been planned for.

Our second concern is that we believe that the tentative decision **fails to depict appropriately the substance and the reality of the whole transaction** by focusing only on one aspect.

The analysis provided in the staff paper and reflected in the tentative agenda decision does not properly reflect the way the operations are conducted in practice and therefore does not reflect the legal substance of the various arrangements that are involved. The tentative agenda decision focuses only on one part of the arrangements, that is, the lease contract. It fails to address the fact that the key substance and the combined legal effect of the

arrangements (the lease contract and the joint operating agreement) result in the lead operator entering into an agreement on behalf of the joint operation.

In such a context, contracts entered into with the lessor go much further than a mere recourse clause against other joint operators in the event of non-payment by the lead operator. Contracts generally specify not only the lead lessor but also other participants, i.e. joint operators other than the lead operator, since the latter is entitled to assign the contract to any participant without requiring the consent of the service provider (the lessor in this case). Lessors are aware that the lead operator enters into the contact because it operates on behalf of the members of the JO and lessors are also aware that operatorship might be transferred to any other participant. There would be no contract with the lessor if there was no JO.

We therefore believe that in these circumstances, the other members of the JO should be considered also as primary obligors and not merely as sureties.

In previous discussions about joint operations (July 2014 agenda paper 2B), the committee concluded that a guarantee contract could affect the rights and obligations of all parties to a joint operation. We therefore consider that the Committee cannot today deny that it is the substance of all the elements of the arrangement taken as a whole that should be accounted for. We believe that the Committee should not disregard the cases where the joint arrangement impacts the rights and obligations of each operator with external contracts.

We are also troubled by the absence of any discussion about the subsequent accounting for the ROU in the tentative agenda decision. We believe that the Committee should analyse the whole accounting treatment with a consistent assessment of the effect of the joint arrangement on both liabilities and the assets of all operators.

We therefore recommend that the committee

1/ Defer the publication of the agenda decision and undertake a more holistic analysis that may lead to an amendment of the current standard.

2/ Otherwise, be much less radical in its conclusions and if published, an agenda decision should only conclude that the accounting treatment should be established in a case-by-case assessment based on all specific facts and circumstances.

If you require any clarification or information, please do not hesitate to contact us.

Yours sincerely,

ACTEO

Patrice MARTEAU
Chairman



AFEP

François SOULMAGNON
Director General



MEDEF

Agnès LEPINAY
Director of economic
and financial affairs





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Chairman
PDC/CT
N° 115

Paris, 21 November 2018

Mrs Lloyd
IFRS Interpretations Committee Chair
7 Westferry Circus, Canary Wharf
LONDON, UK, E14 4HD

September 2018 - IFRS-IC tentative agenda decisions

Dear Mrs Lloyd, *Dear Sue,*

I am writing on behalf of the Autorité des Normes Comptables (ANC) to express our views on the IFRS-IC tentative decisions published in September 2018 IFRIC Update regarding IFRS 9 / IAS 39 – *Application of the highly probable requirement in a cash flow hedge relationship* as well as IFRS 11 / IFRS 16 – *Liabilities in relation to a joint operator's interest in a joint operation*. This letter sets out two critical comments raised by interested stakeholders involved in ANC's due process.

Application of the Highly Probable Requirement in a Cash Flow Hedge Relationship (IFRS 9 and IAS 39)

ANC concurs with the conclusion of the Committee which is a relative straight forward application of IFRS 9 as written. Our constituents have also confirmed that load-following swaps are currently not common in our jurisdiction.

We however are concerned that the case raises a broader application issue. Those load-following swaps as well as certain “deal contingent derivatives” (that cease to exist if the hedged transaction does not materialise) do provide a perfect hedge even if the occurrence of the hedged transaction is not highly probable. This is for instance the case when an instrument hedges the foreign currency risk on a forecasted business combination or forecasted cash flows from a tender. This is because in those cases, the hedge is perfect, i.e. there is no mismatch between the hedged item and the hedging instruments. The fact that the quantity or the timing of the hedged item is linked to a contingency doesn't create any ineffectiveness as long as such contingency is perfectly reflected into the hedging instrument.

We are of the view that the issue raised would require an amendment of IFRS 9 and IAS 39 allowing to skip the “highly probable” test when a hedging instrument is designed in a way that ensures that the quantity of the hedging instrument reflects the quantity of the hedged item: in those specific limited circumstances, we do not see the need for the highly probable test.

Liabilities in relation to a Joint Operator's Interest in a Joint Operation (IFRS 11 and IFRS 16)

ANC concurs with the conclusion of the Committee based on the specific assumptions made in the fact pattern, namely that (i) the joint operation is not structured through a separate vehicle and that (ii) the lead operator is the sole signatory of the lease agreement, having primary responsibility for the entire liability, whereas other joint operators are not party to the lease contract.

We also support the Committee when it highlights that "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." In order to prevent any extrapolation of the above specific case, we encourage IFRIC to also illustrate other cases referred to in § 21 of AP 3: for instance when the lead operator is entitled to assign the contract to any participant without requiring the consent of the lessor.

However, French constituents are concerned by the timing, magnitude and scope of the agenda decision, issued shortly before the effective implementation date of IFRS 16.

We have been reported that very significant industries (oil & gas but also pharmaceutical, utilities and construction industries) did not anticipate such an impact of the first time application of IFRS 16 on joint operations either on the liability or on the asset side. This raises a very practical issue.

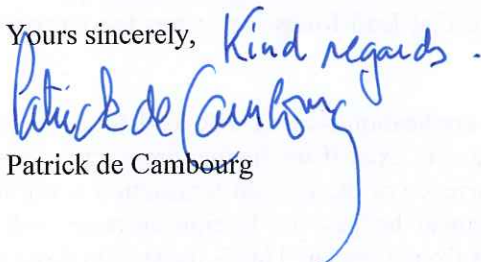
The time constraint is exacerbated by the fact that the agenda decision only deals with the accounting for the obligation but does not address the debit side of the entry. When considering what the accounting should be for the debit side, ANC is concerned that it is also a complex issue that could give rise to diversity in practice. The lack of conclusion of the Committee on the accounting treatment of the assets generated by IFRS 16 concurs to provide the impression that such a clarification may not be straight forward.

As a conclusion, ANC is concerned that a late and incomplete decision at the eve of the first time application of IFRS 16 may have a significant impact. We therefore suggest addressing this question in a holistic manner, i.e. extending the original question raised to analysing the accounting treatment of the newly recognised right of use.

Regarding the time constraint, we reiterate the full support made in our comment letter¹ to the contemplated IAS 8 amendment regarding agenda decisions acknowledging that an immediate application would generally be unreasonable.

Please do not hesitate to contact us should you want to discuss any aspect of our letter.

Yours sincerely,

Kind regards -


Patrick de Cambourg

¹ http://www.anc.gouv.fr/files/live/sites/anc/files/contributed/ANC/2.%20Normes%20internationales/NI%202018/Lettre_ANC_%20ED_IASB_Accounting-policies-changes_2018-01.pdf

21 November 2018

Ms. Sue Lloyd
Chair
IFRS Interpretations Committee (Committee)
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Ms. Lloyd

Tentative Agenda Decision – Liabilities in relation to a joint operator’s interest in a joint operation (IFRS 11 *Joint Arrangements*)


The Malaysian Accounting Standards Board (MASB) welcomes the opportunity to provide comments on the above Tentative Agenda Decision.

We agree with the Committee’s decision not to take this issue onto its agenda and we agree with the Tentative Agenda Decision.

If you need further clarification, please contact the undersigned by email at beeleng@masb.org.my or at +603 2273 3100.

Thank you.

Yours sincerely,


TAN BEE LENG
Executive Director

November 21, 2018

(By e-mail to ifric@ifrs.org)

IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Sirs,

Re: Tentative agenda decision on IFRS 11 *Joint Arrangements* – Liabilities in relation to a joint operator's interest in a joint operation

This letter is the response of the staff of the [Canadian Accounting Standards Board](http://www.frascanada.ca) (AcSB) to the IFRS Interpretations Committee's tentative agenda decision on liabilities in relation to a joint operator's interest in a joint operation. This tentative agenda decision was published in the September 2018 IFRIC® Update.

In formulating the views expressed in this letter, we discussed the tentative agenda decision with members of the AcSB's [IFRS® Discussion Group](#).¹ The Group consists of members with a range of backgrounds and experience, including preparers, users and auditors of financial statements prepared in accordance with IFRS Standards.

We agree with the Committee's decision not to add this item to its agenda for the reasons set out in the tentative agenda decision. Based on the limited facts included in the submitter's request, addressing only the accounting by the lead operator for its obligations to the lessor is appropriate. We agree that the liabilities a joint operator recognizes include those for which it has primary responsibility.

¹ The Group discussed this tentative agenda decision at its October 16, 2018 meeting as part of the topic, "IFRS 11 and IFRS 16: Identifying the Customer in a Lease Contract for the Use of Assets by a Joint Arrangement."

We understand that the terms and conditions in joint arrangements can differ and therefore, could affect the accounting outcome. As such, we suggest that the agenda decision acknowledge this point as part of explaining how the terms and conditions could affect a joint operator's identification of the liabilities it incurs, and those it incurs jointly with other parties to the joint arrangement.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me at +1 416 204-3476 (e-mail lcheng@acsbcanada.ca), or, alternatively, Davina Tam, Principal, Accounting Standards at +1 416 204-3514 (e-mail dtam@acsbcanada.ca).

Yours truly,

A handwritten signature in blue ink that reads "Lester Cheng". The signature is fluid and cursive, with the first name "Lester" and last name "Cheng" clearly distinguishable.

Lester Cheng, CPA, CA
Director, Canadian Accounting Standards Board
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23 November 2018

Re: IFRS Interpretations Committee tentative agenda decisions published in the September 2018 IFRIC Update

Dear Ms Lloyd,

We are pleased to have the opportunity to provide our comments on the IFRS Interpretations Committee (“the Committee”) tentative agenda decisions included in the September 2018 IFRIC Update.

Our comments refer to the following tentative agenda decisions:

- Assessment of promised goods or services (IFRS 15 – Revenue from Contracts with Customers);
- Liabilities in relation to a joint operator’s interest in a joint operation (IFRS 11 – Joint Arrangements);
- Investment in a subsidiary accounted for at cost: step acquisition (IAS 27 - Separate Financial Statements);
- Deposits relating to taxes other than income tax (IAS 37 – Provisions, Contingent Liabilities and Contingent Assets);
- Load following swap (IFRS 9/IAS 39 Financial Instruments).

[...]

Liabilities in relation to a joint operator's interest in a joint operation

We note that paragraph B11 of IFRS 16 states that (emphasis added): "*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*".

This paragraph is not mentioned in the tentative agenda decision. In our view, this paragraph is important, because it seems to say that if a joint operator signs a lease contract on behalf of a joint arrangement, then the joint operation (and not the lead operator) is the customer of the contract. Thus, according to this paragraph, the lead operator should recognise only its share of any liabilities incurred by the joint operation.

We understand that many companies in the extractive industry are interpreting paragraph B11 of IFRS 16 in this way. Consequently, we do not agree with the Committee's conclusion that the requirements in existing IFRS Standards provide an adequate basis for the lead operator to identify and recognise its liabilities in relation to its interest in a joint operation.

[...]

Should you need any further information, please do not hesitate to contact us.

Yours sincerely,

Angelo Casò
(Chairman)

17 November 2018

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The Global Financial Reporting Collective is pleased to offer its comments on the Tentative Agenda Decision— Liabilities in relation to a joint operator’s interest in a joint operation.

We agree with the conclusion reached in the Tentative Agenda Decision. The parties that sign a lease are the parties with whom the lessor has a contractual relationship. The signatories might well have a claim from other operators through a joint agreement but that is their receivable.

The staff paper states that “(a)lthough the question relates to the application of IFRS 11, it is very much linked to the application of IFRS 16 Leases.” In fact, there are over 20 references to IAFRS 16 in the staff paper discussed in September. There are no references to that Standard in the Tentative Agenda Decision. We think a final Agenda Decision needs to refer to IFRS 16 and state that IFRS 16.B11 does not relieve the signatories of their primary obligations, as the paper explains. Without that explanation the Agenda Decision lacks the substance and clarity we need to understand why IFRS 16.B11 does not establish a joint obligation.

As it stands you use the general requirements in IFRS 11.20(b) to justify the recognition of the gross liability. IFRS 11.21 says we need to account for those liabilities “in accordance with other IFRSs applicable to the particular ... liabilities ...” We can understand why someone would look to IFRS 16.B11 if they follow IFRS 11.21. We also understand why IFRS 16.B11 does not create a joint liability but the Tentative Agenda Decision gives no hint of that thought process. We think it is fundamental to the Agenda Decision.

The Agenda Decision does not cover the accounting by the other joint operators, or how the primary operator accounts for the amounts receivable from those other operators. We agree that this need not be part of the Agenda Decision. It was not one of the questions that the Committee was asked to answer. However, there is a bigger issue here.

The staff paper does discuss how the other operators should account for this, characterising it as a sub-lease. When we listened to the recording of the meeting we heard several Committee members state that they had concerns about that analysis. However, they were not allowed to explain or discuss those concerns. This leaves us with a staff paper as a public document over which there seem to be some doubts about the analysis. We do not know what the Committee members were concerned about, although at least one said that they didn’t think it was a sub-lease.

We are sure that the staff did this additional analysis with the best of intentions. Having done the analysis it needs to be discussed or withdrawn. The latter is not really practical. It is particularly

worrying if it is not discussed yet it is obvious that some Committee members have concerns about it.

We use staff papers to help students develop analytical skills. Listening to the Committee discussions is also important. We now have doubts about some of the analysis in Paper 3 from the September meeting. We also worry that joint operators will pick up this staff paper having no idea that Committee members have expressed concerns about the analysis. The paper will have far more visibility than the meeting recording and IFRIC Update makes no reference to the fact that some members were concerned about the parts of the paper that were not discussed. The only published reference we could find is in the IAS Plus summary of the meeting. That summary states that “Several members said they had questions or concerns about the sub-lease parts of the paper. These were not discussed in the meeting.”

We are not sure what you can do about this now. We support finalising the decision, subject to discussing FRS 16 in the decision. We are not sure that discussing the accounting by the other parties now is particularly helpful. However, if Committee members have concerns about the analysis in Paper 3 it would be helpful if IFRIC Update acknowledged that. It would at least warn people that the Committee has not discussed it and that people should not rely on that part of the paper.

Thank you for considering our comments.



Global Financial Reporting Collective

20 November 2018