IFRS

# STAFF PAPER

September 2019

## IASB® Meeting

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



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## Purpose

1. At its July 2019 meeting, the Board tentatively decided to seek views in the Request for Information, to be published as part of the 2019 Comprehensive Review of the *IFRS for SMEs* Standard, not to align Section 15 *Investments in Joint Ventures* of the *IFRS for SMEs* Standard with IFRS 11 *Joint Arrangements*.[1]

2. The objective of this paper is to summarise the potential consequences arising from the Board's tentative decision to seek views on aligning Section 9 *Consolidated and Separate Financial Statements* of the *IFRS for SMEs* Standard with IFRS 10 *Consolidated Financial Statements* whilst not seeking views to align Section 15 with IFRS 11.

## Summary of staff recommendation

3. Staff recommend that, in view of further analysis performed in paragraphs 9-21, the Board reconsider its tentative decision made at the July 2019 meeting and instead seek views on whether and how to align Section 15 with IFRS 11 as part of the Request for Information.

[1] See ***July 2019 Agenda Paper 30C***.

4. Staff note that, should Section 15 not be aligned with IFRS 11 but Section 9 be aligned with IFRS 10, the definition of control of an investee and the definition of joint control would not be based on consistent principles.

## Structure of the paper

5. This paper is structured as follows:
   (a) Background (paragraphs 6–8);
   (b) The relationship between 'control of an investee' and 'joint control' (paragraphs 9–17);
   (c) Staff recommendation (paragraphs 18–22);
   (d) Question for the Board;
   (e) Appendix A—Extract from the Basis for Conclusions of IFRS 11 *Joint Arrangements*.

## Background

6. At its July 2019 meeting, the Board discussed seeking views in the Request for Information on aligning Section 15 with IFRS 11.[2] The Board tentatively decided to seek views in the Request for Information not to align Section 15 with IFRS 11 because:
   (a) IFRS 11 has proven challenging for entities to apply in practice, even though its objective was to clarify and resolve issues that existed with the predecessor Standard[3]; and
   (b) work on the Post-implementation Review of IFRS 11 has only recently started. Insights gained from the Post-implementation Review would assist in better understanding how IFRS 11 is implemented in practice and would

[2] See ***July 2019 Agenda Paper 30C***.

[3] IAS 31 *Interest in Joint Ventures*.

provide evidence to help the Board assess whether and how Section 15 should be aligned with IFRS 11.

7. Whilst staff had identified that IFRS 10 and IFRS 11 have in common the concept of control (including that an investor has the ability to direct the 'relevant activities' of the investee) the analysis presented did not address the potential consequences of the Board tentatively deciding to seek views on aligning the definition of control in Section 9 with IFRS 10 but tentatively deciding not to seek views on aligning Section 15 with IFRS 11.

8. Consequently, this paper includes additional analysis performed by staff to identify and address the potential consequences of aligning Section 9 with IFRS 10, but not aligning Section 15 with IFRS 11.

## The relationship between 'control of an investee' and 'joint control'

9. At its July 2019 meeting, the Board deliberated the alignment of Section 9 and IFRS 10.[4] The Board tentatively decided that, in the Request for Information, it will seek views on aligning Section 9 with IFRS 10. In particular on:

   (a) aligning the definition of 'control of an investee'; and

   (b) retaining the presumption that an entity controls an investee if it has direct power over that investee solely from voting rights.

10. The Board's tentative decision would require the definition of 'control of an investee' in Section 9 (and the glossary to the *IFRS for SMEs* Standard) to be amended to:

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

[4] See ***July 2019 Agenda Paper 30B***.

11. IFRS 10 and IFRS 11 require the consistent application of the concept of control. Appendix A to IFRS 11 defines 'joint control' as:

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

12. In paragraph BC21 of the Basis for Conclusions on IFRS 11, the Board specifically acknowledges that the concept of control in IFRS 11 differs from that in the predecessor Standard. It goes further to state that:[5]

> …the reason for the change is to align the definition of 'joint control' with the definition of 'control' in IFRS 10. IFRS 11 directs parties to an arrangement to assess first whether all the parties, or a group of the parties, control the arrangement collectively, on the basis of the definition of control and corresponding guidance in IFRS 10.

13. Currently, the glossary of the *IFRS for SMEs* Standard defines control as:

> The power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

14. Similarly, paragraph 15.2 of the *IFRS for SMEs* Standard defines 'joint control' as:

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

15. Consequently, consistent with the principles supporting the concept of control in both IFRS 10 and IFRS 11, staff consider that the definition of 'joint control' in Section 15 relies on the concept of control as defined in Section 9. Should Section 9 be aligned with IFRS 10 whilst Section 15 not be aligned with IFRS 11, the definition of control of an investee and the definition of joint control would not be based on consistent principles.

[5] See Appendix A.

### *Potential consequences of not aligning Section 15 with IFRS 11*

16. Staff are concerned that not aligning the definition of 'joint control' in the *IFRS for SMEs* Standard whilst aligning the definition of 'control':

    (a) would contradict the principle of simplicity that underpins the alignment of the *IFRS for SMEs* Standard with full IFRS Standards because the definitions would not be based on consistent principles. For example, complexity may be introduced into the *IFRS for SMEs* Standard as there would be two definitions of control which rely upon differing underlying principles; and

    (b) could result in unintended consequences, for example, the inconsistent application of 'control of an investee' and 'joint control'. This could, in turn, affect the comparability of financial statements prepared applying the *IFRS for SMEs* Standard.

## Staff recommendation

17. Staff appreciate the concerns raised by Board members about not having the benefit of the completed Post-implementation Review of IFRS 11 and about the difficulties with implementing IFRS 11 in practice. However, after analysing the issue, the staff takes the view that the potential consequences of having differing definitions of 'control' in the *IFRS for SMEs* Standard outweigh the potential benefits of not aligning Section 15 with IFRS 11.

18. Furthermore, when applying the *IFRS for SMEs* Standard, entities are not required or permitted to apply proportionate consolidation in accounting for investments in joint ventures as this option does not form part of Section 15. Staff are therefore of the view that the challenges which existed in implementing IFRS 11 may not be applicable in the alignment of Section 15.

19. Staff also note that using the Request for Information to gather evidence does not preclude the Board from deciding against aligning Section 15 and IFRS 11 at a later date. Evidence gathered on this issue from the Request for Information can be used to identify challenges entities face in applying Section 15 and IFRS 11. Such

evidence may be useful in future reviews of the *IFRS for SMEs* Standard and in the Post-implementation Review of IFRS 11.

20. The Board could, in the Request for Information, explain the relationship between the definition of ‘control of an investee’ and ‘joint control’ and therefore highlight the potential impact of aligning Section 9 without aligning Section 15.

21. Consequently, staff recommend that in view of the further analysis the Board reconsider its tentative decision[6] made at the July 2019 meeting and instead seek views on whether and how to align Section 15 with IFRS 11 as part of the Request for Information.

## Question for the Board

| **Question** |
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| In view of the staff analysis, does the Board agree with the staff recommendation to reconsider its tentative decision made at its July 2019 meeting and seek views in the Request for Information on aligning Section 15 of the *IFRS for SMEs* Standard with IFRS 11? |

[6] See ***July 2019 Agenda Paper 30C***.

## Appendix A—Extract from the Basis for Conclusions on IFRS 11 *Joint Arrangements*

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### Joint Control

BC20 In ED 9, the proposed definition of 'joint arrangement' required 'shared decision-making' by all the parties to the arrangement. Some respondents questioned how 'shared decision-making' was intended to operate and how it differed from 'joint control'. The Board introduced the term 'shared decision-making' in the exposure draft instead of 'joint control' because control was defined in IAS 27 *Consolidated and Separate Financial Statements* in the context of having power over the financial and operating policies of an entity. During its redeliberation of ED 9, the Board concluded that in joint arrangements, it is the activity undertaken by the parties that is the matter over which the parties share control or share decision-making, regardless of whether the activity is conducted in a separate entity. Consequently, the Board concluded that 'joint control' is a term that expresses better than 'shared decision-making' that the control of the activity that is the subject matter of the arrangement is shared among the parties with joint control of the arrangement.

BC21 The Board did not reconsider the concept of 'joint control' as defined in IAS 31 or in ED 9 (ie the requirement of unanimous consent for the decisions that give the parties control of an arrangement). However, the definition of 'joint control' in the IFRS is different from those in IAS 31 and ED 9. The reason for the change is to align the definition of 'joint control' with the definition of 'control' in IFRS 10. IFRS 11 directs parties to an arrangement to assess first whether all the parties, or a group of the parties, control the arrangement collectively, on the basis of the definition of control and corresponding guidance in IFRS 10. Once an entity has concluded that the arrangement is collectively controlled by all the parties, or by a group of the parties, joint control exists only when decisions about the activities that significantly affect the returns of the arrangement (ie the relevant activities) require the unanimous consent of those parties.

BC22 In response to concerns expressed by some respondents who pointed out that, unlike IAS 31, ED 9 did not include the term 'investors in a joint arrangement', the Board clarified during its redeliberation of ED 9 that not all the parties to a joint arrangement need to have joint control for the arrangement to be a joint arrangement. Indeed, some of the parties to a joint arrangement can have joint control whereas others, although able to participate, do not have joint control of the arrangement. The Board decided to use the terms 'joint operators' to designate parties with joint control of a 'joint operation' and 'joint venturers' to designate parties with joint control of a 'joint venture'.

BC23 The Board observed that the parties to a joint arrangement might agree to change or modify the governance and decision-making process of the arrangement at any time. As a result of such a change, a party might gain or lose joint control of the arrangement. Consequently, the Board concluded that if facts and circumstances change, the parties to a joint arrangement should reassess whether they are parties with joint control of the arrangement.

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