Applying IFRS

IFRS Interpretations
Committee agenda decisions
relating to IFRS 11

April 2015
What you need to know

• In March 2015, the IFRS Interpretations Committee issued a number of agenda decisions relating to the application of IFRS 11 Joint Arrangements.

• The agenda decisions provide helpful clarifications about the application of IFRS 11 in certain situations.

• For some entities, the application of IFRS 11 continues to be challenging and will require significant judgement.
Overview

IFRS 11 Joint Arrangements applies to entities that have an interest in arrangements that are controlled jointly and has been effective since 2013. During 2013, the IFRS Interpretations Committee (the Interpretations Committee) received a number of requests regarding the application of IFRS 11. The requests were discussed at several meetings and in March 2015 the Interpretations Committee published agenda decisions addressing the following topics¹:

- Classification of joint arrangements: the assessment of ‘other facts and circumstances’
- Classification of joint arrangements: application of ‘other facts and circumstances’ to specific fact patterns
- Classification of joint arrangements: consideration of two joint arrangements with similar features that are classified differently
- Accounting by the joint operator: recognition of revenue by a joint operator
- Accounting by the joint operator: the accounting treatment when the joint operator’s share of output purchased differs from its share of ownership interest in the joint operation
- Accounting in the separate financial statements: accounting by the joint operator in its separate financial statements
- Accounting in the separate financial statements: accounting by the joint operation in its financial statements

We consider each of the agenda decisions below.

¹ The full text of the agenda decisions is published in the IFRIC Update March 2015, available at www.ifrs.org
1. Classification of joint arrangements

IFRS 11 requires an entity to determine the type of joint arrangement it is involved with and specifies that the classification as a joint operation or a joint venture depends on the rights and obligations of the parties to the arrangement.

A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets and obligations for the liabilities relating to the arrangement.

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

The classification requires an entity to apply judgement to assess its rights and obligations by considering the structure and legal form of the arrangement, the terms agreed by the parties and, when relevant, other facts and circumstances.

The assessment of ‘other facts and circumstances’

The Interpretations Committee considered whether the assessment of other facts and circumstances should consider only those facts and circumstances that create rights to the assets and obligations for the liabilities, or whether the assessment should also consider the design and purpose of the joint arrangement, the entity’s business needs and the entity’s past practices.

Paragraph 14 of IFRS 11 requires the classification of a joint arrangement to depend on the rights and obligations of the parties to the arrangement. Paragraph B30 of IFRS 11 explains that the assessment would lead to a joint operation classification when the other facts and circumstances give a party both rights to the assets and obligations for the liabilities relating to the arrangement.

Therefore, the Interpretations Committee noted that the assessment of other facts and circumstances should focus on whether they create enforceable rights to the assets and obligations for the liabilities.

How and why particular facts and circumstances create rights and obligations

The Interpretations Committee discussed how and why particular facts and circumstances create rights and obligations that result in the joint arrangement being classified as a joint operation when the joint arrangement is structured through a separate vehicle whose legal form causes the separate vehicle to be considered in its own right. The Interpretations Committee observed that, in order to classify the joint arrangement as a joint operation as a result of assessing facts and circumstances, it is necessary to demonstrate that:

a) a party to the joint arrangement has rights and obligations relating to economic benefits of the assets of the arrangement, and

b) it provides cash to the arrangement, through legal or contractual obligations, which is used to settle the liabilities of the joint arrangement on a continuous basis.
Implication of economic substance
The Interpretations Committee noted that the concept of economic substance may not be consistently understood regarding the assessment of other facts and circumstances. It also noted that the consideration of other facts and circumstances is not a test of whether a party is closely involved with the operation of the separate vehicle, but is a test of whether other facts and circumstances override the rights and obligations conferred upon the party by the legal form of the arrangement.

On the basis of this analysis, the Interpretations Committee concluded that the assessment of other facts and circumstances should focus on whether they create rights to the assets and obligations for the liabilities. As the assessment is made in the light of existing IFRS requirements, the Interpretations Committee decided not to add this issue to its agenda.

Application of ‘other facts and circumstances’ to specific fact patterns
The Interpretations Committee discussed the application of ‘other facts and circumstances’ to four specific fact patterns, as follows.

Output sold at a market price
The Interpretations Committee observed that the sale of output from a joint arrangement to the parties at market price does not, on its own, determine the classification of the joint arrangement. The parties need to apply judgement, based on the other facts and circumstances.

Financing from a third party
The Interpretations Committee noted that if the cash flows to the arrangement from the sale of output to the parties, along with any other funding the parties are obliged to provide, satisfy the liabilities of the joint arrangement, then third-party financing alone would not affect the classification.

Nature of output
The Interpretations Committee observed that whether the output produced by the joint arrangement and purchased by the parties is fungible or bespoke does not, on its own, determine the classification of the arrangement.

Determining the basis for ‘substantially all of the output’
The Interpretations Committee noted that when determining whether the parties to the joint arrangement take ‘substantially all of the output’ as part of the assessment of other facts and circumstances, the assessment is based on the monetary value of the output, not the physical quantity.

The Interpretations Committee determined that, in all of the specific fact patterns, sufficient guidance exists and so decided not to add these issues to its agenda.
Two joint arrangements with similar features that are classified differently

The Interpretations Committee discussed a situation where two joint arrangements that have similar features may be classified differently because one is structured through a separate vehicle and the other is not. This is because the legal form of the separate vehicle may affect the rights and obligations of the parties to the joint arrangement. The Interpretations Committee believe different accounting would not conflict with the concept of economic substance because economic substance means that the classification of the joint arrangement should reflect the rights and obligations of the parties to the joint arrangement and the presence of a separate vehicle plays a significant part in determining the nature of those rights and obligations.

Therefore, the Interpretations Committee determined that sufficient guidance exists in IFRS and decided not to add this issue to its agenda.

How we see it

The agenda decisions relating to classification of joint arrangements provide helpful clarifications that should result in a more consistent application of IFRS 11. However, for some entities, classifying joint arrangements will still require significant judgement based on the specific facts and circumstances.
2. Accounting by the joint operator

In relation to an interest in a joint operation, a joint operator recognises:

- Its assets, including its share of any assets held jointly
- Its liabilities, including its share of any liabilities incurred jointly
- Its revenue from the sale of its share of the output arising from the joint operation
- Its share of the revenue from the sale of the output by the joint operation
- Its expenses, including its share of any expenses incurred jointly

IFRS 11 requires each of the above to be accounted for in accordance with the applicable IFRS. However, it does not give any further guidance and so careful consideration of what the joint operator is entitled to and what it is responsible for is needed.

Recognition of revenue by a joint operator

The Interpretations Committee discussed whether a joint operator should recognise revenue in relation to the output from the joint operation that is purchased by the parties. If a joint arrangement is structured through a separate vehicle, but is classified as a joint operation because the joint operators purchase all of the output, a joint operator would recognise its revenue only when the output is sold to third parties. This means a joint operator would only recognise ‘its share of the revenue from the sale of the output by the joint operation’ when the joint operation sells output to third parties.

The Interpretations Committee determined that this analysis is in light of existing IFRS requirements and that sufficient guidance exists. Therefore, the Interpretations Committee decided not to add this issue to its agenda.

The accounting treatment when the joint operator’s share of output purchased differs from its share of ownership interest in the joint operation

The Interpretations Committee discussed a situation where a joint arrangement is structured through a separate vehicle and the parties purchase substantially all of the output, resulting in a joint operation classification. However, the parties’ percentage ownership interest in the separate vehicle differs from the percentage share of the output produced that each party is obliged to purchase. When the contractual arrangement does not specify the allocation of assets, liabilities, revenue and expenses, the question arises as to what share should each operator recognise. Specifically, should the share of assets, liabilities, revenue and expenses recognised reflect the percentage of ownership of the legal entity, or should it reflect the percentage of output purchased by each party?

The Interpretations Committee noted that there may be different reasons why this situation arises. For example, it could occur because the share of output purchased varies over the life of the arrangement, or it could occur because there are other arrangements that exist outside the joint arrangement itself. Therefore it is important to understand why the share of output differs from the ownership interest in the joint operation.
The Interpretations Committee acknowledged that there are concerns about the sufficiency of the guidance in IFRS 11 on the accounting by a joint operator in the circumstances described above. The Interpretations Committee decided that the development of additional guidance would require a broader analysis than can be achieved by the Interpretations Committee and so it decided not to add this issue to the agenda.

How we see it

We believe significant judgement is required to apply joint operation accounting in some instances. We support the Interpretations Committee’s decision to refer, to the IASB, the issue concerning the accounting treatment when the joint operator’s share of output purchased differs from its ownership interest in the joint operation. However, as there is diversity in practice, we encourage the IASB to address this issue as quickly as possible.
3. Accounting in the separate financial statements

IFRS 11 applies to the accounting by joint operators in the separate financial statements. However, it does not apply to the accounting by the separate vehicle that is a joint operation.

Accounting by the joint operator in its separate financial statements

The Interpretations Committee discussed the accounting by a joint operator in its separate financial statements for its share of the joint operation, when that joint operation is structured through a separate vehicle. IFRS 11 requires that a joint operator, in its separate financial statements, accounts for the joint operation in the same way as in the consolidated financial statements. That is, the joint operator recognises its share of the assets, liabilities, revenue and expenses of the joint operation. Therefore, the joint operator would not additionally account for its shareholding in the separate vehicle, either in accordance with IAS 27 Separate Financial Statements or in accordance with IFRS 9 Financial Instruments.

As this determination is made in the light of existing requirements, the Interpretations Committee decided not to add this issue to its agenda.

Accounting by the joint operation in its separate financial statements

The Interpretations Committee discussed the accounting by a joint operation that is a separate vehicle in its financial statements. The joint operators are required to recognise their share of assets, liabilities, revenues and expenses in both consolidated and separate financial statements. This raises the question whether those assets, liabilities, revenues and expenses should also be recognised in the financial statements of the joint operation itself.

The Interpretations Committee noted that IFRS 11 does not apply to the financial statements of the separate vehicle and they would be prepared in accordance with the applicable IFRS. When identifying the assets and liabilities of the separate vehicle, it is necessary to understand the joint operators’ rights to the assets and obligations for the liabilities.

The Interpretations Committee considered that sufficient guidance exists in IFRS and so decided not to add this issue to its agenda.

How we see it

We believe there is significant uncertainty regarding how a joint operation should account for assets and liabilities in its separate financial statements, and this is likely to lead to diversity in practice. Careful judgement will be required to determine what needs to be reflected in the financial statements of the joint operation itself.
4. Conclusion and next steps

The agenda decisions issued by the Interpretations Committee provide helpful clarifications that will improve consistency of application of IFRS 11. However, the application of IFRS 11 remains challenging and there are a number of areas where additional guidance is needed.

The IASB are expected to start the post-implementation review process of IFRS 11 in 2016. We urge the IASB to start this process as soon as possible to identify other difficult areas of application.
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