IFRS™

Agenda ref 10

STAFF PAPER

IFRS Interpretations Committee Meeting

Project	IFRS 11 *Joint Arrangements*		
Paper topic	Summary of outreach on implementation issues		
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Purpose of this paper

1. The purpose of the paper is to respond to several requests received by the IFRS Interpretations Committee ('the Interpretations Committee') with regard to the application of the requirements of IFRS 11 *Joint Arrangements*.

2. This agenda paper:

   (a) provides background information on the requests received;

   (b) presents a summary of outreach conducted;

   (c) presents a summary of comments and additional issues raised from the outreach request; and

   (d) asks the Interpretations Committee for direction for the next steps.

Background information

3. In January 2013, the Interpretations Committee received several requests to clarify the application of the requirements of IFRS 11. The issues raised deal with:

   (a) the classification of a joint arrangement as a joint venture or a joint operation; and

   (b) the accounting for joint operations.

4. In July 2013, we sent an outreach request about the various issues raised by the submitters. Specifically, we asked whether:

   (a) **(Request 1)** the issues and views that have been raised regarding the application of IFRS 11 have been appropriately summarised in the outreach request; and

   (b) **(Request 2)** there are, to your knowledge, additional significant issues that have been raised regarding the application of IFRS 11 that we should take into consideration.

5. With regard to **Request 1** above, we have summarised the principal issues that were raised in the submissions. The issues that have been summarised in the outreach request are as follows:

   (a) **Question 1**: Should the assessment of 'other facts and circumstances' be based only on contractual (and legal) enforceable terms?

   (b) **Question 2**: When the parties have an obligation to purchase substantially all the output produced by the arrangement, does the fact that the output is sold at a market price prevent the arrangement from being classified as a joint operation?

   (c) **Question 3**: When assessing 'other facts and circumstances', does financing from a third party prevent an arrangement from being classified as a joint operation?

   (d) **Question 4**: When assessing 'other facts and circumstances', should the assessment be made at the level of the parties as a group or by each party in isolation?

   (e) **Question 5**: How should the parties to a joint operation account for their share of assets and liabilities when the share of output purchased by the parties from the arrangement differs from the parties' ownership interest in the arrangement?

Outreach feedback summary

6. We received 20[1] comments in response to the outreach request sent in July 2013:

Standard-setters	8
Auditors	7
Preparers	3
Securities Regulators	2
Total	20

7. We divided the comments into three groups on the basis of the type of comment:

   (a) The **first group** (three respondents) did not express their views on each issue summarised in the outreach request. Instead they merely acknowledged that we have appropriately summarised the issues and views that have been raised regarding the application IFRS 11 in the outreach request.

   (b) The **second group** (three respondents) provided the same specific example of a joint arrangement, which is frequently set up among real estate developers. It is generally called as SCCV (Société Civile de Construction Vente) in France. Among the three respondents, two respondents said that there are two views (ie View 1—a SCCV is a joint operation and View 2—a SCCV is a joint venture); and one respondent supported View 1.

   (c) The **third group** (fourteen respondents) expressed their own views on Request 1 (ie issues collected in the outreach request) and Request 2 (ie providing additional issues to consider).

Approach to considering the comments

8. We think that the **first group** indirectly expressed their views on each question summarised in the outreach request. Their views can be interpreted as saying that the current Standard is not clear on the issues in those questions and therefore there is diversity in practice[2].

[1] One of the original submitters has not replied to this outreach request.

[2] When we describe in each specific issue that respondents said there is diversity in practice, indicating the number of the respondents, we will not include the respondents of this group in that number.

9. As for the comments from the **second group**, we note that the issue relates to a specific type of a joint arrangement. We summarised some key points in issues presented by the respondents in **Category E** as noted below and also include the submission in **Appendix A**.

10. For the purpose of effectively considering the comments from the **third group**, we will classify the comments into four categories:

    (a) **Category A**—Issues in this category relate to the classification of a joint arrangement; they are subcategorised into **Category A1** and **Category A2**. Category A1 relates to unclear wordings in IFRS 11 and Category A2 relates to lack of guidance in IFRS 11. Questions 1, 2, 3 and 4 in the outreach request and some additional issues are classified in category A.

    (b) **Category B**—Issues in this category relate to changes in the classification of a joint arrangement; some of the additional issues raised are classified in this category.

    (c) **Category C**—Issues in this category relate to the recognition and measurement of a joint arrangement. Question 5 in the outreach request and some of the additional issues raised are classified in this category.

    (d) **Category D**—Issues in this category relate to how to recognise and measure a joint arrangement with respect to losing joint control or acquiring interests while retaining a joint control; they are subcategorised into **Category D1** and **Category D2**. Category D1 relates to losing joint control and Category D2 relates to acquiring interests while retaining joint control.

    (e) **Category E**—Issues in this category relate to other issues raised from outreach activity.

11. In the following section, we present by category: (1) comments received from respondents on each question and (2) additional issues collected from outreach activity.

Issues classified as Category A

12. The issues in this category relate to the classification of a joint arrangement. They are subcategorised into Category A1 and Category A2.

Issues in Category A1

13. The issues in this category relate to unclear wordings in IFRS 11. Five issues are included in this category as follows:

    (a) **(Question 1)** Should the assessment of 'other facts and circumstances' be based on contractual (and legal) enforceable terms?

    (b) **(Question 2)** When assessing 'other facts and circumstances and the parties have an obligation to purchase substantially all the output produced by the arrangement, does the fact that the output is sold at a market price prevent the arrangement from being classified as a joint operation?

    (c) **(Question 3)** When assessing 'other facts and circumstances', does financing from a third party prevent an arrangement from being classified as a joint operation?

    (d) **(Question 4)** When assessing 'other facts and circumstances', should the assessment be made at the level of the parties as a group or by each party in isolation?

    (e) **(Additional issue 1)** Are the parties required to have both rights and obligations or either of them, in order for a joint arrangement to be classified as a joint operation?

Comments received with regard to Question 1

14. In the outreach request, we included the following issue as Question 1:

    Q1. Should the assessment of 'other facts and circumstances' be based only on contractual (and legal) enforceable terms?

15. We provided three views on this issue:

    (a) **View 1**: yes, the assessment of the parties' rights and obligations when considering 'other facts and circumstances' (as described in paragraphs 29-B32 of IFRS 11) is based **on enforceable terms**;

(b) **View 2**: no, **economic compulsion** on the joint arrangement to sell to the parties and on the parties to purchase the output from the arrangement (without the contractual and legal requirement to do so) is sufficient; and

(c) **View 3**: no, **intention** alone is sufficient.

16. Five respondents clearly supported View 2. In addition, two other respondents mentioned that although they would largely support View 1, View 2 and View 3 should also be considered. On the other hand, one respondent said that it supports View 1. Another five respondents recognised that there is diversity in views. In addition, one respondent in the 'second group' also supported View 2 in its analysis of the case of SCCV.

17. Some respondents also indicated that this issue is common in practice and therefore it is critical for the Interpretations Committee address the issue.

Comments received with regard to Question 2.

18. In the outreach request, we asked the following issue as Question 2:

> Q2. When the parties have an obligation to purchase substantially all the output produced by the arrangement, does the fact that the output is sold at a market price prevent the arrangement from being classified as a joint operation?

19. We provided two views on this issue:

(a) **View 1**: No, the parties' obligation to purchase substantially all of the output produced by the arrangement indicates that the arrangement is a joint operation (see paragraphs B31-B32 of IFRS 11);

(b) **View 2:** Yes, the parties' obligation to purchase substantially all of the output produced by the arrangement is not sufficient. The parties do not have an obligation for the liabilities if the market price can fluctuate and be lower than a cost price or a cost-plus price (ie a price that covers all the costs incurred by the joint arrangement).

20. Three respondents explicitly supported View 1. Eight respondents suggested another view (hereinafter we call it View 3). View 3 would be that price is not a sole factor,

and thus the classification of a joint arrangement depends on other facts and circumstances.

Comments received with regard to Question 3.

21. In the outreach request, we presented the following issue as Question 3:

    Q3. When assessing 'other facts and circumstances', does financing from a third party prevent an arrangement from being classified as a joint operation?

22. We provided three views on this issue:

    (a) **View 1**: no, not if it is guaranteed by the parties. The guarantee is an in-substance obligation;

    (b) **View 2:** no, not if it is during the pre-production, construction phase;

    (c) **View 3**: yes.

23. Four respondents explicitly supported View 1; one respondent further stated that even if the finance for a joint arrangement is not guaranteed by the parties, it can be classified as a joint operation. One respondent said that there are mixed views (View 1 and View 2). Six respondents suggested another view, which is that financing from a third party in isolation is not determinative for the classification of a joint arrangement.

Comments received with regard to Question 4.

24. In the outreach request, we asked the following issue as Question 4:

    Q4. When assessing 'other facts and circumstances', should the assessment be made at the level of the parties as a group or by each party in isolation?

25. We provided two views on this issue:

    (a) **View 1**: a single assessment should be performed at the level of the joint arrangement; and

(b) **View 2:** separate assessments should be performed by each party to the joint arrangement.

26. Five respondents broadly supported View 1:

(a) one respondent said that there could be a situation in which separate assessment is required, but it would be rare;

(b) another respondent said that most investors seem to be taking View 1, but noted that the issue can arise depending on certain specific circumstances;

(c) another respondent stated that one preparer commented that it takes View 1.

27. On the other hand, four respondents supported View 2.

28. Meanwhile, one respondent proposed another view whereby an entity can have an option to choose either View 1 or View 2 as an accounting policy. In addition, another respondent acknowledged that there are divergent views in practice, stating that some suggest an additional view, which is a combination of View 1 and View 2. The additional view means that the assessment should be performed both at the level of the arrangement (ie the parties as a group should take substantially all of the output) and by each party to the arrangement (ie each party has a right to a specified proportion of the output).

Additional issues collected from the outreach request

Additional issue 1: 'Rights and obligations' or 'rights or obligations'

29. Three respondents raised an issue about whether parties are required to have both rights and obligations or only either one of them, in order for a joint arrangement to be classified as a joint operation. Two views are as follows:

(a) **View 1**: in order for a joint arrangement to be classified as a joint operation, the parties to the joint arrangement must have both rights to the assets and obligations for the liabilities[3]. Accordingly, if the parties to the joint

[3] Paragraph 15 of IFRS 11 states that:

> 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. Those parties are called joint operators.

arrangement have only rights to the assets or only obligations for the liabilities, the joint arrangement should be classified as a joint venture.

(b) **View 2**: in order for a joint arrangement to be classified as a joint operation, it is sufficient that the parties would have either rights to the assets or obligations for the liabilities. If the parties have only rights to the assets or obligations for the liabilities, it is clear that the parties do not have rights to the net assets of the joint arrangement and therefore the joint arrangement could not be classified as a joint venture.

Issues in Category A2

30. The issues in this category relate to lack of guidance in IFRS 11. Five issues are included in this category as follows:

(a) **(Additional issue 2)** When assessing 'other facts and circumstances', how does the nature of output sold affect the classification of the joint arrangement?

(b) **(Additional issue 3)** When assessing 'other facts and circumstances' and in a circumstance where the parties are taking substantially all of the output, should the assessment be based on volumes or monetary values of the output?

(c) **(Additional issue 4)** In order for a joint operator to have obligations for the liabilities, what should the nature of the obligation be?

(d) **(Additional issue 5)** How should a joint arrangement that is a limited-life entity be classified?

(e) **(Additional issue 6)** How should a joint arrangement with limited liability structures be classified?

Additional issues collected from the outreach request

Additional issue 2: Nature of output sold

31. One respondent said that the application guidance does not discuss whether the fact that the arrangement produces a **fungible output** (eg oil or gas) that can be sold on the market, or a **specific output** (eg automotive parts) that can only be used in the

manufacturing processes of the parties, is a decisive indicator for the classification of joint arrangements.

32. One view is that the nature of the output sold is not a decisive factor for the classification of a joint arrangement. However, there is another view that whether the output is fungible or not would probably affect the terms of the contractual arrangement and the other agreements relating to the arrangement agreed on by the parties. Consequently, it is more likely that an arrangement that produces only a specific output (i.e. an output that can be used only by the parties for their own individual manufacturing processes) would lead to the agreement of contractual terms that oblige the parties to purchase all the output.

Additional issue 3: Assessment based on volumes or monetary value

33. One respondent asked whether assessment should be based on volumes or monetary values when assessing 'other facts and circumstances in a circumstance where the parties are taking substantially all of the output.

Additional issue 4: Nature of obligation for the liabilities

34. One respondent commented that in order for a joint operator to have obligations for the liabilities, the obligation should (1) be a primary, rather than a secondary, obligation; and (2) represent a non-contingent, ongoing obligation, rather than an obligation that will be settled if and when a certain event occurs.

Additional issue 5: Limited-life entities

35. Two respondents raised a question about the classification of a joint arrangement that is a limited-life entity set up to conduct a specific project. In particular, they provided fact patterns in which such an entity has: (1) a limited purpose and therefore a limited life; (2) no employees (its activities are subcontracted to either its shareholders or third parties); (3) reputational risk of the parties to the joint arrangement.

Additional issue 6: Limited liability structures

36. One respondent asked how to classify a joint arrangement with limited liability structures[4]. The respondent stated that:

   (a) limited liability structures are created between parties to a joint arrangement and the joint arrangement itself, in order to constrain the liability exposure of the parties to the operations of the arrangement;

   (b) some think that this would mean that the joint arrangement is automatically classified as a joint venture because of the separation between the parties and the joint arrangement created by these limited liability structures; and

   (c) some, however, adopt a 'look through' approach to these arrangements, and often come to the conclusion that they are classified as joint operations.

Issues classified as Category B

37. Issues in this category relate to a change in the classification of a joint arrangement. Two issues are included in this category.

   (a) **(Additional issue 7)** Should the classification of a joint arrangement change in a circumstance when investors agree to buy the product that is produced by an asset for less than the useful life of the asset?

   (b) **(Additional issue 8)** Should the classification of a joint arrangement change when different rights and obligations arise in different phases (eg pre-production and production)

Additional issue 7: Commitment to purchase output for only part of the useful life of the assets

38. One respondent indicated that IFRS 11 addresses demand, inventory and credit risk in its illustrative example in which parties to a joint arrangement determine the classification of a joint arrangement (paragraph IE26 of IFRS 11); however, it is silent on whether and how other risks, such as price risk, environmental risk and liquidity risk, arising from the activities of the arrangement affect the classification. The

[4] The most common forms of vehicle used to structure joint arrangements are limited liability companies, partnerships, corporations, associations and trusts.

respondent provided an example in which Entity A and Entity B (the parties) agree to buy all the output of Entity C for the first five years, and the assets in the joint arrangement have a useful life of ten years, assuming that Entity C is a joint arrangement.

39. It presented two views:

(a) View 1 is that Entity C is a joint venture. This is because the portion of the useful lives of the asset of the joint arrangement extends beyond the term of the arrangement, which is significant.

(b) View 2 is that Entity C is a joint operation. Any ‘risk’ that remains within Entity C with regard to the fixed asset does not, by itself, preclude the joint arrangement from being classified as a joint operation.

Additional Issue 8: Multi-phase arrangement

40. Four respondents raised a question about whether the classification of a joint arrangement should change because of different rights and obligations depending on different phases (eg pre-production and production). They claimed that it should be clarified whether the decision on to how to account for assets and liabilities needs to be made independently for each phase of the arrangement (ie: singular or continuous assessment).

Issues classified as Category C

41. Issues in this category relate to the recognition and measurement of a joint arrangement. Three issues are included in this category.

(a) **(Question 5)** How should the parties to a joint operation account for their share of assets and liabilities when the share of output purchased by the parties from the joint arrangement differs from the parties’ ownership interest in the arrangement?

(b) **(Additional issue 9)** How should a party to a joint arrangement measure a joint arrangement when there is a change in classification of a joint arrangement?

(c) **(Additional issue 10)** How should a party to a joint arrangement measure a joint arrangement when there is a so-called 'hidden' partner?

Comments received with regard to Question 5.

42. In the outreach request, we presented the following issue as Question 5:

> Q5. How should the parties to a joint operation account for their share of assets and liabilities when the share of output purchased by the parties from the arrangement differs from the parties' ownership interest in the arrangement?

43. We provided two views on this issue:

(a) **View 1**: the parties should account for their share of assets and liabilities based on the share of output purchased by the parties from the arrangement if this determines the rights and obligations that the parties have in respect of the assets and liabilities relating to the arrangement; and

(b) **View 2:** the parties should account for their share of assets and liabilities based on their ownership interest in the arrangement.

44. No respondent explicitly supported View 1. Two respondents preferred View 2. One respondent indicated that either View 1 or View 2 can be appropriate depending on fact patterns. In addition, two respondents supported neither View 1 nor View 2; they mentioned that the share of output purchased by the respective parties is not necessarily an appropriate basis on which to attribute the underlying assets and liabilities between the parties.[5]

45. Many other respondents raised some questions that would arise if View 1 is taken. These questions can be summarised as:

(a) On what basis should parties recognise their share of assets and liabilities?[6];

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[5] One of the two respondents said that there may be a circumstance in which output is shared unequally in the interest of optimising the returns for all of the parties. The other respondent mentioned that there may be a situation on which one party (party A) provides some 'benefits' to another party (party B), such as a premium for party B providing the production technology to the arrangement, which would benefit party A.

[6] One respondent commented that "investors may share assets and liabilities in one way, but revenue and expenses in another. A strict read of the guidance may suggest that the balance sheet items drive the investor's 'share' in the arrangement. Yet, many would argue a share of revenue is a more accurate attribution of implied

(b) How should parties account for the imbalance between the amount invested by each party and the amounts recognised by each party for its share of assets and liabilities?

46. With regard to addressing this issue, some suggested that (numerical) examples should be addressed in IFRS 11; and some others requested that more guidance should be provided in the integral part of the Standard.

Additional issues collected from the outreach request

Additional Issue 9: Change in classification

47. One respondent asked how an entity should measure a joint arrangement when joint control is continuous, but the classification changes because of a change in facts and circumstances (eg a change in contractual terms).

Additional Issue 10: 'Hidden' partner

48. One respondent asked us to consider the following case:

> there is a structure where two partners will share costs and revenues on a 50-50 basis. However, the customer only knows A (B is a "hidden" partner). Such a structure is sometimes known as "Société en Participation occulte". How should revenues and costs associated to the project be recognized? Should A and B recognize revenues on a 50-50 basis or should A recognize 100% of revenues if it assesses that it is principal in the transaction with the customer? If so how should B account for its share in the operation?

Issues classified as Category D

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interest than the sharing of assets and liabilities for investors in an arrangement that provides services (rather than tangible output)."

Two respondents questioned whether a party should account for its share of assets and liabilities based on the share of output to which the party has a (contractual or enforceable) right to purchase, or instead on the share of output to which a party has a (contractual or enforceable) obligation to fund. In some cases, when a party to an arrangement has the right of first refusal to output produced, the share of output that the party has a right to purchase may differ from the share of output that the party has the obligation to fund.

49. The issues in this category relate to how to recognise and measure a joint arrangement with respect to (1) **Category D1**: losing a joint control and (2) **Category D2**: acquiring interests while retaining a joint control. The issues are assumed that (1) a joint operation is deemed to be a business and (2) the share of assets and liabilities is equivalent to the interest owned[7].

Issues classified as Category D1

50. The issues in this category relate to losing joint control. Two issues are included in this category.

    (a) **(Additional issue 11)** How should an investor account for a transaction in which the investor obtains control of a joint operation through a step-acquisition (adding to a previously held interest) when joint control ceases to exist but other investors or interest holders remain?

    (b) **(Additional issue 12)** How should an investor account for a transaction in which the investor obtains control of a joint operation through a single purchase?

Additional issues collected from the outreach request

Additional issue 11: Obtaining control of an unincorporated joint operation through a step acquisition (adding to a previously held interest), in a transaction in which joint control ceases to exist but other investors or interest holders remain

51. One respondent identified that there are three views when an investor obtains control of a joint operation through a step acquisition (adding to previously held interest) in a transaction in which joint control ceases to exist but the other investors or interest holders remain.

    View 1: Account for as an asset purchase

    View 2: Apply business combination accounting without step up of previously held interest

[7] The respondent also assumed that a joint operation is not in a legal entity, but it noted that most of the issues also arise in joint operations in a legal entity.

View 3: Apply business combination accounting with step up of previously held interest to fair value

Additional issue 12: Obtaining control of an unincorporated activity (that was previously a joint arrangement) through a single purchase

52. One respondent identified that there are two views when an investor obtains control of a joint operation through a single purchase.

View 1: Apply business combination accounting, recording the full fair value of assets acquired and liabilities assumed, including the non-controlling party's share of the fair value of assets acquired and liabilities assumed.

View 2: Apply business combination accounting, recording the controlling party's share of the fair value of assets acquired and liabilities assumed.

Issues classified as Category D2

53. The issues in this category relate to acquiring interests but retaining joint control. Four issues are included in this category.

(a) **(Additional issue 13)** How should an investor recognise and measure its interest when the investor initially acquires its interest in a joint operation?

(b) **(Additional issue 14)** How should an investor recognise and measure its interest when the investor acquires an additional interest in a joint operation whilst retaining joint control?

(c) **(Additional issue 15)** How should an investor recognise and measure its interest in a business or assets contributed by other parties to the joint arrangement when the investor contributes a business to a joint operation at the formation of the joint arrangement?

Additional issue 13: Initial recognition of acquisition of interest in a joint operation

54. One respondent identified that there are two views when an investor initially acquires its interest in a joint operation.

View 1: Treat as asset purchase. Allocate consideration on relative fair value. Initial recognition exemption for deferred tax applies. Include transaction costs in consideration.

View 2: Apply business combination accounting in accordance with IFRS 3 *Business Combinations.* Initial recognition exemption for deferred tax does not apply. Record goodwill.

55. We note that this issue was addressed by the Exposure Draft *Acquisition of an interest in a Joint Operation* (ED/2012/7)[8].

Additional issue 14: Recognition on acquisition of a further interest (2nd or successive purchases) in an unincorporated joint operation without obtaining control

56. One respondent identified that there are three views when an investor acquires a further interest in a joint operation whilst retaining joint control.

View 1: Use a cost accumulation approach based on asset purchase accounting

View 2: Business combination accounting without step up of previously held interest

View 3: Business combination accounting with step up of previously held interest to fair value

Additional issue 15: Contribution of a business to a joint operation at the formation of the joint operation in exchange for an interest in a business or assets contributed by other parties to the joint arrangement

57. One respondent identified that there are two views when an investor contributes a business to a joint operation at the formation of the joint operation in exchange for an interest in a business or assets contributed by other parties to the joint arrangement.

View 1: Recognise partial gain by analogy to guidance for asset contributions to joint arrangements.

View 2: Recognise full gain by analogy to guidance in IFRS 10 on disposals.

[8] At its October 2013 meeting, the IASB decided to finalise the amendments, supporting View 2.

Issues classified as Category E

58. The issues in this category are other issues raised from the outreach request. Four issues are included in this category.

    (a) **(Additional issue 16)** How should separate financial statements of the joint operation be prepared?

    (b) **(Additional issue 17)** How should a joint operator account for an investment in subsidiary held by the joint operation in its separate financial statements?

    (c) **(Additional issue 18)** Should it be necessary to amend IAS 23 *Borrowing costs* to allow the capitalisation of borrowing costs incurred for investments accounted for using the equity method?

    (d) **(Additional issue 19)** Two transition items when changing from proportionate consolidation to the equity method: (1) Can the transition requirement to allocate goodwill on a 'relative carrying value basis' be superseded by a more relevant allocation methodology? and (2) does the transition guidance in IFRS 11 (using carrying value as 'cost basis') supersede the guidance in IAS 28 (revised 2011) when a conflict arises?

    (e) **(Additional issue 20)** First-time application issue: Can a first-time adopter recognise a reversal of impairment for its investment when changing from proportionate consolidation to the equity method?

    (f) **(Additional issue 21)** How should a joint arrangement (generally called an SCCV) in the real estate industry be classified?

Additional issues collected from the outreach request

Additional issue 16: Separate financial statements of the joint operation

59. One respondent raised a concern about accounting in preparing separate financial statements of the joint operation. Specifically, the respondent asked how a joint operation contained in a separate legal vehicle should recognise, measure, and disclose its financial information, because all of its assets, liabilities, revenues, and expenses are included on the face of the financial statements of its investors.

Additional issue 17: Separate financial statements of the joint operator

60. One respondent raised a recognition issue about the accounting in preparing separate financial statements of the joint operator. The issue relates to a circumstance in which a joint operation has an investment in a subsidiary. Specifically, the respondent questioned whether a joint operator should recognise an additional share of assets if the joint operator finances the cost of the investment[9].

Additional issue 18: Capitalisation of borrowing costs

61. One respondent raised a concern that an investor can no longer capitalise its own borrowing costs when it changes the accounting for its joint venture from proportionate consolidation to the equity method as a consequence of the application of IFRS 11. More specifically, the respondent's concern is as follows:

    (a) investors that proportionately consolidated its joint controlled entity used to capitalise their own borrowing costs related to certain qualified assets of the joint controlled entity even when the jointly controlled entity itself does not incurred such borrowing costs in accordance with IAS 23 *Borrowing costs*;

    (b) according to paragraph BC22(c) of IAS 23, investments accounted for using the equity method are not qualifying assets;

    (c) Therefore, if such investors change the accounting from proportionate consolidation to the equity method as a consequence of applying IFRS 11, they cannot capitalise the borrowing costs even though there is no change in the business model or operations between the investors and joint ventures.

62. Consequently, the respondent proposed that IAS 23 be amended to allow the capitalisation of borrowing costs incurred for investments accounted for using the equity method.

[9] The respondent provided the following example: a joint operation (Entity C) has an investment in subsidiary (Entity D) whose cost is CU20. The cost of the investment was financed with an additional CU20 of equity from the two joint operators (ie CU10 from each Entity A and B). Entity D sells all its output to Entity C. At the year end, Entity D has sold CU10 of output (not yet collected) and purchased CU7 of materials (not yet paid). The respondent questioned whether Entities A and B should additionally recognise its share of assets (CU10 plus CU5), liabilities (CU 3.5), revenues (CU5) and costs (CU 3.5).

Additional issue 19: Transition items

63. One respondent raised concerns over two transition issues:

 (a) When changing from proportionate consolidation to the equity method, can the transition requirement to allocate goodwill on a 'relative carrying value basis' be superseded by a more relevant allocation methodology when an entity makes the transition from proportionate consolidation to equity method upon the adoption of IFRS 11?[10]

 (b) If conflict arises, does the transition guidance in IFRS 11 (using carrying value as 'cost basis') supersede the guidance in IAS 28 (revised 2011)?[11]

Additional issue 20: First-time application

64. One respondent raised an issue over first-time application. The issue is as follows:

 (a) For example, if the joint venture accounted for using proportionate consolidation (50%) has CU 120 of assets and CU 70 of liabilities at the transition date, the deemed cost of the equity method under IFRS 11 would be CU 50.

 (b) There might be circumstances in which the value of the assets under proportionate consolidation was diminished for impairment in years before the transition (set as the immediately preceding period) to IFRS 11 (for example CU 40).

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[10] The respondent has observed instances in which a company disposes of an investment shortly after the beginning of the most recent comparative period. As a result of that disposal, it performs a goodwill allocation based on relative fair value that is significantly different from relative carrying value.

[11] The respondent has observed cases in which a company has remeasured its original equity holding upon gaining/losing joint control. IFRS 11 contains specific transition guidance related to the cost basis of a joint venture in the earliest period presented. However, that guidance is silent on the requirement in IAS 28 to reverse prior remeasurements of equity interests.

For example, assume an entity had owned 30 per cent of an arrangement and obtained joint control by purchasing an additional 20 per cent. The company remeasures the original 30 per cent at the time of the transaction and puts any gain/loss through the P/L. Using IAS 28 (revised 2011), that remeasurement in the prior period would be reversed if the investment was accounted for using the equity method both before and after the transaction (eg if it is a joint venture). IFRS 11 is silent on the need for this reversal and whether it should be performed to determine the cost basis of the joint venture at adoption.

(c) If this is the case, it is unclear whether after transition to IFRS 11, using the equity method, it is possible to recognize a reversal of impairment. Although it is intuitive that there is a corresponding loss recognised in the past, because the transition requirements of IFRS 11 define the value of the assets accounted for by using the equity method at the transition as a deemed cost, any reversal of past impairment recognized before transition could be seen as a revaluation of the deemed cost and therefore it should not be allowed.

Additional issue 21: Accounting for a joint arrangement (generally called an SCCV) in the real estate industry

65. As we noted in the section ‘outreach feedback summary’ of this paper, three respondents provided a specific case of a joint arrangement (generally called an SCCV), which is commonly set up and conducted in the real estate industry.

66. They summarised some key issues involving whether an SCCV should be classified as a joint operation or a joint venture. More specifically, the issues relate to how to assess ‘other facts and circumstances’ as required by IFRS 11. This is because there are no terms in the contractual arrangement that specify that the parties have rights to the assets and obligations for the liabilities relating to the arrangement. The respondents presented two views and supporting arguments for each view.

67. **View 1** is that **a SCCV is a joint operation** and supporting arguments are as follows:

(a) The parties have rights to substantially all the economic benefits of the assets held in the SCCV because proceeds from the sale, which comes from the one-time sale of the property containing the residential units, may be immediately transferred to the parties.

(b) The SCCV is continuously relying on the parties for settling the liabilities relating to the activity conducted through the arrangement because (1) any potential remaining liability, in substance, will be assumed by the parties until the liquidation of the joint arrangement in a legal entity; (2) the parties are severally liable for the debt of the SCCV; and (3) parties contribute in full or in part to settle the liabilities on a continuous basis.

(c) The parties take major risks (ie demand risk and budget overruns/delivery delays) because they are responsible for delivering the services to the ultimate customer and for fulfilment of the order.

68. **View 2 is that a SCCV is a joint venture** and supporting arguments are as follows:

(a) The parties' exposure to the liabilities of the SCCV is similar to a guarantee legally granted to third parties.

(b) The output of the SCCV is not provided to the parties or purchased by them.

(c) Financing for the SCCV is mainly provided by the deposits and advance payments received from customers, once the project is started.

(d) The obligation assumed by the parties to buy unsold properties does not create any right to the assets nor any obligation to settle the liabilities.

Summary and question for Interpretations Committee

69. The Issues presented above are summarised as follows:

Categories	Summary of Issues
Category A1: Classification of joint arrangements – issues relating to unclear wording	
Category A1 (Question 1)	Should the assessment of 'other facts and circumstances' be based only on contractual (and legal) enforceable terms?
Category A1 (Question 2)	When the parties have an obligation to purchase substantially all the output produced by the arrangement, does the fact that the output is sold at a market price prevent the arrangement from being classified as a joint operation?
Category A1 (Question 3)	When assessing 'other facts and circumstances', does financing from a third party prevent an arrangement from being classified as a joint operation?
Category A1 (Question 4)	When assessing 'other facts and circumstances', should the assessment be made at the level of the parties as a group or by each party in isolation?
Category A1 (Additional Issue 1)	Are the parties required to have both 'rights and obligations' or either of them, in order for a joint arrangement to be classified as a joint operation?
Category A2: Classification of joint arrangements – issues relating to lack of guidance	
Category A2 (Additional Issue 2)	When assessing 'other facts and circumstances', how does the nature of output sold affect the classification of the joint arrangement?
Category A2 (Additional Issue 3)	When assessing 'other facts and circumstances' and in a circumstance where the parties are taking substantially all of the output, should the assessment be based on volumes or monetary values of the output?
Category A2 (Additional Issue 4)	In order for a joint operator to have obligations for the liabilities, what should be the nature of the obligation be?
Category A2	How should a joint arrangement that is a limited-life entity be

Categories	Summary of Issues
(Additional Issue 5)	classified?
Category A2 (Additional Issue 6)	How should a joint arrangement with Limited liability structures be classified?
Category B: Classification of joint arrangements – changes in classification	
Category B (Additional Issue 7)	Should the classification of a joint arrangement in a circumstance when investors agree to buy the product that is produced by an asset for less than the useful life of the asset?
Category B (Additional Issue 8)	Should the classification of a joint arrangement change when different rights and obligations arise in different phases (eg pre-production and production)?
Category C: Recognition and measurement of joint arrangements	
Category C (Question 5)	How should a party to a joint operation account for their share of assets and liabilities when the share of output purchased by the parties from the arrangement differs from the parties' ownership interest in the arrangement?
Category C (Additional Issue 9)	How should a party to a joint arrangement measure a joint arrangement when there is a change in classification of a joint arrangement?
Category C (Additional Issue 10)	How should a party to a joint arrangement measure a joint arrangement when there is a so-called 'Hidden' partner?
Category D1: Recognition and measurement of interests in a joint operation: acquiring control over a joint operation	
Category D1 (Additional Issue 11)	How should an investor account for a transaction in which the investor obtains a control of a joint operation through a step-acquisition (adding to previously held interest) when joint control ceases to exist but other investors or interest holders remain?
Category D1 (Additional Issue 12)	How should an investor account for a transaction in which the investor obtains a control of a joint operation through a single

Categories	Summary of Issues
	purchase?
Category D2: Recognition and measurement of interests in a joint operation: acquiring an interest whilst obtaining or retaining joint control	
Category D2 (Additional Issue 13)	How should an investor recognise and measure its interest when the investor initially acquires its interest in a joint operation?
Category D2 (Additional Issue 14)	How should an investor recognise and measure its interest when the investor acquires additional interest in a joint operation without obtaining control?
Category D2 (Additional Issue 15)	How should an investor recognise and measure its interest in a business or assets contributed by other parties to the joint arrangement when the investor contributes a business to a joint operation at the formation of the joint arrangement?
Category E: Other issues	
Category E (Additional Issue 16)	How should separate financial statements of the joint operation be prepared?
Category E (Additional Issue 17)	How should a joint operator account for an investment in subsidiary held by the joint operation in its separate financial statements?
Category E (Additional Issue 18)	Should it be necessary to amend IAS 23 *Borrowing costs* to allow the capitalisation of borrowing costs incurred for investments accounted for using the equity method?
Category E (Additional Issue 19)	Two transition items when changing from proportionate consolidation to the equity method: (1) Can the transition requirement to allocate goodwill on a ‘relative carrying value basis’ be superseded by a more relevant allocation methodology? and (2) does the transition guidance in IFRS 11 (using carrying value as ‘cost basis’) supersede the guidance in IAS 28 (revised 2011) when conflict arises?
Category E (Additional Issue 20)	First time application issue: Can a first-time adopter recognise a reversal of impairment for its investment when changing from

Categories	Summary of Issues
	proportionate consolidation to the equity method?
Category E (Additional Issue 21)	How should a joint arrangement (generally called an SCCV) in the real estate industry be classified?

70. In this paper we have presented a summary of the results of the outreach we conducted on implementation issues arising from IFRS 11. We would like to receive the Interpretations Committee's direction on how to respond to the range of issues raised. For example:

    (a) For the issues raised through the feedback we have not yet undertaken outreach to IFASS and securities regulators to understand how widespread those issues are. We could undertake this outreach for issues that the Interpretations Committee thinks should be followed up further.

    (b) We could analyse the issues raised against the requirements of the Standard. Are there particular issues raised that the Interpretations Committee would like us to focus on or particular categories/themes that should be analysed?

Question for the Interpretations Committee
What are the next steps that the Interpretations Committee would like us to take with respect to the findings of the outreach?

Appendix A—Submission relating to a joint arrangement (generally called an SCCV) in the real estate industry

[Information rendered anonymous]

Michael Stewart
Director of Implementation
Activities IFRS Interpretations
Committee 30 Cannon Street
London EC4M 6XH

Dear Mr Stewart,

We have recently be made aware of your outreach request in relation to IFRS 11 significant implementation issues and we very much appreciate the opportunity to provide you with some views and input on a issue which is of very significant concern to our real-estate development industry in France,

This concerns the classification as joint-operations or joint entities of our real-estate co-promotion programs which are constantly set up through special purposes entities under the legal form of a SCCV - Societe Civile de Construction Vente. Real Estate developers in France unanimously view such entities as joint operations under IFRS 11 on the basis of an in depth "other facts and circumstances analysis" that we will present to you further in this paper. It would however appear that views be mixed on this classification as joint-operations.

We understand that supporters of a classification as joint entities mainly argue that the parties to the SCCV do not actually purchase the output, therefore a literal reading of IFRS 11 "other facts and circumstances" criteria cannot support a joint-operation classification.

We strongly believe that substance should be included in the detailed analysis of the "other facts and circumstances" criteria of IFRS 11 considering all contractual, legal and economic features of such arrangements, including how parties practically manage such arrangements.

Our most significant concerns, in the hopefully remote case where SCCV co-promotions would be classified as joint entities, are presented below (with increasing concern):

- SCCV Co-promotion arrangements are widely spread in our real-estate development industry in France and some real-estate developers operate most if not all of their activity through such arrangements. Should such arrangements be classified as joint-entities, then some of real-estate developers would no longer have any P&L figures (revenue, cost of sales...) except for profit of JVs under equity method in their income statement; while such real estate developers are not operating investment activities. They actually operate such co-promotions with their own teams (commercial, development, technical supervision, legal...) actively and are directly

involved in the development, building supervision and selling of each program together with their partner(s)' own teams. **Their financial statements would therefore not reflect their operations**

- Alternative routes to structure differently such co-promotion arrangements have been considered by our industry but are not possible in practice without unbearable additional costs. The two possible alternative routes identified would achieve easy IFRS 11 joint operation classification as they involve no separate vehicle. One of these is "joint-ownership" and it is well established that the contractual responsibility to third parties (in particular customers, banks, tax authorities...) of joint-owners on one side and parties to SCCV co-promotion arrangements on the other are similar, all the more than such SCCV parties remain unlimitedly liable even after the SCCV has been liquidated. The problem lies into the fact that **structuring co-promotions as "joint-ownerships" is conceptually possible but almost impossible in practice as it would trigger huge administrative complexity and unbearable additional costs!** (Similarly creating a "physical output" "temporary" transfer to the parties to the SCCV before immediate resale of the units to the customer would trigger also significant tax and legal costs for no substantial changes in the arrangement and operation, except for Joint Operation classification...).

- Last but not least, SCCV co-promotion arrangements are generally financed directly by the parties to the SCCV arrangement rather than financed from third parties with guarantee of the parties to the arrangement (no external financing would be possible without such guarantees). With SCCV co-promotion classifies as joint arrangements, all financial liabilities are presented in the consolidated financial statements of real-estate developers. **Assuming that SCCV co-promotions would be classified as joint-entities, no doubt that the industry would consider switching to the guaranteed external financing of SCCV-co-promotions approach, so that no financial liabilities would no longer be on the consolidated financial statements of real-estate developers** in relation with co-promotion programs.

We therefore believe that the IFRS Interpretation Committee should rapidly clarify that the "other facts and circumstances" analysis suggested in IFRS 11.17 should not be limited to an "output" or even more restrictive "physical output" analysis, but should rather be a more general "substance analysis" as to whether the "arrangement depends on the parties on a continuous basis for settling the liabilities of the activity conducted through the arrangement". In the case of SCCV co-promotion arrangements the answer is definitively YES!

Appendix 1 to this letter contains our presentation of SCCV co-promotions arrangements and analysis of why they should be classified as joint operations (in relation to your question 1)

[Information rendered anonymous]

Appendix 1

Presentation of SCCV co-promotion arrangements

In France, real estate developers commit to achieve a real estate program in a limited timeframe. The sale of new construction apartments (hereafter "units") is usually made off plan, under the VEFA regime (Vente en I'Etat Futur d'Achevement) which provides a legal framework for the operation and defines the responsibilities of the real estate developer.

A real estate program usually involves the key structuring following steps that drive the profitability of the program:

1. Finding and evaluating constructible land → call option signed with vendor
2. Technical studies and securing construction permit
3. Setting the tarrifs
4. Pre-sale agreements of the units with customers (up to 40% on average before the construction of the program is confirmed)
5. Securing financing
6. Selection of the contractor and
7. Acquisition of the land and Supervising the building operations
8. Follow-up of commercialization: pre-sale agreements are converted to sale agreements and residual units for sale are commercialized
9. Delivery of the residential units
10. Post-delivery and follow-up of the guarantees provided to the customers

SCCV co-promotions arrangements are structured when two or more real estate developers want to actively operate together for one program. In this context, the program key structuring steps are conducted as follows:

- Steps 1 to 6 are taken directly by the "parties to the SCCV arrangement" (hereafter the "SCCV Partners", before the SCCV has even been created. They are key to the existence and the profitability of the program. Steps 1 to 6 are the steps that create the vast majority of the value of the Program.
- Set up of a "special purpose entity" under the legal form of a SCCV- Societe Civile de Construction-Vente equally held by two or more developers who have common control.
- Steps 7 to 10 are contractualised between SCCV and other parties but with operations being conducted by the SCCV Partners as the SCCV has no own resources (no staff, no financial resources except for financing received from the SCCV Partners...)

Real estate co-promotion programs are set up for operational reasons, in order to benefit from the expertise of the partners, to comply with the requirements of the local communities that deliver construction permits, or to share the programs' risks... The use of a SCCV is explained by its

functionality, as it offers the benefits of joint ownership (IN DIVISION) without its drawbacks, such as the associated administrative burden and related costs.

The SCCV co-promotions have the following typical characteristics:

- The Business purpose of the SCCV is to achieve one single program, once the initial structuring key steps have been taken by the SCCV partners directly. Once that purpose is achieved (construction and commercialization), the SCCV is liquidated (either once the delivery claims/litigations are over or at the latest once all warranties given to customers have expired, i.e. after 10 years but the entity could also be liquidated before the expiration of the warranty period). In any case, the SCCV Partners will directly assume all liabilities arising from the SCCV activity, including the program/units warranty).
- The only revenues of the SCCV are the sale of the program units to the external customers. The cash cannot be reinvested in other programs and will be transferred to the partners on a continuous basis, mainly as repayment to the financing provided by the SCCV Partners and as payment to assistance (technical, administrative, commercialization...) fee. If any residual, it is repaid to the partners on a yearly basis.
- The sole purpose of a SCCV is to facilitate the administrative burden of steps 7 to 10 of the program cycle.
- The SCCV is fully dependent on its SCCV partners' resources (staff, financing, offices...) to achieve its "contractual purpose". It is like an empty legal shell a s :
    - the commercialization (step 8) keeps on been achieved by the SCCV partners team in a - context where the external customer has no knowledge of the existence of the SCCV until it signs the agreement: commercialization resources are SCCV partners staff, brands known to the customer are the SCCV partners'... this service being charged to the SCCV
    - all other steps from 7 to 10 are conducted by the SCCV partners Staff. Such services being charged to the SCCV
    - they are financially dependent of the SCCV partners who provide financing through partners' current accounts which are called upon when needed (it would be possible to set up an external financing in a SCCV but exclusively with SCCV partners guarantee)
    - The SCCV creditors have a right of recourse against the SCCV partners, which is much stronger than in any other legal form of legal entity as:
        - o They are entitled to claim against the SCCV partners even before they have been through all recourses against the SCCV, ie as soon as their first claim to the SCCV has but been unsuccessful (source: art. L211-2 alinea 2 Code de la Construction et de ('Habitation).
        - o They are entitled to claim liabilities against SCCV partner seven after the SCCV has been liquidated or after the SCCV partner has disposed of its share of the SCCV. (same source)

IFRS 11 analysis

1. Is the SCCV a separate vehicle?

The SCCV is a separate vehicle whose assets and liabilities are legally distinct from those of the partners.

→ **SCCVs are separate vehicles**

With the following mitigation :

- An « empty legal shell » the timeframe of which is very limited
- The purpose of which is achieved directly through the SCCV partners means
- The Intuitu personae feature of the agreement between the SCCV partners. No tnsfer of share is possible without preliminary agreement of all SCCV partners and preliminary acceptance by the new SCCV partners of the convention contractualising how the operations of the SCCV are conducted by the partners.

2. Does the legal form of the SCCV give the partners rights to the assets, and obligations for the liabilities relating to the SCCV?

1. Rights to the assets relating to the SCCV

The assets of the SCCV are mainly the cash (pre-payments made by the buyers), the land and the property in construction. The construction is legally the property of the SCCV. The partners of the SCCV would not have access to the assets of the SCCV during the life of the entity (by law) except by acquiring the assets, which is possible at any time by any SCCV partner assuming they acquire at the sale tariff agreed by the SCCV partners.

2. Obligations for the liabilities relating to the SCCV

The SCCV partners are severally but not jointly liable for all the debts of the SCCV. Each partner is liable for its own portion of the debt corresponding to its interest in the SCCV. However the creditors of the SCCV:

- o have right of recourse against the partners with respect to their share of debt and obligation of the SCCV as soon as their first claim against the SCCV ("Mise en demeure") has been successful and even before they have been through all recourses.
- o are entitled to claim liabilities against SCCV partner seven after the SCCV has been liquidated or after the SCCV partner has disposed of its share of the SCCV. (same source)

→ The legal form of the SCCV does not directly give the SCCV partners actual rights to the assets but it should be considered that they almost create actual obligations for the liabilities relating to the SCCV.

3. Do the terms of the contractual arrangement specify that the partners have rights to the assets and obligations for the liabilities?

Real estate developers have considered including such provisions in the agreement structuring the SCCV, however such provision would be nil by law (at least for the assets). French law explicitly sets - for the purpose of protecting final customers in the course of construction when the sale (VEFA) has been signed - that SCCV assets cannot be transferred to the SCCV partners

→ Contractual arrangement does not give the SCCV partners any additional rights to the assets of the SCCV.

With the following mitigation:

- Once sale agreement has been signed and because the continuous/on-going transfer of the unit construction work to the customer, the asset of the SCCV is cash, which is immediately transfer back to the SCCV partners via the current-account mechanism that have been set-up initially to finance the program.

- All non-financial asset required to conduct the operations of the SCCV are SCCV partners' non financial assets: brands, internet commercialization sites, marketing / sale / site material

4. Other facts and circumstances:

1. Do the partners have rights to substantially all the economic benefits of the assets held in the SCCV?

The assets held by the entity are mainly the cash received from customers' prepayments, the program units in progress:

- As long as the sale agreements have not been signed with customers, the SCCV assets are the program units in progress (land and construction) that are financed (payment to suppliers....) by current accounts mechanism by the SCCV partners
- Once sale agreement has been signed and because the continuous/on-going transfer of the unit construction work to the customer, the asset of the SCCV is cash, which is immediately transfer back to the SCCV partners via the current- account mechanism that have been set-up initially to finance the program
- Cash is never (<u>and cannot be</u>) reinvested in other programs by the SCCV.

Hence, taking into account the specific business model features of the SCCV (as described above and further discussed below in "3. Additional considerations"), the partners have rights to all the economic benefits of the assets held in the SCCV.

2. Does it depend on the partners on a continuous basis for settling the liabilities relating to the activity conducted through the arrangement?

The SCCV is continuously relying on the partners for settling the liabilities relating to the activity for the following reasons:

- The SCCV has been set up to execute one single project/program, which would not even exist had the SCCV partners not taken directly Steps 1 to 6 of the project/program cycle. The purpose of the SCCV is only to execute Steps 7 to 10 on behalf of the SCCV partners, in a context where :
  - Execution is achieved through the SCCV partners' means, primarily : staff and financing

- Any decision to be made in relation that goes beyond pure execution (e.g. modification of tariffs in case of difficult commercialization,..) are made directly by the SCCV partners

- The SCCV partners are unlimitedly liable for the liabilities of the SCCV, even after liquidation and disposal of share, and including before all recourse have been through against the SCCV

- As mentioned just above, the cash cycle (in and out) of the SCCV - financing and then repaying - is exclusively provided and received by the SCCV partenrs

Therefore, partners contribute in full or in part to settle the liabilities on a continuous basis.

3. Other facts and circumstances: additional considerations

A. Does the SCCV assume risks with the project? Agent *us* Principal

This is not an indicator for the classification, however example 5 of IFRS 11.B32 refers to the risks assumed by the partnership in order to assess the classification. If the SCCV does not assume risks with the project, it would indicate that the SCCV is acting as an agent for the principals (the venturers) - Refer to Appendix 2

Assessing the wide-spread criteria used for distinguishing agent vs principal would result into the following:

• The SCCV partners are responsible for delivering the services to the ultimate customer and fulfilment of the order:

- The SCCV partners select and evaluate the constructability of the land and the feasibility of the operation, conduct and finance studies to obtain the construction permit that they transfer to the SCCV. The partners also support operating expenses until the pre-commercialisation rate reaches a minimum level.

- The SCCV partners directly negotiate the acquisition of the land with its owner and sign a provisional sales agreement which can provide for a tie-up compensation - such compensation is assumed by the SCCV partners.

- The SCCV partners negotiate the financing of the operation and the relating financial guarantees, especially the performance bond (Garantie Financiere d'Achevement - GFA), which is required by law.
- The SCCV is set-up only when the pre-commercialisation rate reaches at least 40% (or more). Until then, reservations are signed directly by the SCCV partners. SCCV substitutes for the SCCV partners when it is created.

- The SCCV cannot choose the contractors, nor can it manage the operations in any way (commercialisation, technical, administrative, legal...). Only the SCCV partners can do so, as per the SCCV's set-up agreements.

- Ultimately the customer has no knowledge of the SCCV in its process of reserving and acquiring a program unit. The real-estate developing parties visible to the customer are the SCCV partners (internet site, marketing material....) until signing the sale agreement. For the customer only the SCCV partner is substantially responsible for the sale and the delivery process (the SCCV will in no way be a choice criterion while the SCCV partners' names can be)

- The SCCV is the legal owner of the program units in progress and sign the notarial acts with the final customers. However, those customers are, in substance, those of the partners as they are obtained through the partners' commercial resources (personnel, websites, classified ads, trade name...).

- Real estate development presents two major risks: demand risk (unsold constructions) and construction budget overruns/delivery delays. Credit risk is relatively insignificant as sales are usually tied with bank financing. Legally, it is the SCCV that supports the risks relating to operations. However in substance:

  - The SCCV has no stand-alone means and any loss or cash needs are immediately passed on to the SCCV partners, who finance the SCCV through current accounts (and vice-versa).

  - As a legal requirement, non completion risk is covered by a performance bond required by law (GFA) that is counter-guaranteed by the SCCV partners (the SCCV could not enter a performance bond on its own).

  - Any major litigation arising during or after the operations are managed by the partners' legal services. Moreover, such litigations are often accompanied by direct legal actions against the SCCV partners.

  - Any insurance relating to the operation is directly included in the insurance policies of the SCCV partners: real estate developers negotiate group insurance contracts to which SCCVs are attached.

  => In substance major risks attached to the real-estate development program are born by the SCCV Partners.

- Only the SCCV Partners and their teams may decide a modification of the tariff

- Modification of the program in the course of construction: the SCCV Partners and their teams are directly in charge of supervising contractors. Any decision to be made to modify some feature of the program is made by the SCCV Partners and their teams and the financial consequences are negotiated with contractors and/or clients by them. Same in the context of the delivery of units and the warranty period.

→ the SCCV is an "empy legal shell" that is the contracting party in relation to the execution of the program but that is no more than the agent of the SCCV Partners who are principal in this operation/arrangement, as being responsible for the decision and bearing all risks attached to the operation.

B. Does the SCCV assume risks with the project? Design of the SCCV and nominal residual profit of the SCCV

Economically most of the value of program results from Steps 1 to 6, which are conducted directly by the SCCV Partners before the SCCV has even be created.

In setting up the SCCV, agreements are signed by the SCCV partners addressing how (and by whom) the activities of the SCCV will be conducted by the SCCV Partners, and how much they will charge the SCCV for such services. Also they transfer to the SCCV all contractual documents resulting from their direct activities (construction permit, call option on the land, customers' reservations, contracts with contractors... (Resulting from Steps 1 to 6 of the Program cycle, which are the steps that create the vast majority of the value of the Program) On an arms' length transaction, such transfer would result in significant compensation from the transferee to the transferor, what is actually never done when the SCCV is set up, which confirms that the arrangement is not on arms length between the SCCV Partners on one side and the SCCV on the other side.

This suggests that any "residual profit" that may nominally exist in the SCCV has no substance and is determined conventionally by the SCCV partners. **Such nominal and conventional profit should not be a relevant basis for arguing that the SCCV Partner's only right is to the residual profit of the SCCV (basis for classification as Joint Venture) taking into consideration that SCCV Partners may design the SCCV differently** so that there is no profit and all flows are attributed to them.

→ **Partners have rights to substantially all the economic benefit of the assets and are continuously responsible for settling the liabilities of the SCCV.**

Therefore, **real estate co-promotion programs conducted through SCCVs are Joint Operations.**