STAFF PAPER

March 2014

IFRS Interpretations Committee Meeting

Project	**IFRS 11 *Joint Arrangements***
Paper topic	Analysis of implementation issues

CONTACT(S) Won-Hee Han whan@ifrs.org +44 (0)20 7246 6960

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

Introduction

1. As mentioned in Agenda Paper 5, at its January 2014 meeting, the IFRS Interpretations Committee (the Interpretations Committee) requested the staff to provide further analysis on implementation issues relating to IFRS 11 *Joint Arrangements*.

2. In response to the request, this Agenda Paper deals with how and why 'other facts and circumstances' create rights and obligations that result in the joint arrangement being classified as a joint operation, including fact patterns illustrating Issues 1B–1E (please refer to Agenda paper 5).

3. Specifically, we will aim to:

   (a) clarify how IFRS 11 provides guidance for how and why particular facts and circumstances create rights and obligations that result in the joint arrangement being classified as a joint operation (**Analysis 1**);

   (b) assess Issues 1B–1E by using examples (**Analyses 2–5**);

The IFRS Interpretations Committee is the interpretative body of the IASB, the independent standard-setting body of the IFRS Foundation.
IASB premises │ 30 Cannon Street, London EC4M 6XH UK │ Tel: +44 (0)20 7246 6410 │Fax: +44 (0)20 7246 6411 │ info@ifrs.org│ www.ifrs.org

Staff analysis

Analysis 1: understanding the guidance in IFRS 11 with respect to assessing 'other facts and circumstance'

Overview of Analysis 1

4. Basically, the assessment of 'other facts and circumstances' is performed when the parties to the joint arrangement do not have (direct) rights to the assets, and (direct) obligations for the liabilities, relating to the joint arrangement. The assessment of 'other facts and circumstances' thus focuses on whether the parties to the joint arrangement have other rights to the assets and other obligations for the liabilities, which can be considered to be, in substance, 'direct' rights to the assets, and 'direct' obligations for the liabilities, relating to the joint arrangement (hereinafter referred as '**inferred**' **rights** and '**inferred**' **obligations**[1]).

5. The meaning of the term 'direct' can be understood by referring to paragraph B27 of IFRS 11, which describes 'rights to assets in the joint operation when assessing the terms of the contractual arrangement:

Assessing the terms of the contractual arrangement		
	Joint operation	Joint Venture
Rights to assets	the contractual arrangement establishes that the parties to the joint arrangement share all interests (eg rights, title or ownership) in the assets relating to the arrangement in a specified portion (eg in proportion to the parties' ownership interest in the	…

[1] We use the term 'inferred' rights and 'inferred' obligations only in the contexts in which paragraph 4 of this paper describes.

	arrangement or in proportion to the activity carried out through the arrangement that is directly attributed to them)	

Assessing the terms of the contractual arrangement		
	Joint operation	Joint Venture
Obligations for liabilities	the contractual arrangement establishes that the parties to the joint arrangement share all liabilities, obligations, cost and expenses in a specified proportion (eg in proportion to the parties' ownership interest in the arrangement or in proportion to the activity carried out through the arrangement that is directly attributed to them).	…
	The contractual arrangement establishes that the parties to the joint arrangement are liable for claims raised by third parties.	…

6. We will explore the meaning of 'inferred' rights and 'inferred' obligations and how they are created in the examinations below.

Examination 1: how and why do ‘other facts and circumstances’ create ‘inferred’ rights to the assets of the joint arrangement?

7. We will examine how and why ‘other facts and circumstances’ create ‘inferred’ rights to the underlying assets of the joint arrangement in IFRS 11 by comparing the two cases:

   (a) (Case 1) when the joint arrangement sells output to its parties; and

   (b) (Case 2) when the joint arrangement sells output to third parties.

8. We first note paragraph B31 and Example 5 in paragraph B32 of IFRS 11 (emphasis added):

   > B31 When the activities of an arrangement are primarily designed for the provision of output to the parties, this indicates that the parties have rights to **substantially all the economic benefits** of the assets of the arrangement. The parties to such arrangements often ensure their access to the outputs provided by the arrangement by preventing the arrangement from selling output to third parties.

Application example
Example 5 … From the fact pattern above, the following facts and circumstances are relevant: • **The obligation of the parties to purchase all the output produced by entity C** reflects the exclusive dependence of entity C upon the parties for the generation of cash flows and, **thus, the parties have an obligation to fund the settlement of the liabilities of entity C**. • The fact that the parties have rights to all the output produced by entity C means that the parties are consuming, and therefore have rights to, all the economic benefits of the assets of entity C. These facts and circumstances indicate that the arrangement is a joint operation. The conclusion about the classification of the joint arrangement in these circumstances would not change if, instead of the parties using their share of the output themselves in a subsequent manufacturing process, the parties sold their share of the output to third parties. If the parties changed the terms of the contractual arrangement so that **the arrangement was able to sell output to third parties**, **this would result in entity C assuming demand, inventory and credit risks.** In that scenario, such a change in the facts and circumstances would require reassessment of the classification of the joint arrangement. **Such facts and circumstances would indicate that the arrangement is a joint venture.**…

(Case 1) when the joint arrangement sells output to parties to the joint arrangement

11. We note that (1) the first sentence of paragraph B31 of IFRS 11 and (2) the first bullet point cited above from Example 5 in paragraph B32 of IFRS 11 explain how and why the case of selling output to parties to the joint arrangement would establish 'inferred' rights to the assets of the joint arrangement. We will examine these two parts of guidance.

12. **The first sentence of paragraph B31 of IFRS 11** describes that when the parties to the joint arrangement purchase substantially all the output produced, it indicates that the parties have rights to substantially all the economic benefits of the assets. We note that this description highlights the term 'rights to substantially all the economic benefits' rather than the term 'purchasing output'. This is because there are other situations in which the parties to the joint arrangement can have 'rights to substantially all the economic benefits' of the assets. For example, if the parties to the joint arrangement acquire rights to use the assets in a lease contract from the separate vehicle, it could also indicate that they have 'rights to substantially all the economic benefits' of the assets. Consequently, we think that the first sentence of paragraph B31 of IFRS 11 suggests that:

    (a) the parties purchasing output from the separate vehicle would not be the only example that can establish rights to the underlying assets that generate those economic benefits; and

    (b) the parties have 'inferred' rights to the assets of the joint arrangement because they have '**rights** to substantially all the **economic benefits**' of the assets.

13. Next, **the first bullet point cited above from Example 5 in paragraph B32 of IFRS 11** indicates that parties to the joint arrangement need to have an '**obligation**' to purchase all the output of the separate vehicle so that the parties have 'inferred' rights to the assets of the separate vehicle. In other words, if the parties only have

'rights to substantially all the economic benefits' of the asset, it would not be sufficient to create 'inferred' rights to the assets of the separate vehicle.

14. For example, if the parties have an option contract to purchase the output of the assets of the separate vehicle, they would have 'rights to substantially all the economic benefits' of the assets, but would not have 'obligation' to purchase the output of the assets of the separate vehicle. Consequently, those parties would not have 'inferred' rights to the assets of the separate vehicle.

(Case 2) when the joint arrangement sells output to third parties

15. Meanwhile, we note that (1) the second sentence of paragraph B31 of IFRS 11 and (2) the last paragraph cited above from Example 5 in paragraph B32 of IFRS 11 relate to how and why the case of selling output to third parties would not establish 'inferred' rights to the assets of the joint arrangement. We will examine these two parts of guidance.

16. **The second sentence of paragraph B31 of IFRS 11** raises the question about whether sales to third parties would change the classification of a joint arrangement. Then, **the last paragraph cited above from Example 5 in paragraph B32 of IFRS 11** illustrates why the case of selling output to third parties does not create 'inferred' rights to the underlying assets of the arrangement that generate the output sold to third parties, referring to the fact that it is not the parties but the joint arrangement that faces the '**risks**' involving selling the output to third parties (ie demand, inventory and credit risks). This implies that the 'risks' relating to acquiring the economic benefits is another condition to create the parties' 'inferred' rights to the assets of the separate vehicle.

Illustration of Cases 1 and 2

17. To understand more clearly how 'inferred' rights are created, we will compare Cases 1 and 2 using a simple example. Suppose two scenarios assuming there are two parties (Party A and Party B) that set up a joint arrangement structured through a separate vehicle (Entity C) in which Party A owns 40 per cent of the shares of Entity C and Party B owns 60 per cent of the shares of Entity C.

    (a) (**Scenario 1**) Parties A and B are obligated to purchase their shares of output of the assets of Entity C. Parties A and B can then choose to sell their shares of the output to third parties or to use it themselves; and

    (b) (**Scenario 2**) Entity C sells all the output to third parties and Parties A and B have rights to the net profits generated by those sales in proportion to their shares of Entity C.

18. **In Scenario 1**, Parties A and B have 'inferred' rights to the assets of Entity C because:

    (a) each party acquires its share of the economic benefits of the assets; and

    (b) their obligation to purchase the output means that they assume the risks involving their shares of the economic benefits (ie risks involving the output).

19. In other words, Party A has 40 per cent of the economic benefits generated by the assets of the arrangement and it assumes 40 per cent of the total risks as a consequence of purchasing the output; and Party B has 60 per cent of the economic benefits generated by the assets of the arrangement and it assumes 60 per cent of the total risks as a consequence of purchasing the output.

20. **In Scenario 2**, Parties A and B do not have rights associated with the output, but they have rights to the net profits from the sale of the output. This may indicate that they have rights to their shares of the economic benefits generated by the assets of Entity C, although in this

case, the economic benefits are not 'output' but net profits. However, we do not think that this type of economic benefits would represent the same economic benefits of the assets of the joint arrangement as IFRS 11 requires as a condition to create 'inferred' rights. This is because it is not 'gross' economic benefits of the 'assets' of the joint arrangement.

21. Similarly, Parties A and B do not assume the same risks to the economic benefits of the assets as IFRS 11 requires as a condition to create 'inferred' rights. In Scenario 2, Parties A and B assume 'net' risks relating to the economic benefits because they are only entitled to the net economic benefits (ie the net profits obtained), whereas we think IFRS 11 requires the parties to the joint arrangement to have 'gross' risks relating to the economic benefits.

22. We use the term '**gross**' here for economic benefits and risks because we think that IFRS 11 requires the parties to have rights to the assets and obligations for the liabilities, rather than rights and obligations for the net of the assets and liabilities. In other words, we would not be able to say that Party A assumes 40 per cent of the total risks relating to the economic benefits of the assets and Party B assumes 60 per cent of the total risks relating to those economic benefits of the assets.

23. Accordingly, we think that in Scenario 2, Parties A and B do not have 'inferred' rights to the assets of Entity C.

Conclusion of the comparison between Case 1 and Case 2

24. On the basis of our analysis above, we note that the parties to the joint arrangement would have 'inferred' rights to the assets of the joint arrangement when they:

    (a) have **rights** to economic **benefits** (for example, 'output') of the assets of the joint arrangement; and

    (b) have **obligations** to acquire those economic benefits and therefore assume **risks** relating to those economic benefits (for example, the risks relating to the 'output').

We also note that when the separate vehicle sells output to third parties, the parties to the joint arrangement would not have ‘inferred’ rights to the assets of the joint arrangement because they do not have rights to ‘gross’ economic benefits and ‘gross’ risks relating to the output from the assets. Accordingly, the case of selling output to third parties would not result in the classification of a joint operation.

Examination 2: how and why do ‘other facts and circumstances’ create ‘inferred’ obligations for the liabilities of the joint arrangement?

25. We note that (1) paragraph B32 of IFRS 11 and (2) the first bullet point cited above from Examples 5 in paragraph B32 of IFRS 11 explain how and why ‘other facts and circumstances’ create ‘inferred’ obligations for the liabilities of the joint arrangement:

> B32 The effect of an arrangement with such a design and purpose is that the liabilities incurred by the arrangement are, in substance, satisfied by the cash flows received from the parties through their purchases of the output. When the parties are substantially the only source of cash flows contributing to the continuity of the operations of the arrangement, this indicates that the parties have an obligation for the liabilities relating to the arrangement.

Application example
Example 5 … From the fact pattern above, the following facts and circumstances are relevant: • **The obligation of the parties to purchase all the output** produced by entity C reflects the exclusive dependence of entity C upon the parties for the generation of cash flows and, **thus, the parties have an obligation to fund the settlement of the liabilities of entity C**. • The fact that the parties have rights to all the output produced by entity C means that the parties are consuming, and therefore have rights to, all the economic benefits of the assets of entity C. (emphasis added) …

26. **Paragraph B32 of IFRS 11** indicates that the following two conditions should be met in order to create an 'inferred' obligation for the underlying liabilities of the joint arrangement that are incurred for the production of the output:

    (a) the **liabilities** incurred by the arrangement are, in substance, **satisfied** by the cash flows received from the parties through their purchases (first sentence of paragraph B32); and

    (b) the parties are substantially the **only source** of cash flows contributing to the **continuity of the operation** of the joint arrangement (second sentence of paragraph B32).

27. We note that there may be a situation in which cash flows from the parties are the 'only source**'** of cash flows for the operations of the separate vehicle, and yet those cash flows might not be sufficient to

satisfy the liabilities incurred by the arrangement. In this situation, we think it would be necessary to assess whether the cash flows can ensure the continuity of the operation of the joint arrangement.

28. We think that the guidance in paragraph B32 is described more generally in the diagram following paragraph B33 of IFRS 11. The diagram illustrates that one of the criteria for the classification of joint operation is that "[the joint arrangement] depends on the parties **on a continuous basis** for settling the liabilities relating to the activity conducted through the arrangement".

29. We think that the meaning of 'continuous basis' is that the cash flows from the parties to the joint arrangement settle the liabilities of the separate vehicle '**in the normal course of business**' as described in paragraph B14 of IFRS 11[2]. In this sense, we think that if the parties to the joint arrangement have a secondary obligation (for example, a guarantee obligation) for the liabilities of the separate vehicle, it would not meet the criterion above because such an obligation would not require the parties to the joint arrangement to settle the liabilities 'on a continuous basis' (ie a guarantee would only represent an obligation for the parties when a specific event occurs).

30. **The first bullet point cited above from Example 5 in paragraph B32 of IFRS 11** describes a connection between 'inferred' rights and 'inferred' obligations. "The obligation of the parties to purchase all the output produced by entity C" would create 'inferred' rights to the assets, and then such obligation would create 'inferred' obligations for the liabilities when it can lead to "fund the settlement of the liabilities of entity C". In this sense, the assessment of 'inferred' obligation would **not** be **independent** of the assessment of 'inferred' rights.

[2] Paragraph B14 of IFRS 11 states that "the classification of joint arrangement required by this IFRS depends upon the parties' rights and obligations arising from the arrangement **in the normal course of business**. (…)" (emphasis added)

31. On the basis of our analysis above, we note that the parties to the joint arrangement would have 'inferred' obligations for the liabilities of the joint arrangement when they:

    (a) are, through 'inferred' rights to the assets of the joint arrangement, substantially the only source of cash flows that:

        (i) can ensure the settlement of the liabilities of the joint arrangement; and

        (ii) can continue the operation of the arrangement; and

    (b) settle the liabilities of the joint arrangement **on a continuous basis.**

Examination 3: comparison of 'inferred' rights and obligations and 'enforceable' rights and obligations

32. We will clarify how 'inferred' rights and obligations relate to 'enforceable' rights and obligations.

33. Suppose that the parties to the joint arrangement have a (call) option contract to buy substantially all output from the separate vehicle and the separate vehicle has a (put) option contract to sell substantially all output to the parties.

34. We first note that rights and obligations, by nature, are enforceable and therefore the options contracts above would also be enforceable. We also note that if the parties have 'enforceable' rights and 'enforceable' obligations, relating to the economic benefits of the assets of the joint arrangement, they would have 'inferred' rights to the assets of the joint arrangement according to our Examination 1 above. In this sense, the parties in the example above have 'inferred' rights to the assets of the joint arrangement.

35. However, we think that those enforceable option contracts would not oblige the parties to settle the liabilities of the joint arrangement 'on a continuous basis' because settling the liabilities would depend on the exercise of the option contracts. As shown in Examination 2 above, if

the parties to the joint arrangement cannot settle the liabilities 'on a continuous basis', they would not have 'inferred' obligations for those liabilities.

Summary of Analysis 1

36. The assessment of 'other facts and circumstances' would focus on whether the parties to the joint arrangement have 'inferred' rights to the assets and 'inferred' obligations for the liabilities, relating to the joint arrangement.

37. The parties to the joint arrangement have 'inferred' rights to the assets of the joint arrangement when they:

    (a) have **rights** to economic **benefits** (for example, 'output') of the assets of the joint arrangement ; and

    (b) have **obligations** to acquire those economic benefits and therefore assume **risks** relating to those economic benefits (for example, the risks relating to the 'output').

38. The parties to the joint arrangement have 'inferred' obligations for the liabilities of the joint arrangement when they:

    (a) are, through 'inferred' rights to the assets of the joint arrangement, substantially the only source of cash flows that:

        (i) can ensure the settlement of the liabilities of the joint arrangement; and

        (ii) can continue the operation of the arrangement; and

    (b) settle the liabilities of the joint arrangement **on a continuous basis**.

Analysis 2: (Issue 1B) selling output at market price

39. In this analysis, we will consider a joint arrangement whereby two mining entities, Entities G and H (the parties), enter into a contractual arrangement to build a plant and manufacture a product (product A).

Suppose that this joint arrangement has the following terms agreed to by the parties:

(a) Both parties are required for all decisions.

(b) The joint arrangement requires the establishment of a separate vehicle, Entity J, which is an incorporated entity.

(c) The legal form of Entity J confers separation between the parties and Entity J (i.e. Entity J can be considered in its own right). Entities G and H each own 50 per cent of the shares of Entity J. The construction of the plant is funded through the equity capital contributed by the parties to Entity J.

(d) The contractual arrangements specify that Entities G and H are committed to use substantially all of the capacity of the plant for 20 years, which is aligned with the useful lives of the equipment.

(e) Entities G and H are obliged to purchase product A from Entity J at a **market price** [3].

(f) Entities G and H agree to contribute to Entity J any funds needed to meet any unexpected contingent losses in accordance with their ownership percentage.

40. We can consider two situations:

(a) (Situation 1) it is reasonably probable that the market price would be high enough to cover the cost of Entity J and thus cause Entity J to make profits; and

(b) (Situation 2) it is reasonably probable that the market price would fall below the amount needed to cover Entity J's costs and thus cause Entity J to incur losses.

41. In Situation 1, Entities G and H will eventually regain the amount that they paid for product A in excess of all the cost incurred by Entity J by having a distribution of the profits that Entity J made. In this regard,

[3] We may assume that selling at market price is a requirement in the jurisdiction in which Entities G and H operate the joint arrangement.

we think that Situation 1 would not be different from the case in which the parties purchase output at a cost-price.

42. In Situation 2, we think that selling product A to Entities G and H at a market price would not contradict the criterion 'substantially all the economic benefits' for the classification of a joint operation. This is because whether the economic benefits that Entities G and H are entitled to are 'substantially all' would not vary depending on the price level of product A. Accordingly, we think that the first criterion for 'inferred' rights as noted in Analysis 1 would be met. We note that Entities G and H would also meet the second criterion because they have obligation to purchase product A and therefore assume risks relating to product A. Consequently, we think that Entities G and H would have 'inferred' rights to the underlying assets (ie the plant) of Entity J that generate product A purchased by the parties.

43. Considering Situation 2, we also note that an assessment needs to be performed on whether Entities G and H have 'inferred' obligations for the liabilities of Entity J. Specifically, the assessment would be focused on whether selling product A at market price would prevent:

    (a) the liabilities of the arrangement from being, in substance, satisfied by the cash flows received from the parties through their purchases of the output; or

    (b) the parties to the joint arrangement from being substantially the only source of cash flows for the continuity of the operation of the joint arrangement (conditions in paragraph B32 of IFRS 11).

44. Situation 2 may indicate that Entities G and H do not have 'inferred' obligations for the liabilities of Entity J because:

    (a) Entities G and H still might be 'the only source of cash flows' for the continuity of the operation of Entity J; and

    (b) however, if the cash flows from Entities G and H through their purchases of the output are not sufficient to enable Entity J to meet its liabilities, it would be questionable whether the cash

flows from Entities G and H ensure the continuity of the operation of Entity J.

45. However, we note that Entities G and H are obliged to provide funds to Entity J for any unexpected contingent losses as described in subparagraph (f) of paragraph 39. We think that this condition would meet the criteria for 'inferred' obligations because it will lead to settling the liabilities of Entity J on a continuous basis.

46. On the basis of this analysis, we think that selling at market price itself would not be a determinative factor for the classification of the joint arrangement but it is a critical factor that needs to be considered.

Analysis 3: (Issue 1C) third-party financing

47. We consider a joint arrangement where two entities, Entities M and N (the parties) enter into a contractual arrangement to build and operate a plant. The arrangement has the following terms agreed to by the parties:

    (a) Both parties are required for all decisions;

    (b) the contractual arrangement requires the establishment of a separate vehicle, Entity O, which is an incorporated entity;

    (c) the legal form of Entity O confers separation between the parties and Entity O;

    (d) Entities M and N each own 50 per cent of the shares of Entity O;

    (e) the arrangement comprises two phases: the construction phase (ie the phase during which the plant is built) and the production phase (ie the phase during which the plant produces output); and

    (f) the parties have obligation to purchase substantially all the output produced by the arrangement during the production phase at a price designed to cover costs.

48. In this setting, we consider two scenarios:

(a) (Scenario 1) Entity O enters into financing agreement with a syndicate of banks for the construction of the plant that exists only during the construction phase; and

(b) (Scenario 2) Entity O enters into financing agreement with a syndicate of banks that exists during both the construction phase and the production phase, but Entities M and N guarantee the financing.

49. First, considering Scenario 1, the fact that there are two phases (construction phase and production phase) would not affect the assessment of whether Entities M and N have 'inferred' obligations for the liabilities of Entity O. This is because the assessment would focus on whether Entities M and N could settle the liabilities of Entity O 'on a continuing basis'. In other words, 'settling the liabilities on a continuing basis' should be examined throughout the two phases. Accordingly, the assessment of the case in which third-party financing exists only during the construction phase as in Scenario 1 should not be different from the assessment of the case in which third-party financing exists throughout the two phases.

50. Second, considering Scenario 2, the guarantee from Entities M and N also would not affect the assessment of whether Entities M and N have 'inferred' obligations for the liabilities of Entity O. This is because a guarantee does not represent 'direct' obligations for the underlying liabilities that the guarantee covers (ie it only represents an obligation when a specific event occurs) and thus would not meet the criterion of 'settling the liabilities on a continuing basis'.

51. Lastly, third-party financing, by itself, would not affect the classification of the joint arrangement if the cash flows from the operations would be expected to fund the repayment of the external funds.

52. On the basis of our analysis above, for the purposes of the classification of the arrangement, it would not matter whether the financing was provided by third parties or by the parties to the joint arrangement.

Analysis 4: (Issue 1D) nature of output

53. We consider a joint arrangement where two entities, Entities P and Q (the parties) enter into a contractual arrangement to produce output specific to them. The arrangement has the following terms agreed to by the parties:

    (a) Both parties are required for all decisions;

    (b) the contractual arrangement requires the establishment of a separate vehicle, Entity R, which is an incorporated entity;

    (c) the legal form of Entity R confers separation between the parties and Entity R;

    (d) Entities P and Q each own 50 per cent of the shares of Entity R;

    (e) Entity R produces automotive parts that can be used only in the manufacturing processes of Entities P and Q.

54. In this setting, we consider three scenarios:

    (a) (Scenario 1) any contractual terms do not require Entities P and Q to purchase the products from Entity R and there are other sources from which the parties can purchase the same products;

    (b) (Scenario 2) any contractual terms do not require Entities P and Q to purchase the products from Entity R and there are **no** other sources from which the parties can purchase the same products; and

    (c) (Scenario 3) there is an option contract between the parties and Entity R in which Entities P and Q can buy the products from Entity R.

55. In Scenarios 1 and 2, Entities P and Q would not have ‘inferred’ rights to the assets of Entity R because they do not have rights to substantially all the economic benefits of the assets of Entity R. In Scenario 3, Entities P and Q have (enforceable) rights to substantially all the economic benefits of Entity R. However, they would not have ‘inferred’ rights to the asset of Entity R because such an option contract

does not give Entities P and Q an obligation to purchase the output and therefore they do not have the risks associated with the (output from) the assets.

56. We, however, note that that these scenarios may be unusual because an arrangement that produces the output specific to the parties to the joint arrangement would probably cause the parties to oblige each other to purchase all the output.

Analysis 5: (Issue 1E) the unit of assessment (ie whether the assessment should be based on volumes or monetary values)

57. We consider a joint arrangement where two entities, Entities S and T (the parties) enter into a contractual arrangement to undertake manufacturing activity. The arrangement has the following terms agreed to by the parties:

    (a) Both parties are required for all decisions;

    (b) the contractual arrangement requires the establishment of a separate vehicle, Entity U, which is an incorporated entity;

    (c) the legal form of Entity U confers separation between the parties and Entity U;

    (d) Entities S and T each own 50 per cent of the shares of Entity U;

    (e) Entity U produces two main products during the project and a cost price per product is CU1,000[4]

    (f) Entity U also produces one hundred by-products during the project and a cost price per product is CU1.

58. In this setting, we assume two scenarios in which Entities S and T have obligation to purchase the output produced by Entity U:

[4] In this Agenda Paper, currency amounts are denominated in 'currency units' (CU).

(a) (Scenario 1) Entities S and T have obligation to purchase only main products at a cost price in proportion to their shares of interests in Entity U; and

(b) (Scenario 2) Entities S and T have obligation to purchase only by-products at a cost price in proportion to their share of interest in Entity U.

59. The assessment of whether Scenarios 1 and 2 meet the criterion of 'substantially all the economic benefits' would depend on whether the assessment is based on 'monetary values' or 'volumes'. If the assessment is based on 'monetary values', Scenario 1 would meet the criterion of 'substantially all the economic benefits'; whereas, if it is based on 'volumes', Scenario 2 would meet the criterion of 'substantially all the economic benefits'.

60. We note that to classify the joint arrangement as a joint operation on the basis of the guidance in paragraph B32 of IFRS 11, cash flows received from the parties through their purchase of output need to be substantially the only source of cash flows contributing to the continuity of the operations of the joint arrangement. In other words, paragraph B32 of IFRS 11 focuses on 'cash flows' of the joint arrangement in terms of the classification. In this sense, when assessing whether the parties have rights to substantially all the economic benefits of the underlying assets of the joint arrangement that produce the output that the parties purchase, we think that such 'economic benefits' relate to cash flows.

61. Consequently, we think that it would be appropriate to make the assessment based on the monetary value of the output rather than based on physical quantities. Accordingly, only Scenario 1 would meet the criterion of 'substantially all the economic benefits'.

Summary of staff analysis

62. IFRS 11 provide criteria for how to assess whether the parties to the joint arrangement have 'inferred' rights to the assets and 'inferred'

obligations for the liabilities, relating to the joint arrangement. (**Analysis 1**)

63. Applying the criteria in IFRS 11 to some example cases show that:

    (a) the fact that output is sold at market price would not be a determinative factor for the classification of the joint arrangement (**Analysis 2**);

    (b) whether the financing is provided by third parties or by the parties to the joint arrangement would not affect the classification of the joint arrangement (**Analysis 3**);

    (c) the nature of output would not be a determinative factor for the classification of the joint arrangement (**Analysis 4**); and

    (d) the assessment of the criterion 'substantially all the economic benefits of the assets' should be based on monetary value rather than physical quantities (**Analysis 5**).

Staff recommendation

64. We ask below if the Interpretations Committee agrees with our analyses. If it does, on the basis of our analysis, we think that the requirements in IFRS 11 are consistent in terms of how to assess 'other facts and circumstances'. However, taking into account the fact that stakeholders have divergent view regarding the assessment of 'other facts and circumstances', we recommend that the Interpretations Committee should consider adding illustrative examples to IFRS 11.

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff analysis that: (a) IFRS 11 provide criteria for how to assess whether the parties to the joint arrangement have 'inferred' rights to the assets and 'inferred' obligations for the liabilities, relating to the joint arrangement (Analysis 1); and

(b) IFRS 11 provide sufficient guidance for several cases analysed (Analyses 2 to 5) in this paper?

2. Does the Interpretations Committee agree with the staff recommendation that:

   (a) Illustrative examples should be added to IFRS 11?