

STAFF PAPER

May 2014

IFRS Interpretations Committee Meeting

Project	IFRS 11 <i>Joint Arrangements</i>		
Paper topic	Consideration of next steps		
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. The IFRS Interpretations Committee (the Interpretations Committee) has been discussing several implementation issues relating to IFRS 11 *Joint Arrangements* at its November 2013, January 2014, March 2014 and May 2014 meetings. This Agenda Paper aims to clarify where the Interpretations Committee stands through the past discussion and to consider next steps. In order to identify the next steps, this paper proposes some options the Interpretations Committee can take relating to the priority issues, which the Interpretations Committee identified at its November 2013 meeting and has discussed at its subsequent meetings.

Where we stand

2. As mentioned in Agenda Paper 2, the Interpretations Committee identified two priority issues for further consideration at its November 2013 meeting. The two priority issues are:
 - (a) **(Issue 1)** whether an assessment of ‘other facts and circumstances’ should take into account facts and circumstances that do not involve contractual and (legal) enforceable terms; and

- (b) **(Issue 2)** how the parties to a joint operation should recognise assets, liabilities, revenues and expenses, especially if the parties’ interests in the assets and liabilities differ from their ownership interest in the joint operation.
3. In the past meetings, the Interpretations Committee has dealt with only Issue 1 by addressing five sub-issues.
- (a) **Issue 1A**—Should the assessment of ‘other facts and circumstances’ be based only on contractual (and legal) enforceable terms?
 - (b) **Issue 1B**—Does the fact that the output from the joint arrangement is sold at a market price prevent the joint arrangement from being classified as a joint operation, when assessing ‘other facts and circumstances’?
 - (c) **Issue 1C**—Does financing from a third party prevent an arrangement from being classified as a joint operation?
 - (d) **Issue 1D**—Does the nature of the output produced by the joint arrangement determine the classification of a joint arrangement when assessing ‘other facts and circumstances’?
 - (e) **Issue 1E**—When assessing ‘other facts and circumstances’ in the case in which parties are taking substantially all of the output, is the assessment based on volumes or monetary values?

Issue 1A

4. The Interpretations Committee tentatively decided not to add Issue 1A to its agenda at its January 2014 meeting, noting that the assessment of ‘other facts and circumstances’ should be focused on whether those facts and circumstances create enforceable rights to the assets and obligations for the liabilities. Agenda Paper 13 of this meeting also brings a comment letter analysis on this tentative agenda decision, recommending that the Interpretations Committee to finalise the agenda decision.

5. Meanwhile, the Interpretations Committee continued discussion over the issue of how to assess ‘other facts and circumstances’ and it decided to consult IASB members on how the concept of ‘substance over form’ should be applied to this matter before progressing this matter further. As mentioned in Agenda Paper 2A, the result of the consultation with IASB members shows that with one exception, all IASB members who we spoke to thought that a narrow view of the assessment of ‘other facts and circumstances’ is appropriate and this should focus on whether the parties have ‘indirect’ rights and ‘indirect’ obligations, relating to the joint arrangement, that can be identified to be, in substance, ‘direct’ rights to the assets and ‘direct’ obligations for the liabilities, relating to the joint arrangements.

We think that the feedback from the consultation with IASB members is consistent with the tentative agenda decision on Issue 1A at the January 2014 Interpretations Committee meeting.

Issues 1B-1E

6. The Interpretations Committee considered an analysis of various examples (relating to Issues 1B–1E) aimed at illustrating the application of the related guidance in IFRS 11 and noted that the analysis can be useful in understanding the guidance in IFRS 11¹. However, the Interpretations Committee noted that the examples are fact-specific and thought that adding illustrative examples to IFRS 11 might not be the most effective way of clarifying the issues raised.

The issues still to be discussed

7. The Interpretations Committee will address the following issues at this meeting or at the July 2014 meeting:
- (a) The Interpretations Committee will address an issue relating to separate financial statements at this meeting (Agenda Paper 2B).

¹ Refer to Agenda Paper 5A for the March 2014 Interpretations Committee meeting (<http://www.ifrs.org/Meetings/AP5A>)

- (b) The Interpretations Committee will discuss comment letter analysis on the tentative agenda decision relating to Issue 1A at this meeting (Agenda Paper 13).
- (c) Regarding Issue 1, the staff will bring an analysis of common joint arrangement structures (so-called project entities²) to the July 2014 Interpretations Committee meeting.
- (d) The staff will bring an analysis of Issue 2 (ie recognition and measurement issue, especially when the parties' interests in the assets and liabilities of the joint operation differ from their ownership interest in the joint operation) to the July 2014 Interpretations Committee meeting.

Consideration of the next steps

8. We think that the Interpretations Committee has reached on a consensus on how to apply the assessment of 'other facts and circumstances' through the past meetings, and its view was documented in the March 2014 IFRIC *Update*. Specifically, the view of the Interpretations Committee was that:
 - (a) the assessment of 'other facts and circumstances' should be based on a narrow view (ie an assessment based on 'indirect' rights and 'indirect' obligations, relating to the joint arrangement) rather than a broader one (for example, a view that also considers design, economic compulsion and business needs); and
 - (b) adding illustrative examples to the Standard might not be appropriate to clarify the issue.
9. We think that the following circumstantial factors might help the Interpretations committee to consider the next steps:
 - (a) Many jurisdictions are in the second year of applying IFRS 11, with EU countries in the process of implementation this year.

² The 'project entity' that will be addressed has a joint arrangement structure that is established for a bespoke construction project for delivery of a single product or service to a single customer.

- (b) Informal feedback received from stakeholders who are in the second year of applying IFRS 11 suggests that the narrow view (ie an assessment based on ‘indirect’ rights and ‘indirect’ obligations, relating to the joint arrangement) is prevalent in their jurisdictions.
 - (c) A Post-implementation Review (PiR) of IFRS 11 is expected to start towards the end of 2015.
10. Taking into account the consensus of the Interpretations Committee and the circumstantial factors noted above, we think that the Interpretations Committee could consider the following two main alternatives.
- (a) (Alternative 1) Wait for practice to continue to develop over the next 18 months and allow the PiR of IFRS 11 to consider whether any further standard-setting action is required; or
 - (b) (Alternative 2) Convert the Interpretations Committee’s conclusions from this and previous meetings into guidance by:
 - (i) Issuing an Interpretation; or
 - (ii) Adding to the application guidance (ie to Appendix B) of IFRS 11.
11. Meanwhile, we note that the Interpretations Committee is expected to discuss at its July 2014 meeting:
- (a) common joint arrangement structure (ie so-called ‘project entity’) (related to Issue 1); and
 - (b) recognition and measurement issue, when the parties’ interests in the assets and liabilities differ from their ownership interest in the joint operation entity (Issue 2)

Staff recommendation and question for the Interpretations Committee

12. We note that the informal feedback that we have received recently in respect of Issue 1 suggests that practice has so far developed in a manner consistent with the Interpretations Committee’s conclusions relating to that issue. Our

recommendation, therefore, is that the Interpretations Committee follows Alternative 1 described above.

13. We note that one of the issues scheduled to be discussed at the July meeting also relates to Issue 1, so we think that a final decision could be made following the discussion of that issue at the July meeting. We think that Issue 2 is independent of Issue 1 and so a separate consideration of next steps should be made after the discussion of that issue.

Question for Interpretations Committee

What does the Interpretations Committee think should be the next steps in respect of its work on Issue 1, relating to the classification of a joint arrangement?