Ihre Ansprechpartner

Sehr geehrte Damen und Herren,

für Rückfragen zu der beigefügten Publikation „In depth" zur Thematik „IFRS 11 'Joint Arrangements' – Implementation issues considered by the IFRS Interpretations Committee" stehen Ihnen folgende Ansprechpartner gerne zur Verfügung:

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In depth
A look at current financial reporting issues

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IFRS 11, 'Joint arrangements' – Implementation issues considered by the IFRS Interpretations Committee

What are the implications?

At a glance

IFRS 11 seems to have given rise to a record number of issues for the IFRS Interpretations Committee (IC) even before its widespread adoption.

The IC published tentative agenda decisions on a number of these issues in November 2014. These might provide some additional clarity on the application of the standard, particularly the 'facts and circumstances' around classification as a joint operation.

This In depth summarises the tentative conclusions reached by the IC and the practical implications. The conclusions are not expected to result in a significant change in how the standard is applied.

Background

IFRS 11 was issued in 2011 and contains principles for financial reporting by entities that have an interest in jointly controlled arrangements. Since inception, a number of practical implementation issues have arisen.

Two narrow scope amendments have been published: one on how to account for the acquisition of an interest in a joint operation; and the other on contributions of a business to a joint venture. Issues continue to be raised, with discussion of IFRS 11 at every IC meeting since November 2013. The assessment of 'other facts and circumstances' in classification and the recognition and measurement of joint operations have been popular sources of issues.

Further amendments to IFRS 11 are not expected ahead of the post-implementation review. Instead, the IC discussions to date have been documented through a series of agenda decisions.

Following a public comment period, the tentative agenda decisions made in the November 2014 IC meeting will be re-deliberated in March 2015 and are expected to be finalised.

Implementation issues

1. Should the assessment of 'other facts and circumstances' be based only on contractual and legally enforceable terms?

Facts and circumstances that involve contractual and legally enforceable terms are seen as most relevant to the classification decision.

The IC considered two views in its discussions, whether:
- only enforceable rights and obligations should be relevant to the assessment; or
- the assessment should also consider the design and purpose of the joint arrangement, the entity's business needs and the entity's past practices.

Rights and obligations are, by nature, enforceable. The IC concluded that the assessment of the effect of 'other facts and circumstances' on the classification of a joint arrangement should be based on enforceable terms.

2. Does the sale of the output from the joint arrangement to the parties at a market price prevent classification as a joint operation?

Output sold at market price is not, by itself, a determinative factor for the classification of a joint arrangement; judgement needs to be exercised to consider if the parties have rights to assets and obligations for liabilities of the joint arrangement.

The IC observed that, in order to classify a joint arrangement as a joint operation due to other facts and circumstances, it is necessary to demonstrate that:
- the parties have rights and obligations relating to substantially all of the economic benefits (such as output) of the assets of the arrangement; and
- they provide cash to the arrangement through legal or contractual obligations, which is used to settle the liabilities of the joint arrangement on a continuous basis.

The cash flow provided by the parties' purchase of the output at market price might not be at a sufficient level to ensure that the liabilities of the arrangement are settled on a continuous basis. This might indicate that the parties have no obligation to settle liabilities.

Consider a joint arrangement which produces gold and must sell the output to the parties at the prevailing LME gold price. The price could fluctuate to a level that would be unprofitable for the arrangement. This might signal that the arrangement would be unable to settle its debts on a continuous basis.

Alternatively, the price might be determined on a cost-plus or break-even basis. This could be seen as giving the parties not only the rights to all of the output, but also the obligation (in substance) for settling the liabilities of the joint arrangement on a continuous basis.

3. What factors might be less relevant when assessing other facts and circumstances?

Nature of output

The IC observed that the nature of the output, whether fungible or bespoke, does not impact the assessment of other facts and circumstances. The focus of considering obligations for liabilities is on cash flows between the parties and the joint operation, rather than the nature of the product itself.

Closely and fully involved parties

Consideration of other facts and circumstances is not a test of whether the parties to the joint arrangement are closely or fully involved with the operation of the separate vehicle. It is an assessment of whether other facts and circumstances override rights and obligations conferred on the parties by the legal form of the separate vehicle.

Financing from a third party

Third party financing alone should not determine the classification of a joint arrangement. If the cash flows from operations are expected to be sufficient for repayments, it is not relevant if the financing is provided by third parties or by the parties to the joint arrangement.

4. What is 'substantially all of the output'?

Parties to the joint arrangement should have rights to substantially all of the 'economic benefits' of the assets of the arrangement in order to have 'direct rights to the assets'. What does this mean when by-products or joint products are generated by the arrangement? For example, product A, having a higher unit value, is produced in small quantities, whereas product B, having a lower unit value, is produced in large quantities.

The IC noted that economic benefits relate to the cash flows arising from the parties' rights and obligations for the asset. It is the monetary value of the output and not the physical quantities that are more relevant.

5. Can two arrangements be classified differently if one is structured as a separate vehicle and the other not?

Yes, because the legal form of the separate vehicle affects the rights and obligations of the parties to the joint arrangement. Different accounting does not conflict with the concept of 'economic substance'. The presence of a separate vehicle plays a significant role in determining the nature of the rights and obligations of the parties and thus the economic substance of the arrangement.

6. How should the joint operators recognise financial statement items in relation to their interest in a joint operation?

Revenue recognition when all of the output is taken by the parties

Joint operators would not recognise any amount for the sale of output by the joint operation to other joint operators. If all of the output is taken by the parties and there is a joint operation, the joint operators only recognise revenue when they sell their output to third parties.

Example 1: Two parties, A and B, form a company to build and use a pipeline to transport gas. Party A has a 40% ownership interest and party B has a 60% ownership interest in the company. The arrangement is classified as a joint operation because the shareholder agreement requires the investors to take 100% of the output at a cost-plus price.

In this scenario, neither party would recognise its share of revenue from the sale of output by the joint operation; to do so would mean that it would be recognising revenue from output sold to itself. Parties A and B would only recognise revenue when they sell their share of output taken from the joint operation to a third party.

Share of output purchased differs from the share of ownership interest

Joint operators are required to account for their assets, liabilities, revenues and expenses in accordance with the shares specified in the contractual arrangement. A situation could arise where there is a difference between the joint operator's share of output purchased and its share of ownership interest. It is important to understand why there is a difference. Judgement will be needed to determine the appropriate accounting.

One or more of the joint operators might make a substantial investment in the joint operation that differs from their ownership interest. This could indicate that there are other elements or agreements in place. The identification of these other elements might provide relevant information to determine how to account for the difference between ownership interest and share of output.

Example 2: Following on from the scenario in example 1 above, the contractual terms are that parties A and B must each use 50% of the pipeline capacity. This share of output differs from the share of ownership interest, which is at 40% and 60% respectively.

Some questions to consider, in understanding this disconnect between the ownership interest and share of output, include:

- Why are the parties required to take all of the output?
- Has one party contributed more initial capital or assets than the other?
- Does the split of output taken change over time and, if so, why?

The contractual requirement for the parties to purchase all of the output at a price covering the costs of the arrangement provides rights to the underlying assets and obligations for the liabilities of the arrangement. This determined classification as a joint operation. Therefore, the parties account for the operation based on their share of the output, or pipeline capacity.

Party A initially contributed less equity than party B. In this case, party A's share of the joint operation is funded, in substance, partly by party B. The contractual terms require party A to settle the difference arising between the capacity interest taken and ownership interest on liquidation of the arrangement. Party A therefore accounts for its share of assets and liabilities at 50%. The difference that arises between this and the equity that party A contributed to the joint operation of 40% represents a payable to party B.

Party B would recognise its share of assets and liabilities of the joint operation at 50%. The difference from the 60% that it contributed is a receivable from party A. Party A will pay back this source of financing to party B on liquidation of the arrangement.

7. Accounting by a joint operator for its interest in a joint operation in its separate financial statements

The joint operator is required to account for its rights and obligations in relation to the joint operation. Those rights and obligations are the same, whether separate or consolidated financial statements are prepared. Therefore the same accounting is required in the consolidated financial statements and in the separate financial statements of the joint operator.

The IC observed that the joint operator would not additionally account in its separate or consolidated financial statements for its shareholding in a joint operation in a separate vehicle; this is because it is required to account for the activity of the joint operation within its own financial statements.

8. Accounting by the joint operation, that is a separate vehicle, in its own separate financial statements

IFRS 11 applies only to the accounting by joint operators and not to the accounting by the separate vehicle that is the joint operation. Therefore the financial statements of the separate vehicle would be prepared in accordance with applicable standards.

The IC concluded that it would be important to reflect the effect of the joint operators' rights and obligations in the accounting for the joint operation's assets and liabilities. This might affect the assets and liabilities reported by the joint operation.

Implications and next steps

The agenda decisions are currently tentative. Agenda decisions do not have 'authority' in the body of IFRS literature but are seen, particularly by some regulators, as a form of guidance. Most entities have long concluded on the classification of their joint arrangements. However, entities might want to read and consider the agenda decisions carefully if they have joint arrangements in a separate entity classified as joint operations.

The IC has commented that it believes that the agenda decisions are consistent with how practice has broadly developed in the application of IFRS 11. If so, widespread change based on the agenda decisions is unlikely.

The IC is scheduled to re-deliberate and finalise the decisions at its March 2015 meeting. Although the formal comment period in relation to the tentative decisions ended in January 2015, we expect that the IC would continue to consider differences in view or concerns with the summarised conclusions.

Practice will likely continue to develop with the benefit of the guidance contained in the agenda decisions. The IASB will consider whether any further action is required as part of the post-implementation review of IFRS 11, which is planned to start towards the end of 2015.

Questions?

PwC clients who have questions about this *In depth* should contact their engagement partner.

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