

# IFRS 11: Application Issues

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## Extract, IFRS Discussion Group Report on Meeting – September 5, 2013

Issues have been raised regarding the classification of a joint arrangement as a joint venture or a joint operation and the accounting for joint operations under IFRS 11 *Joint Arrangements*.

Group members were asked to determine which of the following six issues are most significant in practice in Canada.

### **Issue 1: Should the assessment of “other facts and circumstances” be based only on enforceable contractual terms?**

- **Issue 1.1: What if the entity, based on its stage of development, currently is not producing output and has not yet documented a contractual obligation for the parties to take the output, when and if such output should arise?**

*View 1A – Yes, the assessment is based only on current enforceable contractual terms.*

*View 1B – No, economic compulsion is sufficient.*

*View 1C – No, intention alone is sufficient.*

### **Issue 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?**

*View 2A – No, the arrangement is a joint operation.*

*View 2B – Yes, the arrangement is not a joint operation.*

*View 2C – It depends, this fact alone should not be considered in isolation.*

### **Issue 3: When assessing “other facts and circumstances”, does financing from a third party prevent an arrangement from being classified as a joint operation?**

*View 3A – No, not if it is guaranteed by the parties.*

*View 3B – No, not if it is during the pre-production, construction phase.*

*View 3C – No, ultimately the parties to the arrangement need to fund any external debt.*

*View 3D – Yes, third party debt prevents classification as a joint operation.*

*View 3E – It depends, this fact alone should not be considered in isolation.*

### **Issue 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?**

*View 4A – A single assessment should be performed at the level of the joint arrangement.*

*View 4B – Separate assessments should be performed by each party to the joint arrangement.*

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**Issue 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?**

*View 5A – Based on the share of output.*

*View 5B – Based on ownership interest.*

**Issue 6: Does a party with joint control classify the arrangement based on viewing all phases of the arrangement at the inception or only the current phase?**

- **Issue 6.1: When assessing “other facts and circumstances”, how should arrangements that are in the pre-production or pre-construction phase or have sequential activities be assessed?**

*View 6A – Current phase only.*

*View 6B – All phases.*

*The Group's Discussion*

AcSB staff conducted an informal survey of the observers and Group members at the meeting to find out which issues were considered most significant in practice in Canada. Issues 1, 5 and 6 were identified as the most significant and the Group discussed why. Although the Group did not discuss Issues 2, 3 and 4, some observers and Group members noted that those issues are encountered in practice in Canada as well.

**Issue 1: Other facts and circumstances based only on enforceable contractual terms**

Group members explained that this issue needs to be addressed because it is not clear whether entities should look at facts and circumstances beyond the legal terms.

Group members noted that the three views appear to be relatively complete:

*View 1A – Yes, the assessment is based only on current enforceable contractual terms.*

The assessment of the parties' rights and obligations when considering other facts and circumstances (as described in paragraphs B29-B32 of IFRS 11) is based on enforceable terms. By definition, rights and obligations must arise from contractual and/or enforceable terms. A right or an obligation that is not enforceable is not a right or an obligation.

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*View 1B – No, economic compulsion is sufficient.*

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. Some arrangements are designed so that, realistically, the joint arrangement can only sell to the parties, and the parties are economically compelled to purchase the output. The notion of economic compulsion is consistent with the reference to “design” and “in substance” in paragraphs B31-B32 of IFRS 11.

*View 1C – No, intention alone is sufficient.*

The other facts and circumstances test is an in-substance test and, therefore, intention evidenced through design is sufficient to meet the requirement on its own. Paragraphs B31-B32 of IFRS 11 focuses on the design of the arrangement. No mention is made of the need for a contract or economic compulsion.

***Issue 5: Share of output differs from the ownership interest***

Group members noted that the issue is faced by entities in Canada. Group members observed that care should be taken in addressing this issue because the appropriate view might depend on the facts and circumstances of the joint arrangement:

*View 5A – Based on the share of output.*

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.

*View 5B – Based on ownership interest.*

The parties should account for their share of assets and liabilities based on their ownership interest in the arrangement. IFRS 11 does not specify how to account for the imbalance between the amount invested by each party and the amounts recognized by each party for the share of assets and share of liabilities, both at inception of the joint operation and on an ongoing basis.

***Issue 6: Arrangements in the pre-production or pre-construction phase***

Group members noted that some joint arrangements operate in phases, such as those in the mining/extractive, construction, and real-estate industries.

Group members observed that this issue is common in Canada, particularly when classifying an arrangement prior to any output being generated. Group members noted that the question focuses on whether all phases, or the current phase, should be considered when classifying a joint arrangement, and the answer to this question may depend on the facts and circumstances of the joint arrangement.

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Group members noted that a better question for the IFRS Interpretations Committee to consider is whether IFRS 11 requires, or should require, a continuous assessment model similar to the one in IFRS 10 *Consolidated Financial Statements*. Exploring the answer to this question would provide a principle that could be applied across different arrangements regardless of the phase.

Group members observed that IFRS 12 *Disclosure of Interests in Other Entities* specifically requires disclosures in this area.

The Group decided that no further action was required at this time because all six issues are currently being considered by the IFRS Interpretations Committee. AcSB Staff will continue to monitor that Committee's work on these issues.