IFRS

STAFF PAPER

December 2021

IASB® Meeting

Project	**Second Comprehensive Review of the *IFRS for SMEs*® Standard**
Paper topic	Towards an Exposure Draft—IFRS 11 *Joint Arrangements*

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Introduction

1. This paper discusses whether and, if so, how to propose amendments to the *IFRS for SMEs* Standard to align Section 15 *Investments in Joint Ventures* with IFRS 11 *Joint Arrangements*.

2. In this paper the following definitions are used:

   (a) The term SMEs refers to small and medium-sized entities that are eligible to apply the *IFRS for SMEs* Standard.

   (b) A **joint venture** is defined in Section 15 of the *IFRS for SMEs* Standard as:

   A contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control.

   (c) A **joint arrangement** is defined in IFRS 11 as:

   An arrangement of which two or more parties have joint control.

   (d) A **joint venture** is one of two classifications for joint arrangements in IFRS 11, defined as:

   A joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

3. To avoid confusion, for the purpose of this paper, the staff use the terminologies in IFRS 11 (joint arrangement in IFRS 11 instead of joint venture in Section 15).

Purpose of the paper

4. The purpose of this paper is to ask the International Accounting Standards Board (IASB) to:
   (a) consider feedback on the Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard* (Request for Information), published in January 2020, and the recommendations of the SME Implementation Group (SMEIG) on the alignment of the *IFRS for SMEs* Standard with IFRS 11; and
   (b) decide whether and, if so, how to propose amendments to the *IFRS for SMEs* Standard to align with IFRS 11.

Summary of staff recommendations

5. The staff recommend the IASB propose amendments to the *IFRS for SMEs* Standard to partially align with IFRS 11 while leaving other parts of Section 15 unchanged on the basis that was set out in the Request for Information, in particular:
   (a) aligning the definition of joint control in Section 15 with IFRS 11;
   (b) retaining the classifications of joint arrangements: jointly controlled operations, jointly controlled assets and jointly controlled entities; and
   (c) retaining the accounting requirements of Section 15, including the accounting policy election for jointly controlled entities in Section 15.

Structure of the paper

6. This paper is structured as follows:

   (a) background (paragraphs 7–12);

   (b) question in the Request for Information (paragraph 13);

   (c) feedback and SMEIG recommendation (paragraphs 14–21);

   (d) Post-implementation Review of IFRS 11 (paragraphs 22–24);

   (e) staff analysis:

      (i) aligning the definition of joint control in Section 15 with IFRS 11 (paragraphs 26–37); and

      (ii) retaining the classifications of joint arrangements and the accounting requirements (paragraphs 38–52);

   (f) question for the IASB; and

   (g) Appendix—Extract from the Request for Information.

Background

7. Section 15 of the *IFRS for SMEs* Standard is based on IAS 31 *Interests in Joint Ventures*, requiring entities that are jointly controlled to be classified as either jointly controlled operations, jointly controlled assets or jointly controlled entities.

8. The definition of joint control in Section 15 of the *IFRS for SMEs* Standard is aligned with the concept of control as defined in Section 9 *Consolidated and Separate Financial Statements* of the *IFRS for SMEs* Standard. The *IFRS for SMEs* Standard currently defines joint control as:

> The contractually agreed sharing of control over an economic activity and exists only when the strategic financial and operating decisions relating to

> the activity require the unanimous consent of the parties sharing control (the venturers).

9. IFRS 11 addressed two features of IAS 31 that the IASB regarded as impediments to high-quality reporting on joint arrangements. Applying IAS 31:
   (a) the structure of the joint arrangement was the sole determinant of the accounting for that arrangement; and
   (b) an entity had an accounting policy choice for interests in jointly controlled entities to either apply the equity method or proportionate consolidation (see paragraph 10 of this agenda paper).

10. A significant difference between Section 15 and IAS 31 is that Section 15 does not permit proportionate consolidation for jointly controlled entities. Consequently, if the IASB were to align Section 15 with IFRS 11 entities would not be transitioning from proportionate consolidation.

11. The definition of joint control in IFRS 11 is:

> The contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

In developing IFRS 11, the IASB did not reconsider the concept of joint control but updated the definition to align the definition of 'joint control' with the definition of 'control' in IFRS 10.[1]

12. Applying IFRS 11, an entity classifies its joint arrangements as either joint operations or joint ventures on the basis of the rights and obligations arising from the arrangement. IFRS 11 requires an entity to measure its interests in joint ventures applying the equity method.

[1] Paragraph BC21 of the Basis for Conclusions on IFRS 11.

Question in the Request for Information

13. Question S4 of the Request for Information asked for views on:

    (a) aligning the definition of joint control in Section 15 with IFRS 11;

    (b) retaining the classifications of joint arrangements: jointly controlled operations, jointly controlled assets and jointly controlled entities; and

    (c) retaining the accounting requirements of Section 15, including the accounting policy election for jointly controlled entities in Section 15.

Feedback and SMEIG recommendations

Methods for obtaining feedback

14. Stakeholders provided feedback on Question S4 of the Request for Information in several ways, including comment letters, an online survey and outreach.

15. The SMEIG met on 4–5 February 2021 to discuss the feedback from stakeholders on the Request for Information and develop recommendations to enable the IASB to decide on whether and, if so, how to align the *IFRS for SMEs* Standard with IFRS 11.

Feedback from comment letters

16. Most respondents agreed with the IASB that Section 15 should be aligned with IFRS 11 in respect of the definition of joint control because alignment should:

    (a) result in consistency between the definition of control and joint control; and

    (b) further contribute to the achieving the principle of faithful representation.

17. Many respondents were also supportive of retaining the classifications and accounting requirements of joint arrangements in Section 15 rather than aligning with IFRS 11. These respondents were of the view that retaining the classifications should reduce the

difficulty and significant judgements involved in applying the classification requirements in IFRS 11.

18. Some respondents were supportive of aligning the classifications in Section 15 with IFRS 11 because in their views, the requirements in IFRS 11 provide a clearer principle in classifying joint arrangements.

Feedback from online survey and outreach

19. Most respondents via the online survey and stakeholders in outreach events agreed that Section 15 should be aligned with the IFRS 11 definition of joint control to reduce divergence between *IFRS for SMEs* Standard and full IFRS Standards.

20. Respondents via the online survey and in outreach events had divided views on aligning the classification requirements in Section 15 with IFRS 11:

    (a) Those respondents that supported alignment for the classifications of joint arrangements thought alignment would reduce the differences between *IFRS for SMEs* Standards and full IFRS Standards and increase comparability among SMEs.

    (b) Those respondents who supported retaining the classifications of joint arrangements and therefore requirements in Section 15 said:

        (i) retaining the classifications of joint arrangements in Section 15 would avoid application challenges for SMEs; and

        (ii) the classifications of joint arrangements and requirements in Section 15 are simpler to apply than IFRS 11.

SMEIG recommendation

21. SMEIG members generally agreed that the feedback provides evidence for the IASB to:

    (a) align the definition of joint control in Section 15 with IFRS 11; and

(b) retain the classifications and requirements for joint arrangements in Section 15.

Post-implementation Review of IFRS 11

22. The IASB is nearing completion of the Post-implementation Review of IFRS 10 *Consolidated Financial Statements*, IFRS 11 and IFRS 12 *Disclosure of Interests in Other Entities*. The IASB, at its October meeting, concluded, based on the feedback, that IFRS 10, IFRS 11 and IFRS 12 are working as intended.

23. The feedback on the Request for Information of the Post-implementation Review of IFRS 11 generally indicated that stakeholders support the principle in IFRS 11, that is the accounting for joint arrangements should reflect the rights and obligations arising from the arrangements. Some respondents to the Request for Information of the Post-implementation Review of IFRS 11 referred to challenges in assessing other facts and circumstances when classifying a joint arrangement structured through a separate vehicle.

24. The IASB is considering, based on the feedback on the Post-implementation Review, whether to undertake work on several topics. The staff does not consider any of the topics that the IASB is considering to be relevant to this agenda paper.

Staff analysis

25. The staff's analysis separately reviews whether to align with IFRS 11 in two areas:

    (a) the definition of joint control; and

    (b) the requirements for classifying joint arrangements and the related accounting requirements.

Aligning the definition of joint control with IFRS 11

26. The staff's analysis in this agenda paper assumes that the IASB agrees with aligning the definition of control in Section 9 with IFRS 10, which is analysed in Agenda Paper 30B

for this meeting. If the IASB disagrees with aligning the definition of control in Section 9 with IFRS 10, the staff may need to reconsider the alignment of Section 15 and bring another agenda paper to the IASB in a future meeting.

27. The staff think the IASB should, consistent with its thinking when developing the Request for Information, align the definition of joint control in Section 15 with IFRS 11.

Relevance to SMEs

28. The definition of joint control in Section 15 is aligned with the definition of control in Section 9. The definition of joint control in IFRS 11 is aligned with the definition of control in IFRS 10.

29. In the Request for Information the IASB noted:

> The Board took into consideration the alignment between IFRS 10 and IFRS 11 and is seeking views on aligning the definition of control in Section 9 with IFRS 10 and the definition of joint control in Section 15 with IFRS 11.

30. The Basis for Conclusions on IFRS 11 states that the reason for the change (of the definition of joint control) is to align the definition of 'joint control' with the definition of 'control' in IFRS 10. As analysed in Agenda Paper 30B for this meeting, alignment of the definition of control in Section 9 with IFRS 10 is relevant to SMEs because it may change the boundaries of a group. As a consequence of aligning the definition of control in Section 9 the staff support the views of respondents on the Request for Information that the definition of joint control should be aligned with IFRS 11.

Simplicity

31. The simplicity principle involves looking at the IFRS Standards that have satisfied the relevance condition and then assessing what simplifications are appropriate.

32. Evaluating possible changes to the definition of joint control against the simplicity principle can be helped by looking at what the alternatives would be if the definition of joint control were to remain unchanged. The staff identified two alternative methods:

    (a) maintaining two sets of control definition in Section 9 and Section 15, which would:

        (i) complicate the *IFRS for SMEs* Standard;

        (ii) reduce the quality of the *IFRS for SMEs* Standard; and

        (iii) confuse SMEs when assessing control and joint control.

    (b) requiring an SME to assess:

        (i) in the first step, whether all the parties or a group of parties controls a joint arrangement according to the definition of control in Section 9 which is aligned with IFRS 10; and

        (ii) in the second step, whether the SME has joint control applying the existing definition of joint control in Section 15. The staff analysed the drawback of this method in the analysis of faithful representation principle.

33. Neither of the methods complies with the simplicity principle because they both complicate the *IFRS for SMEs* Standard.

Faithful representation

34. The staff think the effect of aligning the definition of joint control with IFRS 11 would be similar to the effect of implementation of IFRS 11— to supersede IAS 31 in respect of the changes in the definition of joint control, that is faithful representation would be improved.

35. Applying the alternative method in paragraph 32(a) of this agenda paper, which is maintaining two sets of control definition, might be able to achieve faithful representation only when governing a joint arrangement's financial and operating policies can be identified as relevant activities that most significantly affect the investee's return. If

governing financial and operating policies cannot be identified as relevant activities that most significantly affect the investee's return, an inappropriate conclusion might be drew that fails to faithfully represent the SME's interests in the joint arrangement.

36. Applying the alternative method in paragraph 32(b) of this agenda paper might not be able to achieve faithful representation. Under this method, an SME determines whether all the parties or a group of parties control a joint arrangement assessing if they have the ability to direct relevant activities. The SME would then need to determine whether it has joint control by assessing if the SME has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

37. The SME might encounter difficulties if the relevant activities identified are not the same as governing the joint arrangement's financial and operating policies, which would result in a meaningless situation that fails to faithfully represent the SME's interests in the joint arrangement.

Retaining the classifications of joint arrangements and the accounting requirements

38. The staff think the IASB should, consistent with its thinking when developing the Request for Information, retain the classifications of joint arrangements in Section 15 into jointly controlled operations, jointly controlled assets and jointly controlled entities and the related accounting requirements. Whilst the staff believe the classifications are relevant to SMEs, as the IASB stated in the Request for Information, the introduction of the IFRS 11 classifications could introduce complexity into the *IFRS for SMEs* Standard.

Relevance to SMEs

39. One of the objectives in developing IFRS 11 was to address a concern that the structure of the joint arrangement was the sole determinant of the accounting for that arrangement applying IAS 31.

40. Applying IFRS 11, a joint arrangement is classified either as a joint operation or a joint venture. When IAS 31 was superseded by IFRS 11, the three classifications of joint arrangements (jointly controlled operations, jointly controlled assets and jointly controlled entities) were replaced with two classifications (joint operations and joint ventures).

41. The principle in IFRS 11 is that a party to a joint arrangement recognises its rights and obligations arising from the arrangement. Accordingly, the classification of a joint arrangement is determined by assessing the rights and obligations of the parties arising from that arrangement.

42. The staff think the improvement made by introducing IFRS 11 applies to SMEs that are parties to joint arrangements and thus aligning the classification requirements with IFRS 11 would meet the relevance principle.

Simplicity

43. IFRS 11 states that the classification of a joint arrangement as a joint operation or a joint venture depends upon the rights and obligations of the parties to the arrangement. Therefore, judgement may be required in classifying a joint arrangement.

44. In the Basis for Conclusions on IFRS 11, the IASB noted the decision to merge 'joint operations' and 'joint assets' (as proposed in ED 9 *Joint Arrangements*) into a single type of joint arrangement called 'joint operations' resulted in simplification of the IFRS Standard.[2] However, the staff do not think moving from three to two classifications is a simplification for SMEs because reducing the classifications is not simply combining jointly controlled operations and jointly controlled assets into joint operations. For example, applying IFRS 11, an entity is required to consider other facts and circumstances when classifying a joint arrangement that is structured through a separate vehicle.

[2] Paragraph BC25 of the Basis for Conclusions on IFRS 11.

45. In addition, reclassifying joint controlled entities applying IAS 31 into joint operations or joint ventures applying IFRS 11 requires an entity to assess its rights and obligations arising from these arrangements, which requires the entity to exercise judgement. In the Post-implementation Review of IFRS 11, respondents noted that assessing other facts and circumstances to classify joint arrangements can require significant judgement.

46. In view of the above, the staff think aligning Section 15 with the classification requirement in IFRS 11 may introduce complexity to SMEs. The classification of a joint arrangement in accordance with Section 15 depends upon the structure of the joint arrangement which in many respondents' view, is simpler for SMEs to apply.

47. Thus, aligning the classification requirements with IFRS 11 could introduce complexity therefore the staff, agree with the basis on which the IASB asked for views in the Request for Information, that it is simpler to retain the classification requirements in Section 15.

Faithful representation

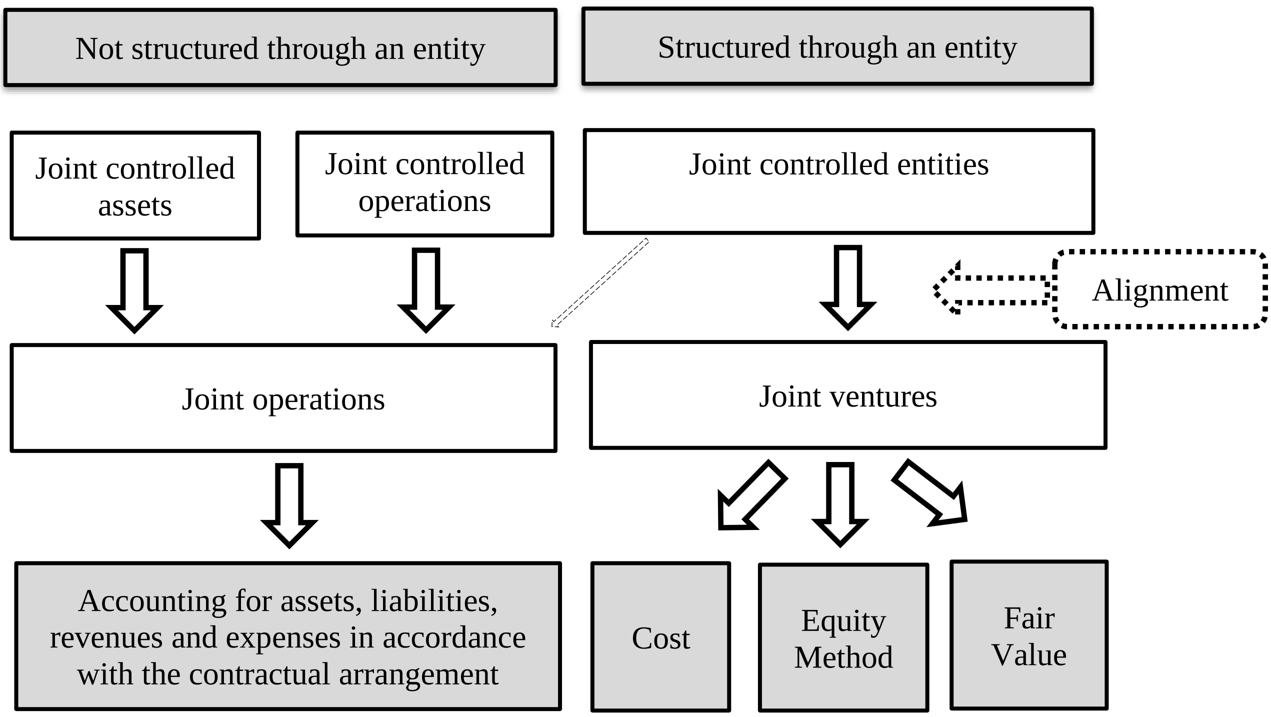
48. In developing IFRS 11 the IASB decided the accounting for joint arrangements should reflect the rights and obligations that the parties have because of their interests in the joint arrangement. Feedback in the Post-implementation Review of IFRS 11 provided evidence that stakeholders support the principle that the accounting for joint arrangements should reflect the parties' rights and obligations.

49. However, in developing the Request for Information the Board asked for views on retaining the classifications and the accounting requirements of joint arrangements. It is considered that retaining these requirements would not significantly impede faithful representation because:

    (a) the accounting outcome of joint controlled assets and joint controlled operations according to Section 15 is similar to the accounting outcome of joint operations in accordance with IFRS 11; and

    (b) the effect analysis of IFRS 11 stated that joint arrangements that are structured through separate vehicles will become 'joint operations' in IFRS 11 only in a very limited number of situations (as illustrated in the diagraph in paragraph 50 of this agenda paper).

50. The diagraph illustrates the possible effect if aligning with the classification requirement of IFRS 11 and the related accounting outcome:



Cost and benefit analysis

51. The staff think the cost of aligning the classification requirements in Section 15 with IFRS 11 cannot be justified by the benefit of using classification of joint operations and joint ventures.

52. As stated in paragraph 44 of this agenda paper, SMEs would be required to exercise judgement to reconsider the classification of their joint arrangements by assessing their rights and obligations arising from the arrangements. However, the accounting outcome for many SMEs would be similar if the classification requirements remain unchanged.

Question for the IASB

Do you agree with the staff's recommendations to propose amendments to the *IFRS for SMEs* Standard to partially align with IFRS 11 while leaving other parts of Section 15 unchanged, in particular:

(a) aligning the definition of joint control in Section 15 with IFRS 11;

(b) retaining the classifications of joint arrangements: jointly controlled operations, jointly controlled assets and jointly controlled entities; and

(c) retaining the accounting requirements of Section 15, including the accounting policy election for jointly controlled entities in Section 15.

Appendix—Extract from the Request for Information

How the Board developed this Request for Information—Aligning Section 15 Investments in Joint Ventures of the *IFRS for SMEs* Standard with IFRS 11 *Joint Arrangements*

B50 Question S4 asks for views on aligning Section 15 of the IFRS for SMEs Standard with IFRS 11 Joint Arrangements.

B51 The definition of joint control in Section 15 of the IFRS for SMEs Standard is aligned with the concept of control as defined in Section 9. Similarly, the definition of control in IFRS 10 and the definition of joint control in IFRS 11 are aligned.

B52 The Board took into consideration the alignment between IFRS 10 and IFRS 11 and is seeking views on aligning the definition of control in Section 9 with IFRS 10 and the definition of joint control in Section 15 with IFRS 11.

B53 The Board, however, acknowledged the feedback that IFRS 11 had been challenging for entities to apply in practice, specifically in deciding how to classify a joint arrangement as either a joint operation or a joint venture. The Board noted that it could align the definition of joint control without changing the classification of joint ventures in Section 15. It is therefore seeking views on retaining the existing categories of joint ventures, namely jointly controlled operations, jointly controlled assets and jointly controlled entities, and the accounting requirements of Section 15.

B54 Section 15 permits an entity to account for all of its interests in jointly controlled entities using the cost model, the equity method or the fair value model. In contrast, IFRS 11 requires the equity method. The accounting policy election was introduced by the Board because SMEs experienced difficulty applying the equity method and because fair values are relevant for lenders. The Board is seeking views on retaining the accounting policy election.