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Item 5 of the Agenda

Draft EPSAS Screening Report
IPSAS 37 – Joint arrangements

Paper by PwC in cooperation with Eurostat

- for discussion -

This document was commissioned by Eurostat. It analyses the consistency of the named IPSAS standard with the draft EPSAS framework, with a view to informing future EPSAS standard setting. This version was prepared taking into account comments received from the participants of the Cell on Principles related to EPSAS Standards.

EPSAS screening report

IPSAS 37 - Joint arrangements

September 2020

pwc

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Background

Objectives

We refer to the general introduction to the pilot EPSAS screening reports that covers the following elements:

- Key objectives of EPSAS.
- Standard setting process in the public sector.
- Purpose and scope of the screening reports.
- Approach of the screening reports.
- European public good.
- Common elements considered when preparing the reports.

General introduction to IPSAS 37

IPSAS 37 is drawn primarily from International Financial Reporting Standard (IFRS) 11 'Joint Arrangements' published by the International Accounting Standards Board (IASB). In developing IPSAS 37, the International Public Sector Accounting Standards Board (IPSASB) applied its 'Process for Reviewing and Modifying IASB Documents' that identifies public sector modifications where appropriate. This approach enables the IPSASB to build on best practices in private sector financial reporting, while ensuring that the unique features of the public sector are addressed.

The objective of the IPSAS 37 standard is to establish principles for financial reporting by entities that have an interest in arrangements that are jointly controlled (i.e., joint arrangements). IPSAS 37 should be applied by all entities that are a party to a joint arrangement.

A joint arrangement is an arrangement of which two or more parties have joint control. Joint control is the agreed sharing of control of an arrangement by way of a binding arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

Under IPSAS 37, a joint arrangement is either a joint operation or a joint venture. The classification depends upon the rights and obligations of the parties to the arrangement. It is important because it impacts the accounting treatment in the consolidated financial statements.

Joint arrangements not structured through a separate vehicle are joint operations. When a joint arrangement is structured through a separate vehicle, the entity should determine its classification considering the following:

- the legal form of the separate vehicle;
- the terms of the binding arrangement;
- when relevant, other facts and circumstances such as rights to assets, obligations for liabilities, allocation of revenues and expenses or share in the

surplus or deficit and guarantees given to third parties in relation to the joint arrangement.

When an entity has rights to the assets, and obligations for the liabilities, relating to the arrangement, the arrangement is a joint operation. A joint operator accounts for assets, liabilities, revenues and expenses arising from its interest in a joint operation.

When an entity has rights to the net assets of the arrangement, it is a joint venture. A joint venture recognises its interest in a joint venture as an investment, using the equity method.

Scope of the report

The present screening report analyses the principles for financial reporting by entities that have an interest in arrangements that are controlled jointly.

Reference to EFRAG assessment

IASB issued IFRS 10 'Consolidated Financial Statements', IFRS 11 'Joint Arrangements', IFRS 12 'Disclosure of Interests in Other Entities', IAS 27 'Separate Financial Statements' (2011) and IAS 28 'Investments in Associates and Joint Ventures' (2011) on 12 May 2011. On 30 March 2012, the EFRAG provided its opinion on those.

EFRAG has considered whether IFRS 11 meets the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002, in other words that IFRS 11:

(a) is not contrary to the principle of 'true and fair view' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

(b) meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG also considered whether it would be not conducive to the European public good to adopt IFRS 11 and it concluded that it is in the European interest to do so.

On 24 July 2014, EFRAG submitted its Endorsement Advice relating to the 'Acquisition of an Interest in a Joint Operation (Amendment to IFRS 11)' for use in the European Union and European Economic Area. The Amendment to IFRS 11 aimed to introduce guidance on how a joint operator should account for the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in IFRS 3 Business Combinations. EFRAG assessed that the Amendments meet all technical endorsement criteria of the IAS Regulation and are conducive to the European public good. It therefore recommended their endorsement. The endorsement was published in the Official Journal of the European Union on 25 November 2015.

Reference to EPSAS issue papers[1]

The PwC study of 2014[2] analysed the suitability of the IPSAS standards as a basis for developing EPSAS. This included the analysis of IPSAS 7' Investments in associates' and IPSAS 8 'Interests in joint ventures' that were replaced by IPSAS 37. Following this analysis, no major comment has been made by Member States on IPSAS 7 and IPSAS 8, but the requirements included in these standards may potentially be impacted by the discussions on IPSAS 6 as some of the principles of these standards are linked to each other. The most important concern related to the definition of the scope of consolidation and the application of the control concept in IPSAS 6. IPSAS 7 and IPSAS 8 are classified under category 3 'Standards that might be implemented with minor or no adaption'.

In the course of developing the technical proposal on EPSAS, Eurostat commissioned a series of twenty technical issues papers (IPs), which analyse in particular key public sector specific accounting issues. The papers were discussed at the EPSAS Working Group meetings during 2016-2018. The papers are all publicly available on Eurostat's website.

Each of the IPs seek to identify conclusions and key issues for further discussion. Taking into consideration the analyses provided in the IPs and the initial views exchanged with Member States' public sector accounting experts during the Working Group meetings, Eurostat drew tentative conclusions that may serve, together with the IPs themselves, as considerations for future standard setting.

One EPSAS IP is in some respects relevant to the assessment of the area of investments in associates and joint ventures. It was produced in October 2018 and covered the consolidation of financial statements with a view to financial reporting requirements under the future European Public Sector Accounting Standards (EPSAS).

Three main types of issues linked to the preparation of consolidated financial statements discussed in the EPSAS Issue paper on Consolidation of financial statements issued in November 2018 are:

- Determination of the level at which consolidated financial statements should be prepared.
- Determination of the consolidation scope.
- Cost and complexity linked to the preparation of consolidated financial statements.

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[1] EPSAS Issues papers are available on https://ec.europa.eu/eurostat/web/epsas/key-documents/technical-developments

[2] Collection of information related to the potential impact, including costs, of implementing accrual accounting in the public sector and technical analysis of the suitability of individual IPSAS standards (Ref. 2013/S 107-182395)

Screening of IPSAS 37 'Joint Arrangements' against criteria set in the draft EPSAS framework

Introduction

The EPSAS criteria listed in the draft EPSAS framework have been used to perform an assessment of IPSAS 37 'Joint arrangements', published in 2015 by the IPSASB.

In order to develop recommendations, one should first consider whether IPSAS 37 would meet the qualitative characteristics of the draft EPSAS CF, i.e. whether it would provide relevant, reliable, complete, prudent, neutral, verifiable, economically substantive, understandable, timely and comparable information and would not be contrary to the true and fair view principle.

This report considers classification, measurement as well as presentation and disclosure requirements applicable to joint arrangements for each of the qualitative characteristics of the draft EPSAS CF.

Further, this paper includes a high-level comparison between the requirements of IPSAS 37 and other international accounting and financial reporting frameworks applied by the public sector entities in various jurisdictions, such as IFRS, ESA 2010 and EU Accounting Rules, bearing in mind the objective of alignment, reduction of cost of implementation and compliance cost.

Finally, it is assessed whether IPSAS 37 would be conducive to the European public good.

The findings are presented below, and the conclusion is included in the next section of this report.

Conformity with Qualitative Characteristics

Relevance

Financial and non-financial information is relevant if it is capable of making a difference in achieving the objectives of GPFRs. Financial and non-financial information can make a difference when it has confirmatory value, predictive value, or both.

The objective of the IPSAS 37 is to establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly (i.e., joint arrangements) and to prescribe the accounting treatment so that users of financial statements can discern information about an entity's investments and changes in such investments.

The principal issues in accounting for joint arrangements are:

- The classification of joint arrangements;
- The accounting principles applicable to each types of joint arrangements.

The disclosure requirements for joint arrangements are within the scope of IPSAS 38 ‘Disclosure of interests in other entities’.

A joint arrangement is an arrangement of which two or more parties have joint control which has the following characteristics:

(a) The parties are bound by a binding arrangement;

(b) The binding arrangement gives two or more of those parties joint control of the arrangement. (IPSAS 37 para 10)

A joint arrangement is either a joint operation or a joint venture (IPSAS 37 para 11).

An entity that is a party to an arrangement shall assess whether the binding arrangement gives all the parties, or a group of the parties, control of the arrangement collectively. All the parties, or a group of the parties, control the arrangement collectively when they must act together to direct the activities that significantly affect the benefits from the arrangement (i.e., the relevant activities).

Classification and accounting for interests in joint arrangements

<u>Considerations related to joint operations</u>

A joint operator shall recognise in relation to its interest in a joint operation:

(a) Its assets, including its share of any assets held jointly;

(b) Its liabilities, including its share of any liabilities incurred jointly;

(c) Its revenue from the sale of its share of the output arising from the joint operation;

(d) Its share of the revenue from the sale of the output by the joint operation; and

(e) Its expenses, including its share of any expenses incurred jointly. (IPSAS 37 para 23)

IPSAS 37 requires parties to joint arrangements which have rights to the assets and obligations for the liabilities to the joint arrangement, to recognise those assets and liabilities in their financial statements.

According to IPSAS 37, the recognition of the share of assets, liabilities, revenue and expenses based on the contractual rights of the parties and which could in some cases be different from the share of assets, liabilities, revenue and expenses recognised based on the ownership interest in a joint arrangement. In our opinion, the information based on those contractual rights and obligations would have more predictive value and therefore it provides relevant information.

IPSAS 37 states that rights and obligations conferred on the parties can arise in various ways: from a legal perspective, from binding arrangements between the parties to the arrangements or from other facts and circumstances.

Under IPSAS 37, an entity would recognise assets and liabilities relating to its interests in the joint operation, if they meet the IPSASs recognition criteria for assets and liabilities. The accounting for interests in joint operations not structured through separate vehicle does not raise any concerns about relevance. In particular, when the legal form of a joint arrangement does not grant a separation between the parties and the separate vehicle, the parties have rights to the assets of the joint arrangement and are liable for its obligations. Therefore, the accounting required under IPSAS 37 reflects this lack of ‘separation’ in an appropriate manner and provides relevant information. Also, when a joint arrangement gives the parties direct rights to the assets and the parties agree to take over the liabilities of this joint arrangement, recognition of these assets and liabilities in the financial statements of the parties is appropriate and brings relevant information to users. However, the principle of considering other facts and circumstances might result in an entity recognising liabilities that do not arise from the legal rights and obligations.

When a joint arrangement has been structured through a separate vehicle, and the legal form grants a separation between the parties and this feature has not been reversed by a binding arrangement, it should not be concluded that the parties have rights to assets and obligations for liabilities based solely on the other facts and circumstances (e.g. whether the parties purchase the output of the arrangement or not). The reason is that the parties may not be severally liable for the obligations of the joint arrangement from a legal perspective and in case of liquidation of a separate entity their potential loss is limited to their share in the net assets.

Recognising assets and liabilities in the financial statements of the parties if they have direct rights to the assets and are liable for the obligationsresults in relevant information to users.

Considerations related to joint ventures

A joint venturer should recognise its interest in a joint venture as an investment and should account for that investment using the equity method in accordance with IPSAS 36 'Investments in associates and joint ventures', unless the entity is exempted from applying the equity method as specified.

In line with IPSAS 37, if parties to a joint arrangement have neither rights to assets nor obligations for the liabilities, they recognise their interest in the joint venture in accordance with the equity method, as this reflects the fact that the parties have only rights to the net assets of the joint arrangement. The parties are not liable for the obligations of the joint venture and should therefore not recognise these as liabilities. They also do not have direct rights to the specific assets of the joint arrangement.

With this requirement, IPSAS 37 eliminates optional proportionate consolidation, which means that the parties to joint arrangements structured through a separate legal vehicle will not be able to recognise a share of assets and liabilities, revenue and expenses of the joint arrangement in their financial statements unless they have rights to the assets and obligations for the liabilities.

The equity method provides limited information and insight for the purposes of performing debt analysis of the operations that are jointly controlled, so this accounting treatment provides less information about the performance of a joint venture and its debt. However, considering this limitation IPSAS 38 includes enhanced disclosure requirements on joint arrangements, particularly those accounted for using the equity method to provide additional information about the risks associated with those interests. Under IPSAS 38 much of the information about the assets, liabilities and performance of the joint venture should be presented separately for each joint venture considered material to the reporting entity. In relation to individually immaterial joint ventures, limited aggregate information is provided about an entity's share in the joint ventures' revenue, tax expense, pre-tax gain or loss recognised on the disposal of assets or settlement of liabilities attributable to discontinuing operations and surplus or deficit. Moreover, summarised financial information for each joint venture is disaggregated from the assets, liabilities, revenues and expenses of the parties as presented on the face of the financial statements which is considered useful for users.

Overall, the accounting in IPSAS 36 is complemented by the disclosure of interests in joint arrangements under IPSAS 38, the potential loss of information on the face of the financial statements will be, at least partially, compensated for by the information provided in the notes to the financial statements. Based on the overall assessment performed, the classification and accounting for interests in joint operation meets the relevance criterion.

Parties without joint control having an interest in a joint operation

Under IPSAS 37, parties to a joint operation that do not have joint control in the arrangement, are required to recognise their interest in the arrangement in the same

way as joint operators, provided that they have rights over the assets and obligations for the liabilities of the arrangement (recognition of assets, liabilities, revenue and expenses). Parties to a joint operation that do not have joint control and neither rights to assets nor obligations for the liabilities, account for their interests in the joint operation in accordance with the IPSAS rules applicable to their interests (i.e. the rules applicable to interests in associates under the scope of IPSAS 36 or the rules applicable to financial assets under IPSAS 41).

Some parties to a joint operation that do not have joint control of the arrangement should not prevent them from recognising assets to which they have rights or obligations for which they are liable as they might have an agreement that gives them access to their share of the assets and obligations for their share of liabilities. Also, such parties may receive their returns in the form of product produced by the arrangement. When parties without joint control have rights to assets and obligations for the liabilities of the joint operations, recognising those rights and obligations in their financial statements would provide relevant information.

Accounting for interests in joint operations in the separate financial statements

Under existing IPSASs, interests in jointly controlled entities are accounted for at cost or at fair value under IPSAS 41.

Under IPSAS 37, a joint operator will recognise its assets, liabilities, revenues and expenses relating to its interests in a joint operation. An investor (a joint operator or a party to joint operation which does not have joint control) only recognises assets and liabilities of a joint operation to the extent that it has rights to the assets and obligation for the liabilities, in which case the assets and liabilities must meet the recognition criteria from the investors' perspective. Interests in joint operations are accounted for in the separate financial statements in the same manner as they are accounted for in the consolidated financial statements.

It is appropriate to recognise those assets and liabilities in the separate financial statements of the entity. Based on the assessment, IPSAS 37 enables users to have access to the relevant information about the rights and obligations of the parties to the joint operation directly in their separate financial statements. This information is relevant if a joint operation is structured through a legal entity. Moreover, this information could be particularly valuable for users in relation to those entities that do not have subsidiaries and are therefore not otherwise required to produce this information. IPSAS 37, in relation to the information provided for the joint operations in separate financial statements, satisfies the relevance criterion because joint operators recognise in their separate financial statements those assets and liabilities that meet the IPSAS recognition criteria.

Faithful representation / Reliability

To be reliable, financial and non-financial information must provide a faithful representation of the substance of economic and other phenomena that it purports to

represent. The notion of faithful representation and reliability in the draft EPSAS CF is linked to the qualitative characteristics of completeness, prudence, neutrality, verifiability, substance over form and being free from material error. These characteristics are separately discussed below.

Classification and accounting for interests in joint arrangements

IPSAS 37 requires an entity to consider a number of factors when assessing classification of joint arrangements: their legal form, binding arrangements, and when relevant, other facts and circumstances.

This classification principle based on indicative factors such as legal form of the vehicle, binding arrangements, and where necessary the purpose and design of the arrangement, helps an entity to make a comprehensive assessment about why it is involved with the joint arrangement. This approach is, therefore, likely to help entities make the right assessment and thus provide reliable information.

Parties without joint control having an interest in a joint operation

IPSAS 38 requires the parties to the joint arrangement that do not have joint control to recognise their interests in the joint operation according to their contractual rights and obligations. In our view, this requirement does not affect reliability.

Accounting for interests in joint operations in the separate financial statements

IPSAS 37 does not provide new requirements in terms of measurement, it simply prescribes the same recognition and measurement requirements for joint operations in the consolidated accounts and the separate accounts of the joint operator. It therefore does also not affect reliability.

Overall, the approach in IPSAS 37 seeks to show of what constitutes the economic substance of an entity's interests in joint arrangements. Based on our assessment IPSAS 37 faithfully represents joint arrangement transactions and satisfies the reliability criterion.

Completeness

The information which fulfils the recognition criteria should be complete within the bounds of materiality and cost-benefit considerations.

IPSAS 37 requires an entity to determine the type of joint arrangement in which it is involved and in accounting for the rights and obligations of the joint arrangement. The standard should be applied by all entities that are a party to a joint arrangement, even parties that do not have joint control. No specific scope exemptions apply.

Joint venturers should not present their share of the assets, liabilities, items of income, expenses and cash flows of the entities that they jointly control. This could be considered as affecting to some extent the completeness of the information provided. However, the accounting focuses on the substance of the arrangements and, in the

case of a joint venture, the substance is that the joint venturer has rights to the net assets of the joint venture, not to its assets and liabilities. This accounting treatment is complemented by the obligation under IPSAS 38 to provide summarised financial information about joint ventures in the notes.

Based on the above analysis, IPSAS 37 does not raise any significant issues concerning completeness.

Prudence

Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or revenue are not overstated while liabilities or expenses are not understated.

Existence of joint control

After concluding that all the parties, or a group of the parties, control the arrangement collectively, an entity should assess whether it has joint control of the arrangement. An entity needs to apply judgment when assessing whether all the parties, or a group of the parties, have joint control of an arrangement. An entity should make this assessment by considering all facts and circumstances. If facts and circumstances change, an entity should reassess whether it still has joint control of the arrangement.

The assessment of joint control can involve a significant degree of judgment, particularly in cases in which several investors separately have the ability to direct different relevant activities and when more than one party has decision-making authority over different activities of another entity and that each activity may significantly affect the benefits. Identifying the relevant activities requires judgement, which might also affect the reliability of information.

In cases where the evaluation is judgemental, the disclosures about assumptions and judgement used to determine the controlling entity should be helpful to explain decisions reached in those more challenging scenarios and thereby either enhances relevance of information or limits the loss of relevance that might result from applying inappropriate judgement.

Classification for interests in joint arrangements

An entity should determine the type of joint arrangement in which it is involved, based upon the parties' rights and obligations arising from the arrangement in the normal course of operations. An entity assesses its rights and obligations by considering the structure and legal form of the arrangement, the terms agreed by the parties or established by legislative or executive authority and, when relevant, other facts and circumstances. If facts and circumstances change, an entity shall reassess whether the type of joint arrangement in which it is involved has changed.

An entity applies judgment when assessing whether a joint arrangement is a joint operation or a joint venture:

- when an entity has rights to the assets, and obligations for the liabilities, relating to the arrangement, the arrangement is a joint operation;
- when an entity has rights to the net assets of the arrangement, the arrangement is a joint venture.

A joint arrangement that is not structured through a separate vehicle is a joint operation. A joint arrangement in which the assets and liabilities relating to the arrangement are held in a separate vehicle can be either a joint venture or a joint operation.

Determining the type of joint arrangement structured through a separate vehicle requires a degree of judgement, as IPSAS 37 does not provide 'bright lines' for the classification of a joint arrangement. In particular, this is the case when the legal form of the separate vehicle ensures the separation between the parties and the joint arrangement, and the binding arrangements does not explicitly provide the parties with the rights and the obligations, the entities should consider other facts and circumstances to conclude on the classification. IPSAS 37 provides guidance on the facts and circumstances that should lead to classifying the separate entity as a joint operation. However, in some cases the guidance may require a considerable degree of judgement particularly in complex fact patterns.

o remediate this, the disclosures required by IPSAS 38 provide useful information to users that help them understand the assessments made by the entity, which should mitigate concerns about the exercise of significant judgement.

Accounting for interests in joint arrangements

IPSAS 37 requires the parties to a joint operation to recognise their assets and liabilities, revenues and expenses based on the binding arrangements, and to account for them in accordance with all applicable IPSASs. This should lead to the provision of reliable information as it only broadens the application of existing standards.

In some cases, the contract may not state clearly the percentage of assets to which a party to a joint operation has rights (the same for liabilities, revenue and expenses). This may happen when the classification to the joint operation is based solely on the fact that the parties purchase the output of the joint arrangements and the percentage purchased may either vary from the ownership percentage and, vary from year to year. In these cases, management would need to apply judgement to determine the appropriate share of assets, liabilities, revenue and expenses that should be recognised in the financial statements.

Based on the overall assessment, in relation to the classification and accounting for interests in joint operation, IPSAS 37 satisfies the QC 'Prudence' of the EPSAS CF.

Neutrality

Information is neutral if it is free from bias. GPFSs are not neutral if the information they contain has been selected or presented in a manner designed to influence the making of a decision or judgment in order to achieve a predetermined result or outcome.

The principles included in IPSAS 37 have been tested for many years in the private sector. Users perceived no negative impact of IFRS 11 on the neutrality of the IFRS financial statements. In some cases, the guidance and examples provided in IPSAS 37 might be interpreted in different ways which may lead to inconsistency and diverse application within the group entities. In particular, determining the classification for of an arrangement as joint operation rather a joint venture may lead to differences in the reported information.

This is inherent to a principles-based control model, the use of judgement is required. On the other hand, the disadvantage of applying principles instead of rules, is that there might be room for divergence in practice. As noted earlier in the discussion about relevance and reliability QCs, the level of judgment required by IPSAS 37 is not so exceptional in nature that it would be impracticable to apply the standard in a consistent manner and achieve neutral presentation of the reporting entity.

Verifiability

Verifiability is the quality of information that helps assure users that GPFSs is based on supporting evidence in a way that it faithfully represents the substance of economic and other phenomena that it purports to represent.

Binding arrangements can be evidenced in several ways, as it may often, but not always, be stated in writing, in the form of a contract or documented discussions between the parties. Statutory mechanisms such as legislative or executive authority can also create enforceable arrangements, similar to contractual arrangements, either on their own, or in conjunction with contracts between the parties.

When joint arrangements are structured through a separate vehicle, the binding arrangement, or some aspects of the binding arrangement, can in some cases be incorporated in the articles, charter or by-laws of the separate vehicle. The existence of joint arrangement and joint control by an entity is verifiable and result in limited extent of judgements, if it can be supported by specific binding arrangement provisions and/or it can be traced back to other reliable evidence or information.

The cohesiveness between various disclosure notes required by IPSAS 38 provides evidence of verifiable and reliable information.

The screening exercise has not revealed any significant potential issues that could have a negative impact on the QC of ‘Verifiability’.

Substance over form

Accounting policies are determined by classes of assets having similar economic characteristics. This allows the substance of transactions to be reflected in the accounting treatment for each class.

Existence of joint control

In certain cases, the decision-making process that is agreed upon by the parties in their binding arrangement implicitly leads to joint control. For example, the parties can implicitly agree that they have joint control of the arrangement because decisions about the relevant activities cannot be made without both parties agreeing.

In other circumstances, the binding arrangement requires a minimum proportion of the voting rights to make decisions about the relevant activities. When that minimum required proportion of the voting rights can be achieved by more than one combination of the parties agreeing together, that arrangement is not a joint arrangement unless the binding arrangement specifies which parties (or combination of parties) are required to agree unanimously to decisions about the relevant activities of the arrangement.

The requirement for unanimous consent means that any party with joint control of the arrangement can prevent any of the other parties, or a group of the parties, from making unilateral decisions (about the relevant activities) without its consent. If the requirement for unanimous consent relates only to decisions that give a party protective rights and not to decisions about the relevant activities of an arrangement, that party is not a party with joint control of the arrangement.

The main principles of IPSAS 37 reflect the economic substance of transactions, therefore enhance QC ‘Substance over form’.

Classification for interests in joint arrangements

<u>Separation of specific activities that form part of the agreement</u>

Sometimes the parties are bound by a framework agreement that sets up the general terms for undertaking one or more activities. The framework agreement might set out that the parties establish different joint arrangements to deal with specific activities that form part of the agreement. Even though those joint arrangements are related to the same framework agreement, their type might be different if the parties’ rights and obligations differ when undertaking the different activities dealt with in the framework agreement. Consequently, joint operations and joint ventures can coexist when the parties undertake different activities that form part of the same framework agreement, and as a result the identification and classification of the underlying joint arrangements shall reflect the economic reality of the agreement to enhance QC ‘Substance over form’.

Consideration of other facts and circumstances

A joint arrangement might be structured in a separate vehicle whose legal form confers separation between the parties and the separate vehicle. The binding terms agreed among the parties might not specify the parties' rights to the assets and obligations for the liabilities, yet consideration of other facts and circumstances can lead to such an arrangement being classified as a joint operation. This is the case when other facts and circumstances give the parties rights to the assets, and obligations for the liabilities, relating to the arrangement.

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 service potential or 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. In such cases the effect of an arrangement with such a design and purpose is that the economic benefits generated by those assets flow entirely (or substantially) to the parties that jointly control the arrangement and therefore the parties are required to recognise those assets in their financial statements. A similar argument could be used for the liabilities of a joint arrangement, if the liabilities it incurs, are in substance, satisfied by the parties either through a binding arrangements or 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, which they should recognise.

Considering the above, the substance of the joint arrangement overrides its legal form and parties have in essence set up a joint arrangement with the intention to have access to the assets and not in order to receive a profit from the investment. The 'Substance over form' QC is therefore achieved, as the underlying transactions, other events, activities or circumstances are accounted for and presented in accordance with their economic reality, and not merely their legal form which is the case in as a result of this requirement.

Understandability

The 'Understandability' QC is achieved when information is presented in a manner that facilitates expert and non-expert users to comprehend its meaning.

The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence. Although there are a number of aspects to the notion of 'understandability', most of the aspects are covered by the discussion above about relevance, reliability and comparability.

Classification and accounting for interests in joint arrangements

IPSAS 37 requires joint operators to recognise and account for their assets, liabilities, revenue and expenses in accordance with all applicable IPSASs. Furthermore, the joint venturers should apply the equity method to their interests in joint ventures. In our view, the requirements in IPSAS 37 do not make the reported information complex. Moreover, the requirement of IPSAS 38 to disclose significant judgements and assumptions made in determining the type of joint arrangement ensure that the information produced under IPSAS 37 is understandable to users, as it enables them to better understand the financial information provided in case of more complex arrangements, particularly when the classification assessment is based on other facts and circumstances and the structure of the joint arrangement is complex.

Parties without joint control having an interest in a joint operation

By requiring the parties to the joint operation without joint control but with rights to assets and obligations for liabilities to recognise those assets and liabilities instead of a single line investment IPSAS 37, the understandability of the financial statements is enhanced.

Accounting for interests in joint operations in the separate financial statements

The requirements of IPSAS 37 do not introduce any new complexities in the separate financial statements that may impair understandability and we believe that IPSAS 37 would improve understandability in most cases as comparability is enhanced between consolidated and separate financial statements.

Based on our assessment, the principles of IPSAS 37 are straightforward, do not raise any significant concerns and introduce any complexities that may impair understandability. The accounting treatment of joint arrangements under IPSAS 37 provides understandable information to the users of the financial statements, especially under the equity method.

Comparability

Comparability is the quality of information that enables users to identify similarities in, and differences between, two sets of phenomena in different reporting entities or in one reporting entity at different points in time. A key objective of EPSAS is to achieve the necessary level of financial transparency and comparability of financial reporting, between and within EU Member States.

Classification for interests in joint arrangements

IPSAS 37 requires the parties to classify their interests in joint arrangements as joint operations or joint ventures based on the assessment of their rights and obligations in relation to the joint arrangements. Some might consider that IPSAS 37 lacks clear guidance on the application of the criteria to determine whether a joint arrangement is a joint operation or a joint venture that could result in different interpretations and create a

lack of comparability of information, which might generate diversity by not ensuring that the classification decision is made consistently. In performing the classification, the parties should consider the legal form of an arrangement, contractual terms and other facts and circumstances. Therefore, in our view, IPSAS 37 would lead to the provision of comparable information, by ensuring that like arrangements are being accounted for similarly, while dissimilar transactions would not be accounted for as if they were similar.

Other than that, IPSAS 37 does provide limited guidance to address situations in which a joint arrangement that is structured through separate vehicle undertakes more than one activity. In such cases, the rights and obligations of the parties might differ with regards to the different activities undertaken by the joint arrangement. We believe that the guidance in IPSAS 37 is sufficient to enable consistent application in situations when two separate activities coexist in one separate vehicle.

The classification of joint arrangements structured through a separate vehicle requires judgement which in some cases may lead to a different classification of similar joint arrangements and affect comparability. To mitigate this risk, IPSAS 37 requires the entities to disclose the significant judgements and assumptions applied when determining the type of joint arrangements, which should be helpful to address at least some of the concerns expressed above about comparability.

Accounting for interests in joint arrangements

IPSAS 37 requires all interests in joint ventures to be accounted for using the equity method and does not allow a choice of accounting policy for those interests. Furthermore, IPSAS 37 develops a single accounting method for all interests in joint operations. The elimination of accounting options together with the requirement applicable for all joint arrangements, that the interests in the joint arrangements should be recognised based on the parties' rights and obligations enhances comparability of information.

IPSAS 37 does not provide specific guidance about how a party to a joint operation should recognise its share of assets and liabilities when the parties to a joint arrangement have ownership interests that are different to the percentage of output acquired (or the right to reserve capacity) - on the basis of ownership interest or on the basis of percentage of output acquired. IPSAS 37 assumes that the binding arrangements will include terms that make reference to the share of assets, liabilities, revenue and expenses to which each joint operator is entitled to and requires the joint operators to refer to the contracts. A lack of specific guidance in IPSAS 37 could lead to diversity in practice and reduce comparability. However, in most cases, parties to a joint arrangement are likely to agree on their rights and obligations in the contractual terms of their joint arrangement and entities are then able to consistently reflect these in the accounting.

Parties without joint control having an interest in a joint operation

Based on our assessment, IPSAS 37 would lead to provision of comparable information in similar situations, by requiring the parties to a joint arrangement that do not have joint control to always recognise - regardless of the legal form - the assets to which they have rights and the liabilities for which they have an obligation.

Accounting for interests in joint operations in the separate financial statements

IPSAS 37 ensures that, in the separate financial statements of the joint operator, joint operations structured through an entity are accounted for in the same way as those that are not structured through an entity. Furthermore, IPSAS 37 requires other parties to a joint operation which do not have joint control but have rights to assets and obligations for the liabilities of the joint operation to recognise those assets and liabilities also in their separate financial statements. IPSAS 37 should therefore result in economically similar transactions being accounted for in a similar way in the separate financial statements of the joint operators.

The recognition criteria for joint operations structured through a separate vehicle might look inconsistent with the requirements that apply to the treatment of subsidiaries in the separate financial statements and might lead to additional costs to entities in jurisdictions in which separate financials statements are required to be reported in accordance with IPSASs. Based on our view, the fact that an entity has rights to the assets of a subsidiary and is liable for its obligations should be taken into account in preparing the consolidated as well as the separate financial statements. Accordingly, such rights and obligations should be accounted for in accordance with the IPSASs applicable to the particular assets, liabilities, revenues and expenses that they give rise to.

Overall, the application of the requirements of IPSAS 37 combined with appropriate disclosures provided in the notes about the accounting estimates and judgment used are likely to result in comparable application of the standard across the EU and by entities over time. The guidance in IPSAS 37 should help with consistent interpretation and application of the accounting requirements.

Alignment with other frameworks

ESA 2010

Consolidation is a method of presenting the accounts for a set of units as if they constituted one single entity (unit, sector, or subsector). It involves eliminating transactions and reciprocal stock positions and associated other economic flows among the units being consolidated (ESA 2010 20.152).

Consolidation does not affect balancing items because the consolidated items appear symmetrically within each account. For example, a grant from a central government to a

local government unit is consolidated by eliminating the expenditure from central government and the revenue from the local government, thus leaving unchanged the net lending/net borrowing of general government (ESA 2010 20.154).

The case of joint ventures where government units are involved is covered in ESA 2010, chapter 20 Government accounts. ESA 2010 paragraph 20.49 mentions that 'many public units enter into arrangements with private entities or other public units to undertake a variety of activities jointly, on market or non-market basis'. Three types of arrangements are foreseen: jointly controlled units ('joint ventures'), jointly controlled operations and jointly controlled assets.

The determination of joint ventures and a notion of joint control can be found in ESA 2010 rules. In the case of joint ventures, a unit is set up (as corporation, partnership or any other legal form) which is clearly an institutional unit, i.e. meeting the criteria as defined in ESA 2010 paragraph 2.12, i.e. entering into contracts in its own name and possibly raising finance for its own purpose. A joint venture maintains its own accounting records. Normally, the percentage of ownership should be sufficient to determine control. If each owner owns an equal percentage of the joint venture, the other indicators of control must be considered.

If the joint venture is owned by an exact equal percentage of ownership by a government unit and a private unit, it is recommended to consider other indicators of control than ownership, as mentioned in ESA 2010 paragraph 20.307. It may happen that government holds some rights higher than for the private partner(s), such as veto power or priority rewards, or bear more risks. In these cases, the rule mentioned in paragraph 5 should apply.

In case the joint venture is owned by a government unit and a private unit in equal percentages, and that there is no evidence of some superiority of control by either party, ESA 2010 paragraph 20.320 states that if the joint-controlled unit does not satisfy the criteria to be classified as a market producer, it must be fully allocated to the general government sector. If it is recognised as a market producer, the unit would be included in the non-financial corporations sector S.11 but should be split, one half being considered public-controlled public corporation and the other half allocated to the private sector.

If the joint venture is not owned by exactly equal percentages of ownership, by each of the public or private parties, the unit must be allocated to the party that holds the majority. If it is the government unit, the unit will be classified within the government sector if the joint venture has a predominant non-market activity and as a public corporation if the unit is recognised as a market producer. It is, however, recommended to check whether some other provisions related to rights and decision power are not de facto giving a different view as far as the effective control of the joint unit is concerned.

When a joint venture involves only units classified in the public sector (for instance a joint venture between a public corporation and a government unit), the sector allocation of the unit will depend on its market/non-market nature. Non-market units are recorded

in the government sector and market units within the public corporations subsector (S.11).

For the other arrangements which are not run by a separate institutional unit, but involve only some assets, it must be determined which unit owns the asset on the basis of which unit is exposed to the majority of risks and rewards allocated to the assets. Both expenses and revenues, recorded on gross basis, are nevertheless re-allocated according to the arrangement (ESA 2010 paragraph 20.49).

In case a separate unit is jointly set up to carry out an activity, the single criterion of the percentage of ownership may not be sufficient to decide on the sector classification of the unit. Other features of control need to be analysed. In many cases, government has de facto more influence than the private partner(s) and taking more advantage of it. The exact purposes of the creation of the unit, notably the importance of public interest reasons, should be closely considered. For other types of arrangements involving assets but without any separate unit jointly, any asset in national accounts is allocated to only one controlling unit and thus to its institutional sector.

IFRS[3]

IPSAS 37 'Joint arrangements', is drawn primarily from IFRS 11 'Joint arrangements' (issued in 2011). The main differences between IPSAS 37 and IFRS 11 are as follows:

- IPSAS 37 uses different terminology, in certain instances, from IFRS 11.
- IPSAS 35 defines the term 'binding arrangement. This term is broader than the term 'contractual arrangement', which is used in IFRS 11.
- IPSAS 37 contains additional illustrative examples that reflect the public sector context.

EU accounting rules

The objective of EU Accounting Rule 2 'Consolidation and accounting for joint arrangements and associates' is to define the economic entity in the European Union (EU) context, controlled entities, jointly controlled entities and associates, to identify the circumstances in which they should be consolidated and how they should be included in the consolidated accounts. This accounting rule also requires certain information to be disclosed about interests in controlled entities, joint arrangements, associates and structured entities in the notes to the financial statements.

[3] Refer to the IPSAS-IFRS Alignment Dashboard regularly updated by the IPSASB available on https://www.ifac.org/system/files/uploads/IPSASB/Agenda%20Item%201.5%20IPSAS%20IFRS%20Alignment%20Dashboard_June%202019.pdf

This accounting rule is based on the following IPSAS standards:

- IPSAS 35 'Consolidated financial statements'
- IPSAS 36 'Investments in associates and joint ventures'
- IPSAS 37 'Joint arrangements', and
- IPSAS 38 'Disclosure of interests in other entities',
- as well as articles 141, 147, 148, 152 and 208 of the Financial Regulation (Regulation (EU, Euratom) 2018/1046 of 18 July 2018).

The principles applied are included in EU AR 2 are similar to IPSAS.

This accounting rule applies to accounting for controlled entities, jointly controlled entities, associates and joint ventures in the financial statements of the EU and those EU entities which prepare and publish separately their financial statements and have interests in other entities. It establishes requirements for the preparation and presentation of consolidated financial statements by EU entities having interests in other entities.

In case of exclusive control, in order to determine the scope of consolidation in the EU consolidated financial statements, this accounting rule applies the ‘control concept’. The definition and indicators of control are provided further in the section 4.2 of this accounting rule. It is noted that Art. 241 FR foresees that (i) Union institutions (as listed in Art. 2 FR) and (ii) Union bodies set up under the TFEU and the Euratom Treaty having legal personality and receiving contributions charged to the budget (see Article 70 FR) are included in the scope of consolidation by virtue of their legal status alone (although it is understood that the consolidation of these entities is also in compliance with the control concept).

In case it is assessed that the EU entity does not have an exclusive control over another entity, it should further consider whether it has joint control of and significant influence over an entity following guidance provided in sections 4.3 and 4.4 of EU AR 2.

Two types of joint arrangements are identified on the basis of the rights and obligation of the parties to the joint arrangement, a joint operation and joint venture.

In relation to its interests in joint operations, the EU entity should recognise in their financial statements:

a) Its assets, including its share of any assets held jointly;

b) Its liabilities, including its share of any liabilities incurred jointly;

c) Its revenue from the sale of its share of the output arising from the joint operation;

d) Its share of the revenue from the sale of output by the joint operation; and

e) Its expenses, including its share of any expenses incurred jointly.

The EU entity should account for the assets, liabilities, revenues and expenses relating to its interests in a joint operation in accordance with the EU accounting rules applicable the particular assets, liabilities, revenues and expenses.

In its consolidated financial statements, the EU entity should report its interest in a associate or joint venture using the equity method. If the EU entity participates in a joint venture but has no control of the joint venture nor significant influence, it should account for its interests in the joint venture in accordance with the EU AR 11 'Financial instruments'.

An EU entity should consider the level of detail necessary to satisfy the disclosure objective. It should aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or aggregation of items that have different characteristics.

European Public Good

Assessing whether IPSAS 37 is conducive to the European public good

The assessment of whether IPSAS 37 would be conducive to the European public good addresses the following items:

a) Whether the standard will improve financial reporting;
b) The costs and benefits associated with the standard; and
c) Whether the standard could have an adverse effect to the European economy, including financial stability and economic growth.

These assessments will allow the EU authorities to draw a conclusion as to whether the standard is likely to be conducive to the European public good.

The analysis revealed no reasons why IPSAS 37 would not be conducive to the European public good:

- Recognition and measurement in accordance with IPSAS 37 and respectively, the presentation and disclosure requirements of IPSAS 38 will provide useful information to the users of the GPFSs and will improve the overall quality of financial reporting in the public sector. The requirements on the accounting of equity interest will enhance the quality of the financial information reflected in the financial reporting information of investors.

- Implementation of the standard should result in a moderate one-off cost and should be relatively cost-neutral on an ongoing basis for preparers. These practical challenges do not overweight the conceptual merits of the standard.

- Considering its conceptual merits, the standard will bring improved financial reporting when compared to heterogeneous reporting requirements currently applied in the EU. As such, its endorsement is conducive to the European public

good in that improved financial reporting improves transparency and assists in the assessment of management stewardship. The analysis has not identified any adverse effect of the standard to the European economy, including financial stability and economic growth, or any other factors that would mean the standard is not conducive to the European public good.

Conclusion

Assessing IPSAS 37 against the criteria formulated in the draft EPSAS framework

The analysis has not revealed major conceptual issues with IPSAS 37 'Joint arrangements' and has not identified any inconsistency between IPSAS 37 and the draft EPSAS framework.

Following the screening analysis summarised in the present report, the future standard setter could consider the following conclusions. The information resulting from the application of IPSAS 37:

- would provide relevant, reliable, complete, prudent, neutral, verifiable, economically substantive, understandable, timely and comparable information needed for making economic decisions and achieving the necessary level of financial transparency and comparability of financial reporting in the European Union;
- would not be contrary to the true and fair view principle; and
- would be conducive to European public good.

However, in order to achieve consistent application of the new standard within the EU context and therefore better address the comparability objective of EPSAS financial statements, additional guidance and improvements in certain areas might be desirable.

- *Judgment and comparability*. The use of judgment and estimates is inherent in the preparation of financial statements and may to some extent affect the comparability of financial statements. In the case of this standard, this can mainly relate to the analysis of other facts and circumstances in order to determine classification of the joint arrangement or the share of a joint operator in the assets, liabilities, revenue and expenses arising from its interests in the joint operation.

The analysis has not identified any adverse effect of the standard to the European economy, including financial stability and economic growth, or any other factors that would mean the standard is not conducive to the European public good.

The future standard setter could consider the conclusions of this assessment and likely net benefit of using the requirements of IPSAS 37 as a starting point in implementing the equivalent EPSAS, considering the need for additional guidance in certain areas and resolution of the matters identified in the present EPSAS screening report.