

DRAFT INTERPRETATION

HKAS-INT – 13 **Jointly Controlled Entities** **- Non-Monetary Contributions by Venturers**

Paragraph 14 of HKAS 1, Presentation of Financial Statements, requires that financial statements should not be described as complying with Hong Kong Accounting Standards unless they comply with all the requirements of each applicable Standard and each applicable Interpretation. Interpretations are not intended to apply to immaterial items.

Reference: HKAS 31 *Interests in Joint Ventures*

ISSUE

1. HKAS 31.48 refers to both contributions and sales between a venturer and a joint venture as follows: “When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction should reflect the substance of the transaction”. In addition, HKAS 31.24 says that “a jointly controlled entity is a joint venture which involves the establishment of a corporation, partnership or other entity in which each venturer has an interest”. There is no explicit guidance on the recognition of gains and losses resulting from contributions of non-monetary assets to jointly controlled entities (“JCEs”).
2. Contributions to a JCE are transfers of assets by venturers in exchange for an equity interest in the JCE. Such contributions may take various forms. Contributions may be made simultaneously by the venturers either upon establishing the JCE or subsequently. The consideration received by the venturer(s) in exchange for assets contributed to the JCE may also include cash or other consideration that does not depend on future cash flows of the JCE (“additional consideration”).
3. The issues are: (a) when the appropriate portion of gains or losses resulting from a contribution of a non-monetary asset to a JCE in exchange for an equity interest in the JCE should be recognised by the venturer in the income statement; (b) how additional consideration should be accounted for by the venturer; and (c) how any unrealised gain or loss should be presented in the consolidated financial statements of the venturer.
4. This Interpretation deals with the venturer’s accounting for non-monetary contributions to a JCE in exchange for an equity interest in the JCE that is accounted for using either the equity method or proportionate consolidation.

CONSENSUS

5. In applying HKAS 31.48 to non-monetary contributions to a JCE in exchange for an equity interest in the JCE, a venturer shall recognise in profit and loss for the period the portion of a gain or loss attributable to the equity interests of the other venturers except when:
 - (a) the significant risks and rewards of ownership of the contributed

non-monetary asset(s) have not been transferred to the JCE;

- (b) the gain or loss on the non-monetary contribution cannot be measured reliably; or
- (c) the contribution transaction lacks commercial substance, as that term is described in HKAS 16 *Property, Plant and Equipment*.

If exception (a), (b) or (c) applies, the gain or loss is regarded as unrealised and therefore is not recognised in profit and loss unless paragraph 6 also applies.

- 6. If, in addition to receiving an equity interest in the JCE, a venturer receives monetary or non-monetary assets, an appropriate portion of gain or loss on the transaction shall be recognised by the venturer in profit or loss.
- 7. Unrealised gains or losses on non-monetary assets contributed to JCEs should be eliminated against the underlying assets under the proportionate consolidation method or against the investment under the equity method. Such unrealised gains or losses should not be presented as deferred gains or losses in the venturer's consolidated balance sheet.

BASIS FOR CONCLUSIONS

- 8. HKAS 31.48 requires that, while the assets are retained in the joint venture, the venturer should recognise only that portion of the gain or loss which is attributable to the interests of the other venturers. Additional losses are recognised if required by HKAS 31.48.
- 9. HKAS 31.48 refers to the transfer of the "significant risks and rewards of ownership" as a condition for recognition of gains or losses resulting from transactions between venturers and joint ventures. HKAS 18.16(a) to (d) contain examples of situations where the risks and rewards of ownership are typically not transferred. This guidance also applies by analogy to the recognition of gains or losses resulting from contributions of nonmonetary assets to JCEs. Since the venturer participates in joint control of the JCE, it retains some "continuing managerial involvement" in the asset transferred. However, this does not generally preclude the recognition of gains or losses since joint control does not constitute control to the degree usually associated with ownership (HKAS 18.14(b)).
- 10. Paragraph 92 of the Framework states: "income is recognised in the income statement when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably". HKAS 18.14(c) requires, among other conditions, that revenue from the sale of goods should be recognised when "the amount of revenue can be measured reliably". The requirement for reliable measurement also applies to the recognition of gains or losses resulting from a contribution of nonmonetary assets to a JCE.
- 11. HKAS 18.12 explains that "when goods and services are exchanged or swapped for goods or services which are of similar nature and value, the exchange is not regarded as a transaction which generates revenue". HKAS 16.22 says that "an item of property, plant and equipment may be acquired in exchange for a similar asset that has a similar use in the same line of business and which has a similar fair value. An

item of property, plant and equipment may also be sold in exchange for an equity interest in a similar asset. In both cases, since the earnings process is incomplete, no gain or loss is recognised on the transaction”. * The same rationale applies to a contribution of nonmonetary assets since a contribution to a JCE is, in substance, an exchange of assets with the other venturers at the level of the JCE.

12. To the extent that the venturer also receives cash or non-monetary assets dissimilar to the assets contributed in addition to equity interests in the JCE, the realisation of which is not dependent on the future cash flows of the JCE, the earnings process is complete. Accordingly, the appropriate portion of the gain on the non-monetary contribution is recognised in net profit or loss for the period.
13. It is not appropriate to present unrealised gains or losses on non-monetary assets contributed to JCEs as deferred items since such items do not meet the recognition criteria for assets or liabilities as defined in the Framework (paragraphs 53 to 64 and paragraphs 89 to 91).

Date of Issue: [] 2004

Effective Date: This Interpretation becomes effective for annual financial periods beginning on or after 1 January 2005; earlier application is encouraged. Changes in accounting policies should be accounted for according to the transition requirements of HKAS 8.

14. The accounting for the non-monetary contribution transactions specified in paragraph 5 shall be applied prospectively to future transactions.
15. If an entity applies HKAS 16, *Property, Plant and Equipment* for an earlier period, it shall also apply this Interpretation for that earlier period.

* HKAS 16 *Property, Plant and Equipment* requires an entity to measure an item of property, plant and equipment acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, at fair value unless the exchange transaction lacks commercial substance. Previously, an entity measured such an acquired asset at fair value unless the exchanged assets were similar.