

Query No. 10

Subject: Accounting for transition in the project upon transfer of rights and obligations of the erstwhile consortium to a new company by way of Government Decree.¹

A. Facts of the Case

1. A public limited company (hereinafter referred to as ‘the Company’), which is a wholly owned subsidiary of a listed government company is in the business of exploration and production of oil and gas and other hydrocarbon related activities outside India. The Company operates overseas projects directly and/or through subsidiaries, by participation in various joint arrangements and investment in joint ventures/associates.

2. The Company joined the unincorporated joint-venture Project S located in a foreign country (‘host country’) in July 2001 by acquiring 20% participating interest (‘PI’) therein. The other partners of the consortium were X (‘the Operator’) with 30% PI, Y with 30% PI, and subsidiaries of Z with 20% i.e. (Z1 with 11.5% and Z2 with 8.5%). Project S was managed and operated by the Operator on behalf of the consortium members as per the underlying Production Sharing Agreement (‘PSA’ or ‘Agreement’) executed between the consortium members and the Government of the host country (‘host government’); and the relationship among the consortium members was governed by Joint Operating Agreement and Crude-offtake Agreement executed amongst the consortium partners. The license for the project is valid upto December 2051. The project is in the development and production phase.

3. Upto the half year ended September 30, 2022, the Company had been accounting for the assets, liabilities, revenues and expenses relating to its PI in Project S by way of proportionate consolidation considering the same as a joint operation in accordance with Ind AS 111, ‘Joint Arrangements’. Accordingly, the assets and liabilities in the financial statements of the Company as at 30th September 2022 also included assets and liabilities pertaining to the Company’s PI in Project S.

4. Actions of the host country in February 2022 caused geopolitical concerns resulting in several international economic sanctions having been imposed on the host country by various nations and international organisations.

5. As a counter measure, on 7th October 2022, the Executive Head of the host country’s Government promulgated a decree (‘Decree’), titled “On the application of additional special economic measures in the fuel and energy sector in connection with the unfriendly actions of certain foreign states and international organisations”. Subsequently, the host Government also notified a Resolution dated 12th October 2022. In terms of the said Decree and the Government Resolution, a new company was formed by the host government namely, S-1 LLC was incorporated by the Government on October 14, 2022 to which all the rights and obligations of the consortium, as provided by the PSA, including the rights and obligations of the operator, were transferred to the new company. (A copy each of the Decree, Government Resolution and Charter of the new company has been supplied by the querist for the perusal of the Committee.)

¹ Opinion finalised by the Committee on 15.5.2024.

6. Further, Decree of the Executive Head also provided that foreign participants of the Agreement (the Company, the Operator X and Y) shall, within one month from the date of incorporation of S-1 LLC, submit to the host government, notifications of their consent to take ownership of shares in the authorised capital of the new company in proportion to their respective PI in the Project-S under the Agreement.

7. Pursuant to the aforesaid Executive Head Decree and Government Resolution, the manager of the new Company served a notice on the foreign participants of the consortium, including the Company on 14th October 2022 notifying the establishment of the new company, namely S-1 LLC with effect from 14th October 2022 and requiring the submission of consent by such foreign participants of the consortium to acquire the share in the charter capital of the new company in proportion to PI under PSA within one month from the establishment thereof.

8. The Company's Board, at its meeting dated 18th October 2022, approved to undertake all actions, including conveying the Company's consent, to retain its existing 20% Participating Interest in Project S and accordingly, the Company submitted its notice of consent to the host government on 8th November 2022. Subsequently, the host government issued communication dated 9th November 2022, which provided conditional approval of the government for retaining 20% PI in the S-1 LLC by the Company subject to the complete transfer of accumulated abandonment funds to the designated bank account of S-1 LLC maintained in the capital of host country.

9. Transfer of abandonment fund amount to S-1 LLC could not be completed by the end of financial year (F.Y.) 2022-23 due to various procedural constraints on account of the sanctions on the host country and the same is still in process. The Company has received its share of the accumulated abandonment fund from the Foreign Party Administrator on 5th & 6th April 2023. The Company is in the process of completing transfer of its share of abandonment fund to S-1 LLC to fulfil the condition precedent. Due to restrictions on the banks of the host country, the Company is in discussion with S-1 LLC for alternative ways to transfer the abandonment fund amount to fulfill the condition precedent.

10. The querist has stated that as the transition in the Project S is unique and unprecedented event and considering no direct coverage of such event under provisions of Ind AS, the Company has carried out accounting for the transition based on the following understanding emanating from the underlying documents and generally accepted accounting principles:

- (i) The economic rights of the Company in the project stand preserved even after the transition. Fulfilment of the condition precedent is only a procedural aspect pending due to the sanction constraints for which the Company has been engaged with S-1 LLC.
- (ii) Transition has in effect changed only the form of holding the rights in the project from direct participation to that of holding through a separate legal entity.

Based on the above understanding, the Company inferred that since the rights and obligations of consortium partners under the PSA have been transferred to new company S-1 LLC, the project may no longer be considered as a joint operation and as such, the Company may not

be able to account for its proportionate share of assets and liabilities relating to the S-1 project.

11. Accordingly, the Company transferred the carrying value of its assets and liabilities pertaining to its PI in the project as on transition date, viz., 14th October 2023 on net basis (i.e., carrying values of the assets net of carrying value of liabilities pertaining to the project previously accounted for by the Company on proportionate basis) to deemed investment under the head Investments in JV/Associates with nomenclature 'Investment Pending Proportionate Ownership Interest in Equity of S-1 LLC'. The 'Investment Pending Proportionate Ownership Interest in Equity of S-1 LLC' as on the date of transition was assessed for impairment provision, if any, and no impairment provision was made in view of the recoverable value of the investment being higher than the carrying amount.

12. Afterwards, during the half year ended September 30, 2023, as stated in paragraph 9 above, the Company has received its share of the accumulated abandonment fund from the Foreign Party Administrator on 5th & 6th April 2023. However, the Company is still in the process of completing transfer of the fund to S-1 LLC and as such, allotment of shares to the Company in the charter capital of S-1 LLC is still in process as on date.

13. Further, post incorporation, interim financial statements of S-1 LLC for the period 14th October 2022 to 31st December 2022 have been received. However, the Company has not received the financial statements for the period from 1st January 2023 to 30th September 2023 and thereafter, considering the pending allotment of shares. Based on the limited information regarding field operations, production summary, wells summary, drilling, and crude transportation operations received from S-1 LLC till 30th September 2023, the Company has estimated the profitability of S-1 LLC for the period from 14th October 2022 to 30th June 2023. The estimate indicates operating profit for the period, however, as a matter of prudence, the estimated share of profit is not accounted for by the Company as shares of S-1 LLC are not yet allotted to the Company.

Issue in question:

14. The querist has further stated that during the course of statutory audit, the auditors were of the view that considering the significance and materiality of the event and non-availability of the direct guidance in Ind AS dealing with the transition, it will be appropriate to refer the issue to Expert Advisory Committee of ICAI for its guidance on accounting undertaken by the Company.

Company's perspective:

15. The Company has analysed the issue of transition from the following aspects:
- (i) Nature of the Company's investment after the transition
 - (ii) Accounting for transfer of assets and liabilities pertaining to the Company's PI in the project and corresponding recognition of Deemed Investment
 - (iii) Equity accounting for estimated share of profit pending the allotment of shares
 - (iv) Accounting for deemed investment on allotment of shares in S-1 LLC
 - (v) Disclosure requirement on allotment of shares in S-1 LLC

16. As regards the first issue of nature of the Company's investment after the transition, the Company understands that new arrangement is in the nature of an incorporated joint venture giving the Company, rights over the net assets of the Company as per Ind AS 111 (Joint Arrangements). In the earlier arrangement, the Company as a member of consortium, was having the joint ownership of assets and hydrocarbons produced as well as obligations towards the consortium liabilities. As such, the arrangement was in the nature of a joint operation as per paragraph 15 of Ind AS 111, as the consortium partners were having joint control of the project alongwith rights to the assets and obligations for the liabilities, relating to the project.

17. However, post the transition, the rights and obligations of the consortium are transferred to the new company S-1 LLC. Since the new arrangement is structured through a separate vehicle instead of direct participation, legal form of the separate vehicle, terms of the contractual arrangement and other relevant facts and circumstances were analysed in order to determine the nature of joint arrangement as per paragraphs B25 to B27 of Ind AS 111.

18. In this regard, according to the querist, following provisions of Decree and Resolution dated 12th October 2022 issued by foreign government as well as the charter of new company S-1 LLC may be underscored:

- **Clause 10 of the Resolution:** Rights and obligations of the consortium under the PSA are transferred to the new company, S-1 LLC
- **Clause 12 of the Resolution:** Licenses for subsoil use issued to the consortium will be reissued to S-1 LLC.
- **Clauses 10 and 11 of the Resolution:** Providing the transfer of ownership rights of all the property and funds of the consortium to the S-1 LLC.

In view of the above provisions, it can be inferred that S-1 LLC steps into the shoes of consortium under the PSA. Further, under the new regime, relationships between the participants will be governed by the charter of the new company S-1 LLC read with the provisions of the Government Resolution. In this context, the following provisions of charter of the company may be highlighted:

- Article 2.6: New company, S-1 LLC is the owner of the property (contributed by participants for shares as well as received as a result of commercial activities).
- Article 2.7: S-1 LLC shall be liable for its obligations with all its property.
- Article 7.1: The property of S-1 LLC (including property of consortium transferred by Decree) belongs to it by the right to ownership and the company has free right to use subject to PSA.
- Article 7.6: The part of the profit of S-1 LLC intended for distribution among its participants is distributed in proportion to their shares in the authorised capital.
- Articles 7.5 and 7.7: Give right to the company for determining the frequency and quantum of distribution of its profits to the participants.

19. Thus, as per the above provisions, neither the legal form of the new arrangement nor the contractual arrangement specifies that the parties have rights to the assets and obligations for the liabilities relating to the project. The same is now vested in the new company S-1 LLC. The Company, as a shareholder in S-1 LLC, will have rights to dividends. Thus,

specific mentioning of ownership of assets and obligations to liabilities in the new company, S-1 LLC itself but not in the participants and participants' rights being limited to distribution of profits by S-1 LLC indicate that the Company is having a joint control with rights over the net assets of S-1 LLC; and therefore, it was understood that the new arrangement is in the nature of a joint venture within the meaning of Ind AS 111 or an associate under Ind AS 28, 'Investments in Associates and Joint Ventures'.

20. As stated above, the event of transition is that of an investment in a joint operation turning into a 20% ownership in a limited company which could convert into a 'joint venture' or at least an 'associate', a situation where the Company will have a 'significant influence' in new company, S-1 LLC. This would necessitate a change from the proportionate consolidation method to equity method (which applies to both – accounting for joint ventures or accounting for associates). As per the querist, the specific situation, i.e., shift from jointly controlled operations (proportionate consolidation method) to joint venture or significant influence does not seem to have been specifically dealt with in accounting standards.

21. However, according to the querist, the transitional provisions provided in paragraph D31AA of Ind AS 101, 'First-time Adoption of Indian Accounting Standards', similar to the provisions of IFRS 11 (Joint Arrangements) provided in paragraphs C2 to C6 of Appendix C state that when changing from proportionate consolidation to the equity method, an entity shall recognise its investment in the joint venture as at the beginning of the immediately preceding period. That initial investment shall be measured as the aggregate of the carrying amounts of the assets and liabilities that the entity had previously proportionately consolidated, including any goodwill arising from the acquisition. It is also provided that the opening balance of the investment is regarded as the deemed cost of the investment at initial recognition. The entity shall assess whether the opening balance of investment is impaired and shall recognise any impairment loss as an adjustment to retained earnings at the beginning of the immediately preceding period.

22. The querist has also stated that though the above provisions are applicable for the first-time adopter of Ind AS and are meant to be applied by the entity in its first Ind AS financials, the essence of the above provisions may be borrowed for accounting in the present case, as substantially, the present case is of changing the form of the Company's investment in the underlying project from one form of joint arrangements to another, i.e., from joint operation to joint venture.

23. In view of the above, the Company has transferred the carrying value of its assets and liabilities pertaining to its PI in the project as on transition date, viz., 14th October 2023 on net basis (i.e., carrying values of the assets net of carrying value of liabilities pertaining to the project previously accounted for by the Company on proportionate basis) to deemed investment under the head 'Investments in JV/Associates' with nomenclature 'Investment Pending Proportionate Ownership Interest in Equity of S-1 LLC' in the standalone financials of the Company. As on the transition date, the Company assessed the impairment on the deemed investment and no impairment loss was identified as the recoverable amount of the underlying cash generating unit was higher than the carrying value thereof.

24. In respect of the equity accounting for the same in the consolidated financials as required by Ind AS 28, since the Company is yet to be allotted the shares in the new company, S-1 LLC as the fulfillment of condition precedent is in process, the Company has not accounted for the estimated share of profit of S-1 LLC as a matter of prudence.

25. As regards the recognition of investment upon allotment of shares to the Company in S-1 LLC, the Company understands that in its financial statements, the initial recognition of the investment on allotment of shares will be at cost only, i.e., the cost at which deemed investment is recognised as mentioned in paragraph 23 above. In the understanding of the Company, requirement of considering fair value at the time of initial recognition as required by paragraph 32 of Ind AS 28 may not apply in this case as the present case is that of a transition in an already existing joint arrangement rather than that of an acquisition of a new investment.

26. The querist has also separately clarified as follows:

- (i) Pursuant to Presidential Decree dated 07th December 2022 and subsequently, the Foreign Government issued Resolution dated 12th October 2022, all rights and obligations of the S-1 Consortium members under the Production Sharing Agreement (PSA), including that of the Operator, are transferred to an incorporated foreign entity, S-1 LLC, which was established on 14th October 2022. The PSA remains valid, and the charter does not supersede the PSA. The charter only transfers the rights under the PSA to an LLC company in which the consortium partners will be having shares.

Based upon the above, the rights of the parties in the PSA are established through another entity which is owned by the parties. Hence, the economic substance of the PSA remains with the parties through the LLC company.

- (ii) Collective reading of the Decree and the Charter grants powers to operate including the execution of sale of hydrocarbons from the project to S-1 LLC. The stakeholders are expected to take part in the distribution of profits of S-1 LLC.

However, in the consent letter of the Company dated 31st October 2022, the Company expressed/assumed that S-1 LLC and its participants shall have full and unrestricted rights, including for export, all quantities of hydrocarbons produced under the agreement to which they are entitled that would be further discussed at the time of finalisation of revised charter of the S-1 LLC. The querist has further informed that the host government authorities have not allowed the right to sale of hydrocarbon requested by the Company. The incorporated entity S-1 LLC is selling crude as S-1 LLC's crude.

- (iii) Under the PSA, the parties were entitled to their share of hydrocarbon produced from the project and free to sell in the open market including for their own use.

The PSA has been transferred to the S-1 LLC; hence the hydrocarbon production would be sold by S-1 LLC to outside parties as per the approval procedure under the charter.

The Company has desired to have right for the sale of hydrocarbon which will be discussed at the time of finalisation of revised charter as noted in point no (ii) above.

The querist has further informed that the revised charter of S-1 LLC has not been finalised. Based on the current understanding, the Company would be getting its share in profits/dividend from S-1 LLC. The request of the Company for hydrocarbon rights has not been agreed by the host government authorities and currently, the Company is also not receiving any share of profit/dividend from S-1 LLC considering pending fulfilment of the condition precedent.

Consequent upon incorporation of a new company, S-1 LLC, rights to the assets and obligations for the liabilities relating to the project have been vested in the new company. Based upon the current position, the Company is entitled to the residual interest in S-1 LLC. Though the Company had requested for hydrocarbon rights from the project, the same has not been agreed by the host government authorities.

B. Query

27. In view of the specific facts of the case and position of financial reporting framework as brought out above, opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India is sought on the following:

Whether-

- (i) The Company has correctly determined the nature of the Company's investment in new arrangement.
- (ii) If the answer to above is affirmative, whether the Company has correctly accounted for the transition of the project from joint operation to joint venture/associate by transferring the carrying value of assets and liabilities pertaining to its PI in the project as on transition date to the cost of deemed investment in S-1 LLC.
- (iii) Whether the approach of the Company of not accounting for the share of profit in S-1 LLC pending the allotment of shares therein is correct.
- (iv) Whether the Company will be required to assess the fair value of investment in S-1 LLC as on the date on which the shares will be actually allotted and account for the difference between such fair value and cost of the investment as recognized by the Company as per paragraph 32 of Ind AS 28.
- (v) Whether there is any specific disclosure requirement on recognition of investment on allotment of shares in S-1 LLC considering the peculiarity of the case.

C. Points considered by the Committee

28. The Committee notes that the basic issue raised by the querist relates to accounting for the Company's investment in S-1 LLC in its consolidated financial statements on change of its interest from joint operation to joint venture/associate. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, accounting for abandonment fund, accounting on transition to Ind AS, accounting for PSA, accounting for transactions between the Company and operator of S-1 LLC or the Company with JVC, accounting in the separate financial statements of the

Company, accounting for prior period item (if any), etc. The Committee has only looked into the issue from an Ind AS perspective and has not looked into the regulatory or legal classification and implications, including those arising under Income-tax Act and Foreign Exchange Management Act, 1999 (FEMA). The Committee wishes to point out that the opinion expressed hereinafter is in the context of Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015 as amended or revised from time to time.

The Committee also wishes to point out that this opinion is based on the specific facts and circumstances of the case and considering the specific terms contained in the existing charter of S-1 LLC, Decree of host government and thus should not be generalised to other facts and situations. Also, the assessment of control is a continuous exercise and the position may change if the relevant facts and circumstances change. Therefore, if there is any change or deviation in any terms and conditions in the Charter or any other Agreement between the parties, the opinion may not hold good.

At the outset, the Committee notes that a query has been raised by the querist regarding the Company's interest/investment in S-1 LLC being changed from joint operation to joint venture/associate. However, the Committee also notes that in paragraph 16 above, the Company has concluded the arrangement after change to be a joint venture. Therefore, the Committee has examined from the perspective of whether the change in the Company's interest in S-1 LLC leads to interest being classified as a joint venture or it continues as joint operation. Also, in this context, the Committee wishes to mention that similar considerations (with respect to accounting on transition as discussed hereinafter) may apply in case the change in interest results in the same being classified as an associate.

29. The first issue to be considered is the classification of the Company's interest or investment in S-1 LLC as to whether the same can be classified as a joint arrangement or not. In other words, whether or not there is joint control by the participants / members in S-1 LLC. The Committee notes that Ind AS 111 provides the following requirements:

- “4 A joint arrangement is an arrangement of which two or more parties have joint control.**
- 5 A joint arrangement has the following characteristics:**
 - (a) The parties are bound by a contractual arrangement (see paragraphs B2–B4).**
 - (b) The contractual arrangement gives two or more of those parties joint control of the arrangement (see paragraphs 7–13).”**
- “7 Joint control 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.**
- 8 An entity that is a party to an arrangement shall assess whether the contractual 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 returns of the arrangement (ie the relevant activities).

- 9 Once it has been determined that all the parties, or a group of the parties, control the arrangement collectively, joint control exists only when decisions about the relevant activities require the unanimous consent of the parties that control the arrangement collectively.”
- “11 An arrangement can be a joint arrangement even though not all of its parties have joint control of the arrangement. This Ind AS distinguishes between parties that have joint control of a joint arrangement (*joint operators or joint venturers*) and parties that participate in, but do not have joint control of, a joint arrangement.
- 12 An entity will need to apply judgement when assessing whether all the parties, or a group of the parties, have joint control of an arrangement. An entity shall make this assessment by considering all facts and circumstances (see paragraphs B5–B11).
- 13 If facts and circumstances change, an entity shall reassess whether it still has joint control of the arrangement.”
- “B3 When joint arrangements are structured through a separate vehicle (see paragraphs B19–B33), the contractual arrangement, or some aspects of the contractual arrangement, will in some cases be incorporated in the articles, charter or by-laws of the separate vehicle.
- B4 The contractual arrangement sets out the terms upon which the parties participate in the activity that is the subject of the arrangement. The contractual arrangement generally deals with such matters as:
- (a) the purpose, activity and duration of the joint arrangement.
 - (b) how the members of the board of directors, or equivalent governing body, of the joint arrangement, are appointed.
 - (c) the decision-making process: the matters requiring decisions from the parties, the voting rights of the parties and the required level of support for those matters. The decision-making process reflected in the contractual arrangement establishes joint control of the arrangement (see paragraphs B5– B11).
 - (d) the capital or other contributions required of the parties.
 - (e) how the parties share assets, liabilities, revenues, expenses or profit or loss relating to the joint arrangement.

Joint control (paragraphs 7-13)

- B5 In assessing whether an entity has joint control of an arrangement, an entity shall assess first whether all the parties, or a group of the parties, control the arrangement. Ind AS 110 defines control and shall be used to determine whether all the parties, or a group of the parties, are exposed, or have rights, to

variable returns from their involvement with the arrangement and have the ability to affect those returns through their power over the arrangement. When all the parties, or a group of the parties, considered collectively, are able to direct the activities that significantly affect the returns of the arrangement (ie the relevant activities), the parties control the arrangement collectively.

- B6 After concluding that all the parties, or a group of the parties, control the arrangement collectively, an entity shall assess whether it has joint control of the arrangement. Joint control exists only when decisions about the relevant activities require the unanimous consent of the parties that collectively control the arrangement. Assessing whether the arrangement is jointly controlled by all of its parties or by a group of the parties, or controlled by one of its parties alone, can require judgement.”

From the above, the Committee notes that in order to determine the nature of arrangement that exists between the parties, it is to be evaluated that whether the arrangement is jointly controlled by all the parties, or controlled by one of the parties alone or whether parties only participate in joint arrangement, but do not have joint control of, a joint arrangement. Further, joint control exists only when decisions about the relevant activities require the unanimous consent of the parties that collectively control the arrangement. The Committee further notes that the assessment of ‘control’ or ‘joint control’ is a matter of judgement and requires periodic assessment, which should be evaluated in the particular facts and circumstances and considering the requirements of any specific contractual arrangement between the parties concerned.

In the extant case, the Committee notes that S-1 LLC was incorporated by the host government by transferring all the rights and obligations of the erstwhile consortium by way of the Presidential Decree, Government Resolution and Charter. The Committee notes that in the extant case, while evaluating joint control, it needs to be determined whether the Government’s Resolution or Decree or the Charter unilaterally grants control of the arrangement to a single party or a group of parties or whether the participants / members jointly control the arrangement, viz., S-1 LLC. In assessing control, as per Ind AS 111, the requirements of Ind AS 110, ‘Consolidated Financial Statements’ are to be considered which include, the purpose and design of the arrangement, what are the relevant activities of the arrangement and how decisions about those activities are made, whether the rights of the parties give them the current ability to direct the relevant activities, whether the parties are exposed, or have rights, to variable returns from their involvement with the arrangement and whether the parties have the ability to use its power over the investee to affect the amount of their returns.

In this regard, considering the afore-mentioned requirements, the Committee is of the view that determination of joint control is a matter of judgement considering various terms and conditions agreed upon between the parties/entities in the specific facts and circumstances. Accordingly, the Committee is of the view that in the extant case, various clauses of the Charter, Presidential Decree, host government Resolution, PSA/JoA and any other related agreement/aspects should be examined carefully by the Company and its auditor in the specific facts and circumstances of the Company to determine the existence of joint control. Since this assessment involves judgement by the Company considering all facts and circumstances, the Committee, in the extant case has relied on the judgement made by the Company in this regard that the ‘joint control’ exists in the extant arrangement (which does

not appear to be disputed by the auditors also) and has proceeded on this premise.

30. The Committee now examines the issue of type of joint arrangement in the extant case, viz., joint operation or joint venture. In this regard, the Committee notes the following requirements of Ind AS 111:

“Types of joint arrangement

- 14 An entity shall determine the type of joint arrangement in which it is involved. 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.**
- 15 A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Those parties are called joint operators.**
- 16 A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Those parties are called joint venturers.**
- 17 An entity applies judgement when assessing whether a joint arrangement is a joint operation or a joint venture. An entity shall determine the type of joint arrangement in which it is involved by considering its rights and obligations arising from the arrangement. An entity assesses its rights and obligations by considering the structure and legal form of the arrangement, the terms agreed by the parties in the contractual arrangement and, when relevant, other facts and circumstances (see paragraphs B12–B33).”
- “19 If facts and circumstances change, an entity shall reassess whether the type of joint arrangement in which it is involved has changed.”

“Joint ventures

- 24 A joint venturer shall recognise its interest in a joint venture as an investment and shall account for that investment using the equity method in accordance with Ind AS 28, *Investments in Associates and Joint Ventures*, unless the entity is exempted from applying the equity method as specified in that standard.”**

“B15 As stated in paragraph B14, the classification of joint arrangements requires the parties to assess their rights and obligations arising from the arrangement. When making that assessment, an entity shall consider the following:

- (a) the structure of the joint arrangement (see paragraphs B16–B21).
- (b) when the joint arrangement is structured through a separate vehicle:
 - (i) the legal form of the separate vehicle (see paragraphs B22–B24);

- (ii) the terms of the contractual arrangement (see paragraphs B25–B28); and
- (iii) when relevant, other facts and circumstances (see paragraphs B29–B33).”

“Joint arrangements structured through a separate vehicle

- B19 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.
- B20 Whether a party is a joint operator or a joint venturer depends on the party’s rights to the assets, and obligations for the liabilities, relating to the arrangement that are held in the separate vehicle.
- B21 As stated in paragraph B15, when the parties have structured a joint arrangement in a separate vehicle, the parties need to assess whether the legal form of the separate vehicle, the terms of the contractual arrangement and, when relevant, any other facts and circumstances give them:
- (a) rights to the assets, and obligations for the liabilities, relating to the arrangement (ie the arrangement is a joint operation); or
 - (b) rights to the net assets of the arrangement (ie the arrangement is a joint venture).”
- “B31 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 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.
- B32 The effect of an arrangement with such a design and purpose is that the liabilities incurred by the arrangement are, in substance, satisfied 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.”

The Committees notes from these requirements of Ind AS 111 that 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. In this regard, the Committee notes that in the extant case, S-1 LLC is a separate company (vehicle) formed by the Decree of the host government. The Committee further notes that as per the requirements of Ind AS 111, when the parties have structured a joint arrangement in a separate vehicle, the parties need to assess whether the legal form of the separate vehicle, the terms of the contractual arrangement and, when relevant, any other facts and circumstances give them: (a) rights to the assets, and obligations for the liabilities, relating to the arrangement (ie the arrangement is a joint

operation); or (b) rights to the net assets of the arrangement (ie the arrangement is a joint venture).

31. In the above context, the Committee notes from the Facts of the Case that pursuant to Presidential Decree dated 07th December 2022 and subsequently, as per the host government issued Resolution dated 12th October 2022, all rights and obligations of the S-1 Consortium members under the Production Sharing Agreement (PSA), including that of the Operator, are transferred to an incorporated entity, S-1 Limited Liability Company (S-1 LLC), which was established on 14th October 2022.

As per Clause 2.3 of the Charter of S-1 LLC, from the moment of its incorporation, S-1 LLC becomes a party to the Agreement (PSA) and assumes all rights and obligations under it that belonged to a consortium of investors as parties to the Agreement, including the rights and obligations of the operator under the Agreement. Thus, all the rights and obligations under PSA of the erstwhile consortium members have been transferred to the S-1 LLC. Further, in this respect, the querist has further clarified that the host government authorities have not allowed the right to sale of hydrocarbon requested by the Company, which it previously held. The incorporated entity S-1 LLC sells hydrocarbons as S-1 LLC's hydrocarbons to outside parties as per the approval procedure under the Charter. Based on the current understanding, the Company would be getting its share in profits/dividend from S-1 LLC. Consequent upon incorporation of a new company S-1 LLC, rights to the assets and obligations for the liabilities relating to the project have been vested in the new company. Based upon the current position, the Company is entitled to the residual interest in S-1 LLC.

Further, although paragraph 3 of the Presidential Decree states that “At incorporation of the Company (S-1 LLC), the host government shall approve its charter which is valid *till the day of new Company charter approval by shareholders*” and “within one month from the date of transfer the ownership for all shares belonging to a Company to persons defined according to the present Decree, *shareholders shall approve a new Company charter and conclude an agreement on execution of rights of the Company shareholders*”, the revised charter has not been finalised.

Accordingly, considering the Company's existing contractual rights and obligations in S-1 LLC and other facts and circumstances, the Committee is of the view that in the extant case, arrangement does not give the Company, the rights to the assets, and obligations for the liabilities, relating to the arrangement (S-1 LLC); rather gives it the rights to the net assets of the arrangement and therefore, the arrangement in the extant case is a joint venture and not a joint operation. Thus, there will be change in classification of the joint arrangement from joint operation to joint venture.

32. The Committee notes that Ind AS 111 does not explicitly address the accounting when a joint operation becomes a joint venture. However, the Committee notes that Ind AS 28, ‘Investments in Associates and Joint Ventures’, states as follows:

“10 Under the equity method, on initial recognition the investment in an associate or a joint venture is recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition. The investor's share of the investee's profit or loss is recognised in the investor's profit or loss. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the

carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's other comprehensive income. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor's share of those changes is recognised in the investor's other comprehensive income (see Ind AS 1, *Presentation of Financial Statements*).”

“32 An investment is accounted for using the equity method from the date on which it becomes an associate or a joint venture. On acquisition of the investment, any difference between the cost of the investment and the entity's share of the net fair value of the investee's identifiable assets and liabilities is accounted for as follows:

- (a) Goodwill relating to an associate or a joint venture is included in the carrying amount of the investment. Amortisation of that goodwill is not permitted.
- (b) Any excess of the entity's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is recognised directly in equity as capital reserve in the period in which the investment is acquired.

Appropriate adjustments to the entity's share of the associate's or joint venture's profit or loss after acquisition are made in order to account, for example, for depreciation of the depreciable assets based on their fair values at the acquisition date. Similarly, appropriate adjustments to the entity's share of the associate's or joint venture's profit or loss after acquisition are made for impairment losses such as for goodwill or property, plant and equipment.”

“40 After application of the equity method, including recognising the associate's or joint venture's losses in accordance with paragraph 38, the entity applies paragraphs 41A-41C to determine whether it is any objective evidence that its net investment in the associate or joint venture is impaired.”

From the above, the Committee notes that an investment is accounted for using the equity method from the date on which it becomes a joint venture. On acquisition of the investment, any difference between the cost of the investment and the entity's share of the net fair value of the investee's identifiable assets and liabilities should be accounted for as per the above-mentioned requirements of Ind AS 28. Further, as per paragraph 10 of Ind AS 28, under the equity method, on initial recognition the investment in a joint venture is recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition.

As far as cost of investment is concerned, since the Standard is silent on this, the Committee notes paragraphs 10 and 11 of Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors', which states as follows:

“10 In the absence of an Ind AS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:

- (a) relevant to the economic decision-making needs of users; and**
- (b) reliable, in that the financial statements:**
 - (i) represent faithfully the financial position, financial performance and cash flows of the entity;**
 - (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;**
 - (iii) are neutral, ie free from bias;**
 - (iv) are prudent; and**
 - (v) are complete in all material respects.**

11 In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:

- (a) the requirements in Ind ASs dealing with similar and related issues; and**
- (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Conceptual Framework for Financial Reporting under Indian Accounting Standards (Conceptual Framework)* issued by the Institute of Chartered Accountants of India.”**

The Committee notes the hierarchy given in above-mentioned paragraphs and is of the view that similar situation of change in nature of interest in other entity is dealt with in Ind AS 110, ‘Consolidated Financial Statements’ when parent loses control of a subsidiary but retains investment. Therefore, the Committee notes paragraph 25 of Ind AS 110 as follows:

“25 If a parent loses control of a subsidiary, the parent:

- (a) derecognises the assets and liabilities of the former subsidiary from the consolidated balance sheet.
- (b) recognises any investment retained in the former subsidiary at its fair value when control is lost and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant Ind ASs. That fair value shall be regarded as the fair value on initial recognition of a financial asset in accordance with Ind AS 109 or, when appropriate, the cost on initial recognition of an investment in an associate or joint venture.
- (c) recognises the gain or loss associated with the loss of control attributable to the former controlling interest.”

From the above, the Committee notes that as per paragraph 25 of Ind AS 110, if a parent loses control of a subsidiary, it recognises any investment retained in the former subsidiary at its fair value. Drawing an analogy from the above, the Committee notes that the fair value of

investment in the joint venture, S-1 LLC can be deemed to be the cost of investment for the purpose of applying the requirements of Ind AS 28. With regard to determination of the fair value, the Committee is of the view that the same should be determined considering the relevant requirements given under Ind AS 113 'Fair Value Measurement'.

However, any difference between the cost of the investment and the entity's share of the net fair value of the investee's identifiable assets and liabilities should be accounted for as per the above-mentioned requirements of Ind AS 28. Therefore, the Company's accounting treatment in this regard to transfer the carrying value of its assets net of carrying value of its liabilities pertaining to its PI in the project to deemed investment in JV is incorrect. The Committee is of the view that the Company's understanding / submission in this regard that requirement of considering fair value on initial recognition as required by paragraph 32 of Ind AS 28 may not apply as the present case is that of a transition in an already existing joint arrangement rather than that of an acquisition of a new investment is inappropriate. Further, the Committee is of the view that the requirements of Ind AS 101, 'First-time Adoption of Indian Accounting Standards' are not applicable in the extant case, as Ind AS 101 is applicable at the time of transition or introduction of new GAAP, and in the extant case, only nature of interest in joint arrangement has changed.

33. Further, the Committee notes that in paragraph 24 above, the querist has submitted that since the Company is yet to be allotted the shares in S-1 LLC, the Company has not accounted for the estimated share of profit of S-1 LLC as a matter of prudence. In this context, the Committee notes the following requirements of Conceptual Framework for Financial Reporting under Indian Accounting Standards:

- “5.6 Only items that meet the definition of an asset, a liability or equity are recognised in the balance sheet. Similarly, only items that meet the definition of income or expenses are recognised in the statement of profit and loss. However, not all items that meet the definition of one of those elements are recognised.
- 5.7 Not recognising an item that meets the definition of one of the elements makes the balance sheet and the statement of profit and loss less complete and can exclude useful information from financial statements. On the other hand, in some circumstances, recognising some items that meet the definition of one of the elements would not provide useful information. An asset or liability is recognised only if recognition of that asset or liability and of any resulting income, expenses or changes in equity provides users of financial statements with information that is useful, ie with:
 - (a) relevant information about the asset or liability and about any resulting income, expenses or changes in equity (see paragraphs 5.12–5.17); and
 - (b) a faithful representation of the asset or liability and of any resulting income, expenses or changes in equity (see paragraphs 5.18–5.25).
- 5.8 Just as cost constrains other financial reporting decisions, it also constrains recognition decisions. There is a cost to recognising an asset or liability. Preparers of financial statements incur costs in obtaining a relevant measure of an asset or liability. Users of financial statements also incur costs in analysing

and interpreting the information provided. An asset or liability is recognised if the benefits of the information provided to users of financial statements by recognition are likely to justify the costs of providing and using that information. In some cases, the costs of recognition may outweigh its benefits.”

“5.11 Even if an item meeting the definition of an asset or liability is not recognised, an entity may need to provide information about that item in the notes. It is important to consider how to make such information sufficiently visible to compensate for the item’s absence from the structured summary provided by the balance sheet and, if applicable, the statement of profit and loss.”

“5.20 In some cases, the level of uncertainty involved in estimating a measure of an asset or liability may be so high that it may be questionable whether the estimate would provide a sufficiently faithful representation of that asset or liability and of any resulting income, expenses or changes in equity. The level of measurement uncertainty may be so high if, for example, the only way of estimating that measure of the asset or liability is by using cash-flow-based measurement techniques and, in addition, one or more of the following circumstances exists:

- (a) the range of possible outcomes is exceptionally wide and the probability of each outcome is exceptionally difficult to estimate.
- (b) the measure is exceptionally sensitive to small changes in estimates of the probability of different outcomes—for example, if the probability of future cash inflows or outflows occurring is exceptionally low, but the magnitude of those cash inflows or outflows will be exceptionally high if they occur.
- (c) measuring the asset or liability requires exceptionally difficult or exceptionally subjective allocations of cash flows that do not relate solely to the asset or liability being measured.”

“5.22 In limited circumstances, all relevant measures of an asset or liability that are available (or can be obtained) may be subject to such high measurement uncertainty that none would provide useful information about the asset or liability (and any resulting income, expenses or changes in equity), even if the measure were accompanied by a description of the estimates made in producing it and an explanation of the uncertainties that affect those estimates. In those limited circumstances, the asset or liability would not be recognised.

5.23 Whether or not an asset or liability is recognised, a faithful representation of the asset or liability may need to include explanatory information about the uncertainties associated with the asset or liability’s existence or measurement, or with its outcome—the amount or timing of any inflow or outflow of economic benefits that will ultimately result from it (see paragraphs 6.60–6.62).”

From the above, the Committee notes that in limited circumstances, when an asset or liability and resulting income or expense are subject to high measurement uncertainty, as contemplated in paragraph 5.22 above or when the cost of recognition of asset, liability,

income and expense in obtaining a relevant measure for such recognition outweighs the benefits of providing useful information to users of financial statements, then such an item should not be recognised. However, in such limited circumstances, explanatory information about the uncertainties associated with measurement and information about that item should be provided in the notes to the financial statements and such information should be made sufficiently visible to compensate for the item's absence as contemplated by paragraph 5.11 of the Conceptual Framework. Accordingly, in the extant case, the share of profit of S-1 LLC may not be recognised, provided the above-mentioned requirements of Conceptual Framework are satisfied and not on the ground of prudence as argued by the querist.

34. The Committee further notes that Ind AS 112, 'Disclosure of Interests in Other Entities' states:

"7 An entity shall disclose information about significant judgements and assumptions it has made (and changes to those judgements and assumptions) in determining:

- (a) that it has control of another entity, ie an investee as described in paragraphs 5 and 6 of Ind AS 110, *Consolidated Financial Statements*;**
- (b) that it has joint control of an arrangement or significant influence over another entity; and**
- (c) the type of joint arrangement (ie joint operation or joint venture) when the arrangement has been structured through a separate vehicle."**

"20 An entity shall disclose information that enables users of its financial statements to evaluate:

- (a) the nature, extent and financial effects of its interests in joint arrangements and associates, including the nature and effects of its contractual relationship with the other investors with joint control of, or significant influence over, joint arrangements and associates (paragraphs 21 and 22); and**
- (b) the nature of, and changes in, the risks associated with its interests in joint ventures and associates (paragraph 23)."**

"21 An entity shall disclose:

- (a) for each joint arrangement and associate that is material to the reporting entity:**
 - (i) the name of the joint arrangement or associate.**
 - (ii) the nature of the entity's relationship with the joint arrangement or associate (by, for example, describing the nature of the activities of the joint arrangement or associate and whether they are strategic to the entity's activities).**

- (iii) the principal place of business (and country of incorporation, if applicable and different from the principal place of business) of the joint arrangement or associate.
- (iv) the proportion of ownership interest or participating share held by the entity and, if different, the proportion of voting rights held (if applicable).
- (b) for each joint venture and associate that is material to the reporting entity:
 - (i) whether the investment in the joint venture or associate is measured using the equity method or at fair value.
 - (ii) summarised financial information about the joint venture or associate as specified in paragraphs B12 and B13.
 - (iii) if the joint venture or associate is accounted for using the equity method, the fair value of its investment in the joint venture or associate, if there is a quoted market price for the investment.
- (c) financial information as specified in paragraph B16 about the entity's investments in joint ventures and associates that are not individually material:
 - (i) in aggregate for all individually immaterial joint ventures and, separately,
 - (ii) in aggregate for all individually immaterial associates.”

The Committee also notes that Ind AS 1, ‘Presentation of Financial Statements’ states as follows:

“122 ²An entity shall disclose, along with material accounting policy information or other notes, the judgements, apart from those involving estimations (see paragraph 125), that management has made in the process of applying the entity’s accounting policies and that have the most significant effect on the amounts recognised in the financial statements.”

“125 An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:

- (a) their nature, and**
- (b) their carrying amount as at the end of the reporting period.”**

² Substituted vide Notification No. G.S.R. 365(E) dated 30th March, 2016 and, thereafter, substituted vide Notification No. G.S.R. 242(E) dated 31st March, 2023.

The Committee notes that the accounting matters mentioned in paragraphs 29-32 above would involve significant management judgement and estimation and therefore, the Company shall provide the appropriate disclosures as required in Ind AS 1 and Ind AS 112 including as required in the paragraphs above.

D. Opinion

35. On the basis of above and subject to statements in paragraphs 28 and 29 above, the Committee is of the following opinion on the issues raised in paragraph 27 above:

- (i) Considering the existing contractual arrangement and facts and circumstances, the nature of the Company's investment in new arrangement as joint venture seems to be appropriate, as mentioned in paragraph 31 above.
- (ii) The Company's accounting treatment for the transition is incorrect for reasons mentioned in paragraphs 31 and 32 above.
- (iii) Refer paragraph 33 above.
- (iv) Refer paragraphs 31 and 32 above.
- (v) Refer paragraphs 33 and 34 above.
