

## IFRS in Focus

# IASB issues new standard on joint arrangements

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### The Bottom Line

- IFRS 11 classifies joint arrangements as either joint operations (combining the existing concepts of jointly controlled assets and jointly controlled operations) or joint ventures (equivalent to the existing concept of a jointly controlled entity).
  - *Joint operation* is a joint arrangement whereby the parties that have joint control have rights to the assets and obligations for the liabilities.
  - *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.
- IFRS 11 requires the use of the equity method of accounting for interests in joint ventures thereby eliminating the proportionate consolidation method.
- The determination of as to whether a joint arrangement is a joint operation or a joint venture is based on the parties' rights and obligations under the arrangement, with the existence of a separate legal vehicle no longer being the key factor.
- Transitional provisions vary depending on how an interest is classified under IAS 31.
- The effective date of IFRS 11 is 1 January 2013, with early application permitted in certain circumstances.

### The new standard

On 12 May 2011, the IASB issued IFRS 11 *Joint Arrangements* which supersedes IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*. Concurrent with the issuance of IFRS 11, the IASB also issued:

- IFRS 10 *Consolidated Financial Statements* (see our separate IFRS in Focus for further discussion);
- IFRS 12 *Disclosure of Involvement with Other Entities*, (see our separate IFRS in Focus for further discussion);
- IAS 27 *Separate Financial Statements* (revised 2011), has been amended for the issuance of IFRS 10 but retains the current guidance for separate financial statements; and
- IAS 28 *Investments in Associates and Joint Ventures* (revised 2011), has been amended for conforming changes based on the issuance of IFRS 10 and IFRS 11.

Each of the standards in the 'package of five' has an effective date for annual periods beginning on or after 1 January 2013, with earlier application permitted so long as each of the other standards in the 'package of five' are also early applied. However, entities are permitted to incorporate any of the disclosure requirements in IFRS 12 into their financial statements without early adopting IFRS 12 (and thereby the standards in the 'package of five').

For more information please see the following websites:

[www.iasplus.com](http://www.iasplus.com)

[www.deloitte.com](http://www.deloitte.com)

### Joint control

IFRS 11 defines a joint arrangement as an “arrangement of which two or more parties have joint control” and makes clear that joint control exists only when “decisions about the relevant activities require the unanimous consent of the parties that control the arrangement collectively.”

#### Observation

The concept of joint control includes control by more than two parties, but not when decisions may be reached by more than one combination of those parties. IFRS 11 provides the following example to illustrate this point:

Assume an arrangement has three parties: A has 50 per cent of the voting rights in the arrangement and B and C each have 25 per cent. The contractual arrangement between A, B and C specifies that at least 75 per cent of the voting rights are required to make decisions about the relevant activities of the arrangement. Even though A can block any decision, it does not control the arrangement because it needs the agreement of either B or C. In this example, A, B and C collectively control the arrangement. However, there is more than one combination of parties that can agree to reach 75 per cent of the voting rights (i.e., either A and B or A and C). In such a situation, to be a joint arrangement the contractual arrangement between the parties would need to specify which combination of the parties is required to agree unanimously to decisions about the relevant activities of the arrangement.

### Joint operations and joint ventures

The new Standard establishes two types of joint arrangements: *joint operations* and *joint ventures*. The two types of joint arrangements are distinguished by the rights and obligations of those parties to the joint arrangement. In a joint operation, the parties to the joint arrangement (referred to as “joint operators”) have rights to the assets and obligations for the liabilities of the arrangement. By contrast, in a joint venture, the parties to the arrangement (referred to as “joint venturers”) have rights to the net assets of the arrangement.

IFRS 11 requires that a joint operator recognise its share of the assets, liabilities, revenues and expenses in accordance with applicable IFRSs while a joint venturer would account for its interest using the equity method of accounting under IAS 28 (revised 2011) *Investments in Associates and Joint Ventures*. The option of proportional consolidation included in IAS 31 has not been retained.

#### Observation

The mechanics of equity accounting, as detailed in IAS 28, have not changed and the accounting for joint operations is consistent with the current treatment of jointly controlled operations and jointly controlled assets.

IFRS 11 applies to all parties that have an interest in a joint arrangement, not just to those that have joint control. Therefore, all parties that have an interest in a joint operation should recognise their share of assets, liabilities, revenues and expenses arising from that interest. However, the accounting for an interest in a joint venture will depend on whether the party has joint control. A party that has joint control or significant influence over a joint venture will account for its interest using the equity method of accounting, a party that does not will apply IFRS 9 *Financial Instruments* (or IAS 39 *Financial Instruments: Recognition and Measurement*, as applicable). Hence, adoption of IFRS 11 requires that all parties to joint arrangements evaluate whether the arrangement meets the definition of a joint operation or a joint venture.

### Distinction between joint operations and joint ventures

The existence of a separate vehicle is a necessary, but not sufficient, condition for a joint arrangement to be considered a joint venture.

In the absence of a separate vehicle, IFRS 11 makes it clear that the parties to the joint arrangement have direct rights and obligations to the assets and liabilities of the arrangement and hence the arrangement will be classified as a joint operation. In an arrangement with a separate vehicle, that may or may not be the case, all relevant facts and circumstances should be considered in determining whether the parties to the arrangement have rights to the *net assets* of the arrangement.

**Observation**

This is a significant change from the requirements of IAS 31, which treats the establishment of a separate legal vehicle as the key factor in determining the existence of a jointly controlled entity.

The Standard provides guidance on factors to consider in the identification of a joint venture.

***Legal form of the separate vehicle***

A joint arrangement that is conducted through a separate vehicle may offer the investors no limitation on the liability of the parties to that arrangement. This indicates that the joint arrangement is a joint operation. However, a joint arrangement that limits the liability of the parties would not necessarily indicate that the arrangement is a joint venture because the terms of the contractual arrangement or other facts and circumstances may affect whether the parties have limited liability.

***Terms of the contractual arrangement***

Contractual arrangements between the parties to the joint arrangement may counteract the legal form of the vehicle. For example, parties may have direct rights to the assets and obligations for the liabilities of the arrangement despite the fact that the legal form of the vehicle would normally shelter the investors from having a direct obligation for its liabilities. This would be the case if the contractual arrangement between the parties establishes that all parties to the arrangement are directly liable for third party claims or establishes a sharing of revenues and expenses based on the relative performance of the parties.

***Other facts and circumstances***

When a separate vehicle is used and the terms of the contractual arrangement do not indicate that the joint arrangement is a joint operation, the parties should consider any other relevant facts and circumstances in determining the type of arrangement. For example, if a separate vehicle is formed to hold the assets and liabilities of the joint arrangement and the parties to the joint arrangement are committed to purchase the entire output of the arrangement, this indicates that the arrangement is a joint operation because the parties have rights to all of the economic benefits generated by the assets of the arrangement. Additionally, the parties are required to fund the settlement of the liabilities of the joint arrangement because the arrangement is exclusively dependent on the parties for the generation of cash flows. This also indicates that the arrangement is a joint operation. However, if the joint arrangement was able to sell output to third parties because the joint arrangement would assume demand, inventory and credit risks, this would indicate the joint arrangement is a joint venture.

**Observation**

It is possible that an investment that previously met the definition of a jointly controlled entity under IAS 31 will be a joint operation under IFRS 11. Additionally, an investor that previously accounted for an interest in a joint operation under IFRS 9 (or IAS 39 as applicable) because it did not have joint control would be affected upon adoption of IFRS 11 since the investor would have to recognise directly its share of assets, liabilities, revenues and expenses relating to the joint operation.

**Separate financial statements**

Joint operations are accounted for in the same manner in the separate financial statements as in the consolidated financial statements (i.e., the investor recognises directly its shares of assets, liabilities, revenues and expenses related to the joint operations).

Joint ventures, like investments in associates and in subsidiaries, are accounted for in the separate financial statements of the venturer either at cost or under IFRS 9 (or IAS 39, as applicable) as permitted by IAS 27.

**Disclosures**

The disclosure requirements for entities involved with joint arrangements are established in IFRS 12. Please refer to our IFRS in Focus newsletter on IFRS 12 for further information on this topic.

### Effective date and transition

IFRS 11 is effective for annual periods beginning on or after 1 January 2013, with early application permitted (so long as IFRS 10, IFRS 12, IAS 27 (2011) and IAS 28 (2011) are adopted at the same time). When adoption of IFRS 11 requires a change in accounting, the impact of the change is calculated as at the beginning of the earliest period presented and the comparative periods are restated.

Adoption of IFRS 11 will require adjustments to the financial statements in two circumstances:

<b>Before</b>  <b>IAS 31</b> Jointly controlled entity accounted for using the equity method	<b>After</b>  <b>IFRS 11</b> Joint operation	<b>Accounting as at the beginning of the earliest period presented</b> <ul style="list-style-type: none"><li>• derecognise the equity method investment;</li><li>• recognise assets (goodwill if any) and liabilities arising from the joint operation;</li><li>• if the amount of net assets recognised exceeds the carrying amount of the equity method investment derecognised, the excess reduces goodwill to the extent it exists, with any remaining excess recognised against retained earnings; and</li><li>• if the amount of net assets recognised is less than the carrying amount of the equity method investment derecognised, the difference is recognised against retained earnings.</li></ul>
<b>Before</b>  <b>IAS 31</b> Jointly controlled entity accounted for using proportionate consolidation	<b>After</b>  <b>IFRS 11</b> Joint venture	<b>Accounting as at the beginning of the earliest period presented</b> <ul style="list-style-type: none"><li>• derecognise assets (including goodwill if any) and liabilities;</li><li>• recognise equity method investment at the carrying amount of the net assets derecognised; and</li><li>• perform an impairment test and recognise the impairment loss, if any, as an adjustment of retained earnings.</li></ul>

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