

IFRS 11 Joint Arrangements

Overview

IFRS 11 describes the accounting for a joint arrangement. The investor will be required to either apply the equity method of accounting or recognize, on a line-by-line basis, its share of the underlying assets, liabilities, revenues and expenses. The accounting treatment required will depend on the substance of the arrangement and the nature of the investor's interest in it. The option to apply proportionate consolidation has been removed. IFRS 11 supersedes the requirements relating to joint ventures in IAS 31 and SIC 13.

Objective

To establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly (*i.e. joint arrangements*).

Scope

All entities that are a party to a joint arrangement.

Effective date

Effective for annual periods beginning on or after 1 January 2013. Early applicaiton is permitted.

Defined terms

IFRS 11 defines the following terms that form an integral part of this IFRS.

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

Joint control – 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.

Joint operation – 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.

Joint operator – A party to a **joint operation** that has **joint control** of that joint operation.

Joint venture – A **joint arrangement** whereby the parties that have **joint control** of the arrangement have rights to the net assets of the arrangement.

Joint venturer – A party to a **joint venture** that has **joint control** of that joint venture.

Party to a joint arrangement – An entity that participates in a **joint arrangement**, regardless of whether that entity has **joint control** of the arrangement.

Separate vehicle – A separately identifiable financial structure, including separate legal entities or entities recognised by statute, regardless of whether those entities have a legal personality.

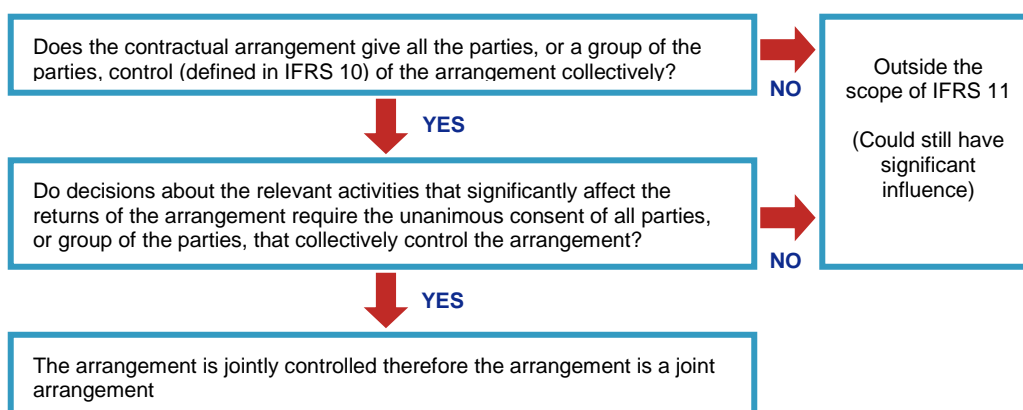
Joint arrangement

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

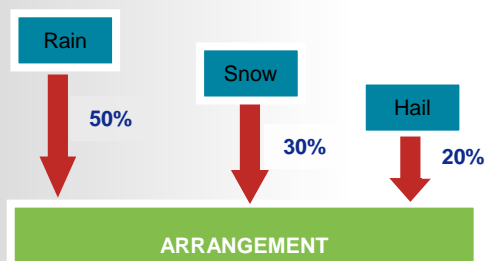
- The parties are bound by a contractual arrangement; and
- The contractual arrangement gives two or more of the parties joint control of the arrangement.

Joint control

Refer to definition above. The following diagram illustrates the key criteria to be met for an arrangement to be classified as a joint arrangement.



Example – Joint Control



The contractual arrangement between Rain, Snow and Hail states that at least 75% is required to make decisions about the Arrangement's relevant activities.

Rain does not control the arrangement as it needs the agreement of Snow. The contractual arrangement therefore implies that Rain and Snow have joint control as decisions about the Arrangement's relevant activities cannot be made without both Rain and Snow agreeing.

Judgement will need to be applied when assessing whether all the parties or a group of parties have joint control over a joint arrangement. This assessment shall be made, by considering all facts and circumstances. If these facts and circumstances change, an entity shall reassess whether joint control of the arrangement still exist.

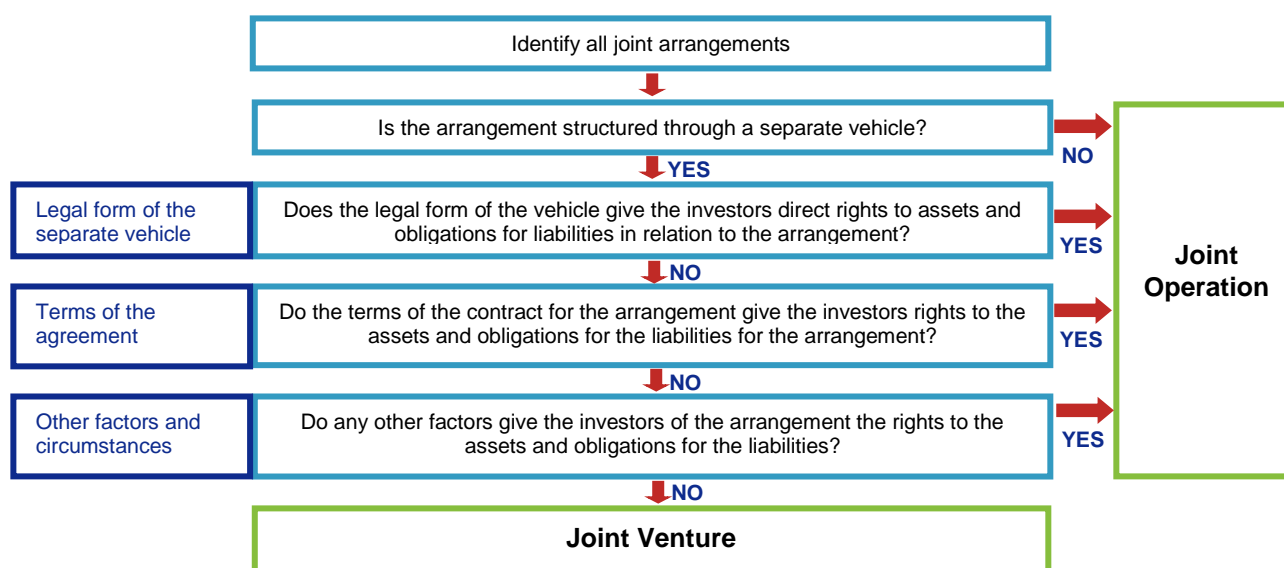
Types and classification of a joint arrangement

A joint arrangement can be classified as a joint operation or a joint venture (refer above for definitions).

Judgement will need to be exercised when making this classification. In arriving at the classification, the parties' rights and obligations arising from the arrangement in the normal course of business must be assessed. In making this assessment, the following shall be considered:

- Structure of the joint arrangement.
- When structured through a separate vehicle:
 - Legal form of the separate vehicle;
 - Terms agreed by the parties in the contractual arrangement; and
 - When relevant, other facts and circumstances.

The process of distinguishing **joint operations** from **joint ventures** is illustrated below.



Example – Joint venture versus Joint operation

iFone and Blakbery structure a joint arrangement in an incorporated entity, Cell. They each have a 50% ownership interest. The purpose of the arrangement is for Cell to manufacture parts for iFone and Blakbery's own manufacturing processes. The arrangement ensures that the 2 parties operate the facility that produces the parts to their specifications.

The legal form of Cell through which the activities are conducted, initially suggest that the assets and liabilities held in Cell are the assets and liabilities of Cell. The contractual agreement does not specify that iFone and/or Blakbery have rights to the assets and obligations for the liabilities of Cell. **Therefore based on the legal form of Cell and the terms to the contractual arrangement, the arrangement is a joint venture.**

However, consider the following aspects of the arrangement

- The parties agreed to purchase all the output produced by Cell in the ratio of their ownership percentage. Cell may not sell its output to third parties, unless this is approved by iFone and Blakbery.
- The arrangement is intended to operate at a break-even level. That is, the selling price is set by both parties and is designed to cover the costs of production and administrative expenses incurred by Cell.

From the above, the following facts and circumstances can be noted

- The obligation of the parties to purchase all the output reflects the exclusive dependence of Cell upon the parties for the generation of cash flows therefore the parties have an obligation to fund the settlement of Cell's liabilities.
- The facts that the parties have rights to all the output means that the parties are consuming and therefore have rights to all the economic benefits of the assets of Cell.

The facts and circumstances indicate that the arrangement is a joint operation.

If the parties changed the contractual arrangement so that Cell was able to sell its output to third parties. Such a change in facts and circumstances would require re-assessment of the classification and such facts and circumstances would indicate that the arrangement is a joint venture.

Financial statements of parties to a joint arrangement

Joint operations

A joint operator is required to recognize in relation to its interest in a joint operation:

- Its assets, including its share of any assets held jointly;
- Its liabilities, including its share of any liabilities incurred jointly;
- Its revenue from the sale of its share of the output arising from the joint operation;
- Its share of the revenue from the sale of the output by the joint operation; and
- Its expenses, including its share of any expenses incurred jointly.

A joint operator shall account for the above relating to its interest in the joint operation in accordance with the relevant IFRSs.

If a party that participates in, but does not have joint control of a joint operation, and rights to the assets and obligations relating to that joint operation:

- Are present, it is required to account for these as above.
- Are not present, it is required to account for its interest in the joint operation in accordance with the applicable IFRSs to that interest.

Joint ventures

A joint venturer is required to recognize its interest in a joint venture as an investment and shall account for that investment using the equity method in accordance with IAS 28 Investments in Associates and Joint Ventures **unless** the entity is exempted from applying the equity method.

A party that participates in, but does not have joint control of a joint venture is required to account for its interest in the arrangement in accordance with IFRS 9 Financial Instruments, **unless** it has significant influence over the joint venture, then it shall account for it in accordance with IAS 28.

Separate financial statements

Joint operations

The same accounting treatment is required as set out above for a joint operator under the heading *Financial statements of parties to a joint arrangement*.

Joint ventures

A joint venture shall account for its interest in accordance with IAS 27 *Separate financial statements*.

A party that participates in, but does not have joint control of a joint arrangement shall account for its interest in a joint venture in accordance with IFRS 9. However, if the party has significant influence over the joint venture it shall apply IAS 27.

In conclusion

As the classification of a joint arrangement requires assessment of the substance of an investor's interest including consideration of related contractual arrangements and other facts and circumstances, this is expected to be an area of judgement requiring careful consideration.