Practical guide to IFRS

Joint arrangements: a new approach to an age-old business issue

July 2011

At a glance

- The IASB released IFRS 11, 'Joint arrangements', on 12 May 2011, introducing an overhaul of the existing accounting for joint arrangements.
- The principles-based approach seeks to provide investors with greater clarity about an entity's involvement in joint arrangements by requiring the entity to recognise the contractual rights and obligations arising from the joint arrangement in which it participates.
- The legal structure of an arrangement is no longer the most significant factor in determining the accounting.
- There are now only two forms of joint arrangement – 'joint operations' and 'joint ventures'.
- Accounting options have been eliminated under the new standard. Equity accounting must be used for joint ventures. The policy choice of proportionate consolidation is gone.
- Mandatory application is required from 1 January 2013. Full transition guidance is provided.
- Early adoption is available where the following standards are also adopted: IFRS 10, 'Consolidated financial statements'; IFRS 12, 'Disclosure of interests in other entities'; the amended IAS 27, 'Separate financial statements' (IAS 27 (revised)); and the amended IAS 28, 'Investments in associates and joint ventures' (IAS 28 (revised)).

Key business impacts

Management should evaluate the new requirements, as they may have a significant impact on how an entity can present its income statement and balance sheet.

PwC observation: Leverage, capital ratios, covenants and financing agreements may be affected as a result of changes to the balance sheet, particularly when moving from equity accounting to the 'share of assets and liabilities approach', and vice versa. Impacts on performance measures, such as interest cover, EBIT or EBITDA, should also be considered.

Clear communication with stakeholders is crucial where significant changes in the presentation of financial results and financial position are expected to occur. Timely assessment and management of the implementation and ongoing impacts of IFRS 11 will help smooth transition to the new standard. It is also important to consider IFRS 11 when structuring new arrangements to ensure the desired accounting outcome is achieved.

Management should start now to consider alternatives to retain their current accounting for joint arrangements, particularly if they have been using proportionate consolidation to present gross assets and gross revenue. It may be possible to restructure existing arrangements that might be classified as 'joint ventures' under the new standard to become 'joint operations'.

Entities may need more detailed financial reporting information from an operator of a joint operation to comply with the accounting and disclosure requirements. Similarly, they may need to provide more detailed information to other parties if they are the operator of a joint operation.

Changes in existing process and controls may be required to cope with initial transition requirements and the annual reassessment of arrangements. Gathering and analysing the information could take considerable time and effort depending on the number of joint arrangements, the inception dates and the records available.

PwC observation: IFRS 11 will impact some entities and industries more than others, although all entities with joint arrangements will be affected. Entities likely to be most affected include those that:
- currently apply proportionate consolidation for jointly controlled entities;
- participate in a number of joint arrangements;
- have old joint arrangements with limited documentation detailing the terms of the arrangement; and
- participate in joint arrangements but do not share joint control.

Entities planning to enter into joint arrangements should consider the requirements of IFRS 11 during the planning process.

Key provisions

Scope

1. IFRS 11 applies to all entities that are a party to a joint arrangement.
2. The exemption in IAS 31, 'Interests in joint ventures', from applying the equity method to an investment in a joint venture that is held directly by a venture capital organisation (VCO), mutual fund, unit trust or similar entities has been moved from the joint arrangements standard to IAS 28 (revised).
3. Investments in joint ventures held by these entities may be measured at fair value through profit or loss in accordance with IFRS 9, 'Financial instruments' (or IAS 39, 'Financial instruments: Recognition and measurement').

PwC observation: The treatment of investments that are joint ventures held by VCOs, mutual funds, unit trusts and other similar entities remains the same under old and new standards. The exemption in IAS 28 (revised) applies to investments that are directly and indirectly held by a VCO, mutual fund, unit trust or similar entities. The exemption does not apply to joint operations.

4. An investment in a joint venture that is classified as held for sale in accordance with IFRS 5, 'Non-current assets held for sale and discontinued operations', is also scoped out of IAS 28 (revised).

Summary of scope exclusions

IFRS 11	None
IAS 28 (revised)	Scope exclusion from applying the equity method to joint ventures where: – Investment held by VCO, mutual fund, unit trust or similar entity; and – Investment is classified as held for sale.

Joint arrangements

5. A joint arrangement is defined as an *arrangement of which two or more parties have joint control* (IFRS 11.4).
6. All joint arrangements have a contractual arrangement that:
   - binds the parties; and
   - provides two or more of those parties with joint control of the arrangement.

PwC observation: The definition of a joint arrangement is generally consistent with the existing IAS 31's definition of a joint venture. An arrangement does not qualify as a joint arrangement if one party is able to unilaterally control the arrangement – that is, that party has the power to make the key decisions by itself.

7. The contractual arrangement sets out the terms upon which the parties participate in the arrangement. It generally addresses matters such as:
   - the objective and duration of the joint arrangement;
   - the specific activities undertaken by the joint arrangement;
   - how the members of the governing body are appointed and how decisions are made;
   - the capital or other contributions required of the parties; and

– how the parties will share assets, liabilities, revenues, expenses, or profits or losses.

8. The contractual arrangement is usually established in writing in the form of a contract between the parties; it can also take the form of a documented discussion, although this is unusual. Joint control can also be established through local legislation, other statutory mechanisms or as part of the governing rules of the entity, either individually or in conjunction with other contractual agreements between the parties.

Example 1 – Joint arrangements established through articles of association

Shareholders A and B form a new joint arrangement (entity J). Entity J's articles of association include a clause that states all shareholders must unanimously agree on the relevant activities of the entity. No other agreements are entered into by the shareholders to manage the activities of entity J.

Even though there is no separate joint venture agreement, entity J does meet the definition of a joint arrangement. The clause included in entity J's articles of association is sufficient for the definition of a joint arrangement to be met, provided entity J's articles of association are legally binding.

Joint control

9. Joint control is a key definition under the standard. It is defined as '*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.*' (IFRS 11.7)

PwC observation: The definition of joint control is similar in substance to the existing IAS 31 definition.

10. Joint control and control are mutually exclusive. At least two parties must have joint control, and this must be a contractually agreed sharing of control requiring unanimous consent.

11. No single party to an agreement is able to act unilaterally to control the activity of the arrangement when joint control exists. The parties to the agreement must act together to control the activity and, therefore, exercise joint control. Each of the parties sharing control must consent to all essential decisions relating to the entity's relevant activities. As a consequence, it is important to consider the ability for parties to veto decisions.

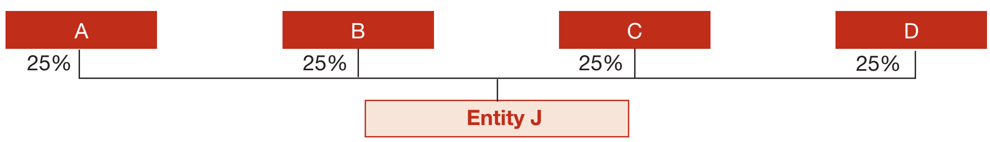
PwC observation: Joint control does not only occur at the outset of an arrangement. The parties must continue to have joint control throughout the life of the arrangement.

12. The principles of joint control are illustrated in the following examples.

Example 2 – Collective control versus joint control

Entities A, B, C and D each hold a 25% interest in entity J. Decisions in entity J need to be approved by a 75% vote of the parties.

Is ABC Limited jointly controlled?



Solution

Entity J is not jointly controlled. For there to be joint control, the voting arrangements would have to require unanimous agreement between those sharing joint control of entity J. The voting arrangements of entity J allow agreement of any combination of three of the four investors to make decisions. The standard refers to this as collective control. Each investor will account for its interest in entity J as an associate since each entity is presumed to have significant influence, but they do not have joint control.

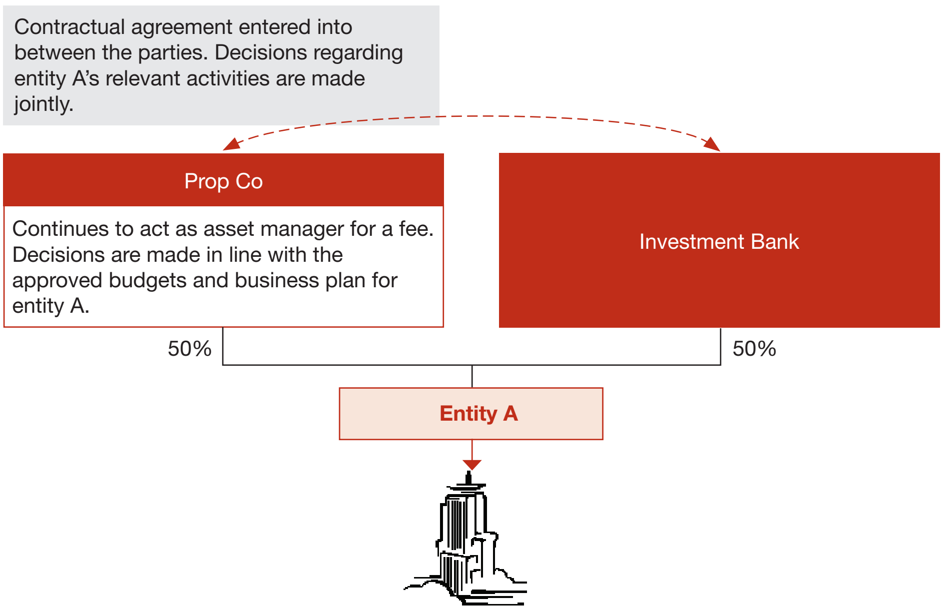
PwC observation: An entity is not automatically a joint arrangement because two or more parties hold equal shares in it. It is therefore important to distinguish between joint control and collective control.

Joint control only exists when there is a contractual agreement requiring two or more parties to unanimously agree on decisions about the relevant activities of the arrangement and the parties together control the arrangement. Joint control would not arise where decisions on relevant activities only require the consent of a majority or super-majority of owners. Here, control is contractually shared; however, the same group of investors does not need to agree to the relevant activities, as the arrangement only requires a majority to agree.

Example 3 – Impact of managing an arrangement

Property Company Limited (Prop Co) has a wholly owned subsidiary, entity A, which holds a portfolio of buildings.

Prop Co wishes to reduce its exposure to this market. It sells 50% of its investment in entity A to Investment Bank. The structure after the sale is as follows:



Is entity A jointly controlled?

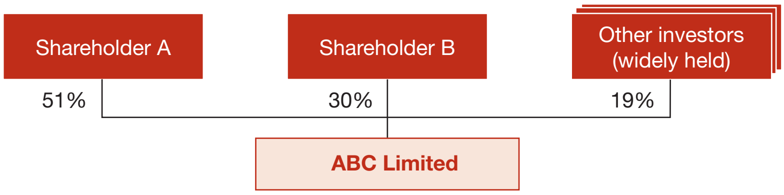
Solution

Entity A is jointly controlled, as Prop Co and Investment Bank are required to unanimously agree on relevant activities, and Prop Co must manage the entity's operations in line with these decisions.

PwC observation: A party to a joint arrangement may be appointed to manage the day-to-day operations of the arrangement's activities. A party is not precluded from acting as a manager of a joint arrangement provided the arrangement's relevant activities are subject to joint decision-making by the parties, and the managing party acts within this framework. Where the managing party can unilaterally make decisions regarding the arrangement's relevant activities, this would not constitute joint control.

Example 4 – Implicit joint control

ABC Limited's articles of association require a 75% majority to approve decisions regarding the relevant activities of the entity. It also outlines that each shareholder is entitled to vote in proportion to their respective ownership interests.



Is ABC Limited jointly controlled?

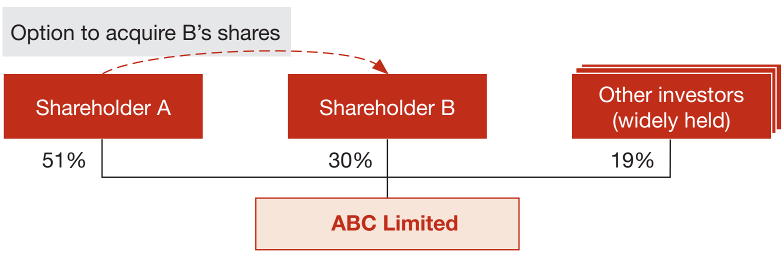
Solution

ABC Limited is jointly controlled by shareholders A and B, as based on their ownership interests (collectively 81%), they must act together to make decisions regarding the relevant activities of the entity. Shareholder A does not control ABC Limited, as it cannot unilaterally make decisions because a 75% majority is required.

PwC observation: The contractual terms of an arrangement do not need to explicitly state that decisions regarding relevant activities are made unanimously between parties. The specific terms or structure of the arrangement may sometimes lead to implicit joint control arising from the contractual arrangement, as illustrated in the above example.

Example 5 – Potential voting rights

The facts are the same as in example 4 above; however, shareholder A has an option to buy shareholder B's shares in ABC Limited. The option may be exercised by shareholder A at any time in the event that shareholders A and B do not agree on a decision regarding the relevant activities. The option price is not set so high that the possibility of exercise is remote.



Is ABC Limited jointly controlled?

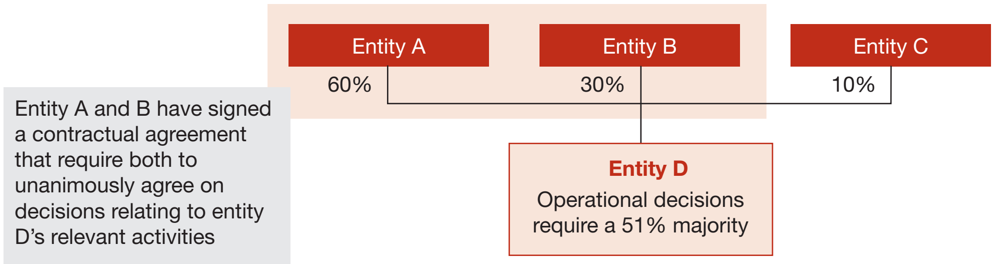
Solution

Joint control does not exist because shareholder A has the ability to impose its decisions at any time by purchasing shareholder B's shares in ABC Limited if shareholder B does not vote in line with shareholder A. In this situation, shareholder A has control.

PwC observation: Agreements may outline that participants are required to unanimously agree on relevant activities, however if another party can ultimately override these decisions, joint control does not exist. Potential voting rights of parties or rules around casting votes should also be considered when determining whether joint control exists.

13. The existence of joint control does not mean that every party to the arrangement will have joint control. A party to the joint arrangement who does not participate in joint control may follow different accounting, discussed on p14. IAS 31 previously called these parties ‘investors’ in the joint arrangement. This term is no longer used.

Example 6 – Party to a joint arrangement that does not share joint control



Is entity D jointly controlled?

Solution

Entities A and B jointly control entity D in this scenario, as both entities must unanimously agree on the relevant activities. This prevents entity A from controlling entity D, as it does not have power to govern the financial and operating policies itself.

Although entity C is a party to the joint arrangement, it does not have joint control because it is not required to agree to the unanimous decisions of entities A and B. The accounting by entity C will vary depending on the classification of entity D as either a joint operation or joint venture.

Relevant activities

14. IFRS 10 defines relevant activities as activities that significantly affect the returns of an arrangement.

15. Judgement is required when assessing what constitutes relevant activities. IFRS 10 provides some examples, including:
    - *selling and purchasing of goods or services;*
    - *managing financial assets during their life (including upon default);*
    - *selecting, acquiring or disposing of assets;*
    - *researching and developing new products or processes; and*
    - *determining a funding structure or obtaining funding.*

(IFRS 10.B11)

16. Relevant activities should be considered for each arrangement in order for entities and users of the financial statements to understand the fundamental decisions that affect each joint arrangement and how these are dealt with under the terms of the agreement.

PwC observation: 'Relevant activities' can be interpreted fairly broadly, but it can be aligned to the existing requirement in IAS 31 of 'financial and operational decisions' of a joint arrangement. Relevant activities essentially are the major decision activities and not just protective rights. Protective rights are still decision-making rights, but they are not the types of rights that provide a party joint control.

17. Arbitration or dispute resolution mechanisms are rights that do not affect decisions regarding relevant activities. They outline the provisions that will allow for decisions to be made in the absence of unanimous consent but do not prevent the arrangement from being jointly controlled.

PwC observation: Mechanisms that allow a single party a casting vote or the final decision in cases of dispute between parties will seldom result in joint control, as one party can override decisions.

Types of joint arrangements

18. Changes in the definitions have reduced the 'types' of joint arrangements to two, compared to IAS 31. They are:
   - joint operations, and
   - joint ventures.

19. The following table summarises the key types of arrangements under IAS 31 and IFRS 11.

<table>
<tr><th>IAS 31</th><td>Jointly controlled assets</td><td>Jointly controlled operations</td><td>Jointly controlled entities</td></tr>
<tr><th rowspan="2">IFRS 11</th><th>Joint operation</th><th colspan="2">Joint venture</th></tr>
<tr><td>This 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 (IFRS 11.15)

For example, the contractual arrangement gives the parties an interest in individual assets and obligations for liabilities of the arrangement</td><td colspan="2">This is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement (IFRS 11.16)

For example, the contractual arrangement only gives the parties rights to a share of the net outcome generated by an economic activity.</td></tr>
</table>

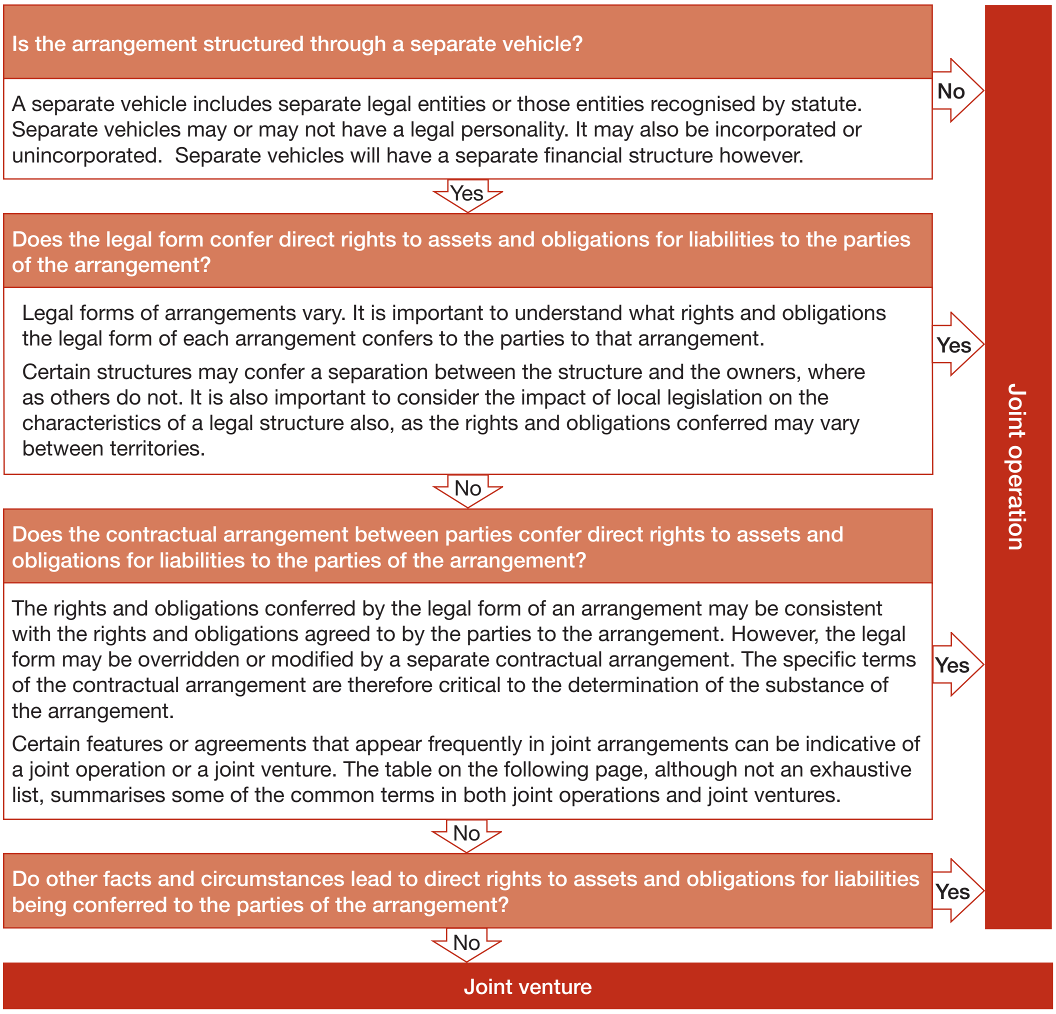
PwC observation: Arrangements that previously fit within IAS 31's 'joint assets' category are likely to qualify as 'joint operations', but each arrangement will need to be assessed to confirm this presumption. 'Jointly controlled entities' under IAS 31 may be joint operations or joint ventures under IFRS 11, depending on the rights and obligations of the parties to the joint arrangement.

Determining the type of joint arrangement

20. The type of joint arrangement that an entity is party to under IFRS 11 will depend upon the rights and obligations that arise from the contractual arrangement.

21. Joint arrangements can be established using many different structures and forms. The substance of the arrangement is determined by the contractual rights and obligations of the parties to the joint arrangement. This determination can be complex.

The following flowchart provides a summary of how to determine the classification of a joint arrangement.



PwC observation: The use of a separate vehicle for a joint arrangement makes the determination of the type of joint arrangement more complex. The underlying rights and obligations of the parties need to be considered in the context of the contractual arrangement and other relevant facts and circumstances. These include any restrictions imposed on the parties, the customer base of the arrangement and funding obligations of the parties.

Comparison of common features in contractual arrangements

	Joint operation	Joint venture
Terms of the contractual arrangement	The parties have rights to the assets and obligations for the liabilities relating to the arrangement.	The parties have rights to the net assets relating to the arrangement.
Rights to assets	The parties share all interests in the assets in a specified proportion.	The assets belong to the arrangement. The parties to the arrangement do not have direct rights, title or ownership of the assets.
Obligations for liabilities	The parties share all liabilities, obligations, costs and expenses in a specified proportion. The parties are liable for claims on the arrangement raised by third parties of the arrangement.	The joint arrangement is liable for the debts and obligations of the arrangement. The parties are liable to the arrangement only to the extent of their respective investments in the arrangement or their respective obligations to contribute any unpaid or additional capital to the arrangement, or both. Creditors of the arrangement do not have any right of recourse against the parties in respect of debts or obligations of the arrangement.
Revenues and expenses and profits or losses	The arrangement establishes an allocation of revenue and expenses based on relative performance of each party (for example, basis of capacity used by each party). This could differ from their ownership interest in the arrangement.	The arrangement establishes each party's share in the profit or loss of the arrangement.
Guarantees	The provision of guarantees by parties to a joint arrangement (or a commitment to provide them) does not by itself result in the classification of an arrangement as a joint operation.	

22. An entitlement to a share of profits in a joint arrangement does not automatically preclude classification as a joint operation. All relevant facts and circumstances, such as rights to assets and obligations for liabilities, are considered.

23. Parties may undertake a number of activities jointly. A framework agreement may be established that sets out the general contractual terms of the arrangement. The activities being undertaken, and the rights and obligations of each party in relation to these, are considered when determining classification. It may be possible that within a single framework agreement the classification of individual activities and arrangements may vary – that is, both a joint operation and joint venture could exist.

24. Continuous reassessment is required for joint arrangements. If any facts or circumstances change in an arrangement, an entity will need to reassess whether joint control has been lost or gained, as applicable. The type of joint arrangement may also need to be reassessed.

Example 7 – Determining joint arrangement classification

- Three separate aerospace companies form a consortium to jointly manufacture an aircraft.
- A consortium agreement is signed, which outlines the activities of the arrangement and establishes a joint operating committee. A representative from each company sits on the joint operating committee; decisions are made by unanimous consent.
- Each company carries responsibility for different areas of expertise such as:
  - manufacturing engines;
  - manufacturing fuselage and wings; and
  - aerodynamics.
- The companies carry out different parts of the manufacturing process, each using its own resources and expertise in order to manufacture, market and distribute the aircraft jointly.
- The three companies share the revenues from the sale of aircraft and jointly incur expenses. The revenues and common costs are shared as contractually agreed in the consortium agreement.
- A separate bank account is established through which revenue is received and shared costs paid. The bank account is in the name of the three parties trading as the consortium.
- Each company also incurs their own separate costs such as labour costs, manufacturing costs, supplies, inventory of unused parts and work in progress. Each company recognises their separately incurred costs in full.

What is the classification of the joint arrangement?

Solution

Is the arrangement structured through separate vehicle?

Yes – separate financial accounting records a trial balance will be maintained for the consortium in respect of common costs and revenues. A separate bank account has also been established

What are the features of the legal form of the arrangement?

Not applicable, as the consortium does not have a separate legal personality.

What are the features of the contractual arrangement between the parties?

The consortium agreement outlines that the parties have rights to the assets and liabilities of the arrangement, that is:

- The common costs of the arrangement are shared by the parties in proportion to their interests. They are also individually liable for the claims on the arrangement.
- The allocation of revenue from the sale of the aircraft is based in proportion to their interests.

Conclusion

This arrangement would be classified as a **joint operation,** as each company has direct rights to the assets and obligations for the liabilities of the arrangement.

Example 8 – Determining joint arrangement classification

- An investment property is equally held by three parties as tenants in common.
- The joint owners agreement outlines that the parties are required to unanimously agree on certain decisions relating to the investment property (relevant activities) including:
  - appointment/removal of a property manager;
  - capital expenditure, including the decision to redevelop part or all of the investment property; and
  - signing/resigning of major leases (>5% of net lettable area).
- The agreement outlines that property expenses are shared by the parties based on their ownership interest. The parties are also jointly and severally liable for claims upon the investment property.
- Rental income is also distributed to the owners based on their relative ownership interest.

What is the classification of the joint arrangement?

Solution

Is the arrangement structured through a separate vehicle?
No, the arrangement is not structured through a separate vehicle.

Conclusion
This arrangement would be classified as a **joint operation**. The arrangement is not structured through a separate vehicle, and each party has a direct interest in the investment property (that is, it is listed as an owner on the title deed). In addition:

- each party has obligations for the liabilities of the investment property, and
- the contractual agreement outlines that each party is entitled to a share of revenue and costs from the property based on their ownership interest.

Example 9 – Determining joint arrangement classification

- A large telecommunications organisation (TelCo) is seeking to establish operations in a relatively undeveloped communications environment. The in-country requirements do not allow a local entity with a telecom licence to be controlled by a foreign company.
- TelCo establishes a separate company with a local investor to allow TelCo to enter this market. The legal form of the company confers the rights to the assets and obligations for liabilities to the company itself.
- A shareholders' agreement is also established between TelCo and the local investor that requires all decisions to be made jointly. The agreement also confirms:
  – The assets of the arrangement are owned by the company. Neither party will be able to sell, pledge, transfer or otherwise mortgage the assets.
  – The liability of the parties is limited to any unpaid capital.
  – Profits of the company will be distributed to TelCo and the investor 60/40, being the parties' interest in the arrangement respectively.

What is the classification of the joint arrangement?

Solution

Is the arrangement structured through separate vehicle?
Yes – the arrangement is structured through a separate legal entity.

What are the features of the legal form of the arrangement?
Under local legislation, the legal form of the arrangement provides a separation between the owners (the parties to the arrangement) and the entity itself. The assets and liabilities of the arrangement are ring-fenced within the company. The parties are only liable for obligations or claims against the company to the extent of any unpaid capital.

What are the features of the contractual arrangement between the parties?
The shareholders' agreement does not alter the features of the legal form of the arrangement and confirms that the parties have rights to the net assets of the arrangement.

Conclusion
This arrangement would be classified as a **joint venture.**

Joint arrangement accounting

Joint operators in a joint operation

25. A joint operator, which is a party to a joint operation that has joint control, will need to recognise the following in relation to its involvement in the 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.*

    (IFRS 11.20)

26. IFRS 11 states that where a joint operator enters into a transaction with a joint operation, it is transacting with the other parties to the joint operation. Any gains or losses resulting from the transaction should only be recognised to the extent of the other parties' interest in that joint operation.

27. The types of transactions specifically contemplated by the standard include the sale, purchase or contribution of assets.

> **PwC observation:** The accounting treatment for joint operations is consistent with the existing treatment under IAS 31 (the operations are treated as if the joint operator conducted them independently). The accounting entries are recognised in the operator's own financial statements, and they flow through into the consolidated financial statements should the operator prepare them.

Joint venturers in a joint venture

28. A joint venturer, which is a party to a joint venture that has joint control, will need to recognise an investment in relation to its involvement in the joint venture and account for that investment using the equity method in accordance with IAS 28 (revised) (unless one of the previously mentioned scope exemptions apply).

> **PwC observation:** This is a significant change from IAS 31, which gave venturers a choice of proportionate consolidation or equity accounting for their interest. The joint venturer does not have rights to individual assets or obligations for individual liabilities of the joint venture and does not therefore reflect these in its financial statements.

29. The equity method involves recognising the venturer's share of profit or loss after tax as a separate line item in the income statement, and its share of other comprehensive income as a separate line item in the statement of comprehensive income.

30. The investment in the joint venture will be shown as a separate line item on the balance sheet. It is initially recognised at cost and subsequently adjusted by the share of profit or loss and other comprehensive income of the joint venture. The share of profit or loss may need to be adjusted to reflect notional fair value adjustments arising from acquisition of the investment (see paragraph 70 below) and to remove the impact of any differences in the accounting policies of the joint venture. Any dividends received are deducted from the carrying amount of the investment.

31. The equity method requires shares of losses to be recognised only until the carrying amount of an interest in a joint venture is reduced to nil. Any further losses are not recognised unless the entity has a legal or constructive obligation in respect of the liabilities associated with those losses. As the equity method is used for arrangements where investors have a share in the net result of an operation rather than underlying liabilities, it is less likely that this obligation exists. However, a clear understanding of the underlying contracts and agreements is critical.

32. The financial information used by the venturer for the purposes of equity accounting should be for the same reporting period unless this is impracticable. The reporting date of the joint venture cannot differ from that of the venturer by more than three months. In any event, adjustments need to be made for any significant transactions occurring between the different reporting dates.

33. Where the joint venture is loss-making, the venturer will only recognise its share of the loss until the carrying amount of its interest in the joint venture is reduced to zero. No further losses are recognised unless the venturer has incurred legal or constructive obligations or made payments on behalf of the joint venture. Where these obligations exist, entities should consider whether they indicate that the arrangement is actually a joint operation.

34. In the separate financial statements of the joint venturer, the venturer's interest in the joint venture is measured at cost or in accordance with IFRS 9 (or IAS 39), per IAS 27 (revised).

35. The new standard only refers to transactions between a joint operator and a joint operation. Accounting for transactions between a joint venturer and a joint venture has been incorporated into IAS 28 (revised).

36. Gains and losses on upstream and downstream transactions between a venturer and joint venture are only recognised to the extent of the other parties' interests in that joint venture. The gains and losses not recorded represent the component not fully realised through a sale to third party by either the venturer or joint venture.

37. Upstream transactions are sales from the joint venture to the venturer; downstream transactions are sales from the venturer to the joint venture.

38. IAS 28 (revised) does not give specific guidance as to how the elimination of such unrealised profits is carried out in practice. In the case of upstream transactions, there are two possible alternatives; either the unrealised profit is eliminated against the carrying amount of the joint venture or against the asset received.

39. In the case of downstream transactions, the elimination of unrealised profits is against the carrying amount of the joint venture, as the related asset has been transferred to the associate.

40. Unrealised losses are not be eliminated (are recognised) to the extent that the transaction provides evidence of an impairment of the asset transferred.

PwC observation: Accounting for transactions between joint venturers and joint ventures is consistent with the previous requirements of IAS 31 and SIC 13, 'Jointly controlled entities – non-monetary contributions by venturers'.

Parties to a joint arrangement that do not share joint control

41. Not all parties to a joint arrangement need to have joint control. Some parties may only have limited involvement, and the accounting for these parties may well be different.

42. Parties to joint operations that do not share joint control should:
   - follow the accounting of a joint operator where the party has rights to the assets and obligations for the liabilities; or
   - account for its interest in the joint operation in accordance with other applicable IFRSs where it does not have rights to the assets or obligations for the liabilities.

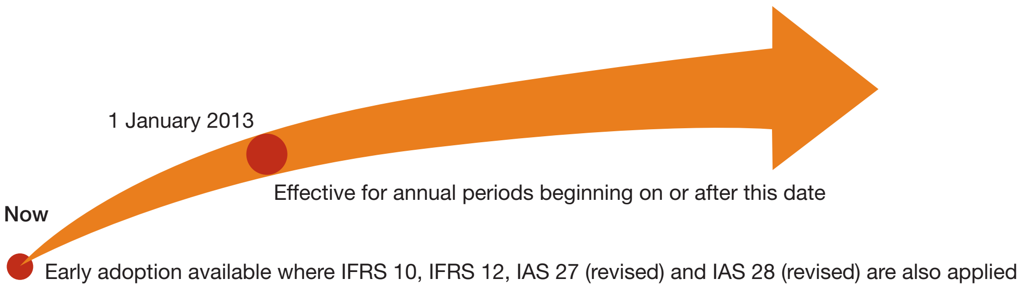
   An example of the latter point may arise where a party has contributed funding to a joint operation in return for a right to the share of the output from the joint operation, as opposed to direct rights to assets or obligations for liabilities. The party will need to account for this right in accordance with IAS 38, 'Intangible assets'.

43. A party to a joint venture that does not share joint control accounts for its interest in accordance with IFRS 9 (or IAS 39), or in accordance with IAS 28 (revised) if the party has significant influence.

Summary of joint arrangement accounting

	Consolidated financial statements	Separate financial statements
Parties that share joint control		
Joint operations	Joint operators recognise their interest in the direct rights and obligations of the arrangement, and their share of those assets, liabilities and transactions incurred jointly.	
Joint ventures	Accounted for in accordance with the equity method, unless a scope exclusion applies.	Investment is measured at cost or in accordance with IFRS 9 (or IAS 39).
Parties that do not share joint control		
Joint operations	Follows the accounting of parties that share joint control, or where the party does not have direct rights or obligations, then in accordance with other applicable IFRSs.	
Joint ventures	*Where the party significantly influences the arrangement:*	
	Accounted for in accordance with the equity method, unless a scope exclusion applies.	Investment is measured at cost or in accordance with IFRS 9 (or IAS 39).
	Where the party does not significantly influence the arrangement:	
	It is accounted for in accordance with IFRS 9 (or IAS 39).	

Transition



Retrospective application is required on all existing arrangements from the beginning of the earliest period presented. Existing arrangements are not grandfathered. Separate transition guidance is provided for joint ventures and joint operations.

Joint ventures – transitioning from proportionate consolidation to equity method

44. An entity that concludes it has an interest in a joint venture may be required to transition from proportionate consolidation to the equity method of accounting.

PwC observation: The previous policy choice between proportionate consolidation and equity accounting is no longer available for joint ventures. This is the most significant change under the new standard. Those who previously selected proportionate consolidation and have interests in joint ventures will need to transition to equity accounting.

45. The equity accounted investment in the joint venture is recognised at the beginning of the earliest period presented as the total of the carrying amounts of the assets and liabilities previously proportionately consolidated by the entity. This includes any goodwill arising from the acquisition.

PwC observation: The transition adjustment consolidates the share of all assets and liabilities previously recognised into a single line item called 'Investment in joint venture'. There is a nil net effect on balance sheet from this exercise where there are no impairment issues. The change could have an effect on certain loan covenants and other agreements, such as those based on asset ratios.

46. The opening balance of the investment is regarded as the deemed cost for the investment. The entity then considers impairment, applying paragraphs 31-34 of IAS 28 (revised). Any impairment will be an adjustment to retained earnings at the beginning of the earliest period presented.

PwC observation: Under IAS 28 (revised), the investment will be seen as a single unit of account for impairment testing; the determination of the 'value in use' uses cash flows different from those used to measure the 'value in use' of individual assets. IAS 28 (revised) directs preparers to consider the impairment triggers in IAS 39.

47. Negative net assets may arise when combining the carrying amount of assets and liabilities into a single line investment. An entity is required to assess whether they have legal or constructive obligations in relation to those negative net assets. If an obligation exists the entity should recognise a liability for the appropriate amount. If there is no legal or constructive obligation in relation to the negative net assets, the entity does not recognise a liability. The entity discloses any liability that has not been recognised, along with the cumulative unrecognised share of losses of the joint venture at the date that the standard is first applied.

48. An entity discloses, on a disaggregated basis, the assets and liabilities that have been aggregated into the single line 'investment in joint venture' balance when IFRS 11 is first applied. The disclosure is presented on a totals basis for all joint ventures that have transitioned from proportionate consolidation to the equity method.

PwC observation: The transition disclosure requirements will apply to the assets and liabilities as at the beginning of the earliest period presented. We suggest presenting the required information in tabular format rather than in narrative form.

49. After initial recognition, an entity should account for its investment in the joint venture using the equity method in accordance with IAS 28 (revised).

Joint operations – transitioning from equity method to accounting for assets and liabilities

50. An entity may determine that an interest in a joint arrangement, previously accounted for under the equity method, meets the definition of a joint operation. The entity will need to account for its share of the assets and liabilities. The amount previously recognised as an investment should be derecognised. The entity then recognises its share of each of the assets and liabilities in the joint operation including any goodwill that formed part of the original investment

51. An entity should measure the initial carrying amounts of these assets and liabilities by disaggregating the carrying amount of the investment at the beginning of the comparative period into its component assets and liabilities. The measurement of these components should be based on the information previously used by the entity for its equity accounting at the beginning of the comparative period, including any goodwill from the original acquisition.

PwC observation: The most visible effect of transition will be a grossing-up of assets and liabilities on the face of the balance sheet. In many cases there will be no difference in net terms between this share of assets and liabilities and the equity investment. However, the Basis for Conclusions notes:

- Assets and liabilities may be higher if the equity investment had been impaired.
- Assets and liabilities may be lower if rights to individual assets are different from the share used for equity accounting – for example, the operator may own 50% of a vehicle but only have rights to 40% of the underlying assets.

Another possibility is that the operator stopped recognising losses where they were previously performing equity accounting, and now concludes that it was not appropriate, as they had an obligation for the liabilities.

Preparers should also be alert to the effect on loan covenants of asset reclassification from non-current to current.

52. Any difference between the previous carrying amount of the investment and the net amount of the shares of assets and liabilities recognised is adjusted as follows:
    - Where the net amount of assets and liabilities is higher than the investment, first offset against any goodwill and then retained earnings at the transition date; or
    - Where the net amount of assets and liabilities is lower than the investment, take directly to retained earnings at the transition date.

PwC observation: Under the equity accounting method, the investment was recognised as a single unit of account. Therefore, any impairment considerations would have been performed on the investment as a whole. If the investment has been impaired previously, its carrying amount may be less than the net amounts of the shares of assets and liabilities recognised for a joint operation on disaggregation. The difference is initially offset against any goodwill; any residual adjustment is taken to retained earnings at the date of transition.

53. An entity transitioning from the joint venture entity classification to a joint operation should provide a reconciliation between the investment derecognised, and the assets and liabilities recognised, as at the beginning of the earliest period presented. Any balance adjusted in retained earnings should be disclosed in this reconciliation.

Transition provisions in an entity's separate financial statements

54. An entity must retrospectively apply IFRS 11 in its separate financial statements.

55. Adoption of IFRS 11 will affect the separate financial statements of an entity with joint arrangements that were:
    - jointly controlled entities under IAS 31 and are concluded to be a joint operation under IFRS 11; and
    - joint operations under IAS 31 and concluded to be a joint venture under IFRS 11.

	Jointly controlled entity → Joint operation	Joint operation → Joint venture
Previous accounting	Entities would have previously followed IAS 27 and accounted in their separate financial statements for their involvement in a joint controlled entity as an investment at cost or in accordance with IAS 39/IFRS 9.	Entities would have previously recognised their interest in the direct rights and obligations of the arrangement, and their share of those assets, liabilities and transactions incurred jointly.
Transition provision	On transition, the entity: – derecognises the investment and recognises its share of the assets and liabilities relating to its involvement in the joint operation, at the amounts determined in accordance with paragraphs 50-53 above; and – provides a reconciliation between the investment derecognised and share of assets and liabilities recognised, together with any balance adjusted in retained earnings, at the beginning of the earliest period presented.	Entities will measure their interest in a joint venture at cost or in accordance with IFRS 9 (or IAS 39) in its separate financial statements. On transition, the deemed cost of the interest in the joint venture is determined by aggregating the total of the carrying amounts of the assets and liabilities previously proportionately consolidated by the entity, including any goodwill arising from the acquisition. Refer to paragraphs 44-49 for further information.

PwC observation: The accounting for jointly controlled operations and assets that are now joint operations, and jointly controlled entities now concluded to be joint ventures under IFRS 11, will be unchanged in the separate financial statements.

Disclosures

56. The disclosure requirements for joint arrangements have been included IFRS 12.

57. The objective of IFRS 12 is to *disclose information that helps financial statement readers to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities (IFRS 12.1). Reporting entities should disclose any additional information that is necessary to meet this objective* (IFRS 12.3).

58. IFRS 12 applies to interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. This practical guide considers disclosures for joint arrangements.

59. The disclosure requirements outlined in IFRS 12 do not apply to parties to a joint arrangement that do not share joint control, except where such parties significantly influence the arrangement.

60. Broadly, the following are required to be disclosed in relation to an entity's involvement with joint arrangements:
    - significant judgements and assumptions made in determining whether there is joint control and the type of joint arrangement;
    - the nature, extent and financial effects of an entity's interest in joint arrangements, including the nature and effects of its contractual relationship with the other investors with joint control of, or significant influence over, joint arrangements; and
    - the nature of, and changes in, the risks associated with its interests in joint ventures

The detailed disclosure requirements of IFRS 12 are outlined in the Appendix, p22.

PwC observation: The financial information to be disclosed for individual joint ventures is far more detailed than previously required by IAS 31. Disclosure is required of certain classes of assets and liabilities as well as particular totals of assets and liabilities. Certain items of revenue and expense also need to be disclosed.

Other considerations

Formation of joint arrangement

Joint operations

61. The standard requires a joint operator to recognise its assets, liabilities, revenue and expenses and its joint share of any of those elements in accordance with the relevant IFRSs.

62. A joint operator may use its own assets in the joint operation. If it retains full ownership or control of those assets, there is no accounting impact.

63. Where the other operators become entitled to an interest in those assets, the joint operator would derecognise the relevant proportion of the asset and recognise a gain or loss for the difference between the amount derecognised and the fair value of any consideration received. Similarly, the operator would recognise its share of the fair value of the assets of the other operators to which it becomes entitled.

64. Where these transactions represent the contribution of assets to the joint operation, gains and losses should only be recognised to the extent of the other parties' interest in the operation.

65. In other cases, the joint operator may acquire assets or incur liabilities jointly with the other operators. The joint operator will record its proportionate interest in those assets and liabilities in accordance with the relevant standards; for example, IAS 16 for interests in property, plant and equipment and IFRS 9 (or IAS 39) for financial assets or liabilities.

Joint ventures

66. The standard directs a joint venturer to IAS 28 (revised) to account for its investment. In accordance with the IAS 28 (revised), an investment in a joint venture is initially recorded at cost. Cost is not specifically defined in the standard. The IASB Glossary of Terms defines cost as *the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction, or, when applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs, e.g. IFRS 2.*

67. If a pre-existing investee becomes a joint venture, the initial measurement of cost depends upon the previous relationship between the venturer and investee, as outlined in the table below.

Previous investment	Accounting upon initial classification as a joint venture
Investments in equity instruments held at fair value through OCI	An accounting policy choice exists: – Fair value as deemed cost – any previously held interest is re-measured to fair value and added to the additional interest, fair value movements in other comprehensive income are reversed, with transaction costs expensed; or – Cost of each purchase – the cost is measured as the sum of the consideration paid for each purchase plus a share of investee's profits and other equity movements (for example, revaluation). Any acquisition-related costs are treated as part of the investment. Fair value movements in other comprehensive income are reversed.
Associate	Equity accounting continues. IAS 28 (revised) does not allow the retained interest to be remeasured to fair value.
Subsidiary	A conflict exists between IAS 28 (revised) paragraphs 28 and 30 and IFRS 10 paragraph 25 in accounting for the loss of control. – IAS 28 (revised) indicates that when non-monetary contributions are made to a joint venture, a gain or loss is recognised in relation to the portion no longer owned (that is, the unrelated investors' interests). – In contrast, IFRS 10 indicates upon loss of control of a subsidiary, any retained interest should be remeasured to its fair value with any resulting gain or loss recognised in profit and loss. As such, a gain or loss is recognised on the portion retained in addition to the gain or loss on the portion no longer owned. – Entities should therefore adopt a policy and consistently apply either IAS 28 (revised) or IFRS 10 when dealing with contributions of a subsidiary to a joint venture.

68. When contributing a business within a subsidiary to a joint venture in return for an equity interest in that joint venture, the same conflict between IAS 28 (revised) and IFRS 10 will arise. An accounting policy choice will also exist in this scenario.

69. Alternatively, a joint venturer may acquire an interest in a joint venture from an existing venturer. In these circumstances, the requirements of IAS 28 (revised) apply. Under the standard, the cost of acquisition is compared to the fair value of the venture's net identifiable assets and liabilities to measure goodwill. Any goodwill is not recognised separately but is embedded in the carrying amount of the investment. A gain may be recognised if the fair value of the net identifiable assets is greater than the cost of acquisition.

70. Any fair value adjustments identified by the joint venturer will not be recognised by the joint venture in the carrying amounts of its assets and liabilities. When equity accounting its interest in the joint venture, the joint venturer will need to adjust the results of the joint venture to take into account the impact of any notional fair value adjustments.

Disposals of interests or loss of joint control

71. An operator or venturer may dispose of their interest in a joint arrangement or otherwise lose joint control by, for example, rescinding the contractual arrangement which gave joint control.

PwC observation: The standard does not deal with accounting for loss of joint control over a joint operation. In our view, a gain or loss would be recognised and measured as the difference between the carrying amount of the assets and liabilities derecognised and the fair value of any consideration received or compensation paid. The party to the arrangement would continue to account for their remaining interest in the assets and liabilities, in accordance with other applicable IFRS.

72. Where an entity loses joint control over a joint venture but retains significant influence, the entity will continue to equity account for its interest in accordance with IAS 28 (revised). The entity does not remeasure its continuing ownership interest to fair value.

73. Where an entity loses joint control over a joint venture, but does not retain significant influence over the investee, the accounting is as follows:
    - If the investee becomes a subsidiary, apply IFRS 3, 'Business combinations', and IFRS 10. The interest held in the investee is remeasured to fair value and forms part of the consideration transferred to obtain control.
    - If the investee is neither a subsidiary nor an associate it is accounted for under IAS 39 or IFRS 9 as a financial asset. The fair value of the retained interest when joint control is lost becomes the fair value on initial recognition under those standards. A profit or loss is recognised for any difference between the fair value of the retained interest, any proceeds from disposal and the pre-existing carrying amount of the investment.

Changes in levels of ownership while retaining joint control

74. Accounting for changes in the level of ownership is relevant where an operator or venturer increases or decreases its interest in the joint arrangement while retaining joint control.

PwC observation: The standard does not deal with accounting for changes in an interest in a joint operation. The accounting should reflect the increase or decrease in the operator's interests in the joint operation's assets and liabilities. A gain or loss will be recognised for the difference between the net amount of the change in interest and the fair value of any consideration received or compensation paid.

75. If a venturer's ownership interest in a joint venture is reduced but equity accounting continues because it retains joint control or obtains significant influence, IAS 28 (revised) requires reclassification to profit or loss of the proportion of the gain or loss previously recognised in other comprehensive income relative to the reduction in ownership interest.

PwC observation: The standard does not deal with accounting for the change in the investor's interest in other components of equity; that is, amounts that have been recognised directly in equity rather than through comprehensive income. These include, for example, reserves recognised for share-based payments, transactions with non-controlling interests or common control transactions. Entities should develop a policy and apply it consistently until the accounting is clarified.

Neither the joint arrangements standard nor IAS 28 (revised) deals with an increase in ownership interest while retaining joint control. In our view, the cost of the additional interest is added to the existing carrying amount. Goodwill is calculated by comparing the cost of the additional interest to the relevant shares of the joint venture's net identifiable assets and liabilities. There is no step up to fair value of the previously held interest.

Industry insights

76. The new joint arrangements standard is expected to affect some industries more than others due to the types and volume of joint arrangements entered into.

77. We will shortly issue supplements to this practical guide that discuss some of the more significant implications for a number of industries to help readers identify and consider the implications of the standard in the following sectors:
    - Mining;
    - Utilities;
    - Telecommunications; and
    - Real estate and construction.

78. We encourage management to read the topics addressed in the supplements and consider the potential effects that the new standard could have on their existing joint arrangement practices and operations.

Appendix: Disclosure checklist

<table>
<tr><th>Disclosures</th><th>Appropriate disclosures made? (Yes/No*/NA)</th></tr>
<tr><td>Significant judgements and assumptions</td><td></td></tr>
<tr><td>An entity shall disclose information about significant judgements and assumptions made (and changes thereto) in determining whether:
(a) an entity has joint control of arrangement, and
(b) the type of joint arrangement (i.e. joint venture or joint operation).

The entity is also required to disclose the significant judgements and assumptions where there are changes in facts and circumstances resulting in a change in assessment as to whether the entity controls, jointly controls or significantly influences the arrangement.</td><td></td></tr>
<tr><td>Nature, extent and financial effects of an entity’s interests in joint arrangements</td><td></td></tr>
<tr><td>Where a joint arrangement is material to the entity, the entity discloses:
(a) the name of the joint arrangement;
(b) the nature of the entity’s relationship with the joint arrangement;
(c) the principal place of business (and country of incorporation, if applicable and different from the principal place of business) of the joint arrangement; and
(d) the proportion of ownership interest or participating share held by the entity and, if different, the proportion of voting rights held (if applicable).</td><td></td></tr>
<tr><td>Where a joint venture is material to the entity, the entity discloses:
(a) whether the investment in the joint venture is measured using the equity method or at fair value;
(b) if the joint venture is accounted for using the equity method, the fair value of its investment in the joint venture if there is a quoted market price for the investment;
(c) dividends received from the joint venture;
(d) summarised financial information** about the joint venture, as presented within the joint venture’s IFRS financial statements, including but not limited to the joint venture’s:
– current assets,
– non-current assets,
– current liabilities,
– non-current liabilities,
– revenue,
– profit or loss from continuing operations,
– post-tax profit or loss from discontinued operations,
– other comprehensive income,
– total comprehensive income,
– cash and cash equivalents ,
– current financial liabilities (excluding trade and other payables and provisions),
– non-current financial liabilities (excluding trade and other payables and provisions),
– depreciation and amortisation,
– interest income,
– interest expense, and
– income tax expense or income.

** Where the joint venture is measured using the equity method, the equity accounted investment may be adjusted by the entity, for example, to align accounting policies. The summarised financial information of the joint venture should include these adjustments, and a reconciliation provided between the summarised financial information presented and the carrying amount of its interest in the joint venture.

Where an entity measures its interest in the joint venture at fair value, and IFRS financial statements are not prepared by the joint venture (as this would be impracticable/cause undue cost), the entity is required to the basis on which the summarised financial information is presented.</td><td></td></tr>
</table>

* If the answer is ‘no’, further justification should be provided.

Disclosures	Appropriate disclosures made? (Yes/No*/NA)
Where a joint venture is individually immaterial to the entity, the entity discloses in aggregate: (a) the carrying amount of its interests in all individually immaterial joint ventures that are accounted for using the equity method; and (b) the entity's share of the joint ventures': – profit or loss from continuing operations, – post-tax profit or loss from discontinued operations, – other comprehensive income, and – total comprehensive income.	
The nature and extent of any significant restrictions on the ability of joint ventures to transfer funds to the entity in the form of cash dividends, or to repay loans or advances made by the entity.	
When the financial statements of a joint venture used in applying the equity method are as of a date or for a period that is different from that of the entity: (a) the date of the end of the reporting period of the financial statements of that joint venture; and (b) the reason for using a different date or period.	
The unrecognised share of losses of a joint venture both for the reporting period and cumulatively, if the entity has stopped recognising its share of losses of the joint venture when applying the equity method.	
Risks associated with an entity's interests in joint ventures	
Commitments that the entity has relating to its joint ventures (including its share of commitments made jointly with other investors with joint control of a joint venture) separately from the amount of other commitments. Examples of such commitments include: (a) unrecognised commitments to contribute funding or resources as a result of, for example, the constitution, capital intensive projects, unconditional purchase obligations, or unrecognised commitments to provide financial support; and (b) unrecognised commitments to acquire another party's ownership interest (or a portion of that ownership interest) in a joint venture if a particular event occurs or does not occur in the future. Contingent liabilities incurred relating to its interests in joint ventures (including its share of contingent liabilities incurred jointly with other investors with joint control of, or significant influence over, the joint ventures), separately from the amount of other contingent liabilities, unless the probability of loss is remote.	

* If the answer is 'no', further justification should be provided.