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**MASTER'S THESIS**

**THE EFFECTS OF IFRS 11 ON BUSINESSES**  
**AND FINANCIAL STATEMENTS**

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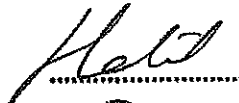

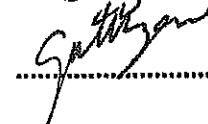
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## **DECLARATION**

I hereby declare that this doctoral thesis titled as “The Effects of IFRS 11 on Businesses and Financial Statements” has been written by myself in accordance with the academic rules and ethical conduct. I also declare that all materials benefited in this thesis consist of the mentioned resources in the reference list. I verify all these with my honour.

27/08/2013

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**ABSTRACT**  
**Master's Thesis**  
**IFRS 11 and Its Effects on Businesses**  
**and Financial Statements**  
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In May 2011, the International Accounting Standards Board (IASB) issued new standard IFRS 11 *Joint Arrangements*. IFRS 11 replaces IAS 31 *Interests in Joint Ventures*. IFRS 11 uses some of the same terms as IAS 31, but with different meanings. This publication describes the requirements of IFRS 11, explores application issues related to IFRS 11 and also describes the related disclosure requirements for joint arrangements and joint ventures.

**Keywords: IFRS 11, Joint Controlled Entity, Joint Venture, Joint Arrangements**

## **ÖZET**

**Yüksek Lisans Tezi**

**UFRS 11 ve İşletmeler ve  
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Mayıs 2011 de Uluslararası Muhasebe Standartları Kurulu, yeni standard olan UFRS 11 Müşterek Anlaşmalar standardını yayınladı. UFRS 11, UMS 31 İş Ortaklıklarındaki Payları standardının yerini almaktadır. Bu çalışma UFRS 11'in temel gereksinimlerini açıklamakta, UFRS 11 ile ilgili uygulama konuları üzerine yoğunlaşmakta ve ayrıca müşterek anlaşmalar ve ortaklar ile ilgili açıklamaları anlatmaktadır.

**Anahtar Kelimeler: UFRS 11, Müşterek Kontrol Edilen İşletme, İş Ortaklığı, Müşterek Anlaşma**

# **THE EFFECTS OF IFRS 11 ON BUSINESSES AND FINANCIAL STATEMENTS**

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## INTRODUCTION

In May 2011, the International Accounting Standards Board (IASB) issued three new standards: IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*. These new standards are effective for annual periods beginning on or after 1 January 2013, and must be applied retrospectively (with some modifications).

IFRS 11 replaces IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly-controlled Entities — Non-monetary Contributions by Venturers*. IFRS 11 uses some of the same terms as IAS 31, but with different meanings.<sup>1</sup> Thus, there may be some confusion whether IFRS 11 is a significant change from IAS 31. For example, whereas IAS 31 identified three forms of joint ventures where there is joint control (i.e., jointly controlled operations, jointly controlled assets and jointly controlled entities, or JCEs), IFRS 11 addresses only two forms of joint arrangements (joint operations and joint ventures).<sup>2</sup>

One of the primary reasons for the issuance of IFRS 11 was to increase comparability within IFRS by removing the choice for JCEs to use proportionate consolidation. Instead, JCEs that meet the definition of a joint venture (as newly defined) must be accounted for using the equity method. This also converges with US GAAP, which generally requires the equity method for joint ventures. For joint operations (including former jointly controlled operations, jointly controlled assets and, potentially, some former JCEs), an entity recognises its assets, liabilities, revenues and expenses, and/or its relative share of those items, if any. Many incorrectly refer to the accounting for joint operations as 'proportionate consolidation'.<sup>3</sup> The two methods are technically different, as discussed further in this publication.

IFRS 11 is intended to broaden the focus for classifying a joint arrangement, so that the structure of the joint arrangement is not the only factor considered. Whereas IAS 31 focused

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<sup>1</sup> Joe B. Hoyle and Thomas F. Schaefer and Timothy S. Douppnik, **Advanced Accounting**, 11<sup>th</sup>. Edition, McGraw-Hill, New York, 2013, p.39.

<sup>2</sup> Joe B. Hoyle and others, p.92.

<sup>3</sup> Floyd A. Beams and Joseph H. Anthony and Robin P. Clement and Suzanne H. Lowensohn, **Advanced Accounting**, 11<sup>th</sup>. Edition, Prentice Hall, New Jersey, 2012, p. 352.

exclusively on the legal form of the entity, IFRS 11 focuses more broadly on the rights and obligations arising from the arrangement.

Many of the disclosure requirements included in IAS 31 have been carried over to IFRS 12. However, one of the most significant changes introduced by IFRS 12 is that an entity is required to disclose the judgements made to determine whether it has joint control over another entity, as well as those made to classify joint arrangements. An entity is also required to disclose summarised financial information for each material joint venture.

This publication describes the requirements of IFRS 11, explores application issues related to IFRS 11 and describes the related disclosure requirements for joint arrangements and joint ventures. Because IFRS 11 uses the principle of control in IFRS 10 to define joint control, This study addresses some of the key questions that are being asked while implementing IFRS 11, recognising that some aspects of the standard are unclear.

## **CHAPTER ONE**

### **OVERVIEW**

#### **1.OVERVIEW**

There are many reasons why one might use a joint arrangement to conduct business, such as to:<sup>4</sup>

- Accelerate the development of new technologies
- Turn existing technologies into marketable products
- Enter new markets or industries
- Expand geographically
- Protect supply chain and production capacity
- Leverage intellectual property held by others (including competitors)
- Distribute risk
- Act as an alternative to raising bank or equity financing
- Bring in additional expertise
- Comply with the requirement of a government stakeholder
- Facilitate distribution of product
- Take the first step in acquiring a business

As discussed in more detail below, IFRS 11 covers all arrangements in which there is joint control. In practice, some agreements that are referred to as 'joint arrangements' or 'joint ventures' actually include arrangements whereby only one party has control, or no parties have joint control.<sup>5</sup> Other arrangements may not use the term 'joint arrangement' or 'joint control', but

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<sup>4</sup> Accounting Interpretation No.2 of APB Opinion No.18, **Investments in Partnerships and Ventures**, American Institute of Certified Public Accountants, New York, 1971, p.4.

<sup>5</sup> Joe B. Hoyle and others, p.643.

could still be joint arrangements, as defined by IFRS 11. Some arrangements split ownership equally (50/50) between two parties — while others may give a greater financial interest to one of the two parties.<sup>6</sup> No matter what terminology is used to describe the arrangement, or its purpose, management will need to carefully evaluate the terms of the arrangement, and the relevant facts and circumstances, to determine if it qualifies as a joint arrangement.

We explore the definition of joint control and the concept of a joint arrangement in more detail in Chapters 2. In Chapters 3, we explain the two types of joint arrangements defined in IFRS 11, joint operations and joint ventures, and explain how to classify a joint arrangement as one or the other. We also discuss in Chapter 3 the importance of considering the rights and obligations in the context of the ‘normal course of business’ when classifying a joint arrangement. Diagram 1 summarises the definitions and accounting for each type of joint arrangement, as well as the interaction between IFRS 10, IFRS 11, IFRS 12 and IAS 28

**Excerpts from IFRS 11**

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.
  - b. The contractual arrangement gives two or more of those parties joint control of the arrangement.
6. A joint arrangement is either a *joint operation* or a *joint venture*.
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.

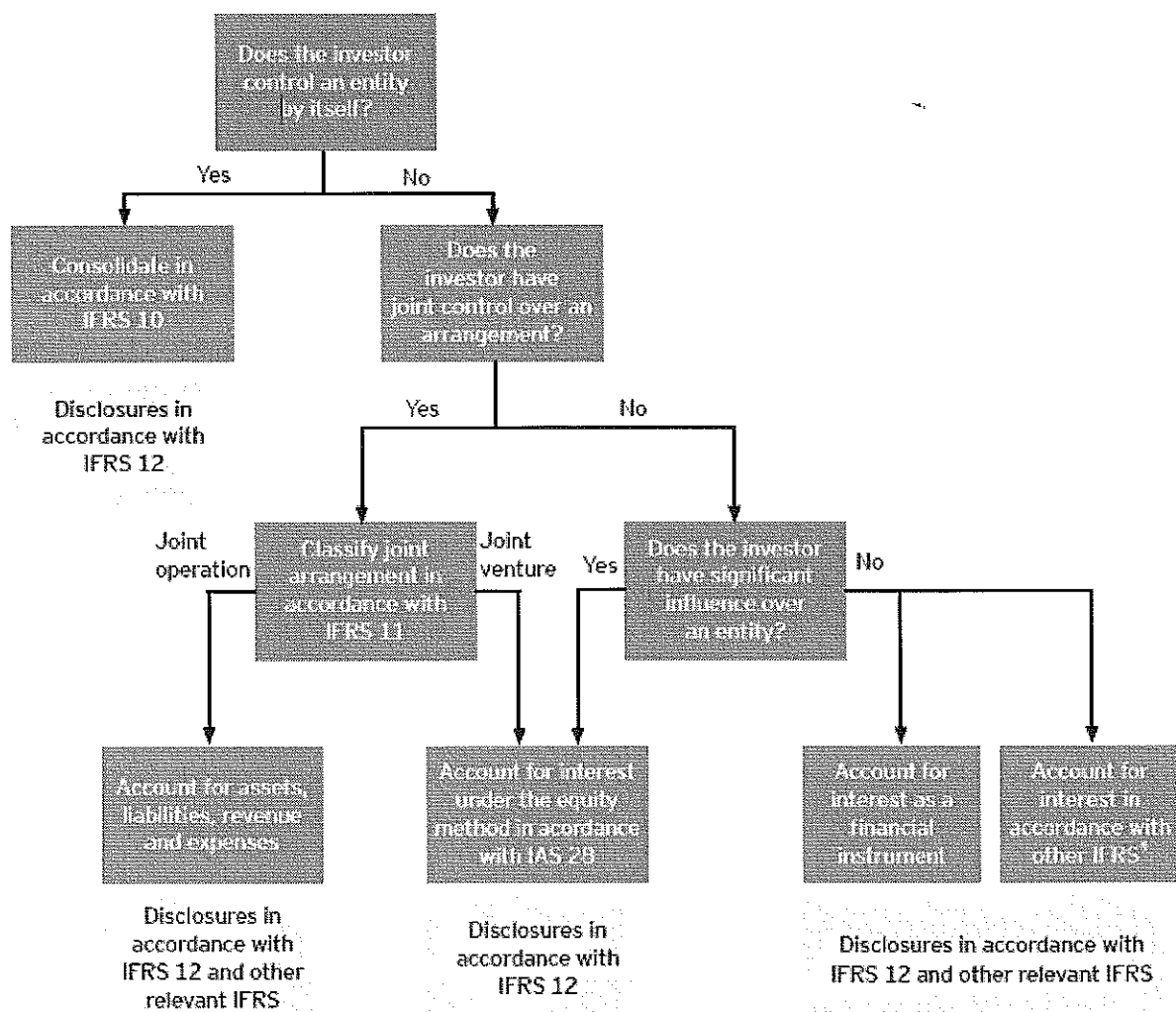
*Investments in Associates and Joint Ventures*.<sup>3</sup> The accounting for joint ventures is discussed in further detail in Chapter 3.

**Box 1:** Excerpts from IFRS 11

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<sup>6</sup> Floyd A. Beams and others, p.98.

**Diagram 15:** Interaction between IFRS 10, IFRS 11, IFRS 12 and IAS 28



## CHAPTER TWO

### SCOPE AND CONCEPTS OF IFRS 11

Although the change in the title of the standard (i.e., from ‘joint ventures’ to ‘joint arrangements’) might indicate otherwise, the scope of IFRS 11 was intended to be generally the same as IAS 31, in that it still describes the requirements for arrangements only where there is joint control. However, since the definition of ‘control’ within ‘joint control’ refers to IFRS 10, and that definition is broader than the notions of ‘control’ under IAS 27, more arrangements might qualify as joint arrangements under IFRS 11.

#### 2.1 APPLICATION BY VENTURE CAPITAL ORGANIZATIONS

IFRS 11 applies to all entities that are party to a joint arrangement, including venture capital organisations, mutual funds, unit trusts, investment-linked insurance funds and similar entities (referred to hereafter as simply venture capital organisations). At first glance, this is a change for these venture capital organisations, which were excluded from the scope of IAS 31.

However, venture capital organisations (which could choose to measure investments in JCEs at fair value under IAS 31) can still choose to measure investments in joint ventures at fair value under IAS 28.<sup>7</sup> The IASB determined that rather than carrying forward the ‘scope exemption’ for venture capital organisations, the option to use fair value was better characterised as a ‘measurement exemption.’ Accordingly, this option is included within IAS 28, which describes how to apply the equity method to joint ventures and associates.

For a venture capital organisation to use the measurement exemption and measure an investment in a joint venture at fair value under IAS 28, it must meet all of the following criteria, per IAS 39 *Financial Instruments: Recognition and Measurement*:

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<sup>7</sup> Ante, Spencer E., *Creative Capital: Georges Doriot and the Birth of Venture Capital*, Harvard Business School Press 2008 Cambridge, 2008.

- The group of financial assets (i.e., the joint ventures and any other investments in that portfolio) must be managed and its performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy<sup>8</sup>
- Information about the group must be provided internally on a fair value basis to the entity's key management personnel<sup>9</sup> (as defined in IAS 24 *Related Party Disclosures*)
- The venture capital organisation must be able to reliably measure the fair value for that group<sup>10</sup>

Venture capital organisations are subject to the disclosure requirements of IFRS 12.

### **2.1.1 Use of the measurement exemption by a 'segment' of an entity**

In some cases, a segment of an entity operates as a venture capital organisation. Under IAS 31, some questioned whether a segment that is a venture capital organisation could measure the segment's investment in a joint venture using fair value, rather than the equity method.<sup>11</sup> IFRS 11 does not provide any further clarity on the issue. On the other hand we continue to believe, as we did under IAS 31, that a segment of an entity that is a venture capital organization may use the measurement exemption under IAS 28 if management monitors that segment as a venture capital business. In addition, venture capital activity must be a substantive part of its business. This is because the measurement exemption refers to investments in joint ventures that are held by venture capital organisations, rather than referring to the financial statements of a venture capital organisation. The latter would have implied that the entire entity must be a venture capital organisation. We persist in our view that venture capital organisations' measurement of investments in joint ventures at fair value generally produces more relevant information than the equity method. In addition, using fair value continues to be a well-established practice in the venture capital industry. However, we still believe that, in such cases, it would be

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<sup>8</sup> Gürbüz Gökçen and Başak Ataman and Cemal Çakıcı, *Türkiye Finansal Raporlama Standartları Uygulamaları*, Türkmen Kitabevi, İstanbul, 2011, p.499.

<sup>9</sup> Gürbüz Gökçen and others, p.499.

<sup>10</sup> Gürbüz Gökçen and others, p.499.

<sup>11</sup> Ralph Tiffin, *Complete Guide to International Financial Reporting Standards: Including IAS and Interpretation*, Thorogood, London, 2004, p.84.

important for a venture capital segment of an entity to demonstrate that it manages its investments in joint ventures based on fair value.

Venture capital organisations, and segments thereof, should closely watch the IASB and the FASB's joint project on investment entities, since the outcome of that project may affect whether such entities will continue to be able to use the measurement exemption in the future

## **2.2 JOINT ARRANGEMENT**

Names can be misleading. Some agreements that are referred to as 'joint arrangements' actually include arrangements whereby one party has control of an entity. In these arrangements, the entity with control would consolidate it and the other parties would account for their interest in that entity based on the nature of their investment. Other arrangements may not be referred to as 'joint arrangements', but may still be joint arrangements, as defined by IFRS 11. In other words, the name of the agreement is not important — it only matters whether it meets the definition of a joint arrangement, as set out in IFRS 11<sup>12</sup>.

IFRS 11 notes that a contractual arrangement is often, but not always, in writing (although we expect unwritten agreements to be rare in practice). Statutory mechanisms can create enforceable arrangements, either on their own or in conjunction with contracts among the parties. A contractual agreement may be incorporated in the articles, charter or by-laws of the entity (or the 'separate vehicle' — a new term that is a broader concept than 'entity'.

Contractual arrangements generally specify the following:

- Purpose, activity and duration of the joint arrangement
- Appointment of members of the board of directors (or equivalent governing body)
- Decision-making processes:
  - Matters requiring decisions from the parties
  - Voting rights of the parties

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<sup>12</sup> A joint arrangement is an arrangement of which two or more parties have joint control. A joint arrangement has the following characteristics: (a) The parties are bound by a contractual arrangement. (b) The contractual arrangement gives two or more of those parties joint control of the arrangement

- Required level of agreement for those matters
- Capital or other contributions requirements
- Sharing of assets, liabilities, revenues, expenses or profit or loss relating to the joint arrangement

### **2.2.1 Unit of Account**

IFRS 11 does not explicitly specify the unit of account for determining whether a joint arrangement exists. However, it seems that the IASB intended for the unit of account for a joint arrangement to be the activity that two or more parties have agreed to control jointly.

Accordingly, it would seem that a party assesses its rights to the assets, and obligations for the liabilities, relating to that activity. Applying the approach from the Basis for Conclusions on IFRS 11 in practice would likely result in the following views:

- Can the unit of account be larger than an entity or separate vehicle? — Yes, if the activity that two or more parties have agreed to control jointly is larger than an entity or separate vehicle. This might be the case when there are multiple arrangements related to the same activity
- Can there be more than one unit of account within an entity or separate vehicle? — Yes, if there is more than one activity that two or more parties have agreed to control jointly within an entity or separate vehicle. Typically, we might expect that there is some sort of division or segmentation between the two activities within the entity or separate vehicle.
- Can there be more than one unit of account within a master agreement? — Yes, if there is more than one activity that two or more parties have agreed to control jointly within the master agreement.

When identifying the unit of account for a joint arrangement, generally, it is appropriate to start by examining the contractual agreement. Frequently, each contractual agreement creates a single joint arrangement.<sup>13</sup> However, some contracts may contain more than one joint

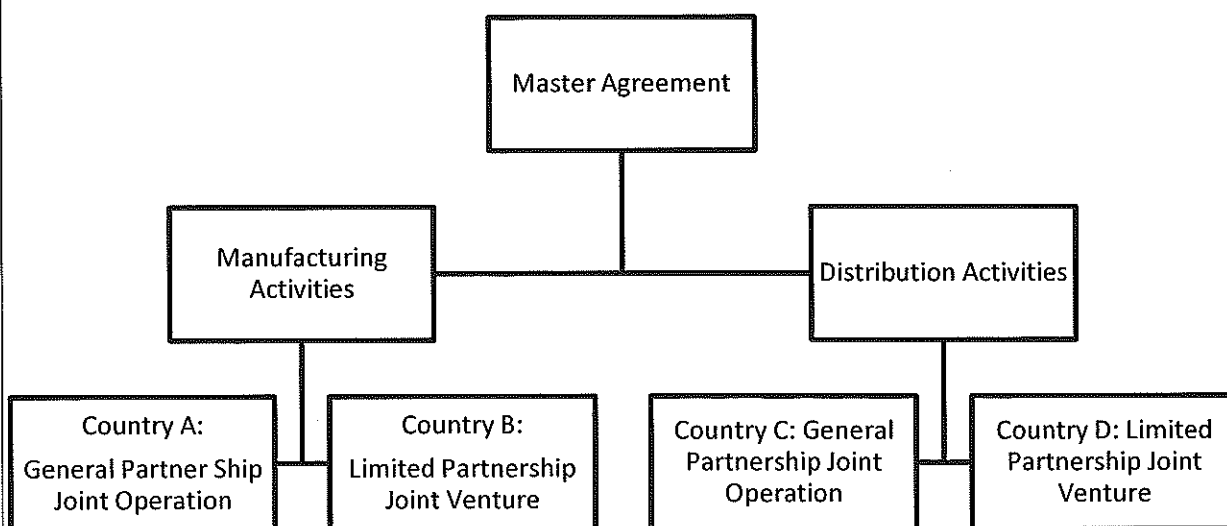
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<sup>13</sup> Floyd A. Beams and others, p.112

arrangement. For example, a master agreement (referred to in IFRS 11 as a ‘framework agreement’) may contain the terms and conditions for numerous separate joint arrangements. Example 1 illustrates a case where a master agreement may be accounted for as several distinct joint arrangements, each of which is classified as either a joint operation or a joint venture.

**Box 2:** Example of Master Agreement for Manufacturing and Distribution

A single contract between two parties specifies the terms and conditions related to manufacturing and distribution activities, and dictates how these activities will be carried out in various jurisdictions through several entities.



The parties may determine that this agreement contains several discrete joint arrangements (one for each activity in each jurisdiction, which corresponds to an entity). In this case, each entity would likely be classified as a joint venture or a joint operation. This would likely be the case if the terms and conditions relating to each activity were distinct for each entity.

**Variation-**A contract between two parties specifies the terms and conditions related to manufacturing and distribution activities, and dictates how these activities will be carried out in various jurisdictions. However, one party has the ability to direct the relevant activities in certain

entities (e.g., the entity in Country A), and the other party has the ability to direct the relevant activities for others (e.g., the entity in Country B). In this case, there would not be joint control between the two parties. Rather, each party controls its respective entities.

In some cases, there will be multiple contractual agreements between parties related to the same activities, which may need to be analysed together to determine whether a joint arrangement exists, and if so, the type of joint arrangement.

In other cases, there may be a single master agreement between two parties that covers several different activities. Some of these activities may be controlled solely by one of the two parties, while other activities may be jointly controlled by the parties. Careful attention is required to determine the unit of account, and which arrangements, if any, are jointly controlled. Example 2 illustrates a case where a contract contains multiple agreements, only one of which is a joint arrangement.

**Box 3: Example of Agreements with control and joint control<sup>14</sup>**

**Example 2:**

A and B enter into a contractual arrangement to buy a building that has 12 floors, which they will lease to other parties. A and B each are responsible for leasing five floors each, and each can make all decisions related to their respective floors and keep all of the income with respect to their floors. The remaining two floors will be jointly managed — all decisions with respect to those two floors must be unanimously agreed between A and B, and they will share all profits equally. In this example, there are three arrangements:

- Five floors that A controls — accounted for under other IFRS
- Five floors that B controls — accounted for under other IFRS
- Two floors that A and B jointly control — a joint arrangement (within the scope of IFRS 11)

In this example, it is possible that the unit of account as determined for A and B under IFRS 11 differs from the unit of account for the previous owner under IAS 40 *Investment Property*

## 2.3 JOINT CONTROL

Since the crucial element of having a joint arrangement is joint control, it is important to understand the definition of this term. *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.<sup>15</sup>

The key aspects of joint control are as follows:

- *Contractually agreed* — See Chapter 3.
- *Control and relevant activities* — IFRS 10 describes how to assess whether a party has control, and how to identify the relevant activities, which are described in more detail in

<sup>14</sup> Ernst & Young, *Challenges in Adopting and Applying IFRS 11*, New York, 2011, p.21.

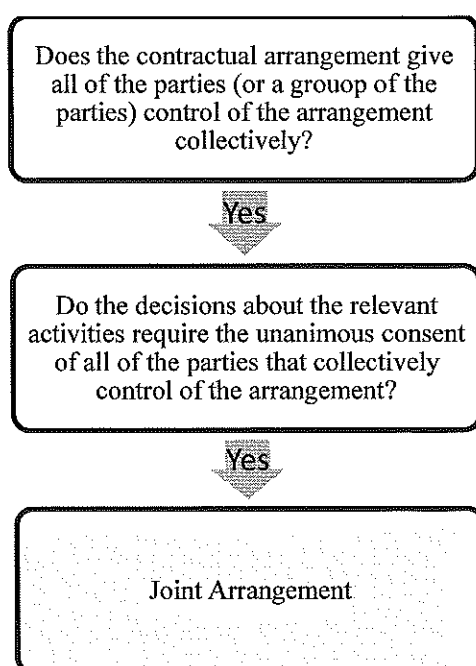
<sup>15</sup> A. Mirza, A. Holt and G.J. Orrell, *IFRS Workbook and Guide*, Wiley, USA, 2010, p.134

*IFRS 10*. We discuss some of the aspects of ‘relevant activities’ and ‘control’ that are most relevant to identifying joint control in this publication

- *Unanimous consent* — IFRS 11 notes that unanimous consent means that any party (with joint control) can prevent any of the other parties, or a group of the parties, from making unilateral decisions about the relevant activities without its consent.

The flowchart in Diagram illustrates how to evaluate if joint control exists.<sup>16</sup>

**Diagram 16:** Is it a joint arrangement?



Management should re-examine joint arrangements, and re-consider whether they have joint control, control or neither of these. Although it was not necessarily the intention of the IASB to widen (or reduce) the scope of IAS 31 when it issued IFRS 11, the change in definition of ‘joint arrangement’ and of ‘control’ may include or exclude different arrangements compared to the past.

<sup>16</sup> Diagram courtesy of IASB, IFRS 11 (paragraph B10).

Above, we discuss the concepts of control, determining the relevant activities, and unanimous consent in the context of joint arrangements. Understanding the purpose and design of an arrangement is crucial to identifying whether there is joint control.

### **2.3.1 Relevant Activities in A Joint Arrangement**

To determine whether a contractual arrangement gives parties control of an arrangement collectively, it is necessary first to identify the relevant activities of that arrangement. That is, what are the activities that significantly affect the returns of the arrangement.

When identifying the relevant activities, consideration should be given to the purpose and design of the arrangement. In particular, consideration should be given to the risks to which the joint arrangement was designed to be exposed, the risks the joint arrangement was designed to pass on to the parties involved with the joint arrangement, and whether the parties are exposed to some or all of those risks.

In many cases, directing the strategic operating and financial policies of the arrangement will be the activity that most significantly affects returns. Often, the arrangement requires the parties to agree on both of these policies. However, in some cases, unanimous consent may be required to direct the operating policies, but not the financial policies (or vice versa). In such cases, since the activities are directed by different parties, the parties would need to assess which of those two activities (operating or financing) most significantly affects returns, and whether there is joint control over that activity.<sup>17</sup> This would be the case whenever there is more than one activity that significantly affects returns of the arrangements, and those activities are directed by different parties. This is illustrated in Example 3.

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<sup>17</sup> A. Mirza and others, p.148.

**Box 4:** Example of more than one activity affects return of an arrangement<sup>18</sup>

Two parties enter into an agreement for the production and sale of a pharmaceutical product. Three activities significantly affect the returns of the arrangement:

- Production of the pharmaceutical product — one party is responsible for this activity
- Marketing and selling activities — the other party is responsible for these activities
- Both parties must approve all financial policies regarding production, marketing and selling activities (e.g., approval of budgets, and any significant amendments and deviations from the approved budgets require unanimous consent)

With respect to the first two activities, operating decisions by either party concerning their responsible area do not require unanimous consent, as long as the party is operating within the constraints of the budgets. That is, the agreement gives the parties freedom to perform their respective responsibilities.

In this example, the parties would have to determine which activity most significantly affects the returns of the arrangement.

The facts and circumstances might be that either of the first two activities could be the activity that most significantly affects the returns of the arrangement. If that were the case, then the party responsible for that activity would have power (and possibly control) over the arrangement, because it has the ability to direct that activity without the other party.

However, the facts and circumstances might be that the relevant activity is the direction of the financial policies. If that were the case, since unanimous consent is required to direct those financial policies, joint control would exist. This assumes that both parties have an exposure to variable returns from the arrangement. Having exposure to variable returns, and the ability to affect that exposure through having power, are requirements of control in IFRS 10, on which IFRS 11 is based.

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<sup>18</sup> Ernst&Young, p.38

### 2.3.1.1 Sequential activities

An arrangement may have different activities that occur at different stages. Generally, there are two situations:

- Parties may have rights to direct different activities
- Parties may collectively direct all of the activities

In the first situation, each party would assess whether it has rights to direct the activities that most significantly affect returns, and therefore whether it controls the arrangement. This situation does not result in joint control, and is described in Example 4, which is from IFRS 10.

In Example 4, there is not joint control, because the parties do not collectively direct the activities of the arrangement. Rather, one party directs each activity. However, if the fact pattern were changed such that they collectively directed the activities of the arrangement, then there would be joint control. This is described in Example 5.

**Box 5:** Example of Directing sequential activities separately<sup>19</sup>

Two investors form an investee to develop and market a medical product. One investor is responsible for developing and obtaining regulatory approval for the medical product. This includes having the unilateral ability to make all decisions relating to the development of the product and to obtain regulatory approval. Once the regulator has approved the product, the other investor will manufacture and market it — this investor has the unilateral ability to make all decisions about the manufacturing and marketing of the project. If all of the activities — developing and obtaining regulatory approval as well as manufacturing and marketing of the medical product — are relevant activities, each investor needs to determine whether it is able to direct the activities that most significantly affect the investee's returns

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<sup>19</sup> Ernst&Young, p.44.

Accordingly, each investor needs to consider whether developing and obtaining regulatory approval or the manufacturing and marketing of the medical product is the activity that most significantly affects the investee's returns and whether it is able to direct that activity. In determining which investor has power, the investors would consider:

- The purpose and design of the investe
- The factors that determine the profit margin, revenue and value of the investee as well as the value of the medical product
- The effect on the investee's returns resulting from each investor's decision-making authority with respect to the factors above
- The investors' exposure to variability of returns

In this particular example, the investors would also consider:

- The uncertainty of obtaining regulatory approval and effort required to do so (considering the investor's record of successfully developing and obtaining regulatory approval of medical products)
- Which investor controls the medical product once the development phase is successful.

**Box 6:** Example of Directing sequential activities jointly<sup>20</sup>

Two investors form an investee to develop and market a medical product; this will occur in two phases. The first phase is developing of the medical product and obtaining regulatory approval for that medical product. The second phase is the manufacturing and marketing of the medical product. The two investors agree that they will jointly make decisions over both phases.

Because the two investors make all decisions together throughout the term of the arrangement, it is unnecessary to determine which of the above activities most significantly affects the returns of

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<sup>20</sup> Ernst&Young, p.53

the arrangement, because they are all directed in the same manner. The investors have joint control over the arrangement.

### **2.3.2 Rights to Control Collectively**

To determine whether a contractual arrangement gives parties collective control of the arrangement, after identifying the relevant activities of that arrangement, it is necessary to determine what rights give a party the ability to direct the relevant activities. This is because, to have joint control, the parties must have collective control. To have control, the parties must collectively have power over the relevant activities<sup>21</sup>.

In many cases, the relevant activities are directed by voting rights that are held in proportion to ownership interests. However, this is not always the case, and attention should be paid to the facts and circumstances in each case.

#### **2.3.2.1 Protective rights**

IFRS 10 defines protective rights. Protective rights are rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.<sup>22</sup>

Protective rights relate to fundamental changes to the activities of the arrangement, or apply in exceptional circumstances. Since power is an essential element of control, protective rights do not give a party control over the arrangement. Holding protective rights cannot prevent another party from having power over an arrangement.<sup>23</sup>

Accordingly, when assessing whether a group of the parties collectively control an arrangement (and therefore whether there is joint control), consideration must be given to whether rightsheld by any of the parties are:

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<sup>21</sup> Gülşirin Bodur, **Finansal Raporlama Standartlarının Getirdiği Temel Değişiklikler ve Finansal Analize Etkileri**, Turhan Kitabevi, Ankara, 2012, p.212.

<sup>22</sup> İdil Kaya , **Türkiye Muhasebe ve Finansal Raporlama Standartlarında Konsolide Finansal Tablolar**, Türkmen Kitabevi, İstanbul, 2011, p.211.

<sup>23</sup> İdil Kaya, p.212.

- Protective (in which case, the other parties might collectively control the arrangement)
- Substantive (in which case, such rights could prevent the other parties from having joint control, or possibly give the holder of those rights control)

**Box 7: Example of Protective rights and joint control<sup>24</sup>**

A, B and C enter into a joint arrangement to conduct an activity in entity Z. The contractual agreement between A and B states that they must agree to direct all of the activities of Z. The agreement of C is not required, except that C has the right to veto the issuance of debt or equity instruments by Z. Issuing equity and debt instruments is deemed a protective right, because they represent fundamental changes in Z's business.

In this fact pattern, A and B have joint control over Z, because they collectively have the ability to direct Z, and the contractual agreement requires their consent. Although C is a party to the joint arrangement, C does not have joint control, because C only holds a protective right with respect to Z.

### **2.3.2.2 Potential voting rights and joint control**

IFRS 11 does not explicitly address how potential voting rights are treated when assessing whether there is joint control. However, since the definition of 'joint control' in IFRS has the same definition of 'joint control' as in IFRS 10, the requirements of IFRS 10 must be considered, if potential voting rights exist.

Understanding the purpose and design of the potential voting right, including the context in which it was issued or granted, is important to evaluating whether the potential voting right is substantive and, if so, whether joint control exists. If the potential voting right is substantive, then the holder could have joint control together with the other parties, if the terms of the contractual arrangement create an implicit case of joint control. For this to be the case, the holder and the

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<sup>24</sup> Ernst&Young, p.54.

other parties to the arrangement need to: (1) collectively control the arrangement; and (2) unanimously agree to direct the relevant activities of the arrangement.<sup>25</sup>

#### **2.3.2.3 Other evidence of joint control**

In some cases, it may be difficult to determine whether a party's rights give it power over an arrangement. In such cases, the party considers other evidence that it has the current ability to direct the relevant activities. This evidence is also considered when evaluating if the parties to an arrangement control that arrangement collectively<sup>26</sup> (i.e., in the evaluation of joint control).

In addition to the examples of evidence listed in IFRS 10, another fact that may indicate that a party has control (or joint control), is whether the parties can obtain the financial information needed to account for the arrangement (e.g., to apply the equity method) and to provide the required disclosures. If a party cannot obtain information regarding an arrangement (e.g., because management of that arrangement refuses to provide it), this might indicate that, the parties do not have collective control (and therefore, no joint control) over that arrangement.

#### **2.3.2.4 Delegated decision-making**

It is common in certain industries for one party to be appointed as manager of the arrangement. For example, this commonly occurs in the extractive industries. The manager in the extractive industries is frequently referred to as 'the operator', but given the introduction of the new terms 'joint operation' and 'joint operator', to avoid confusion we refer herein to such parties as 'manager'. The other parties to the arrangement may delegate some of the decision-making rights to this manager.<sup>27</sup>

Under IAS 31, it was generally concluded that the manager simply carried out the decisions of the parties in the arrangement as an agent. However, under IFRS 10 and IFRS 11, consideration should be given to whether the manager actually controls the arrangement.<sup>28</sup> When decision-making rights have been delegated, IFRS 10 describes how to assess whether the

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<sup>25</sup> Idil Kaya, p.212.

<sup>26</sup> Ernst&Young, *IFRS 10, 11 and 12 on Consolidation and Joint Arrangements*, New York, 2011, p.6.

<sup>27</sup> M.R. Hove, *Consolidated Financial Statements – An International Perspective*, Jute and Co., Cape Town, 2011, p.207.

<sup>28</sup> Ernst&Young, *Accounting for Joint arrangements in the Power and Utilities Sector*, New York, 2011, p.5.

decision-maker is acting as a principal or an agent, and therefore which party (if any) has control. Careful consideration of the following will be required:

- Scope of the manager's decision-making authority
- Rights held by others (e.g., protective, removal rights)
- Exposure to variability in returns through the remuneration of the manager
- Variable returns held through other interests (e.g., direct investments by the manager in the joint arrangement)

#### 2.3.2.5 Related parties and de facto agents

IFRS 10 notes that, in some cases, one party may act as a *de facto* agent for another party. *De facto* agents may include related parties (as defined in IAS 24).<sup>29</sup>

Since the concepts of IFRS 10 extend to IFRS 11, consideration must be given to whether control or joint control exists, when one party is a *de facto* agent of another, as illustrated in Example 7.

#### **Box 8:** Example of *De Facto Agents in Joint Control*<sup>30</sup>

A contractual arrangement has three parties: A has 50% of the voting rights and B and C each have 25%. The contractual arrangement between A, B and C specifies that at least 75% of the voting rights are required to make decisions about the relevant activities of the arrangement.

**Analysis** — There is neither control nor joint control, because more than one combination of parties can reach 75% and therefore direct the relevant activities.

<sup>29</sup> Şeref Demir, *Türkiye Muhasebe ve Finansal Raporlama Standartları*, Seçkin Yayıncılık, İstanbul, 2012, p.412.

<sup>30</sup> Ernst&Young, *Challenging*, p.56.

### Box 9: Variation of Example 7

**Variation** — If the facts and circumstances changed, such that C was deemed to be a *de facto* agent of B, then A and B would have joint control, because effectively B would direct 50% (in combination with C's 25%) and A would need B to agree to direct the relevant activities.

### 2.3.2.6 Role of government

In some emerging economies, the government may insist on retaining a 50% interest in certain arrangements. When a government is party to an arrangement, the arrangement needs to be carefully evaluated to determine whether joint control or control exists. This is illustrated in Example 8.

#### Box 10: Example of *Role of a Government*<sup>31</sup>

A government owns land, which is believed to contain oil reserves. The government enters into a contractual arrangement with an oil company to drill for oil and sell the product, which the oil company will do through a separate vehicle. The oil company will have to evaluate the contractual terms of the arrangement closely to determine whether it has joint control, control, or some other type of interest. The ownership percentages in the separate vehicle do not necessarily determine whether there is control by one party or joint control.

In some cases, the contractual terms may give all final decision-making authority over the development activities to the government, in which case, the government would have control, and the oil company would not have joint control.

However, in other cases, the decision-making authority may require unanimous consent by the government and the oil company to direct the activities, in which case, they would have joint control.

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<sup>31</sup> Ernst&Young, Power, p.6.

### 2.3.3 Unanimous Consent

IFRS 11 states that decisions about the relevant activities require the unanimous consent of all the parties, or a group of the parties, that collectively control the arrangement. Accordingly, it is not necessary for every party to the arrangement to agree to have unanimous consent. To have unanimous consent, only those parties that collectively control the arrangement must agree.

The requirement to have unanimous consent ensures that no single party controls the arrangement. While the requirement for unanimous consent is not new, IFRS 11 clarifies when unanimous consent exists.<sup>32</sup> For example, in some cases, a contractual arrangement may require a minimum proportion of the voting rights to make decisions. When that minimum can be achieved by more than one combination of the parties agreeing, the arrangement is not a joint arrangement unless it specifies which parties (or combination of parties) are required to agree unanimously to decisions about the relevant activities of the arrangement. IFRS 11 provides some examples to illustrate this point, which are summarised in Diagram .<sup>33</sup>

**Diagram 17:** Is it joint control?

Requirement	Scenario 1	Scenario 2
	75% vote to direct relevant activities	75% vote to direct relevant activities
Party A	50%	50%
Party B	30%	25%
Party C	20%	25%
Conclusion	Joint Control: A and B collectively control the arrangement (since their votes and only their votes, together meet the requirements)	No Joint Control: multiple combinations of parties could collectively control the arrangement (i.e., A and B or A and C could vote together to

<sup>32</sup> IASB, *A Guide Through International Financial Reporting Standards*, IASC, London, 2011, p.1531.

<sup>33</sup> Ernst&Young, *Challenging*, p.56.

	Because they are the only combination of the parties that collectively control the arrangement, it is clear that A and B unanimously agree.	meet the requirement). Since there are multiple combinations, and the contractual agreement does not specify which parties must agree, there is no unanimous consent.
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### 2.3.3.1 Passive investors

It is possible for two parties to an arrangement to have joint control, even if a third party has an interest in that joint arrangement, but does not have joint control. This situation is illustrated in Scenario 1 in Diagram 4 above.

IFRS 11 specifies the accounting for parties that participate in a joint arrangement, but who do not have joint control of that joint arrangement.<sup>34</sup>

### 2.3.3.2 Ultimate voting authority

Sometimes an arrangement is structured so that all parties have a vote, but in the case of a tie (deadlock), or disagreement, one party has the deciding vote. If any single party could direct the relevant activities unilaterally, there would not be joint control. Box 9 and 10 illustrate this point.

<sup>34</sup> IASB, 2013 International Financial Reporting Standards IFRS (Red Book), London, 2013, p.789.

**Box 11:** Example for *-Ultimate decision making authority- no joint control No.1*<sup>35</sup>

G and H enter into an agreement and set up a joint steering committee. One party has ultimate decision-making authority in cases where the joint steering committee cannot reach an agreement. In this case, there would not be joint control, since the agreement of the other party is not needed.

To evaluate whether the party with the deciding vote has control, one would also need to assess whether it has exposure to variable returns, and the ability to affect those returns through its power, as required by IFRS 10.

Just because one party has a deciding vote does **not** necessarily mean that it has control, particularly if other parties can act without the agreement of that party. This is illustrated in box 10.

**Box 12:** Example for *Ultimate decision making authority- no joint control 2*<sup>36</sup>

I, J and K enter into an agreement and set up a joint steering committee. Each party has one vote and two votes are needed to carry a motion. K has ultimate decision-making authority in cases where the joint steering committee cannot reach an agreement. For example, if no combination of I, J and K can agree with each other, K would have the ultimate decision making authority.

There is not joint control, since I and J could agree together, without needing the agreement of K. K does not have control, despite its decision-making authority. That is, since K's decision making authority is conditional, K does not have control.

<sup>35</sup> Ernst&Young, Challenging, p.56.

<sup>36</sup> Ernst&Young, Challenging, p.56.

### 2.3.3.3 Arbitration

Contractual arrangements often include terms and conditions relating to the resolution of disputes, and may also provide for arbitration. The existence of such terms and conditions does not prevent the arrangement from being jointly controlled and, consequently, from being a joint arrangement.

### 2.3.3.4 Implicit joint control

Joint control need not be explicitly stated in the terms of the contractual arrangement to exist. That is, joint control can exist implicitly, depending on the contractual terms of the arrangement, and whether the terms of the arrangement explicitly, or implicitly require unanimous consent of the parties.<sup>37</sup>

For example, if two parties have equal (50%) ownership of a separate vehicle, joint control could exist even if the terms of the contractual arrangement do not require unanimous consent over the relevant activities.<sup>38</sup>

In the fact pattern above, it is implicit in the arrangement that the two parties must agree. This is because to have at least 51% of the voting rights, both parties would need to agree, since they each have 50%. This example from IFRS 11 illustrates that it is possible to have implicit unanimous consent to have joint control.

Determining whether joint control exists implicitly depends on a careful evaluation of the contractual terms of the arrangement. It is possible that two parties have equal ownership interests, but the relevant activities are directed by one party according to the contractual arrangement between them. In this case, the party that has the contractual right to direct the relevant activities would have control (i.e., joint control would not exist).

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<sup>37</sup> PricewaterhouseCoopers, *IFRS Pocket Guide*, PWC, 2012, p.51.

<sup>38</sup> Sometimes the decision-making process that is agreed upon by the parties in their contractual arrangement implicitly leads to joint control. For example, assume two parties establish an arrangement in which each has 50 per cent of the voting rights and the contractual arrangement between them specifies that at least 51 per cent of the voting rights are required to make decisions about the relevant activities. In this case, the parties have implicitly agreed that they have joint control of the arrangement because decisions about the relevant activities cannot be made without both parties agreeing.

IFRS 11 notes that statutory mechanisms can create enforceable arrangements. Furthermore, the articles, charter or by-laws of the separate vehicle (when one exists) are also part of the contractual agreement between parties. Accordingly, when evaluating whether an arrangement implicitly results in joint control, consideration needs to be given to the statutory requirements in the relevant jurisdiction under which the arrangement was established, as that might affect the conclusion.<sup>39</sup>

### 2.3.3.5 De facto joint control vs joint de facto control

IFRS 11 states that 'control' in 'joint control' refers to its usage in IFRS 10. As discussed before, joint control can sometimes arise through an implicit arrangement. Accordingly, questions have arisen whether there can be *de facto* joint control or joint *de facto* control. We have defined these terms as follows:

- *De facto* joint control is where two (or more) parties collectively control an arrangement, but there is no requirement for unanimous consent between them.<sup>40</sup>
- Joint *de facto* control is where two (or more) parties collectively control an arrangement, and there is a requirement for unanimous consent between them.<sup>41</sup>

*De facto* joint control (as we have defined it) does not exist under IFRS 11. This is because there is no unanimous consent between the parties. Since unanimous consent is a requirement to have joint control (as shown in Diagram 1 and discussed above), there would be no joint control.

In contrast, theoretically joint *de facto* control (as we have defined it) could exist under IFRS 10 and IFRS 11. This is because two (or more) parties collectively control the arrangement and there is unanimous consent between them. However, we expect joint *de facto* control to be rare in practice. These are illustrated in Diagram 5, and Example 11.

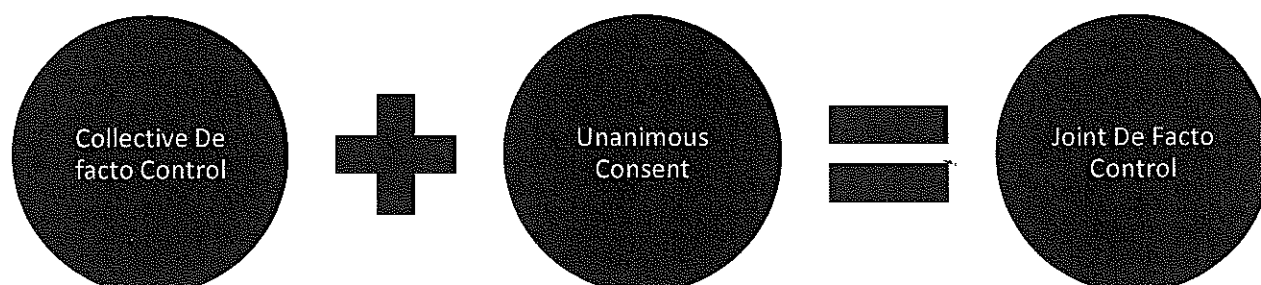
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<sup>39</sup> PricewaterhouseCoopers, p.52.

<sup>40</sup> Hennie Van Greuning, *International Financial Reporting Standards: A Practical Guide*, World Bank, Washington, 2011 p.286.

<sup>41</sup> Hennie Van Greuning, p.286.

**Diagram 18: De facto joint control vs. joint de facto control**



**Box 13: Example of De facto joint control vs joint de facto control<sup>42</sup>**

A and B have an arrangement in which they each have a 24% voting interest. Decisions about the relevant activities require a majority of the voting rights. The remaining 52% is widely dispersed. A and B have an agreement that they will agree on decisions about relevant activities.

Collectively, A and B have *de facto* control (power without a majority of voting rights) based on the requirements of IFRS 10. Since there is a contractual agreement for A and B to agree on all decisions, there is joint *de facto* control, and this would be a joint arrangement, because there is joint control.

**Variation** — assume the same facts as above, except that there is no requirement for A and B to agree on all decisions. In this case, although A and B collectively control the arrangement, since there is no requirement for unanimous consent between them, there is no joint control. In this situation, A and B would likely each have significant influence over the arrangement.

<sup>42</sup> Ernst&Young, Challenging, p.56.

## 2.3.4 Other Practical Issues With Assessing Joint Control

### 2.3.4.1 Lease vs a joint arrangement

In some cases, careful consideration will need to be given to the terms and conditions of an arrangement to determine whether a party is leasing an asset that is controlled by another party (and may with other parties, effectively lease the asset for its entire life), or whether the parties have a joint arrangement.<sup>43</sup> These two cases are illustrated in Example 12.

#### **Box 14:** Example of — A lease? Or a joint arrangement?

Five parties jointly buy an aircraft. By contractual agreement, each entity has the right to use the aircraft for a certain number of days each year and shares proportionately in the maintenance costs. They share decision-making regarding the maintenance and disposal of the aircraft, which are the relevant activities for that aircraft. Those decisions require the unanimous agreement of all of the parties. The contractual agreement covers the expected life of the aircraft and can be changed only by unanimous agreement.

#### **Box 15:** Analysis and Variation of Box 14

**Analysis** — The agreement is a joint arrangement. Through the contractual agreement, the five parties agreed to share the use and costs of maintaining the aircraft, and decisions require unanimous consent.

**Variation** — If, instead, the five parties entered into an agreement with a separate vehicle that controlled the aircraft this may be a lease. This would be the case if they did not have the ability to direct the relevant activities (for example, if the management of the separate vehicle made decisions regarding maintenance or disposal).

<sup>43</sup> Barry Epstein and Eva Jermakowicz, *Interpretation and Application of International Financial Reporting Standards*, John Wiley & Sons, Chicago, 2012 p.354.

#### **2.3.4.2 Evaluate multiple agreements together**

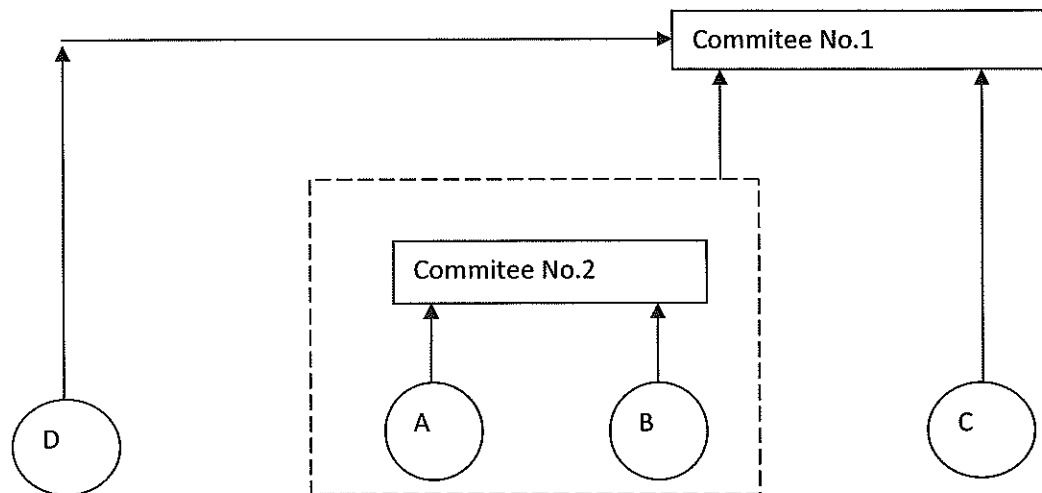
Although not explicitly required by IFRS 11, in some cases, it may be necessary to evaluate multiple agreements together, to understand the purpose and design of an arrangement and to determine if there is joint control. A party may appear to have joint control of a joint arrangement when considering an agreement in isolation, but that party may not have joint control when considered in the full context of its purpose and design.<sup>44</sup> Example 13 illustrates this point.

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<sup>44</sup> IASB, 2013 Red Book, p.762.

**Box 16: Example of Layered agreements<sup>45</sup>**

A, B, C and D enter into agreement No. 1 to undertake oil and gas exploration. Committee No. 1 is formed to direct all activities related to the activity including review and approval of annual budgets and operating policies. Committee No.1 consists of four members nominated by A, B, C and D. The decisions of Committee No. 1 require the unanimous vote of the members.



A and B enter into agreement No. 2, which establishes Committee No. 2 to coordinate cooperation between A and B, with respect to the same oil and gas exploration activity. A and B each appoint one representative to Committee No. 2. Committee No. 2 has the power to make decisions to be submitted for approval to Committee No. 1. Any matter to be decided by Committee No. 2 requires the consent of both parties. However, if agreement cannot be reached between A and B, B has the deciding vote. The decisions made in Committee No. 2 are binding on A and B and they must vote accordingly in Committee No. 1

In this fact pattern, there are two separate contractual agreements. However, they are evaluated together to determine if there is a joint arrangement, because they relate to the same oil and gas exploration activity. For example, if agreement No. 1 were considered in isolation, it would appear that A, B, C and D all have joint control over the arrangement.

<sup>45</sup> Ernst&Young, Power, p.27.

However, agreement No. 1 should be evaluated together with agreement No. 2. Accordingly, only B, C, and D would have joint control over the joint arrangement. Since B can effectively direct A how to vote (by virtue of agreement No. 2) in Committee No. 2, A does not have joint control with the other parties, since it is effectively a *de facto* agent of B.

## 2.4 CLASSIFICATION OF A JOINT ARRANGEMENT

A joint arrangement is classified as either a joint operation or a joint venture, as shown in Diagram .<sup>46</sup>

**Diagram 19:** Joint Operation vs. Joint Venture

Type of Arrangement	Joint Operation	Joint Venture
Definition	The parties with joint control have rights to the assets and obligations for the liabilities of the arrangement.	The parties with joint control have rights to the net assets of the arrangement
Parties with joint control	Joint operator — a party with joint control in a joint operation	Joint venturer — a party with joint control in a joint venture
Accounting overview	<p>A joint operator accounts for the following in accordance with the applicable IFRS:</p> <ul style="list-style-type: none"> <li>• Its assets, including its share of any assets held jointly,</li> <li>• Its liabilities, including its share of any liabilities incurred jointly,</li> <li>• Its revenue from the sale of its share of the output arising from the</li> </ul>	<p>A joint venturer accounts for its investment in the joint venture using the equity method — proportionate consolidation is not a choice.</p>

<sup>46</sup> IASB, 2013 Red Book, p. 787.

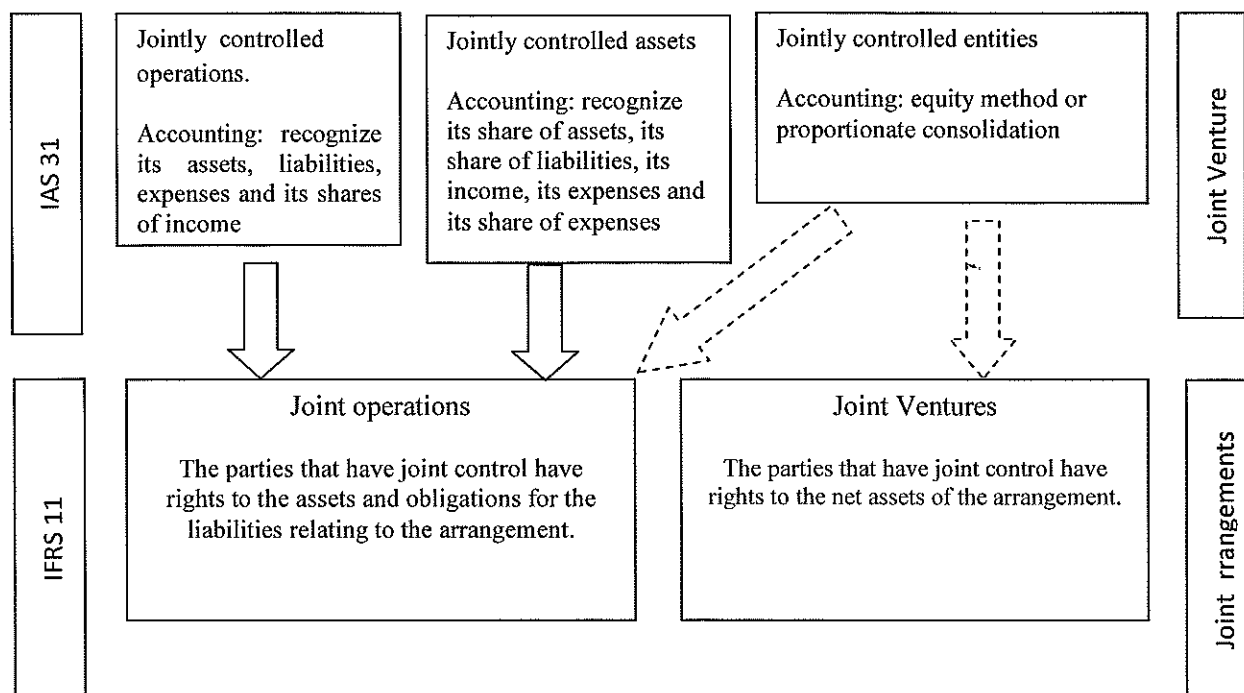
	joint operation, <ul style="list-style-type: none"> <li>• Its share of revenue from the sale of the output by the joint operation,</li> <li>• Its expenses, including its share of any expenses incurred jointly</li> </ul>	
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Although the term ‘joint venture’ is broadly used in practice, this term is narrowly defined in IFRS 11. Under IAS 31, joint ventures included JCEs, jointly controlled assets and jointly controlled operations, whereas under IFRS 11, a joint venture is only one type of joint arrangement.

Jointly controlled assets and jointly controlled operations (as defined under IAS 31), are called joint operations under IFRS 11, and the accounting for those arrangements is the same as under IAS 31. That is, the joint operator continues to recognise its assets, liabilities, revenues, and expenses, and/or its relative shares of those items, if any.

This accounting is technically different from proportionate consolidation. Diagram 6 illustrates how the new terminology differs from the terms used in IAS 31.

**Diagram 20:** Similar concepts, different terms



The main impact of IFRS 11 will be felt where proportionate consolidation was used to account for JCEs under IAS 31, and such entities are classified as joint ventures under IFRS 11. This is because the transition to IFRS 11 will result in substantial changes to the financial statements of the joint venturer. Joint ventures must be accounted for using only the equity method under IFRS 11.<sup>47</sup> This will result in recognising only a single line item investment in a joint venture in the statement of financial position, and a single line item for the proportionate share of net income and changes in equity in the statement of comprehensive income. This could potentially be a significant change in the presentation of these areas of the financial statements of affected entities.

In some cases, there may also be a measurement difference, whereby profit or loss differs from the amount that would have been recognised using proportionate consolidation.

In some cases, there is no difference between having an interest (e.g., 50%) in each of the assets and liabilities of the joint arrangement, and having an interest in the net assets. However, a party that has rights to the assets and obligation for the liabilities generally has no limitation of

<sup>47</sup> IASB, 2013 IFRS Red Book, p.793.

loss on those assets and liabilities. In a joint operation, the party recognises these assets and obligations without limitation, even if that results in the liabilities exceeding the assets.<sup>48</sup> In contrast, in a joint venture, a party has an interest in the net assets and that party's loss is limited to its investment. When a party has an interest in the net assets and any losses exceed the investment, the losses are not recognized (i.e., the party does not recognise a negative investment). Instead, such losses are recognised only to the extent that the party has a legal or constructive obligation to make payments on behalf of the joint venture.

When classifying a joint arrangement as either a joint operation or a joint venture, the first step is to assess whether there is a separate vehicle. If not, the joint arrangement is automatically a joint operation. However, if there is a separate vehicle, the following factors need to be considered:

- Legal form of the separate vehicle
- Contractual terms and conditions
- Other facts and circumstances

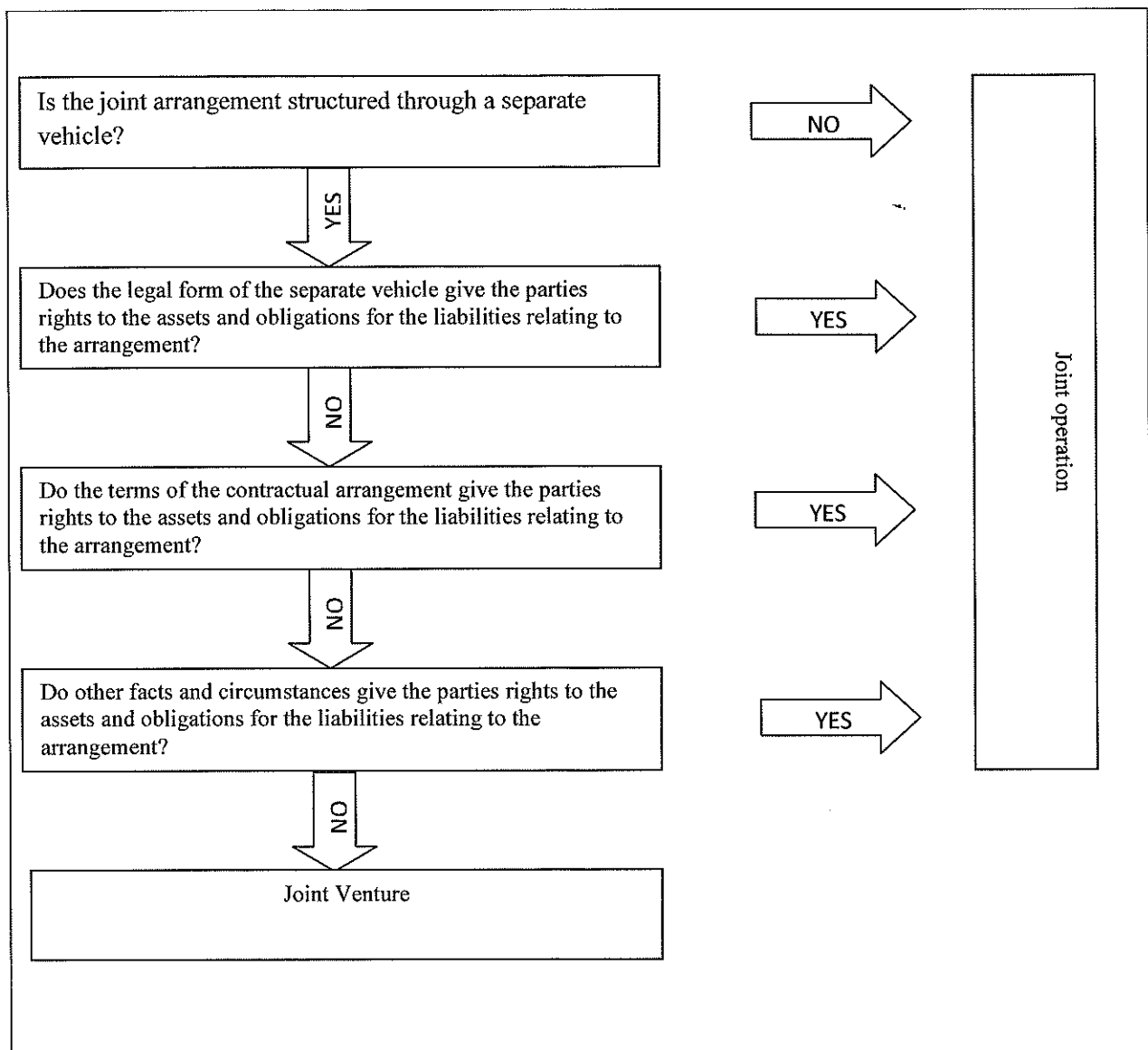
This process is illustrated in Diagram 7 and each of these is discussed in more detail below<sup>49</sup>. This flow chart illustrates several criteria that need to be met for the joint arrangement to be classified as a joint venture. If just one of the criteria indicates that the parties have the rights to the assets and obligations for the liabilities, the joint arrangement would be classified as a joint operation. IFRS 11 also includes examples illustrating this evaluation.

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<sup>48</sup> IASB, Guide, p.1536.

<sup>49</sup> Diagram modified from that provided by IASB in paragraph B33 of IFRS 11.

**Diagram 21: Classifying a joint arrangement**



When classifying a joint arrangement, the IASB generally expects that all parties to that joint arrangement would reach the same conclusion regarding classification of that joint arrangement. To reach different conclusions regarding the classification of a joint arrangement

would mean that the parties have different rights to assets and obligations for the liabilities within the same separate vehicle, which the IASB believes would be rare.<sup>50</sup>

It may be necessary to analyse two (or more) agreements together, such as when there is a master agreement. IFRS 11 also states that the classification of a joint arrangement should also be made in the context of the normal course of business.

#### **2.4.1 Separate Vehicle**

IFRS 11 is intended to broaden the focus for classifying a joint arrangement so that the structure of the joint arrangement is not the only factor considered. However, the first factor in classifying a joint arrangement is the assessment of whether a separate vehicle exists. If yes, then further evaluation must be completed to classify the joint arrangement. However, if no separate vehicle<sup>51</sup> exists, then the joint arrangement is always a joint operation.

For example, a partnership, or corporation would be considered a separate vehicle. In some cases, a trust or a syndicate may also be considered a separate vehicle. Consideration should be given to local laws. In some jurisdictions, an oral agreement is considered sufficient to create a contractual partnership, and thus, the hurdle for having a separate vehicle would be quite low.

A contract may create a separate vehicle, such as when it creates a deemed separate entity (referred to as a 'silo' in IFRS 10). A silo exists when specified assets of an arrangement are the only source of payment for specified liabilities of an arrangement, and parties other than those with the specified liability do not have rights or obligations related to the specified assets or to residual cash flows from those assets. That is, a silo exists when, in substance, all the assets, liabilities and equity of that deemed separate entity are ring-fenced from the 'host' arrangement.<sup>52</sup>

The term 'separate vehicle' is broader than an 'entity' (see Diagram 8). We understand that this change was made primarily to address concerns that, in some jurisdictions, separate vehicles were created to establish a joint arrangement, but these separate vehicles did not meet

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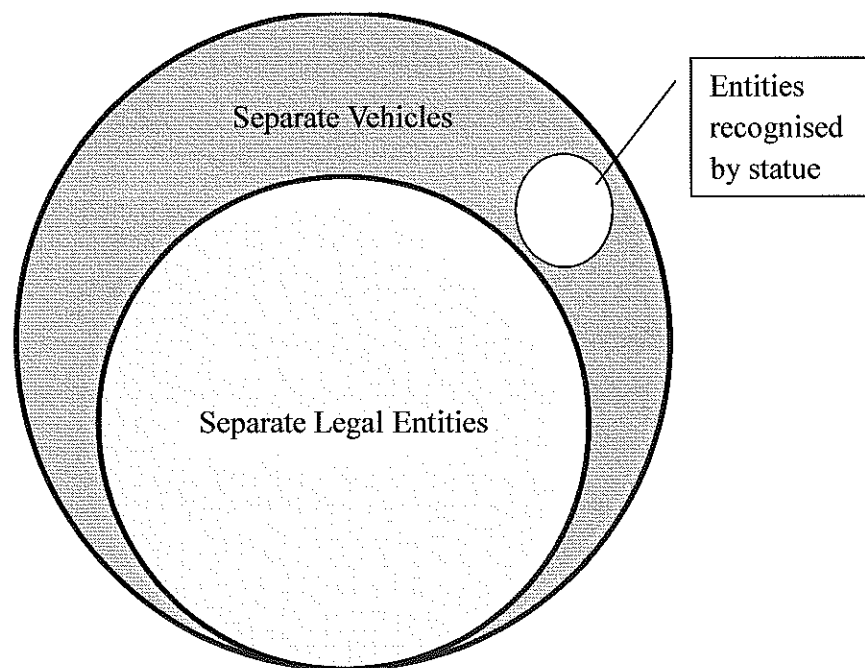
<sup>50</sup> Volkan Demir, Oğuzhan Bahadır, *UFRS / TFRS Kapsamında İşletme Birleşmeleri ve Konsolidasyon*, Nobel Yayın Dağıtım, Ankara, 2008, p.151.

<sup>51</sup> Separate vehicle: A separately identifiable financial structure, including separate legal entities or entities recognized by statute, regardless of whether those entities have a legal personality.

<sup>52</sup> PricewaterhouseCoopers, p. 53.

the definition of an entity in that jurisdiction. Under IAS 31, such separate vehicles would have been automatically excluded from being considered JCEs, even if, in substance, they were economically similar.<sup>53</sup> With the change to 'separate vehicle' in IFRS 11, these arrangements would be further evaluated for classification as either a joint operation or a joint venture.

**Diagram 22: Legal entities are a subset of separate vehicles**



The reason for determining whether there is a separate vehicle is that the IASB concluded it would be rare that a joint arrangement would give the parties rights to the net assets without having a separate vehicle. Thus, if no separate vehicle exists, the process could be cut short to conclude that the joint arrangement is a joint operation.

#### **2.4.2 Legal Form Of The Separate Vehicle**

Once it is determined that a separate vehicle exists, the second step is to analyse the legal form of the separate vehicle. This is a significant change from IAS 31, under which the

<sup>53</sup> Hennie Van Greuning, p.293.

accounting solely depended on whether an entity existed.<sup>54</sup> Under IFRS 11, the legal form of the separate vehicle must be assessed to determine whether it gives the parties rights to net assets, or rights to the assets and obligations for the liabilities of the arrangement. In other words, does the separate vehicle confer separation between the parties and the separate vehicle?

The impact of local laws should be carefully assessed when analysing the form of the separate vehicle. For example, in many countries, a corporation confers separation between the parties and the separate vehicle and also provides the parties with rights to net assets (which are indicators of being a joint venture). That is, the liabilities of the corporation are limited to the corporation. Creditors do not have recourse to the investors in the corporation for those liabilities. However, this may not be true in all countries.

Similarly, partnerships that have unlimited liability (which are common in many countries) often do not confer separation between the parties and the separate vehicle. That is, they provide the partners with rights to the assets and obligations for the liabilities, indicating that the arrangement is a joint operation. However, a partnership that limits the liabilities of its partners to their investment is effectively giving those partners the rights to the net assets; this would be an indicator of a joint venture.<sup>55</sup>

### **2.4.3 Contractual Terms**

The next step in classifying a joint arrangement is to examine the contractual terms of the arrangement, to determine if they provide the parties with rights to the net assets (a joint venture) or rights to the assets and obligations for the liabilities (a joint operation). This is because even if the legal form of the separate vehicle establishes rights for each of the parties, the contractual terms of the joint arrangement may unwind the effects of the legal form and give the parties rights to the assets, and obligations for the liabilities. This requirement is further evidence that, when classifying a joint arrangement, IFRS 11 focuses on the nature and substance of the rights and obligations of the joint arrangement, as compared with its predecessor, IAS 31, which solely looked to the form of the arrangement.

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<sup>54</sup> Aydın Karapınar, Hasan Kaval and Remzi Örtten, *Türkiye Muhasebe-Finansal Raporlama Standartları Uygulama ve Yorumları*, Ankara, 2010, p.734.

<sup>55</sup> Ernst&Young, IFRS 10, 11 and 12, p.9.

IFRS 11 includes examples of common contractual terms found in joint arrangements, and indicates whether these are examples of joint operations or joint ventures. These are summarised in Diagram 9.<sup>56</sup>

**Diagram 23: Examples of common contractual terms in an joint arrangement**

	Joint Operation	Joint Venture
Rights to assets	The parties share all interests (e.g., rights, title or ownership) in the assets relating to the arrangement in a specified proportion.	The assets brought into the joint arrangement or subsequently acquired by it are the arrangement's assets. The parties have no interests (i.e., no rights, title or ownership) in the assets of the arrangement.
Obligations for liabilities	The parties share all liabilities, obligations, costs and expenses in a specified proportion.	The joint arrangement is liable for the debts and obligations of the arrangement.
	The parties are jointly and severally liable for the obligations of the arrangement.	The parties are liable under the arrangement only to the extent of their respective investments in the arrangement, or to their respective obligations to contribute any unpaid or additional capital to the arrangement, or both.
	The parties are liable for claims raised by third parties.	Creditors of the joint arrangement do not have rights of recourse against any party with respect to debts or obligations of the arrangement. <b>I</b>

IFRS 11 also includes an example of how the contractual terms of the joint arrangement can modify the form of the separate vehicle. This is illustrated in box 14.

<sup>56</sup> Ernst&Young, Challenging, p.58.

**Box 17:** Example of Modification of legal form by contractual terms<sup>57</sup>

A and B jointly establish a corporation (C) over which they have joint control. The fact that there is a separate vehicle and the legal form of the separate vehicle (a corporation) preliminarily indicates that C is a joint venture. However, the contractual arrangement states that A and B have rights to the assets of C and are obligated for the liabilities of C in a specified proportion. Effectively, this contractual term unwinds the effects of the legal form (corporation). Therefore, C is a joint operation.

#### **2.4.3.1 Guarantees**

Parties to joint arrangements may provide guarantees to third parties. For example, a party to a joint arrangement may provide a guarantee or commitment that:

- Services provided by the joint arrangement to the third party will be of a certain quality or nature
- The joint arrangement will repay funding received from the third party
- It will support the joint arrangement in the event of distress

One might think that providing a guarantee (or commitment to provide a guarantee) gives a party an obligation for a liability, which would indicate that the joint arrangement should be classified as a joint operation. However, IFRS 11 states this is not the case.

#### **2.4.3.2 Contractual terms upon liquidation or dissolution of joint arrangement**

In some joint arrangements, the parties contribute assets to the joint arrangement to be used in the activity for as long as it continues to operate. However, if the joint arrangement is liquidated or dissolved, the contributed assets revert to the contributing party. The question is

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<sup>57</sup> Ernst&Young, Challenging, p.58.

whether this contractual term gives the parties rights to the assets. If so, this would mean that the joint arrangement is classified as a joint operation.<sup>58</sup>

All relevant facts and circumstances should be considered in reaching a conclusion. For example, if the party contributing the asset has a currently-exercisable call option on that asset, this fact should be considered in evaluating whether the party has rights to the assets and obligations for the liabilities of the joint arrangement; that is, whether it is a joint operation. The call option would also need to be accounted for in accordance with the relevant IFRS.<sup>59</sup>

#### 2.4.4 Other Facts And Circumstances

If the preliminary assessment of the legal form and the contractual terms of the joint arrangement indicate that a joint arrangement may be a joint venture, then the parties must consider any other facts and circumstances to determine whether the parties have rights to the assets and obligations for the liabilities, which would make it a joint operation.

When classifying a joint arrangement as either a joint operation or a joint venture, it is critical to understand the purpose and design of the joint arrangement. It is critical to understand whether the joint arrangement:

- Primarily aims to provide the parties with an output (i.e., the parties have rights to substantially all of the economic benefits of the assets)
- Depends on the parties on a continuous basis for settling its liabilities.

If both of the above are characteristics of the joint arrangement, then that indicates that it is a joint operation. In some cases, judgement will be needed to assess whether these criteria are met. Diagram 10 illustrates how these factors might be present in a joint arrangement.

Box 15 illustrates how the facts and circumstances might indicate that the joint arrangement is a joint operation, even if the legal form and contractual terms point towards the joint arrangement being a joint venture.

**Diagram 24:** Other facts and circumstances

	Joint Operation	Joint Venture
<b>Restrictions on selling output</b>	Restricted from selling output to third parties	None; may be able to sell output to other parties
<b>Requirements to purchase</b>	Parties (individually or	None; other parties might

<sup>58</sup> Demir, Bahadır, s.155.

<sup>59</sup> Demir, Bahadır, s.156.

<b>output</b>	collectively) must purchase substantially all of output produced	purchase output
<b>Source of cash flows to pay liabilities</b>	The parties to the joint arrangement	Third parties, through their purchases of output
<b>Expected financial performance</b>	Designed to operate at break-even, or to generate losses that will be funded by the parties	Designed to generate a profit

**Box 18:** Example of Modification of legal form by facts and circumstances<sup>60</sup>

A and B jointly establish a corporation (C) over which they have joint control. The existence of a separate vehicle, which is in the legal form of a corporation, initially indicates that the assets and liabilities held in C are the assets and liabilities of C, and therefore that C is a joint venture. No contractual terms indicate that A and B have rights to the assets, or obligations for the liabilities, so the arrangement still appears to be a joint venture.

However, A and B agree to the following:

- A and B will purchase all the output produced by C in a ratio of 50:50.
- C cannot sell any of the output to third parties, unless A and B approve it. Because the purpose of the arrangement is to provide A and B with output they require, sales to third parties are expected to be uncommon and not material
- The price of the output sold to A and B is set by A and B at a level that is designed to cover the costs of production and administrative expenses incurred by C. The arrangement is intended to operate at a break-even level.

<sup>60</sup> Ernst&Young, Challenging, p.58.

#### **Box 19: Analysis and Variances of Box 16**

##### **Analysis:**

The obligation of A and B to purchase all of the output produced by C reflects the exclusive dependence of C upon A and B for the generation of cash flows and, thus, implicitly that A and B have an obligation for the liabilities of C.

The fact that A and B have rights to all of the output produced by C means that A and B are consuming, and therefore have rights to, all of the economic benefits of the assets of C. These facts and circumstances indicate that the arrangement is a joint operation.

Variation 1 — If, instead of A and B using their share of the output themselves, they sold their share of the output to third parties, it would still be a joint operation.

Variation 2 — If A and B changed the terms of the contractual arrangement so that the arrangement was able to sell output to third parties, this would result in C assuming demand, inventory and credit risks, such that they would not have substantially all of the economic benefits. Accordingly, in this case, the joint arrangement would likely be classified as a joint venture.

#### **2.4.4.1 Output taken by only one party**

The examples and analysis in IFRS 11 discuss joint arrangements in which the parties to the joint arrangement share in the output. However, in some cases, one party receives or purchases all of the output. For example, this may be the case when:

- One of the parties is not in the business that is the activity of the joint arrangement (e.g., a local government has joint control with a foreign entity). Generally the party that does not

receive output is compensated in some other manner, relative to its respective interests in the joint arrangement.<sup>61</sup>

- The party that receives all of the output is acting as an agent for the other parties to the joint arrangement, and acting on their behalf.

In such cases, the first step should be to confirm that there actually is joint control. A reassessment of the facts and circumstances may indicate that the party that receives all of the output controls the arrangement.

However, if there is joint control, this would likely be a joint operation. This is because the parties collectively have rights to substantially all of the economic benefits of the assets of the joint arrangement. In our view, the nature of the assets is different for each party. That is, one party receives a tangible output, whereas the other receives a financial asset, but both parties have rights to the assets, and obligations for the liabilities of the joint arrangement, rather than rights to the net assets of the joint arrangement.

#### **2.4.4.2 Assessing whether parties provide cash flows**

As noted above, IFRS 11 states that if a joint arrangement depends on the parties on a continuous basis to settle its liabilities, this would be indicative of it being a joint operation.

Questions have arisen whether parties would be considered ‘substantially the only source of cash flows’ if they provide cash flows at inception of a joint arrangement, but are not expected to thereafter, and no other parties are expected to provide cash flows until the end of an activity. Alternatively, parties might provide cash flows through a series of ‘cash calls’ throughout the arrangement.<sup>62</sup>

In our view, when parties provide cash flows at the inception of a joint arrangement, and no other parties are expected to provide cash flows until the end of an activity, the fact that the parties who provided cash flows at inception are the only source of cash flows in the interim does not mean that the joint arrangement is a joint operation. This is because they are not providing cash on a continuous basis, and are not expected to have an obligation to fund the liabilities of the joint arrangement in the normal course of business. Similarly, a requirement or expectation to

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<sup>61</sup> Volkan Demir, *TFRS / UFRS Kapsamında Finansal Araçlar*, Nobel Yayın Dağıtım, Ankara, 2011, p.192.

<sup>62</sup> Hennie Van Greuning, p.286.

provide cash through a series of cash calls also does not necessarily mean that the joint arrangement is a joint operation. These situations are illustrated in box 18.

**Box 20:** Example for Construction and real estate sales<sup>63</sup>

**Fact pattern** — A separate vehicle is established, over which two parties have joint control. Neither the legal form nor the contractual terms of the joint arrangement give the parties rights to the assets or obligations for the liabilities of the arrangement. Other facts and circumstances are as follows:

- The purpose of the joint arrangement is to construct a residential complex for selling residential units to the public
- Contributed equity by the parties is sufficient to purchase land and raise debt finance from third parties to fund construction
- Sales proceeds will be used as follows (in this priority):
  - Repayment of external debt
  - Remaining profit distributed to parties

**Analysis** — Since there is a separate vehicle, and because neither the legal form nor the contractual terms of the joint arrangement give the parties rights to the assets or obligations for the liabilities of the vehicle, the preliminary analysis indicates that this is a joint venture. The fact that the parties are the only source of cash flows at inception does not mean that the joint arrangement is a joint operation. Accordingly, there is nothing in the facts and circumstances that suggests the parties have rights to the assets, or obligations for the liabilities, since they only expect to receive any net profits after the external debt is repaid. Therefore, this would be a joint venture.

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<sup>63</sup> Ernst & Young, Challenging, p.62.

**CHAPTER THREE**  
**ACCOUNTING for JOINT OPERATIONS, JOINT VENTURES, DISCLOSING and**  
**IMPACTS on BUSINESS of IFRS 11**

**3.1 ACCOUNTING FOR JOINT OPERATIONS**

For a joint operation, the joint operator recognises its:

- Assets, including its share of any assets held jointly
- Liabilities, including its share of any liabilities incurred jointly
- Revenue from the sale of its share of the output arising from the joint operation
- Share of the revenue from the sale of the output by the joint operation
- Expenses, including its share of any expenses incurred jointly

The accounting and measurement for each of these items is ‘in accordance with the IFRSs applicable’.

Careful attention should be given to the nature of the rights to the assets, and the obligations for the liabilities (or the share of assets, liabilities, revenues, and expenses) if any, of the joint operation. That is, what does the joint arrangement actually entitle the joint operators to, and make them responsible for.<sup>64</sup>

For example, one of the joint operators may have a direct legal liability for the entire balance of certain liabilities of the joint operation. It may also have a right to reimbursement by the other parties for their share of that liability of the joint operation. This situation frequently arises when the joint operator is the manager of the joint operation.

The joint operator who is responsible for the entire balance of the obligation would recognise 100% for such liability and would recognise a receivable for the reimbursement due from the other parties for their share of such liabilities. IFRS prohibits the offsetting of these

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<sup>64</sup> PricewaterhouseCoopers,, p.57.

liabilities against these receivables. But, other than the gross-up of the balance sheet, there would be no negative impact on the financial statements (e.g., profit), when the liability and receivable are for equal amounts. In most circumstances, this will be the case. This is because the ability, or willingness, of the other parties to reimburse the joint operator for their share of these liabilities might not be in doubt, particularly when cash calls are paid in advance.<sup>65</sup>

However, there may be instances in which the other parties are unable to pay. In these cases, the joint operator would not be able to recognise a receivable for the full amount due. Accordingly, since the receivable would be impaired (or less than the liability recorded), this situation would negatively impact a joint operator's financial statements (e.g., profit).

In some cases, the joint arrangement (or legal form of the separate vehicle, if applicable) gives joint and several liability for the obligations of the arrangement. This may result in the joint operator recognising the entire obligation due, not just its share. The facts and circumstances need to be assessed in each case, and the liability is accounted for in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.<sup>66</sup>

A party to the joint arrangement who has an obligation to reimburse another party would recognise a financial liability, not a liability related to the type of expense being reimbursed.

In some joint operations, one joint operator receives fees from the other joint operators for providing services in respect of the joint operation (this is often the case when one party is the manager of the joint operation). IAS 31 required that such parties account for any fees received in accordance with IAS 18 *Revenue*. This requirement is not repeated in IFRS 11, presumably because it is clear that a party receiving such fees would account for them in accordance with IAS 18 even without this reference.

It will be critical for joint operators to review their joint arrangements in detail, including any subsequent amendments or addendums. Joint operators must ensure that they fully understand the rights and obligations therein, and how they are shared amongst the parties. When a joint operator is required to recognise 100% of a liability, because it is responsible for the entire balance of the obligation of the joint operation, its net financial position and profit will usually not be negatively affected. This is because the joint operator usually will also recognise a separate receivable from the other joint operators and those the receivables are usually

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<sup>65</sup> IASB, 2013 Red Book, p.772

<sup>66</sup> Gürbüz Gökçen and others, p.471.

collectible. However, the joint operator should consider the impact on its leverage or gearing ratios, which will be negatively affected by the gross-up in the balance sheet.<sup>67</sup>

### **3.1.1 Difference From Proportionate Consolidation**

There is often confusion as to whether accounting for a joint operation is the same as 'proportionate consolidation', which an entity could use to account for JCEs under IAS 31. Accordingly, for former JCEs that are classified as joint operations under IFRS 11<sup>68</sup>, it may not be clear whether the adoption of IFRS 11 will affect the joint operator's financial statements.

When a joint operator has rights to a specified percentage of all assets and obligations for the same percentage of all liabilities, there would probably not be a difference between the accounting for a joint operation and proportionate consolidation in practice. However, when the joint operator has differing rights (and percentages) to various assets, and/or different obligations for various liabilities, the financial statements would look different when accounting for those individual rights and obligations, compared with proportionately consolidating a blended percentage of all assets and liabilities.<sup>69</sup> Example below illustrates the accounting for a joint operation under IFRS 11.

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<sup>67</sup> Gürbüz Gökçen and others, p.472

<sup>68</sup> The Board noted that there are two main differences between recognising assets, liabilities, revenues and expenses relating to the activity of the joint operation and proportionate consolidation. The first difference relates to the fact that the rights and obligations, as specified in the contractual arrangement, that an entity has with respect to the assets, liabilities, revenues and expenses relating to a joint operation might differ from its ownership interest in the joint operation. The IFRS requires an entity with an interest in a joint operation to recognise assets, liabilities, revenues and expenses according to the entity's shares in the assets, liabilities, revenues and expenses of the joint operation as determined and specified in the contractual arrangement, rather than basing the recognition of assets, liabilities, revenues and expenses on the ownership interest that the entity has in the joint operation. The second difference from proportionate consolidation is that the parties' interests in a joint operation are recognised in their separate financial statements. Consequently, there is no difference in what is recognised in the parties' separate financial statements and the parties' consolidated financial statements or the parties' financial statements in which investments are accounted for using the equity method.

<sup>69</sup> Hove, p.252.

**Box 21:** Example of Accounting for rights to assets and obligations for liabilities

D and E establish a joint arrangement (F) using a separate vehicle, but the legal form of the separate vehicle does not confer separation between the parties and the separate vehicle itself. That is, D and E have rights to the assets and obligations for the liabilities of F (F is a joint operation). Neither the contractual terms, nor the other facts and circumstances indicate otherwise. Accordingly, D and E account for their rights to assets and their obligations for liabilities relating to F in accordance with the relevant IFRS.

D and E each own 50% of the equity (e.g., shares) in F. However, the contractual terms of the joint arrangement state that D has the rights to all of Building No. 1 and the obligation to pay all the third party debt in F. D and E have rights to all other assets in F, and obligations for all other liabilities in F in proportion to their equity interests (i.e., 50%).

F's balance sheet is as follows (in CUs):

Assets		Liabilities&Equity	
Cash	20	Debt	120
Building No.1	120	Employee Benefit Plan Obligation	50
Building No.2	100	Equity	70
Total Assets	240	Total Liability&Equity	240

Under IFRS 11, D would record the following in its financial statements, to account for its rights to the assets in F and its obligations for the liabilities in F. This may differ from the amounts recorded using proportionate consolidation.

Assets		Liabilities&Equity	
Cash	10	Debt <sup>70</sup>	120
Building No.1 <sup>71</sup>	120	Employee Benefit Plan Obligation	25
Building No.2	50	Equity	35
Total Assets	180	Total Lia.&Equity	180

### 3.1.2 Determining The Relevant IFRS

Joint operators are required to recognise their rights to assets and their obligations for liabilities in accordance with ‘the relevant IFRS’. In some cases, ‘the relevant IFRS’ is clear, but questions have arisen in other cases.

A joint operator will need to carefully analyse the nature of its rights to assets when determining the appropriate accounting. For example, a joint operator would recognise its share of an asset in accordance with IAS 16 *Plant, Property and Equipment*, or IAS 38, as applicable.<sup>72</sup> When the contractual terms of the joint operation provide a joint operator with a right to use an asset, not a share of the asset itself, the joint operator would apply IFRIC 4 *Determining Whether an Arrangement Contains a Lease*.

### 3.1.3 Parties To A Joint Operation Without Joint Control

In some cases, a party is involved in a joint operation, but does not have joint control. That is, it is not a joint operator. However, IFRS 11 states that to the extent that party has rights to assets and obligations for liabilities, the accounting is the same as that for a joint operator, as discussed above.

<sup>70</sup> D’s obligations are for the third-party debt in its entirety.

<sup>71</sup> Since D has the rights to all attached to Building No. 1, it records that amount in its entirety.

<sup>72</sup> Gürbüz Gökçen and others, p.185

If the party does not have rights to the assets and obligations for the liabilities relating to the joint operation, it accounts for its interest in the joint operation in accordance with other relevant IFRS. For example, if it has:

- An interest in a separate vehicle over which it has significant influence — apply IAS 28
- An interest in a separate vehicle over which it does not have significant influence — account for that interest as a financial asset
- An interest in an arrangement without a separate vehicle — apply other applicable IFRS

Effectively, if the joint arrangement is a joint operation, and the party has rights to the assets and obligations for the liabilities relating to that joint operation, it does not matter whether the parties to that joint arrangement have joint control or not — the accounting is the same.

However, the disclosure requirements would likely differ, since IFRS 12 does not apply to joint arrangements in which a party does not have joint control, unless that party has significant influence.<sup>73</sup>

### **3.1.4 Joint Operations With A Non-Controlling Interest/Passive Investor**

Since a joint operation may be conducted through a separate vehicle, there may be a party to the joint operation that has an ownership interest in that separate vehicle, but which does not have joint control (i.e., a passive investor).

In such cases, a joint operator does not recognise the rights to assets and obligations for the liabilities attributable to the non-controlling interest/passive investor, or recognise a noncontrolling interest. Rather, a joint operator only recognizes its share of any assets held jointly and its obligations for its share of any liabilities incurred jointly. This is shown in box 20.

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<sup>73</sup> Ernst&Young, IFRS 10, 11 and 12, p.10.

**Box 22:** Example for Joint operation with a non-controlling interest passive investor<sup>74</sup>

A and B enter into a joint operation Z, which is contained in a separate vehicle. Each of the two entities owns 40% of the shares of the separate vehicle. The remaining 20% of Z is owned by C, but C does not have joint control over Z, as C is not party to the joint arrangement. C is considered a passive investor. The legal form of the separate vehicle does not confer separation between the parties and the separate vehicle itself. That is, A and B have rights to the assets and obligations for the liabilities of Z (therefore, Z is a joint operation). Neither the contractual terms, nor the other facts and circumstances indicate otherwise. Accordingly, A, B and C recognise their assets, including their share of any assets held jointly, and their liabilities, including their share of any liabilities incurred jointly, in accordance with the relevant IFRS.

In A's financial statements, it recognises its assets, liabilities, revenues and expenses in Z, which would be 40% of Z's assets, liabilities, revenues and expenses in accordance with the relevant IFRS. A does not recognise a non-controlling interest related to Z.

### **3.1.5 Transactions Between A Joint Operator And A Joint Operation**

IFRS 11 addresses transactions between a joint operator and a joint operation, and modifies the requirements for accounting for these transactions slightly, as compared to the accounting required by IAS 31.

In contrast, IAS 31 required the transfer of risks and rewards of ownership to the joint venture, before permitting recognition of the portion of the gain or loss attributable to the other joint venturers.<sup>75</sup> IFRS 11 contains no such requirement, because the IASB is moving away from the 'risks and rewards' model, to a 'control' model throughout IFRS.<sup>76</sup>

<sup>74</sup> Ernst&Young, Challenging, p.66.

<sup>75</sup> Gürbüz Gökçen and others, p.410.

<sup>76</sup> When an entity enters into a transaction with a joint operation in which it is a joint operator, such as a sale or contribution of assets, it is conducting the transaction with the other parties to the joint operation and, as such, the joint operator shall recognise gains and losses resulting from such a transaction only to the extent of the other parties' interests in the joint operation. When such transactions provide evidence of a reduction in the net realisable value of the assets to be sold or contributed to the joint operation, or of an impairment loss of those assets, those losses shall

When there are transactions between a joint operator and a joint operation, consideration should be given to whether the transaction changes the nature of the joint operator's rights to assets, or obligations for liabilities. Any such changes should be reflected in the joint operator's financial statements, and the new assets and liabilities should be accounted for in accordance with the relevant IFRS.

Although these requirements do not specifically refer to parties to a joint operation who do not have joint control (e.g., passive investors in the joint operation), we believe it would be appropriate to use the same accounting in such circumstances.

### **3.2 ACCOUNTING FOR JOINT VENTURES**

One of the main reasons for issuing IFRS 11 was to eliminate proportionate consolidation as an option for accounting for JCEs to converge with US GAAP. As a result, joint ventures (many of which will likely have been JCEs under IAS 31) will be accounted for using the equity method.

IFRS 11 does not describe how to apply the equity method. Rather, if an entity has joint control over a joint venture, it must apply IAS 28. All assets, liabilities, revenues and expenses of these entities will net into one 'investment in joint venture' line item, and the joint venturer will recognise its share of net income and changes in equity.

It should be noted that IAS 28 now refers to ownership interests that 'in substance, give access to the returns associated with an ownership interest'.<sup>77</sup> Previously, IAS 28 referred to 'economic benefits'. This is consistent with the changes introduced by IFRS 10.

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be recognized fully by the joint operator. When an entity enters into a transaction with a joint operation in which it is a joint operator, such as a purchase of assets, it shall not recognise its share of the gains and losses until it resells those assets to a third party. When such transactions provide evidence of a reduction in the net realisable value of the assets to be purchased or of an impairment loss of those assets, a joint operator shall recognise its share of those losses.

<sup>77</sup> Gürbüz Gökçen and others, p.282.

As discussed, venture capital organisations can still choose to measure investments in joint ventures at fair value, as they did under IAS 31. This is considered a measurement exemption under IFRS 11, rather than a scope exemption, which means that such entities are subject to the disclosure requirements for joint ventures.

### **3.2.1 Interest in A Joint Venture Without Joint Control**

IAS 28 is applied if an investor does not have joint control over a joint venture, but has significant influence over an entity. However, the disclosure requirements will differ.

If the investor has significant influence, but the joint venture is not an entity (i.e., but is a separate vehicle), IAS 28 would not apply, and the investor would apply the relevant IFRS.<sup>78</sup>

If an investor does not have significant influence, its interest in the joint venture would be accounted for as a financial asset.

### **3.2.2 Contributions of Non-Monetary Assets to A Joint Venture**

Previously, contributions of non-monetary assets to a joint venture were accounted for under SIC-13. As a consequential amendment of IFRS 11, the requirements of SIC-13 are included in IAS 28, and therefore also apply to contributions of nonmonetary assets to associates. Accordingly, when a joint venture contributes a non-monetary asset or liability to a joint venture in exchange for an equity interest in the joint venture, the joint venturer recognises the portion of the gain or loss attributable to the other parties to the joint venture except when the contribution lacks commercial substance.

When the contributed non-monetary asset is a subsidiary of an entity, a conflict arises between the requirements of IAS 28 and IFRS 10.<sup>79</sup>

## **3.3 CONTINUOUS ASSESSMENT**

IFRS 11 incorporates the notion of continuous assessment, consistent with the requirements in IFRS 10. This chapter discusses when to reassess and the accounting if there is a change in the nature of the interest held.

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<sup>78</sup> Mirza and Others, p.156.

<sup>79</sup> Ernst&Young, IFRS 10, 11 and 12, p.11.

If facts and circumstances change, a party reassesses whether:

- It still has joint control of the arrangement
- The type of joint arrangement has changed

### 3.3.1 When To Reassess Under IFRS 11

IFRS 11 does not contain any specific points at which a party reassesses whether it has joint control, or the type of joint arrangement. Accordingly, a party reassesses upon any change in facts and circumstances that might be relevant to those determinations. In some cases, changes in facts and circumstances might result in a party having control over the arrangement (which would, therefore, no longer be a joint arrangement since one party has control). In other cases, an arrangement may remain under joint control, but the classification might change from joint venture to joint operation (or vice versa).<sup>80</sup> A careful evaluation is needed based on the facts and circumstances in each case.

Reassessment of a joint arrangement should occur upon a change in:

**How activities are directed** — For example, A set up Z to develop a new product or technology. Initially, Z had a Board of Directors elected by shareholders, separate management, etc, and the relevant activities were directed by voting rights held exclusively by A. If A enters into an agreement with B so that A and B must agree on all decisions (e.g., they replace the Board, and make decisions for management), reassessment would be required to evaluate whether A and B have joint control of Z.

**Legal form** — For example, a separate vehicle that initially did not confer separation between the parties and the vehicle (e.g., a general partnership) is converted into a separate vehicle that now does confer separation between the parties and the vehicle (e.g., a limited partnership). Reassessment would be required to evaluate whether this indicates a change in classification from a joint operation to a joint venture

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<sup>80</sup> Kaya, p.220.

**Contractual terms** — For example, the terms of a joint arrangement are renegotiated, such that the parties have rights to the assets, or obligations for the liabilities. Reassessment would be required to evaluate whether this indicates a change in classification to a joint operation.

**Other facts and circumstances** — For example, the terms and conditions of a joint operation are renegotiated. Initially, a joint arrangement could sell output only to the parties of the joint arrangement. Subsequently, the joint arrangement may also sell output to third-party customers. Reassessment would be required to evaluate whether this indicates a change in classification from joint operation to a joint venture.

As discussed before another event that might trigger reassessment would be an event that leads a guarantor to have to pay (or perform) under a guarantee.

### **3.3.2 Changes In Ownership With Respect To A Joint Venture**

The accounting for changes in ownership with respect to a joint venture depends on the type of interest held before the change in ownership occurred. changes to a pre-existing interest.

#### **3.3.2.1 Acquisition of an interest in a joint venture**

The accounting for the acquisition of an interest in a joint venture is accounted for as described in IAS 28.

While certain of the procedures are similar to those applied for an acquisition of a business in IFRS 3, it is clear from the scope of IFRS 3 that the formation of a joint venture is not covered by that standard.

#### **3.3.2.2 Control over a former joint venture**

If an entity gains control over a former joint venture, it applies IFRS 3, provided that the acquiree meets the definition of a business. Otherwise, the entity applies paragraph 2(b) of IFRS 3 and measures the assets on a relative fair value basis.<sup>81</sup>

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<sup>81</sup> Spencer, p.238.

### **3.3.2.3 Former subsidiary becomes a joint venture**

When a subsidiary becomes a joint venture, there is a conflict within IFRS between the requirements of IAS 28 and IFRS 10 on how to calculate any gain or loss arising in this transaction. This conflict arises when a parent contributes a subsidiary to a joint venture (or loses control over a subsidiary, which then becomes a joint venture), and receives an ownership interest in that joint venture in exchange. This may occur, for example, if a parent sells shares in a subsidiary to another party and the arrangement becomes a joint venture, or by dilution (i.e., if the subsidiary issues new shares to another party and the arrangement becomes a joint venture).<sup>82</sup>

If IFRS 10 is applied, when an entity loses control of a subsidiary, and gains joint control of a joint venture, the entity will:

- Derecognise the assets and liabilities of the former subsidiary (including any related goodwill and non-controlling interests) from the consolidated statement of financial position
- Recognise the fair value of any consideration received
- Recognise any distribution of shares in the subsidiary to owners
- Recognise the retained investment in the joint venture at its fair value when control is lost and subsequently account for it in accordance with IFRS 11 and IAS 28 (the fair value is deemed its cost under the equity method)
- Reclassify to profit or loss, or to retained earnings (based on the applicable IFRS) amounts recognised in other comprehensive income related to that subsidiary
- Recognise the resulting gain or loss without restriction (i.e., the full gain or loss would be recognised)

In contrast, if IAS 28 is applied, this will limit the gain recognised when a subsidiary is contributed to a joint venture. The IFRS Interpretations Committee recognises that this conflict exists in IFRS and has referred the issue to the IASB.

### **3.3.2.4 Joint venture becomes an associate (or vice versa)**

If a joint venturer loses joint control, but retains an interest in an associate after adopting IFRS 11 and IAS 28, it would continue to apply the equity method. However, in a change from

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<sup>82</sup> Ernst&Young, **Power and Utilities**, p.13.

the previous requirements of IAS 31 and IAS 28, an entity does not remeasure its retained interest in an associate when it loses joint control over a joint venture. Similarly, the entity does not reclassify any amounts previously recognised in other comprehensive income and accumulated in equity (e.g., foreign currency translation adjustments).<sup>83</sup>

In its Basis for Conclusions to IAS 28, the IASB acknowledged that the nature of the investor-investee relationship changes upon changing from joint venture to associate (or vice versa). However, since the investment continues to be accounted for using the equity method (i.e., there is no change in the measurement requirements), and there is no change in the group, it is not an event that warrants re-measurement of the retained interest at fair value.

#### **3.3.2.5 Joint venture becomes a financial asset (or vice versa)**

If a joint venture becomes a financial asset (or vice versa), the measurement method changes. The entity measures the retained interest in the financial asset at fair value, which becomes its fair value on initial recognition as a financial asset.

The entity recognises in profit or loss any difference between:

- The fair value of any retained interest and any proceeds from disposing of a part interest in the joint venture
- and
- The carrying amount of the interest in the joint venture at the date the equity method was discontinued

If a gain or loss previously recognised by the entity in other comprehensive income would be reclassified to profit or loss on the disposal of the related assets or liabilities. IAS 28 requires the entity to reclassify the gain or loss from equity to profit or loss when the equity method is discontinued.<sup>84</sup> For example, gains and losses related to foreign currency translation adjustments accumulated in equity would be reclassified to profit or loss.

#### **3.3.2.6 Disposal of interest in a joint venture**

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<sup>83</sup> Kaya, p.244.

<sup>84</sup> Tiffin, p.299.

When an entity disposes of its interest in a joint venture, it ceases to use the equity method as of that date. It also de-recognises its interest and recognises any gain or loss upon sale.

In such cases, an entity cannot restate its financial statements for the period (or the comparative period) as if it did not have joint control during the reporting period. IAS 28 requires that the entity use the equity method up to the date that the joint venture disposes of its interest in the joint venture.<sup>85</sup> This assumes that the entity is not exempt from preparing financial statements by IFRS 10, IAS 27 or IAS 28, and that it is not using the fair value measurement exemption.

The entity may elect (or be required to) also prepare separate financial statements. Separate financial statements are those in which an entity accounts for its interest in the joint venture either at cost, or as a financial asset. These separate financial statements are prepared in addition to those prepared using the equity method.

The conclusions above also apply to subsidiaries and associates.

### **3.3.3 Changes In Ownership With Respect To A Joint Operation**

The accounting for changes in ownership with respect to a joint operation depends on the type of interest held previously. In Section 3.3.3.1, we discuss acquisitions in a joint operation where no previous interest was held. In the remainder of this section, we discuss changes to an existing interest.

#### **3.3.3.1 Acquisition of an interest in a joint operation**

The acquisition of an interest in a joint operation is not explicitly addressed in IFRS 11 but was recently discussed by the IFRS Interpretations Committee (the Committee) at its meeting in July 2011, and again at its meeting in September 2011.

The Committee observed that uncertainty exists in accounting for the acquisition of an interest in a joint operation in circumstances where the activity of the joint operation constitutes a business as defined in IFRS 3.

The Committee discussed, but did not reach a conclusion on, the view that IFRS 3 is not required to be applied to the particular assets and liabilities of a joint operation in circumstances where the joint operator acquires an interest in a joint operation in which the activity of the joint

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<sup>85</sup> Hoyle and Others, p.381.

operation is a business as defined in IFRS 3. This is because IFRS 3 applies to business combinations and in the acquisition of an interest in a joint operation the acquirer does not obtain control of a business.<sup>86</sup>

To avoid significant diversity in practice, and to address the concerns raised in the submission, the Committee directed the staff to perform further analysis. The staff will analyse whether a premium paid for synergies can (i) be recognised as a separate asset under another standard, e.g., IAS 38 *Intangible Assets*, in circumstances where an entity acquires an interest in a joint operation that contains a business, or (ii) whether IFRS 3 could be applied by analogy. The staff will also consider whether further guidance should be developed on this issue.

The Committee also noted that the IASB did not change the reference to 'the formation of a joint venture' in the scope exclusion in IFRS 3 as a consequential amendment. However, the Committee understood that the IASB did not want to change the scope of IFRS 3. Consequently, the Committee observed that IFRS 3 should have been amended to refer to 'the formation of a joint arrangement,' because IFRS 11 redefined and renamed the different types of joint arrangements. Under IFRS 11 a 'joint venture' is one type of joint arrangement, whereas under IAS 31, it included every type of joint arrangement. The Committee directed the staff to consider whether this issue can be addressed through the annual improvements process. The staff will present the analysis and a draft annual improvement at a future meeting.<sup>87</sup>

### **3.3.3.2 Control over a former joint operation**

If an entity gains control over a former joint operation that meets the definition of a business, it applies the accounting business combinations in IFRS 3, provided that the acquiree meets the definition of a business.<sup>88</sup> Otherwise, the entity applies paragraph 2(b) of IFRS 3 and measures the acquired assets and liabilities on a relative fair value basis.

### **3.3.3.3 Former subsidiary becomes a joint operation**

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<sup>86</sup> Ernst&Young, Challenges, p.69.

<sup>87</sup> Ernst&Young, Challenges, p.70.

<sup>88</sup> IASB, A Guide, p.420.

As stated in IFRS 10, if an entity loses control of a subsidiary and gains joint control of a joint operation, the entity will generally:<sup>89</sup>

- Derecognise the assets and liabilities of the former subsidiary (including any related goodwill and non-controlling interests) from the consolidated statement of financial position
- Recognise the fair value of any consideration received
- Recognise any distribution of shares of the subsidiary to owners
- Recognise the rights to the assets and obligations for the liabilities of the joint operation at fair value
- Reclassify to profit or loss, or to retained earnings (based on the applicable IFRS) amounts recognised in other comprehensive income related to that subsidiary
- Recognise the resulting gain or loss

The above accounting is the same as the approach used when a former subsidiary becomes a joint venture, and the IFRS 10 approach is used (see Section 3.3.2.3). The other approach referred to in Section 3.3.2.3 (the IAS 28 approach) would not be available in this situation, because IAS 28 does not apply to joint operations.

#### **3.3.3.4 Other changes in ownership of a joint operation**

IFRS 11 does not explicitly address the accounting for a former joint operation, and the situation in which it becomes an associate, financial instrument, or it is replaced by control of individual assets or liabilities.

In accordance with IFRS 5, when a joint operator plans to dispose of part of an interest in a joint operation, it reclassifies only the interest to be disposed of as held for sale, when that portion meets the criteria for classification as held for sale.<sup>90</sup> The joint operator continues to account for the retained interest in the joint operation in accordance with IFRS 11 until the disposal of that interest occurs. This is because an entity continues to have joint control over its entire investment in the joint operation until it actually disposes of that interest (and not before).

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<sup>89</sup> Ernst&Young, IFRS 10, 11 and 12, p.22.

<sup>90</sup> Bodur, p.244.

upon disposal, it then reassess the nature of its remaining interest and accounts for that interest accordingly (e.g., as an associate or financial asset).<sup>91</sup>

If an interest (or a portion of an interest) in a joint operation no longer meets the criteria to be classified as held for sale, an entity restates the financial statements for the periods since classification as held for sale.

### **3.3.3.5 Disposal of interest in a joint operation**

When an entity disposes of its interest in a joint operation, it ceases to account for the rights to assets and obligations for liabilities, and recognises any gain or loss as of the disposal date. The only exception would be if rights to assets or obligations for liabilities replaced that interest directly. In this case, there would be no change in accounting, because, in both cases, the assets and liabilities are recognised in accordance with the relevant IFRS.<sup>92</sup>

Consistent with the treatment of joint ventures, as noted in Section 3.3.2.6, an entity continues to reflect its interest in a joint operation for the reporting period (and comparative period) in which it held that interest. An entity does not restate its financial statements as if it never held the interest in the disposed joint operation.

### **3.3.4 Changes From A Joint Operation To A Joint Venture (Or Vice Versa)**

IFRS 11 does not explicitly address the accounting for a former joint operation that becomes a joint venture, or vice versa.

#### **3.3.4.1 Joint operation becomes a joint venture**

When a former joint operation becomes a joint venture, it is generally appropriate to de-recognise the assets and liabilities previously recognised in accordance with IFRS 11 and account for the new interest in the joint venture in accordance with IAS 28. IAS 28.

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<sup>91</sup> Ernst&Young, IFRS 10, 11 and 12, p.25.

<sup>92</sup> PricewaterhouseCoopers, p.62.

### **3.3.4.2 Joint venture becomes a joint operation**

When a former a joint venture becomes a joint operation, it is appropriate to de-recognise the equity method investment and account for the rights to assets and obligations for liabilities as of the date of the change in accordance with IFRS 11.

## **3.4 DISCLOSURES**

IFRS 12 combines the disclosure requirements for an entity's interests in subsidiaries, joint arrangements, associates and structured entities into one comprehensive disclosure standard. Many of the disclosure requirements related to joint arrangements are similar to those included in IAS 31. However, others are new, or clarify the requirements that were in IAS 31.

Below, we describe the disclosure requirements of IFRS 12 with respect to joint arrangements. The disclosure requirements described here are those that apply to parties that have joint control of the joint arrangement; they do not apply to passive investors in a joint arrangement (i.e., parties without joint control).<sup>93</sup> However, if a party has significant influence over the joint arrangement, the disclosure requirements in IFRS 12 with respect to associates would apply, although they differ slightly from those described below.

### **3.4.1 Principles of IFRS 12**

The objective of IFRS 12 is for an entity to disclose information that helps users of its financial statements evaluate:

- The nature of, and risks associated with, its interests in other entities, including the contractual relationship with the other parties that have joint control
- The effects of those interests on its financial position, financial performance, and cash flows

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<sup>93</sup> International GAAP 2012

### **3.4.2 Disclosing Judgements**

One of the new requirements of IFRS 12 is that an entity discloses the significant judgements and assumptions it has made (and changes thereto) in determining whether or not it has joint control of an arrangement. An entity is also required to disclose significant judgements made in determining the type of joint arrangement (i.e., joint operation or joint venture) when the arrangement is structured through a separate vehicle.

The requirements in IFRS 12 reflect the degree of judgement that is required to determine whether an entity has joint control. The following are examples of significant judgements for which disclosure may be required:

- Whether a right is merely a protective right (which does not give joint control) or a substantive right that gives an entity joint control
- Whether a manager of an arrangement is acting as principal or as agent, which would likely affect the conclusion whether the manager has control or joint control
- Whether a joint arrangement is a joint operation or a joint venture, since its classification is not merely based on legal form under IFRS 11 (as it was under IAS 31)<sup>94</sup>

### **3.4.3 Nature of An Entity's Interest In A Joint Arrangement**

IFRS 12 requires that for each joint arrangement that is material to the entity, the entity must disclose all of the following:

- Name of the joint arrangement
- Nature of the entity's relationship with the joint arrangement (by, for example, describing the nature of the activities of the joint arrangement and whether they are strategic to the entity's activities)
- Principal place of business (and country of incorporation, if applicable and different from the principal place of business) of the joint arrangement
- Proportion of ownership interest or participating share held by the entity and, if different, the proportion of voting rights held (if applicable)<sup>95</sup>

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<sup>94</sup> IASB, Red Book, p. 1566.

<sup>95</sup> Ernst&Young, , IFRS 10, 11 and 12, p.30.

The above requirements apply to both to joint operations and joint ventures. Example 19 illustrates these disclosures.

**Box 23: Example of Nature of joint arrangement<sup>96</sup>**

The Group has a 50% ownership interest in F Limited, a joint arrangement, which is held by its subsidiary, K Limited. Due to the terms of the joint arrangement, and the existence of non-voting investors, the Group has a 60% voting interest in F Limited. F Limited's principal place of operations is Eurasia, but it is incorporated in Delaware in the United States. The Group is one of two partners in this joint arrangement, the purpose of which is to extract gas reserves from fields in Eurasia. F Limited is a supplier of gas in Eurasia. F Limited is strategic to the Group's business, given the similarity in business lines to the Group's operations.

**3.4.4 Nature, Extent And Financial Effects Of An Entity's Interest in A Joint Venture**

In addition to the information above, an entity is required to disclose additional information about interests in joint ventures. The table in Diagram summarises which disclosures are required for material joint ventures, which disclosures are required for immaterial joint ventures (in the aggregate), and which disclosures are required for both. The requirements are discussed in more detail in the remainder of this section. The disclosures in Diagram are not required for joint operations.

**Diagram 25:** Required disclosures for joint ventures

Topic	Individually material joint ventures	Individually immaterial joint ventures
Accounting policy (i.e., equity method or fair value)	√	x
Summarised financial information	√	√ (in aggregate)

<sup>96</sup> Ernst&Young, Challenging, pg.71.

Fair value, if quoted market price is available and measured using the equity method	√	x
Restrictions on ability to transfer funds	√	√
Date of financial statements, if different from entity, and reason for different date	√	√
Unrecognised share of losses at financial statement date and cumulatively	√	√
√ Required X Not required		

#### 3.4.4.1 Accounting policy for material joint ventures

For material joint ventures, an entity is required to disclose the accounting policy used to account for that joint venture. Although this is typically the equity method, in some cases, an entity may use fair value.

If fair value is used to measure the investment in the joint venture, or if fair value is disclosed, consideration should also be given to the requirements of IFRS 13 *Fair Value Measurement*. For example, IFRS 13 requires the significant inputs to be disclosed when a fair value measurement is used in the financial statements, and requires the level within the fair value hierarchy to be disclosed.

#### 3.4.4.2 Summarised financial information

An entity is required to disclose summarised financial information for joint ventures. IFRS 12 requires information for each joint venture that is material to the entity, and summarised information in the aggregate for individually immaterial joint ventures. However, the scope of the required information varies between the two, as shown in Diagram. In addition, Diagram shows

the difference between the requirements of IAS 31, as compared to the disclosure requirements under IFRS 12. It should be noted that, to meet the objective of IFRS 12, a joint venturer may need to disclose additional information beyond those items listed in Diagram 12 .

**Diagram 26:** Summarised financial information for joint ventures

	<b>Joint ventures (individually material)</b>	<b>Joint ventures (individually immaterial)</b>
Amount disclosed	Entire amount (i.e., 100%) <sup>97</sup>	Joint venturer's share <sup>98</sup>
Dividends received	New	X
Carrying amount of investment	√ <sup>99</sup>	X
Cash and cash equivalents included in current assets	New	X
Current assets	√	X
Non-current assets	√	X
Current financial liabilities excluding trade payables and other provisions included in current liabilities	New	X
Current liabilities	√	X
Non-current financial liabilities excluding trade payables and other provisions included in current liabilities	New	X
Non-current liabilities	√	X
Revenue	New	X

<sup>97</sup> Under IAS 31, it was not clear whether the summarised financial information relating to JCEs was intended to be the entire amount or the investor's share of the amount reported in the JCE's financial statements. IFRS 12 clarifies that the amounts disclosed are the amounts reported in the joint venture's financial statements, adjusted as discussed below (i.e., not the joint venturer's share of those amounts).

<sup>98</sup> For joint ventures that are individually immaterial, IFRS 12 clarifies that the summarised financial information is aggregated and only the joint venturer's share of the amount that would have been reported in the joint venturer's financial statements is disclosed.

<sup>99</sup> Although not explicitly required, since both the total carrying amount and the carrying amount of the individually immaterial joint ventures in the aggregate are required to be disclosed, it would seem logical to also disclose the carrying amount of the individually material joint ventures.

Depreciation and amortisation	New	X
Interest income	New	X
Interest expense	New	X
Income tax expense or income	New	X
Profit or loss from continuing operations	New	New
Post-tax profit or loss from discontinued operations	New	New
Other comprehensive income	New	New
Total comprehensive income	New	New

When the joint venturer accounts for the joint venture using the equity method, the individual summarised financial information for a material joint venture is adjusted to reflect adjustments made by the joint venturer when using the equity method.<sup>100</sup> For example, this might include:

- Fair value adjustments made at the time of acquisition
- Adjustments for differences in accounting policies

The joint venturer is also required to disclose a reconciliation between the summarised financial information and the carrying amount of its interest in the joint venture. IFRS 12 does not specify which components should be included in the reconciliation. Therefore, a joint venturer should disclose components that are meaningful (and material) to users of the financial statements. For example, these may include goodwill, and other fair value adjustments recognised in the notional purchase price allocation under the equity method.<sup>101</sup>

It should be noted that a joint venturer would include its goodwill arising on the acquisition of the joint venture within the summarised financial information for a material joint venture. However, this is only the joint venturer's own goodwill attributable to its interest in the joint venture. The goodwill attributable to interests in the joint venture held by other joint venturers are presumably not known. Therefore, care will be needed in presenting any such goodwill and in explaining the nature of this goodwill in the reconciliation. In addition, any

<sup>100</sup> Mirza and others, p. 236.

<sup>101</sup> Tiffin, p.387.

goodwill recorded in the financial statements of the joint venture itself would presumably be reflected as a fair value adjustment by the joint venturer upon acquisition of its interest in the joint venture.<sup>102</sup>

Summarised information is also required if the fair value option is used to account for investments in associates and joint ventures (by venture capital organisations). However, this information is not required to be presented in accordance with IFRS if both of the following criteria are met:

- The joint venture does not prepare IFRS financial statements
- Preparation on that basis would be impracticable or cause undue cost ('impracticable' is defined in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*)

That is, if both of the above criteria are met, the summarized financial information may be presented on a non-IFRS basis, when the fair value option is used.

When a joint venture accounted for at fair value does prepare IFRS financial statements, or where the preparation of IFRS financial information would not be impracticable or cause undue cost, the summarised financial information disclosed is that of the joint venture in its IFRS financial statements, on an unadjusted basis.

Summarised information is not required when a joint venture (or a portion of an interest therein) is classified as held-for-sale by the joint venturer in accordance with IFRS 5 (although the disclosure requirements of IFRS 5 would then apply). However, this should not be confused with the situation where the joint venture itself has assets held for sale in accordance with IFRS 5, in which case, summarised financial information for the joint venture is still required.

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<sup>102</sup> Ante, pg.412.

### Example — Summarised financial information

In the example below, F Limited and G Inc. are material joint ventures to the Group. It is assumed that there are no discontinued operations and that the Group has a 50% ownership interest in F Limited and a 35% interest in G Inc.

Note X — Investments in joint ventures (in CUs)	20X2	
F Limited	4,150	4,025
G Inc	3,705	3,670
Other joint ventures	300	290
<b>Total investments in joint ventures</b>	<b>8,155</b>	<b>7,985</b>
<i>Movement in investment in joint ventures during the reporting period</i>		
Balance at beginning of the reporting period	7,985	7,732
Share of total comprehensive income	290	245
Dividends received	(50)	(57)
Exchange and other adjustments	(70)	65
<b>Balance at end of the reporting period</b>	<b>8,155</b>	<b>7,985</b>
<i>Share of comprehensive income from joint ventures</i>		
<i>Profit after tax from continuing operations</i>		
F Limited <sup>103</sup>	225	188
G Inc	34	28
Other joint ventures <sup>104</sup>	7	11
<b>Total share of profit after tax from continuing operations from joint ventures<sup>105</sup></b>	<b>266</b>	<b>227</b>
<i>Other comprehensive income</i>		
F Limited	20	17
G Inc	2	(1)

<sup>103</sup> Neither IFRS 12 nor IAS 1 requires a joint venturer to show the joint venturer's share of profits or comprehensive income from individually material joint ventures. However, to meet the objective of IFRS 12 and to assist in this reconciliation, joint venturers are encouraged to disclose their share of profits and comprehensive income from individually material joint ventures.

<sup>104</sup> IFRS12 requires disclosure of the share of profit and other comprehensive income from immaterial joint ventures in aggregate

<sup>105</sup> IAS 1 requires disclosure of the total share of profit and comprehensive income.

Other joint ventures	2	2
<b>Total share of other comprehensive income from joint ventures</b>	<b>24</b>	<b>18</b>
<i>Other comprehensive income</i>		
F Limited	245	205
G Inc	36	27
Other joint ventures	9	13
<b>Total share of comprehensive income from joint ventures</b>	<b>290</b>	<b>245</b>

Summarised statement of financial position	20X2 F Limited	20X1 F Limited	20X2 G Inc	20X1 G Inc
Cash and cash equivalents	200	850	200	250
Other current assets	300	200	200	100
Total current assets	500	1,050	400	350
Non-current assets, excluding goodwill	9,800	9,023	5,400	5,222
Goodwill	1,725	1,725	2,546	2,546
Total assets	12,025	11,798	8,346	8,168
Current financial liabilities (excluding trade, other payables and provisions)	200	180	100	120
Other current liabilities	200	250	350	300
Total current liabilities	400	430	450	420
Non-current financial liabilities (excluding trade, other payables and provisions)	5,000	5,000	2,000	2,100
Other non-current liabilities	50	43	40	40
Total non-current liabilities	5,050	5,043	2,040	2,140
Total liabilities	5,450	5,473	2,490	2,560
Net assets	6,575	6,325	5,856	5,758
Net assets, excluding goodwill	4,850	4,600	3,310	3,212

Summarised statement of comprehensive income	20X2 F Limited	20X1 F Limited	20X2 G Inc	20X1 G Inc
Revenue	2,500	1,500	750	650
Depreciation and amortisation	200	180	100	110
Interest income	25	20	60	55
Interest expense	180	200	75	85
Profit/(loss) before tax	600	500	130	110
Income tax expense	(150)	(125)	(33)	(28)
Profit/(loss) after tax	450	375	97	82
Other comprehensive income	40	35	5	(4)
Total comprehensive income	490	410	102	78

Reconciliation of share of net assets to carrying amount	20X2 F Limited	20X1 F Limited	20X2 G Inc	20X1 G Inc
Group share of net assets of joint venture, excluding goodwill	2,425	2,300	1,589	1,124
Goodwill on acquisition less cumulative impairment	1,725	1,725	2,546	2,546
Carrying amount of investment in joint venture	4,150	4,025	3,705	3,670

#### 3.4.4.3 Fair value for joint ventures with quoted market prices

IFRS 12 requires disclosure of the fair value of a joint venturer's investment in a material joint venture that is accounted for using the equity method, if there is a quoted market price for that investment. When fair value is disclosed, consideration should also be given to the requirements of IFRS 13, which applies even though the entity is using the equity method (although the disclosure requirements are less than if fair value had been used).

#### 3.4.4.4 Restrictions on joint ventures

Similar to the requirements that existed under IAS 31, a joint venturer is required to disclose the nature and extent of any significant restrictions on:

- The ability of the joint venture to transfer funds to the joint venturer in the form of cash dividends

or

- To repay loans or advances made by the joint venture

For example, restrictions might result from covenants under borrowing arrangements with third parties, regulatory requirements or contractual arrangements between joint venturers.

#### **3.4.4.5 Date of financial statements for applying equity method**

Consistent with IAS 31, 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 joint venturer, the joint venturer is required to disclose both:

- The date of the end of the reporting period of the financial statements of that joint venture or associate
- The reason for using a different date or period

#### **3.4.4.6 Unrecognised losses**

A joint venturer may have stopped recognising its share of losses of the joint venture when applying the equity method (e.g., because the investment has been reduced to nil due to recognition of past losses, and there is no commitment to finance such losses).

In such cases, similar to the requirement that existed in IAS 28, the joint venturer is required to disclose its unrecognised share of losses of a joint venture, both for the reporting period and cumulatively.<sup>106</sup>

#### **3.4.5 Risks Associated With Interests In Joint Ventures**

One of the objectives for the disclosures for joint arrangements relates to the nature of, and changes in, risks related to that joint venture. To meet this objective, a joint venturer is required to disclose:

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<sup>106</sup> Gökçen and others, p.378.

- Commitments that it has relating to its joint ventures, separately from the amount of other commitments
- Contingent liabilities incurred relating to its interests in joint ventures, separately from the amount of other contingent liabilities

These are discussed in further detail in the remainder of Section 3.4.5. These disclosure requirements apply only to joint ventures.

#### **3.4.5.1 Commitments relating to interests in joint ventures**

A joint venturer is required to disclose total commitments it has made, but not recognised at the reporting date relating to its interests in joint ventures. This amount includes its share of commitments made jointly with other joint venturers. A commitment is anything that may give rise to a future outflow of cash or other resources.<sup>107</sup>

IFRS 12 lists several examples of items that may create an unrecognised commitment to contribute funding or resources:<sup>108</sup>

- Constitution or acquisition agreements of the joint venture (e.g., those that require an entity to contribute funds over a specific period)
- Capital-intensive projects undertaken by a joint venture
- Unconditional purchase obligations, comprising procurement of equipment, inventory or services that the joint venturer is committed to purchasing from, or on behalf of, a joint venture
- Commitments to provide loans or other financial support to a joint venture
- Commitments to contribute resources to a joint venture, such as assets or services

A joint venturer may also have an unrecognised commitment to acquire another party's ownership interest (or a portion of that ownership interest) in a joint venture upon a contingent event (or lack thereof).

#### **3.4.5.2 Contingent liabilities with respect to joint ventures**

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<sup>107</sup> Floyd and others, pg.422.

<sup>108</sup> Ernst&Young, Challenges, pg.71.

A joint venturer is required to disclose contingent liabilities incurred relating to its interests in joint ventures, separately from the amount of other contingent liabilities.

This disclosure must be in accordance with IAS 37, which requires disclosure of the following, unless the probability of loss is remote:

- An estimate of the contingent liability
- An indication of the uncertainties relating to the amount or timing of any outflow
- The possibility of any reimbursement

The contingent liability disclosed related to joint ventures includes a joint venturer's share of contingent liabilities incurred jointly with other joint venturers or investors that have significant influence over the joint venture.<sup>109</sup>

### **3.4.6 Joint Arrangements That Are Structured Entities**

It is possible, although perhaps unlikely, that a joint arrangement will meet the definition of a structured entity. When this occurs, the disclosure requirements in IFRS 12 for unconsolidated structured entities would apply. This would also be the case if a party has significant influence over an associate, and that associate meets the definition of a structured entity<sup>110</sup>. While the IASB only refers to joint ventures and associates in its discussion of this point (in the Basis for Conclusions to IFRS 12), the same could also be true for a joint operation.<sup>111</sup>

### **3.4.7 Related Party Transactions**

IFRS 12 notes that the disclosures required related to the risks associated with the joint venturer's interest in its joint venture (discussed in Section 3.4.5) illustrate some of the types of

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<sup>109</sup> Greuning, p.302.

<sup>110</sup> *Structured entity* — An entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements

<sup>111</sup> IASB, Red Book, p. 1566.

disclosure required by IAS 24. Below, we summarise the disclosure requirements related to joint arrangements (including joint operations) in IAS 24, as amended by IFRS 11 and IFRS 12.

#### **3.4.7.1 Scope of related party disclosure requirements**

IAS 24 requires disclosure of related party relationships, transactions and outstanding balances, including commitments, in consolidated, separate or individual financial statements of a:

- Parent
- Joint venture
- Joint operator
- Investor with significant influence over an investee

This is consistent with the previous requirements.

#### **3.4.7.2 Persons or close family members that are related parties**

A person or close family member of that person is related to a reporting entity if that person:<sup>112</sup>

- Has control or joint control of the reporting entity
- Has significant influence over the reporting entity

or

- Is a member of the key management personnel of the reporting entity or of a parent of the reporting entity

Transactions with such parties are considered related party transactions, and are required to be disclosed. The definition of joint control is the same in IAS 24 and IFRS 11. The disclosure applies to both joint ventures and joint operations because of the reference to joint control.

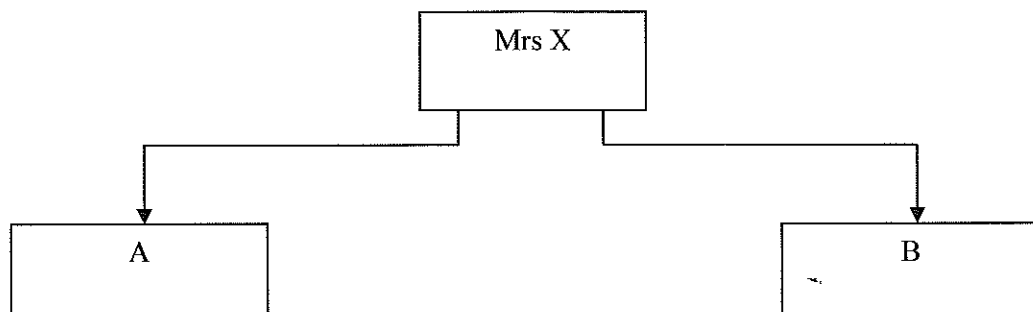
Business relationships that involve an individual or close family member are illustrated in Examples 21 and 22, which are based on illustrative examples in IAS 24.

#### **Box 24: Example of Person with joint control<sup>113</sup>**

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<sup>112</sup> PricewaterhouseCoopers, p.78.

<sup>113</sup> Ernst&Young, Challenging, p.77.



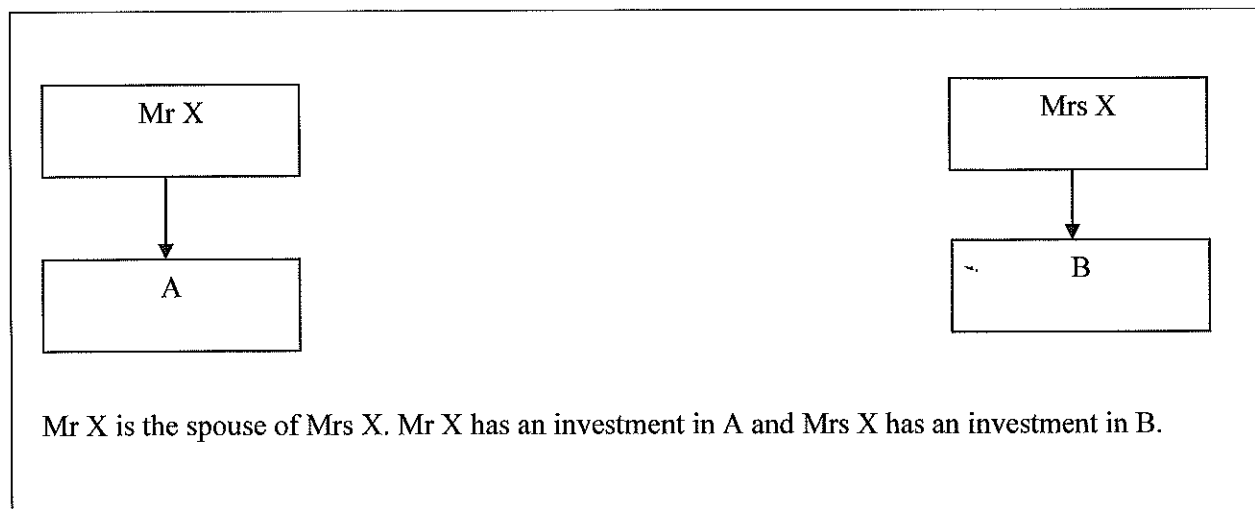
Mrs X has an investment in A and B

For A's financial statements, if Mrs X controls or jointly controls A, B is related to A if Mrs X has control, joint control or significant influence over B.

For B's financial statements, if Mrs X controls or jointly controls B, A is related to B if Mrs X has control, joint control or significant influence over A.

If Mrs X has significant influence (but not control or joint control) over A and B, then A and B are not related to each other

**Box 25: Example of Close members of the family holding investments<sup>114</sup>**



**Box 26: Analysis of Box 25**

For A's financial statements, if Mr X controls or jointly controls A, B is related to A if Mrs X has control, joint control or significant influence over B.

For B's financial statements, if Mr X controls or jointly controls B, A is related to B if Mrs X has control, joint control or significant influence over A.

If Mr X has significant influence (but not control or joint control) over A and Mrs X has significant influence (but not control or joint control) over B, A and B are not related to each other

**3.4.7.3 Related party disclosures for joint ventures**

IAS 24 includes several relationships involving joint ventures in its definition of related party transactions. IAS 24 (as amended by IFRS 11) only refers to joint ventures, and not joint operations, whereas the previous version of IAS 24 referred to joint ventures in a broad sense. Previously, IAS 24 included jointly controlled operations, jointly controlled assets, and JCEs, which were all considered types of joint ventures

<sup>114</sup> Ernst&Young, Challenging, p.77.

The requirement to disclose related party transactions related to joint ventures also applies to investments held by venture capital organisations, even when the investment is accounted for at fair value, rather than under the equity method.

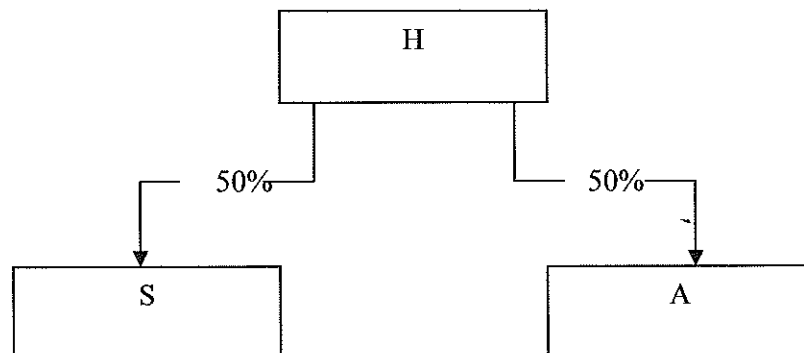
IAS 24 states, with respect to joint ventures, that an entity is related to a reporting entity if:<sup>115</sup>

- One entity is a joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member). Therefore, any joint venturer and its joint venture are related parties.
- Both entities are joint ventures of the same third party (including subsidiaries of the joint venture). Therefore, a joint venture's subsidiary and the joint venturer are related to each other. This is illustrated in Example 23.
- One entity is a joint venture of a third entity and another entity is an associate of the third entity. Therefore, an associate and a joint venture are related parties when they share the same investor/joint venturer. This is illustrated in Example 24.
- The entity is controlled or jointly controlled by a person identified in Section 3.4.7.2, or a close member of that person's family, who has control or joint control over the reporting entity. This is illustrated in below.

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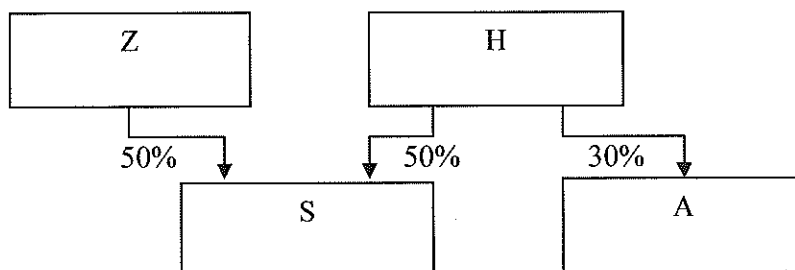
<sup>115</sup> Gökçen and others, p.335.

**Box 27:**Example of Entities that are joint ventures of the same third party<sup>116</sup>



S and A are joint ventures of H and are, therefore, related parties. C, as a subsidiary of A, is also a related party of H and S.

**Box 28:** Example of Entities that are joint ventures and associates of the same third entity<sup>117</sup>



S is a joint venture of H and A is an associate of H. Therefore, S and A are related parties. However, Z and H are not related parties, as discussed in Section 3.4.7.5.

#### 3.4.7.4 Government-related entities

<sup>116</sup> Ernst&Young, Challenging, p.79.

<sup>117</sup> Ernst&Young, Challenging, p.79.

IAS 24 uses the concept of government-related entities, which are entities that are controlled, jointly controlled or significantly influenced by a government. 'Government' in this context refers to government, government agencies and similar bodies whether local, national or international. There may be diversity in practice across different jurisdictions in defining what is meant by government.<sup>118</sup>

When an entity is controlled, jointly controlled or significantly influenced by a government, relationships, transactions and outstanding balances, including commitments with that government are related party transactions under IAS 24. Similarly, transactions and outstanding balances, including commitments, with other entities controlled, jointly controlled or significantly influenced by that government are classified as related party transactions under IAS 24. Related party transactions with government-related entities are exempted from certain disclosure requirements.

#### **3.4.7.5 Parties that are not related parties**

IAS 24 clarifies that the following are not related parties:<sup>119</sup>

- Two entities that have a director or other member of key management personnel in common or because a member of key management personnel of one entity has significant influence over the other entity.
- Two joint venturers that share joint control of a joint venture
- Providers of finance, trade unions, public utilities and departments and agencies of a government that does not control, jointly control or significantly influence the reporting entity, simply by virtue of their normal dealings with the entity (even though they may affect the freedom of action of an entity or participate in its decision-making process)
- A customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, simply by virtue of the resulting economic dependence

The reason for these exclusions is that, without them, many entities that are not normally regarded as related parties could fall within the definition of related party.

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<sup>118</sup> Demir, p.388.

<sup>119</sup> Gökçen and others, pg.337.

IAS 24 only refers to joint ventures as defined by IFRS 11, and not joint operations. The previous version of IAS 24 referred to joint ventures broadly when discussing which parties were not necessarily related parties.<sup>120</sup>

### **3.5 TRANSITION**

IFRS 11 is effective for annual periods beginning on or after 1 January 2013. Early adoption is permitted, as long as the entity also adopts IFRS 10, IFRS 12, IAS 27 and IAS 28 all as of the same date. The reason for requiring simultaneous adoption is that all deal with the assessment of, and related accounting and disclosure requirements about, an entity's relationships with other entities (i.e., control, joint control or significant influence over another entity). As a result, the IASB concluded that applying one of these standards, without also applying the others could cause confusion. Additionally, it would have been difficult to keep track of the consequential amendments between these standards, and other IFRS, if the effective dates had differed.

The one exception is that an entity may early-adopt the disclosure provisions for IFRS 12 (without adopting the other new standards) if doing so would be helpful to users of the financial statements.

IAS 1 requires an entity to present a third balance sheet (as of the beginning of the earliest comparative period) when it adopts a new accounting standard retrospectively,<sup>121</sup> which is the case for IFRS 11.

The impact of transitioning to IFRS 11 depends on how the arrangement was classified under IAS 31, the accounting method applied under IAS 31, and the classification under IFRS 11 as either a joint operation or a joint venture. IFRS 11 provides some practical relief from applying the standard fully retrospectively.

#### **3.5.1 Transition From Proportionate Consolidation To The Equity Method**

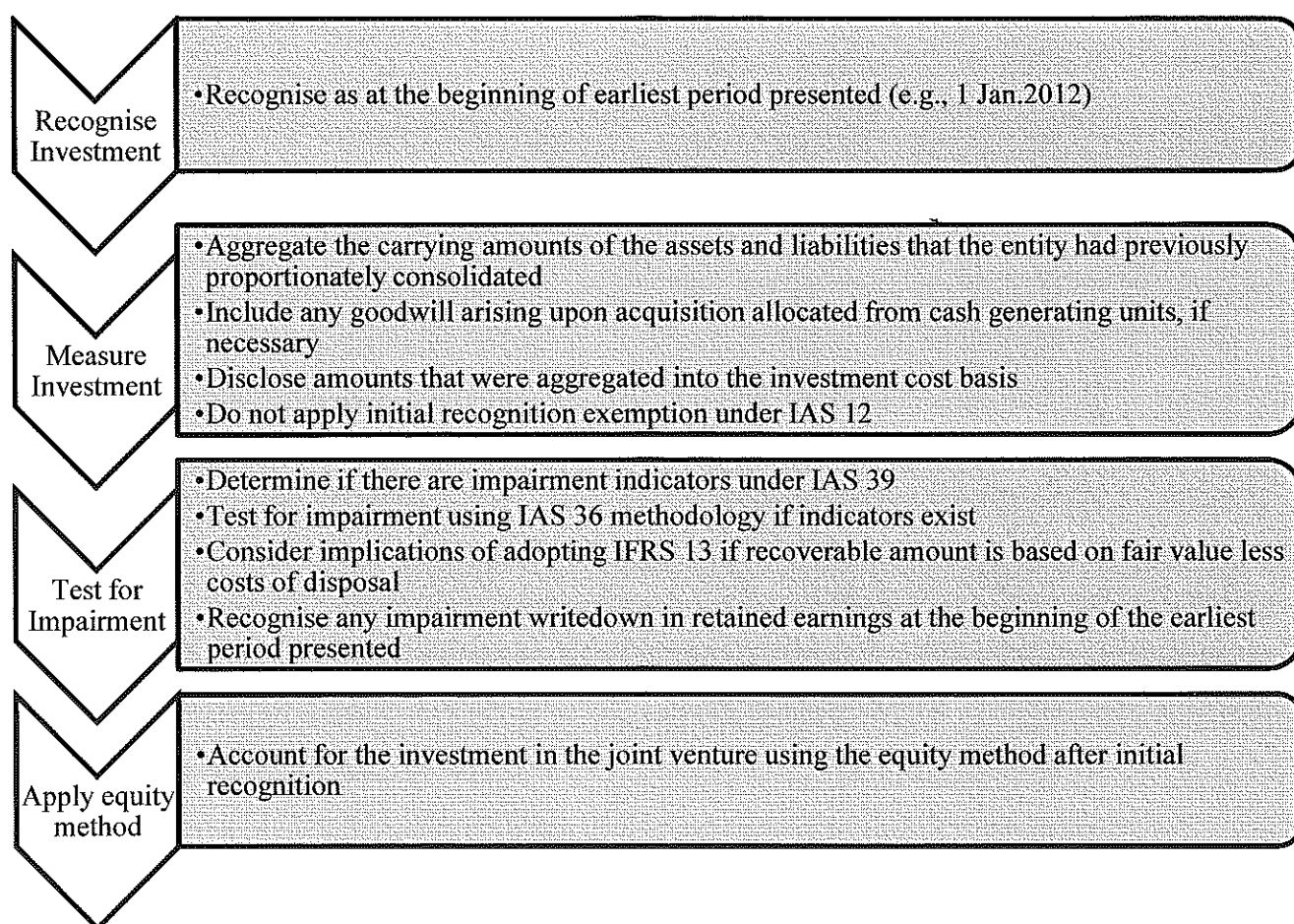
Former JCEs that are classified as joint ventures under IFRS 11 will need to be accounted for using the equity method. Diagram below illustrates this transition process.

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<sup>120</sup> Ernst&Young, Power and Utilities, p.14.

<sup>121</sup> Karapinar and others, p.186.

**Diagram 27:** Transition from proportionate consolidation to the equity method



If the entity voluntarily provides additional comparative information (or is required to provide this information, such as a regulatory requirement for a third income statement), the entity would need to also adopt IFRS 11 for that period. That is, all three income statements should be presented on the same basis with respect to IFRS 11. The requirement to restate comparatives applies even if the entity disposes of its interest in the joint venture (or loses joint control) between the beginning of the earliest period presented (including periods presented voluntarily) and 1 January 2013.<sup>122</sup>

<sup>122</sup> Ernst&Young, Challenging, p.81.

If this process results in negative net assets, the joint venture assesses whether it has a legal or constructive obligation related to the negative net assets and, if so, recognises the corresponding liability. Presumably, this amount would be the joint venturer's legal or constructive liability (as determined under IAS 37) and not just the amount of negative net assets computed above. If the joint venturer does not have a legal or constructive obligation, it does not recognise the liability. However, the joint venturer must disclose this fact, along with the cumulative unrecognised share of losses in retained earnings as of the beginning of the earliest period presented (e.g., 1 January 2012), and as of the date IFRS 11 is first applied (e.g., 1 January 2013).

In addition to testing for impairment upon transition if indicators exist, management should consider whether indicators exist at the end of the previous period (e.g., 31 December 2011). In such cases, an impairment test should be performed as of such date, and any resulting loss should be recognised at that time.<sup>123</sup>

An impairment may be recognised at the beginning of the earliest comparable period, instead of, or in addition to, any impairment recognised at the end of the prior period. This might be due to the differences in the indicators between IAS 36 *Impairment of Assets* and IAS 39. In addition, an impairment loss might be recognised due to differences in the allocation to cash generating units upon transition.

If an impairment test is needed, and the recoverable amount is based on fair value less costs of disposal, management should consider the implications of IFRS 13, which describes how to measure fair value under IFRS. IFRS 13 is also effective on 1 January 2013. IFRS 13 is adopted prospectively, but can be adopted early.

When transitioning from proportionate consolidation to the equity method, IFRS 11 states that the initial recognition exception for deferred tax assets and liabilities in IAS 12 *Income Taxes* does not apply when the joint venturer recognises its equity method investment in a joint venture upon transition. This is consistent with our general view that the initial recognition exception for deferred tax assets and liabilities does not apply to outside basis differences related to joint ventures in other circumstances.

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<sup>123</sup> IASB, Red Book, p.1595.

### 3.5.1.1 Disclosure as an alternative

Proponents who supported proportionate consolidation accounting for JCEs believed that it better reflected their role in managing the JCE, and the risk and reward profile of the JCE. Proponents believed that proportionate consolidation was more transparent to users of the financial statements on the performance and position of the JCE.

Nonetheless, proportionate consolidation is not permitted under IFRS 11. Some JCEs under IAS 31 might be joint operations under IFRS 11. In these cases, the accounting under IFRS 11 might closely resemble what they had using proportionate consolidation under IAS 31.

However, if the JCE becomes a joint venture, entities that are no longer permitted to use proportionate consolidation, and are required to account for their joint ventures using the equity method, might find that they can use other disclosures to communicate the information that was conveyed using proportionate consolidation under IAS 31.<sup>124</sup>

One obvious possibility is that IFRS 12 requires summarized financial information for individually material joint ventures, and summarised financial information in the aggregate for all other joint ventures. In some cases, the information that would have been provided using proportionate consolidation can be obtained from the summarised financial information.

Another possibility is that if a joint venture or joint operation were a reportable segment (as defined in IFRS 8 *Operating Segments*),<sup>125</sup> the joint venturer or joint operator would be required to disclose financial information about that operating segment, if such amounts are provided to the chief operating decision maker. The information used by the chief operating decision maker need not change, just because the accounting method required by IFRS 11 has changed.

### 3.5.2 Transition From The Equity Method To Accounting For Assets And Liabilities

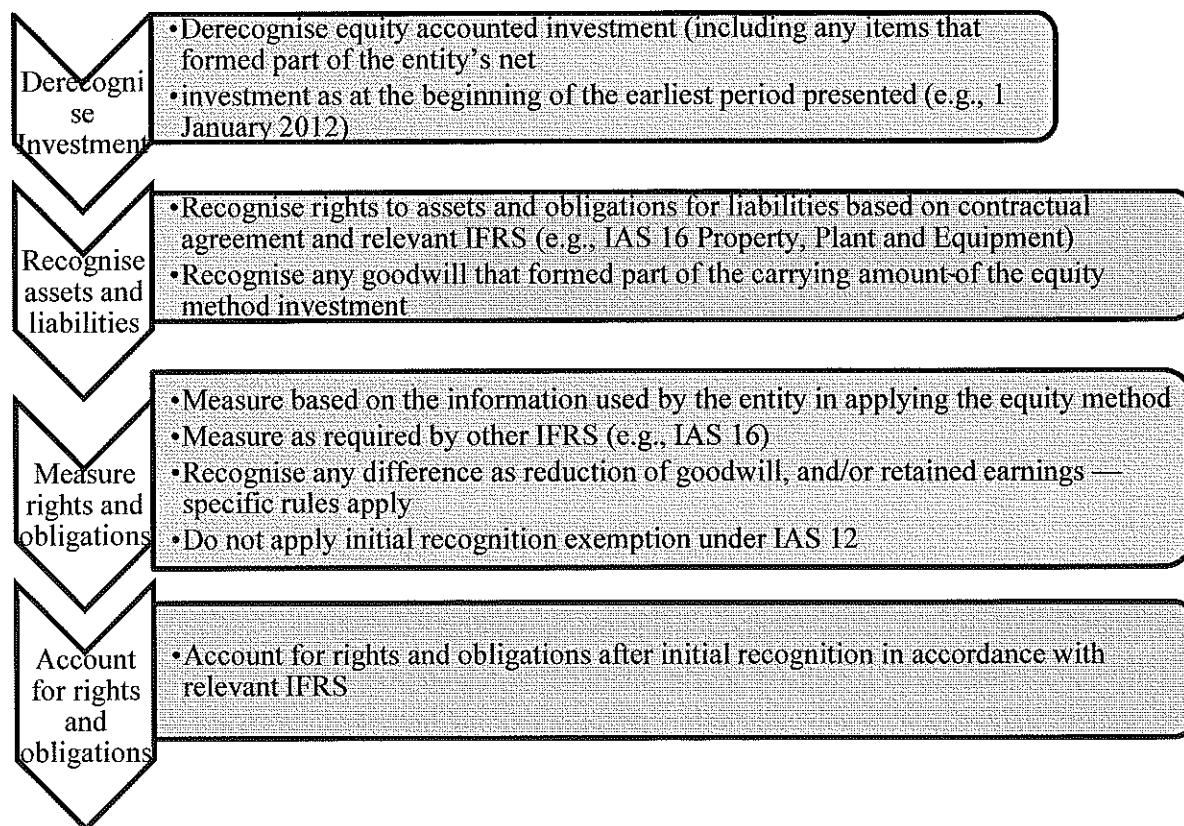
If an entity accounted for a JCE using the equity method under IAS 31, and determines that the joint arrangement is a joint operation under IFRS 11, it would be required to account for its rights to the assets, and its obligations for the liabilities. Diagram below illustrates the process for transition.

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<sup>124</sup> Demir and Bahadır, p.189.

<sup>125</sup> Gökçen and others, p.88

**Diagram 28:** Transition from equity method to accounting for assets and liabilities



An entity transitioning from the equity method to accounting for its rights to the assets and obligations for the liabilities must disclose both of the following at the beginning of the earliest period presented:

- A reconciliation between the investment derecognised, and the assets and liabilities recognized
- Any amount recognised in retained earnings

After initial recognition, a joint operator recognises its assets and obligations, revenues and expenses. An entity's share of individual assets and liabilities that would have been accounted for under the equity method will be presented on separate line items on the statement of financial position, rather than as a one line net investment. Similarly, income and expenses will be presented on separate line items in the income statement, rather than one line in profit or loss.

Management should not underestimate the impact that this change in accounting may have on its financial statements.

### **3.5.3 Proportionate Consolidation To Joint Operation Accounting**

For an entity that used proportionate consolidation under IAS 31 which has a joint arrangement that is a joint operation under IFRS 11 (which means that the joint operator recognises its assets, liabilities, revenues and expenses), in many cases, there will be little (or no) impact upon adoption of IFRS 11. However, in some cases, there will be differences.<sup>126</sup>

For example, under proportionate consolidation, the joint venture recognised its proportionate share of all assets and liabilities of the JCE. In contrast, in a joint operation, the joint operator may have only a share of certain assets and liabilities. In such cases, there may be a significant difference between the results under proportionate consolidation, compared with a joint operation.

This situation is not specifically addressed in the transition provisions of IFRS 11. Accordingly, if the change in classification from a joint venture using proportionate consolidation to a joint operation results in changes to the financial statements, it appears that these changes should be reflected retrospectively (i.e., in accordance with IAS 8).

### **3.5.4 Jointly Controlled Asset Or Operation To Equity Method**

We do not expect it be common that a jointly controlled asset/operation under IAS 31 would be a joint venture under IFRS 11. This is because this situation would occur only when it was determined under IAS 31 that there was no entity, but there is a separate vehicle under IFRS 11 (and that separate vehicle gives the parties rights to the assets and obligations for the liabilities). However, if this were the case, there would be significant changes in the entity's financial statements. This is because the entity would have accounted for jointly controlled assets/operations based on its share of the assets, liabilities, income, and expenses under IAS 31, but will use the equity method under IFRS 11.<sup>127</sup>

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<sup>126</sup> IASB, Red Book. p.1599.

<sup>127</sup> Ernst&Young, IFRS 10, 11 and 12, p.31.

This situation is not specifically addressed in the transition provisions of IFRS 11. Accordingly, upon transition, it appears that these changes would be reflected retrospectively (i.e., in accordance with IAS 8).

### **3.5.5 Impact On Key Performance Metrics — Presentation**

Management should not underestimate the impact that the change in accounting may have upon its financial statements. This may affect key performance metrics such as revenue, gross margin and leverage ratios, used both internally and externally to assess the entity's performance. Example 26 illustrates the potential impact.

While this is perhaps an extreme example, it illustrates the potentially dramatic effect that accounting for joint ventures under the equity method could have on some entities. However, before reaching such a conclusion, care should be taken to reassess whether:

- Joint control exists in such cases
- Such joint arrangements are joint ventures, and not joint operations

**Box 29: Example of Comparison of proportionate consolidation with the equity method<sup>128</sup>**

The business of a manufacturer in an emerging economy is conducted entirely through joint arrangements, because of the legal requirements in that country. Under IAS 31, these joint arrangements were considered JCEs, and the manufacturer accounted for these entities using proportionate consolidation.

Upon adopting IFRS 11, the manufacturer concludes that there is joint control between itself and the local government over each of these arrangements. The manufacturer then assesses the legal form of the separate vehicle, the contractual terms of the arrangement, and other facts and circumstances, and determines that these former JCEs are considered joint ventures under IFRS 11. Accordingly, the manufacturer is required to account for these joint ventures using the equity method.

The table below illustrates the impact:

Balance Sheet (in CUs)	1 Jan. 2012 (before adoption)	1 Jan. 2012 (after adoption)
Current assets	320	—
Non-current assets	2,100	1,520
Total assets	2,420	1,520
Current liabilities	(350)	—
Current liabilities	(550)	—
Total liabilities	(900)	—
Total equity	(1,520)	(1,520)

Statement of Operations (in CUs)	Year ended 31 December 2012	Year ended 31 December 2012
-------------------------------------	--------------------------------	--------------------------------

<sup>128</sup> Ernst&Young, Challenging, p.82.

	(before adoption)	(after adoption)
Revenue	1,070	—
Cost of sales	(840)	—
Gross margin	230	—
Other operating costs	(125)	—
Operating profit	105	—
Interest and taxes	(25)	—
Share of profit from joint ventures	—	80
<b>Net income</b>	<b>80</b>	<b>80</b>

### 3.5.6 Impact On Key Performance Metrics – Measurement

After adopting IFRS 11, net income (or comprehensive income) and net assets may differ from the amounts that would have been reported under IAS 31. This is because the measurement rules for applying the equity method differ from those that would have been applied to other assets and liabilities recognised.

#### 3.5.6.1 Impairment

When changing the accounting from the equity method to accounting for rights to assets and obligations for liabilities, the issues noted in Diagram below may arise.

If valuations are obtained as of a prior date because an impairment test is required when one was not required previously, care should be taken not to use hindsight. Estimates should be based on facts and circumstances that existed at the time.

**Diagram 29:** Possible measurement differences with respect to impairment

	Equity method	Accounting for rights to assets and obligations for liabilities	Impact
<b>When to test for impairment?</b>	IAS 28 requires the joint venture to apply IAS 39 to determine whether it is necessary	Assets are tested for impairment in accordance with IAS 36 (unless the asset is a	The impairment indicators under IAS 39 and IAS 36 differ slightly,

	to recognize any impairment loss for the equity investment. However, the amount of the impairment is measured in accordance with IAS 36. Goodwill related to the joint venture is included in the carrying amount of the joint venture. Therefore, it is not separately tested for impairment.	financial instrument, in which case IAS 39 applies). Goodwill is tested for impairment at least annually.	which means that an entity may need to test for impairment when it did not previously, or the reverse.  Goodwill might need to be tested for impairment for the first time, even if no indicators exist (due to the requirement under IAS 36 to test at least annually).
<b>What is tested?</b>	The entire equity-accounted investment is tested for impairment.	Only the assets for which there are indicators, or goodwill (and other assets within the cash generating unit) are tested for impairment.	If the assets of the joint arrangement are allocated to several cash generating units, impairment might exist where it did not previously, or vice versa
<b>Is reversal of impairment permitted?</b>	As the embedded goodwill is considered an element of the joint venture, impairments recognised upon, or after, transition can be reversed if criteria are met.	Goodwill impairments cannot be reversed. Impairments of other assets recognised upon, or after, transition can be reversed, if criteria are met	Any impairment that was reversed may not be permitted when accounting for rights to assets going forward.

### 3.5.6.2 Borrowing costs

If a JCE that was accounted for under proportionate consolidation did not incur any borrowing costs, then the joint venturer would capitalise its own borrowing costs, in accordance with IAS 23 *Borrowing Costs*. The same would be true for assets recognized for a joint operation. However, borrowing costs cannot be capitalised on equity method investments, because they are not qualifying assets under IAS 23.<sup>129</sup>

<sup>129</sup> Gökçen and others, p. 321.

Accordingly, if a JCE under IAS 31 is a joint operation under IFRS 11, then the joint operator will have to recognise borrowing costs, from the beginning of the earliest comparative period going forward. In addition, the joint operator would also need to recognise any additional depreciation, foreign exchange differences and potential impairment (see Section 3.5.6.1) on the higher carrying amount of those qualifying assets that resulted from the additional capitalization.

### **3.5.6.3 Hedging**

If a JCE was accounted for using proportionate consolidation under IAS 31, the entity may have been able to apply hedge accounting to the assets, liabilities, firm commitments and highly probable forecast transactions of the JCE. If that former JCE is classified as a joint venture under IFRS 11, hedge accounting can be applied only to the equity method investment as a whole. However, a joint operator would be able to apply hedge accounting to assets, liabilities, firm commitments and highly probable forecast transactions of the joint operation.<sup>130</sup>

This means that hedges that may have been deemed effective in the past may no longer be effective, and the resulting ineffectiveness will need to be recognised in profit or loss. For example, this may be the case if a joint arrangement were a proportionately consolidated JCE that is a joint venture under IFRS 11. Management should also consider whether to put new hedges in place with respect to the joint arrangement based on its new accounting under IFRS 11 (if applicable) and IFRS 9 (when effective).<sup>131</sup>

### **3.5.6.4 Remeasurement upon changes to/from associate**

As discussed before, if an entity loses joint control over a joint venture, but retains an interest in the associate (or vice versa), it does not remeasure its retained interest in the associate. Similarly, the entity does not reclassify any amounts that were previously recognised in other comprehensive income and accumulated in equity (e.g., foreign currency translation adjustments). These are changes from the requirements introduced by the consequential amendments from IFRS 3 and IAS 28 in 2008. Those amendments required prospective adoption, when introduced in 2008.

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<sup>130</sup> Demir, p.192.

<sup>131</sup> Ernst&Young, Power and Utilities, p.26.

Interestingly, no transition provisions were included in IAS 28, as amended for IFRS 11. This would seem to indicate that, since transition is not specifically addressed, the general provisions of IAS 8 would apply. This means that retrospective restatement would be required, even if the classification of a joint arrangement was otherwise unaffected by the issuance of IFRS 11.

The same situation would apply in reverse, unless the associate became a JCE that was accounted for using proportionate consolidation. In this case, there appears to be a conflict between the requirements of IFRS 11 and IAS 28, because IFRS 11 does address the transition from proportionate consolidation to the equity method. For this case, IFRS 11 is explicit that the deemed cost of the investment in the joint venture is the aggregate of the amounts recognised using proportionate consolidation under IAS 31, without adjustment (other than impairment testing). This would seem to conflict with the implicit transition requirements, which appear to require that any remeasurement recorded in accordance with IAS 28 (2008) be reversed.

### **3.6 BUSINESS IMPACT**

#### **3.6.1 Systems And Processes**

New processes and systems (or modifications to existing processes and systems) may be needed to gather the information necessary to make judgements and to comply with required disclosures, both at transition and on an ongoing basis. Facts and circumstances that impact the reassessment of joint control, and/or the classification of a joint arrangement, may change over time — processes should be adjusted accordingly.

#### **3.6.2 Estimates And Valuation**

Management may need to make new estimates and may require valuations. For example, valuations might be needed when there are changes in ownership with respect to a joint venture or a joint operation. Valuations also may be needed if a joint venture equity method investment needs to be tested for impairment, including as of the beginning of the earliest comparative

period. Management should consider whether it has access to all the information that will be required.

### **3.6.3 Key Financial Metrics**

When there will be changes to the accounting for a joint arrangement (e.g., changing from proportionate consolidation to the equity method), management should consider how key financial metrics will be impacted. For example, total assets, total liabilities, total revenues and total expenses may increase or decrease. Management should assess how such changes will be presented on analyst calls, in earnings releases and other shareholder communications. Loan covenant compliance should also be considered.

When bonuses, share-based payment vesting conditions and other compensation plans are based on financial measures, management may need to reassess their continued appropriateness.

### **3.6.4 Income Taxes**

Management will need to consider the tax impact of adopting IFRS 11. In many cases, changes to the accounting for joint arrangements will not affect the amount of income tax payable. However, there may be a taxable gain or loss. Management should take steps to ensure that book and tax bases are carefully tracked, so that the presentation of deferred tax assets and liabilities is correct.

## CONCLUSION

The objective of the IFRS is to establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly (ie joint arrangements). The IFRS requires a party to a joint arrangement to determine the type of joint arrangement in which it is involved by assessing its rights and obligations arising from the arrangement.

The IFRS is to be applied by all entities that are a party to a joint arrangement. A joint arrangement is an arrangement of which two or more parties have joint control. The IFRS defines joint control as the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities (ie activities that significantly affect the returns of the arrangement) require the unanimous consent of the parties sharing control.

The IFRS classifies joint arrangements into two types—joint operations and joint ventures. A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement (ie joint operators) have rights to the assets, and obligations for the liabilities, relating to the arrangement. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement (ie joint venturers) have rights to the net assets of the arrangement.

An entity determines the type of joint arrangement in which it is involved by considering its rights and obligations. An entity assesses its rights and obligations by considering the structure and legal form of the arrangement, the contractual terms agreed to by the parties to the arrangement and, when relevant, other facts and circumstances.

The IFRS requires a joint operator to recognise and measure the assets and liabilities (and recognise the related revenues and expenses) in relation to its interest in the arrangement in accordance with relevant IFRSs applicable to the particular assets, liabilities, revenues and expenses.

The IFRS requires a joint venturer to recognise an investment and to 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 as specified in that standard.

The disclosure requirements for parties with joint control of a joint arrangement are specified in IFRS 12 *Disclosure of Interests in Other Entities*. On the other hand companies that

account for JCEs using proportionate consolidation under IAS 31 will need to change their accounting policies. However, rather than automatically switching to the equity method of accounting, management needs to determine whether, based on the legal form, the terms of contractual arrangements, and other facts and circumstances, each party has rights to assets and obligations for liabilities (a joint operation), or rights to the net assets of an arrangement (a joint venture) and account accordingly.

The frequency of strategic alliances is growing, including joint arrangements — particularly when an acquisition is not an option due to cash limitations or risk management reasons. Joint arrangements continue to increase in a number of industries, as entities expand their distribution channels. Companies should consider the impact of IFRS 11 when negotiating new joint arrangements — or modifying existing ones. An early analysis will help avoid surprises and ease transition.

As a result The adoption of IFRS 10 and IFRS 11 may lead to significant changes in an entity's reported financial position and performance. For some companies, the new definition of control will lead to consolidation of entities that were not previously included in the group, potentially resulting in more assets and liabilities on the books. There may also be instances in which companies will have to de-consolidate entities that were previously consolidated, that is, taking those entities off the balance sheet, although this is expected to be rare. Similarly, some joint arrangements that are accounted for using proportionate consolidation under current IFRS will be accounted for using the equity method under IFRS 11. This will result in recognising a single line item for the investment and the reporting entity's share of the joint arrangement's profit or loss. Conversely, there might be some joint arrangements that are currently accounted for using the equity method that will be considered joint operations under the new standard. For those arrangements, the joint operator will recognise its assets, liabilities, revenues, and expenses, and/or its share of those items, if any; that is, the single investment line item will have to be disaggregated into its components on the balance sheet and income statement.

A common feature of both IFRS 10 and IFRS 11 is that they require considerably more judgement than was required under the previous standards, and they remove some of the existing bright lines.

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