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IFRS Project Insights

Joint Arrangements

15 February 2011

The IASB and FASB are jointly working on a project to improve financial reporting for joint arrangements within the scope of IAS 31, *Interests in Joint Ventures*. The IASB has limited the scope of this short-term convergence project to:

- remove the option to apply the proportional consolidation method when accounting for jointly controlled entities; and
- consider the existing definition of a joint arrangement and the differences between a joint venture entity and direct interests in assets and liabilities of a joint arrangement.

ED 9 *Joint Arrangements* was issued in September 2007. The IASB completed its redeliberations of the proposals in the ED and in October 2010 published a staff draft of the final standard. The final standard is expected to be published in late February 2011.

At the 15 February 2011 IASB meeting, the Board decided that the effective date of IFRS 11 *Joint Arrangements* will be 1 January 2013 with early application permitted so long as IFRS 10 *Consolidated Financial Statements*, IFRS 12 *Disclosure of Involvement with Other Entities*, IAS 27 *Separate Financial Statements* (revised 2011) and IAS 28 *Investments in Associates and Joint Ventures* (revised 2011) are also early adopted.

Summary of tentative decisions

The following represents a summary of the tentative decisions reached to date resulting from the redeliberations of the proposals in the ED.

Definition and scope

The new IFRS would apply to all joint arrangements. The existing scope exemption for venture capital organisations or mutual funds, unit trusts and similar entities would be removed and included as part of the measurement section.

Joint arrangements would be classified as either joint operations (combining existing jointly controlled assets and jointly controlled operations) or joint ventures.

- *Joint operations* are direct interests whereby parties have contractual rights to individual assets or a contractual responsibility for individual liabilities.
- *Joint ventures* are indirect interests whereby venturers have rights to a share of the 'net' common outcome expected to be generated from a group of underlying assets and liabilities under their joint control.

Recognition and measurement

A party to a *joint operation* would recognise its contractual rights to assets and contractual obligations in accordance with applicable standards.

A party to a *joint venture* would recognise its right to a share of the outcome expected to be generated from a group of assets and liabilities subject to joint control using the equity method of accounting.

An investor that does not have joint control would account for its interest in a joint arrangement as follows:

- an investor in a joint arrangement that is a *joint operation* would account for its assets, liabilities, revenues and expenses arising from the joint operation.

- an investor in a joint arrangement that is a *joint venture* would account for its interest in accordance with IAS 39 or, if it has significant influence in the joint venture, in accordance with IAS 28.

When joint control of a joint venture is lost but significant influence is retained, the remaining interest would not be remeasured as there is no change in the basis of accounting.

An entity that partially disposes of an interest in a joint venture or in an associate would reclassify as held for sale only the interest disposed of if the partial disposal meets the criteria for classification as held for sale in IFRS 5. The retained interest should continue to be accounted for using the equity method until the disposal occurs. An interest in a joint operation would be classified as held for sale in accordance with IFRS 5 if an entity is committed to a sale plan that fulfils the criteria for classification as held for sale in IFRS 5. If an interest (or a portion of an interest) in a joint venture or in an associate or an interest in a joint operation no longer meet the held for sale criteria, an entity would amend the financial statements for the periods since classification as held for sale.

No changes have been made to the guidance incorporated from SIC 13, so that when non-monetary assets are contributed to a joint venture, the venturer would only recognise that portion of the gains or losses attributable to the equity interests of the other venturers. However, in accordance with IAS 27, where the non-monetary asset constitutes a subsidiary, the gains or losses should be recognised in full. This apparent inconsistency is expected to be carried forward to the final standard.

Transitional provisions

Transitional provisions would vary depending on how an interest has been classified under IAS 31 and the new standard, respectively:

- when transitioning from proportionate consolidation to equity accounting, the respective proportionate consolidation carrying values would be aggregated into a single line item. The investment would need to be tested for impairment in accordance with IAS 36 at the date of transition regardless of whether there is any existing indication that the investment might be impaired; and
- transitioning from equity accounting to accounting for share of assets and liabilities would consist of the derecognition of the investment, and the recognition of the entity's shares of assets and liabilities at their carrying values based on the entity's interests determined in accordance with the contractual arrangement. Any difference between the carrying amount of the investment and the carrying net amount of the individual assets and liabilities would be recognised in retained earnings. Entities would also be required to reconcile the investment derecognised and the breakdown of the shares of assets and liabilities recognised, together with any balance recognised in retained earnings.

Thinking ahead

- Judgment would often be required in determining whether the arrangement is a joint venture or a joint operation. Entities would need to perform a thorough analysis of the agreements. The determination of the type of joint arrangement would become more important because of the differences in accounting that would exist between joint ventures and joint operations (i.e., proportionate consolidation would no longer be permitted for joint ventures).
- Robust accounting policies may need to be developed because of the extent to which judgement is involved.
- Entities may need to educate analysts about the affect of the change in accounting.
- Performance metrics and debt covenants may need to be modified.

Next steps

The Board is expected to publish the final standard in late February 2011.

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