

Straight away

IFRS bulletin from PwC

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IFRS 11, 'Joint arrangements', brings major change to accounting for joint ventures

What is the issue?

The IASB has issued the long awaited IFRS 11, 'Joint arrangements', as part of a 'package' of five new standards (see our 'Straight aways' on the consolidation and disclosure standards).

Changes in the definitions have reduced the 'types' of joint arrangements to two: joint operations and joint ventures. The existing policy choice of proportionate consolidation for jointly controlled entities has been eliminated. Equity accounting is mandatory for participants in joint ventures. Entities that participate in joint operations will follow accounting much like that for joint assets or joint operations today.

The new standard is applicable for accounting periods beginning on or after 1 January 2013. Earlier application is permitted if the entire package of standards is adopted at the same time.

Key provisions

Underlying principles

A joint arrangement is defined as being an arrangement where two or more parties contractually agree to share control. Joint control exists only when the decisions about activities that significantly affect the returns of an arrangement require the unanimous consent of the parties sharing control.

All parties to a joint arrangement should recognise their rights and obligations arising from the arrangement. The focus is no longer on the legal structure of joint arrangements, but rather on how rights and obligations are shared by the parties to the joint arrangement.

The structure and form of the arrangement is only one of the factors to consider in assessing each party's rights and obligations. The terms and conditions agreed by the parties (for example, agreements that may modify the legal structure or form of the arrangement) and other relevant facts and circumstances should also be considered. If the facts and circumstances change, a venturer needs to reassess:

- whether it has joint control; and/or
- the type of joint arrangement in which it is involved.

Types of joint arrangements and their measurement

IFRS 11 classifies joint arrangements as either joint operations or joint ventures. The 'jointly controlled assets' classification in IAS 31, 'Interests in Joint Ventures', has been merged into joint operations, as both types of arrangements generally result in the same accounting outcome.

A joint operation is a joint arrangement that gives parties to the arrangement direct rights to the assets and obligations

for the liabilities. A joint operator will recognise its interest based on its involvement in the joint operation (that is, based on its direct rights and obligations) rather than on the participation interest it has in the joint arrangement.

A joint operator in a joint operation will therefore recognise in its own financial statements:

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

A joint venture, in contrast, gives the parties rights to the net assets or outcome of the arrangement. A joint venturer does not have rights to individual assets or obligations for individual liabilities of the joint venture. Instead, joint venturers share in the net assets and, in turn, the outcome (profit or loss) of the activity undertaken by the joint venture. Joint ventures are accounted for using the equity method in accordance with IAS 28, 'Investments in Associates'. Entities can no longer account for an interest in a joint venture using the proportionate consolidation method.

The standard also provides guidance for parties that participate in joint arrangements but do not have joint control.

Am I affected?

Entities with existing joint arrangements or that plan to enter into new joint arrangements will be affected by the new standard. These entities will need to assess their arrangements to determine whether they have invested in a joint operation or a joint venture upon adoption of the new standard or upon entering into the arrangement.

Entities that have been accounting for their interest in a joint venture using proportionate consolidation will no longer be allowed to use this method; instead they will account for the joint venture using the equity method. In addition, there may be some entities that previously equity-accounted for investments that may need to account for their share of assets and liabilities now that there is less focus on the structure of the arrangement.

The transition provisions of IFRS 11 require entities to apply the new rules at the beginning of the earliest period presented upon adoption. When transitioning from the proportionate consolidation method to the equity method, entities should recognise their initial investment in the joint venture as the aggregate of the carrying amounts that were previously proportionately consolidated. In transitioning from the equity method to accounting for assets and liabilities, entities should recognise their share of each of the assets and liabilities in the joint operation, with specific rules detailing how to account for any difference from the previous carrying amount of the investment.

What do I need to do?

Management of entities that are party to joint arrangements should evaluate how the requirements of the new standard will affect the way they account for their existing or new joint arrangements. The accounting may have a significant impact on entities' financial results and financial position, which should be clearly communicated to stakeholders as soon as possible.

Management should also carefully consider the planned timing of their adoption. If they wish to retain the current accounting for existing arrangements, now is the time to consider how the terms of these arrangements can be reworked or restructured to achieve this.