SLFRS 11 Joint Arrangements

19th June 2013

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Topics of Discussion

- Background and objectives
- Joint arrangements
- Classification of a joint arrangement
- Accounting treatment
- Continuous assessment
- Transition
- Disclosures

Background and objectives

- Eliminate accounting policy choice to account for jointly controlled entities using proportionate consolidation
- Structure is no longer the only determinant of classification
- Converge IFRS and US GAAP

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Joint arrangements

A joint arrangement is an arrangement over which two or more parties have joint control

- A joint arrangement is either a joint operation or a joint venture and has the following characteristics:
  - The parties are bound by a contractual arrangement
  - That contractual arrangement gives two or more of those parties joint control of the arrangement
- Contractual arrangement defines the terms
  - Often, but not always, in writing
  - Documented discussions

Joint arrangements
Joint control

Joint control is the contractually agreed sharing of *control* of an arrangement , which exists only when the decisions about the *relevant activities* require the *unanimous consent* of the parties sharing control

- Control: the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee
- Relevant activities: the activities of the arrangement that significantly affect the investee's returns
- Unanimous consent: no single party controls the arrangement and two or more parties must agree to share control

Joint arrangements
Joint control – Example

- Two investors form an investee to develop and market a medical product
  - One investor is responsible for developing and obtaining regulatory approval
  - Other investor is responsible for manufacturing and marketing
- Determine which activity most significantly affects returns
  - Purpose and design of the investee
  - Factors that affect profit margin, revenue , value, etc
  - Effect on returns from each decision-maker's authority
  - Investors' exposure to variability of returns

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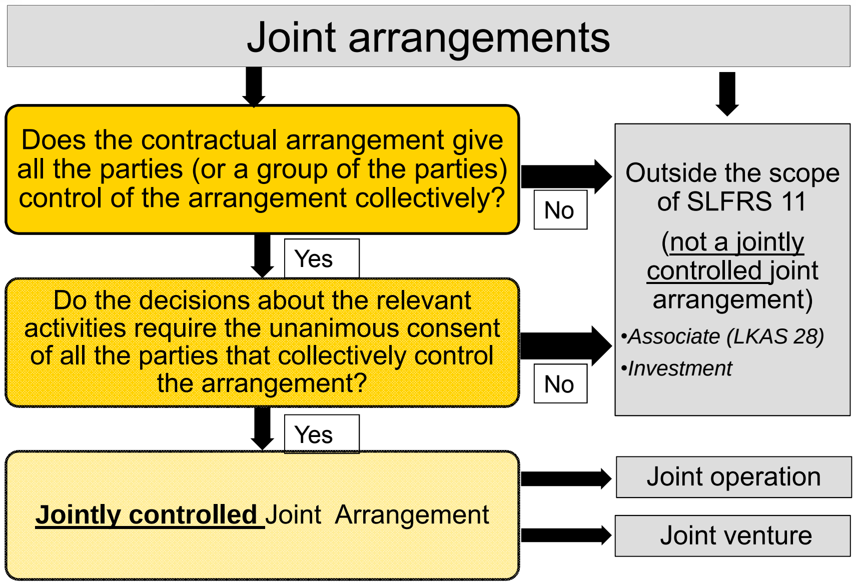

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Joint arrangements
Joint control - Examples

	Example 1	**Example 2**	**Example 3**
Requirement	75% vote to direct relevant activities	75% vote to direct relevant activities	Majority vote to direct relevant activities
Party A	50%	50%	35%
Party B	30%	25%	35%
Party C	20%	25%	Widely dispersed
Conclusion	Even though A can block any decision, A does not control B, because A needs B to agree = **joint control** between A and B.	**No control (or joint control)** because multiple combinations could be used to reach agreement	**No control (or joint control)** because multiple combinations could be used to reach agreement

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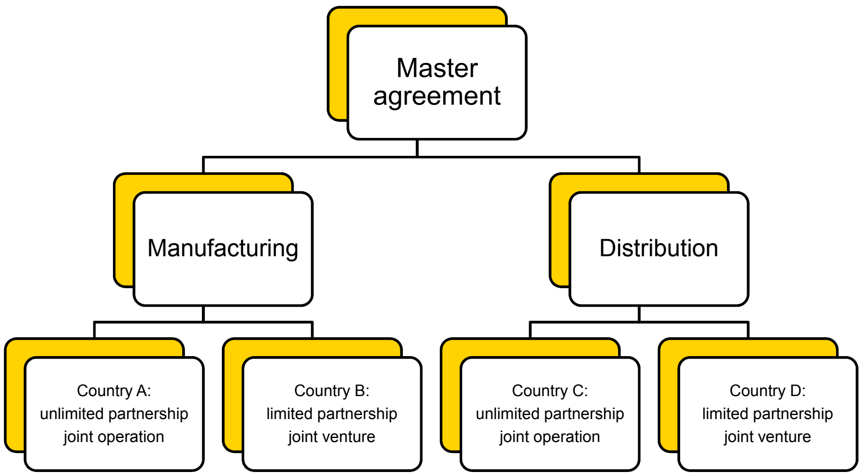
Joint arrangements
Unit of account



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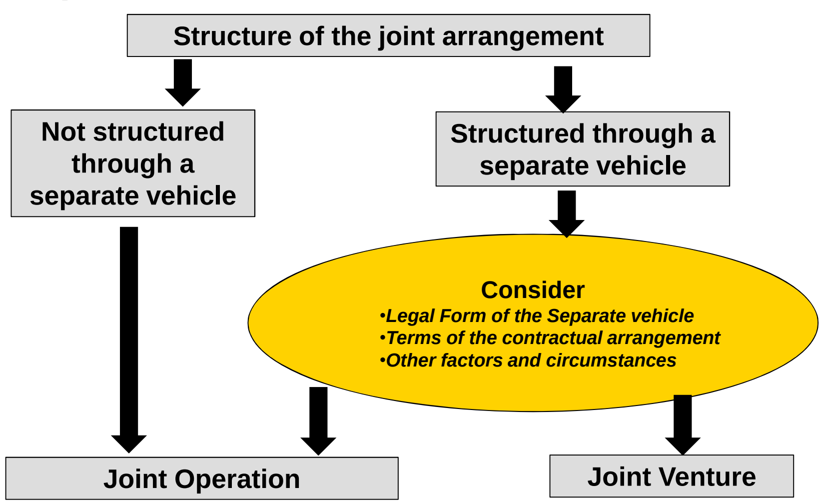
Classification of a Joint Arrangement (B21)



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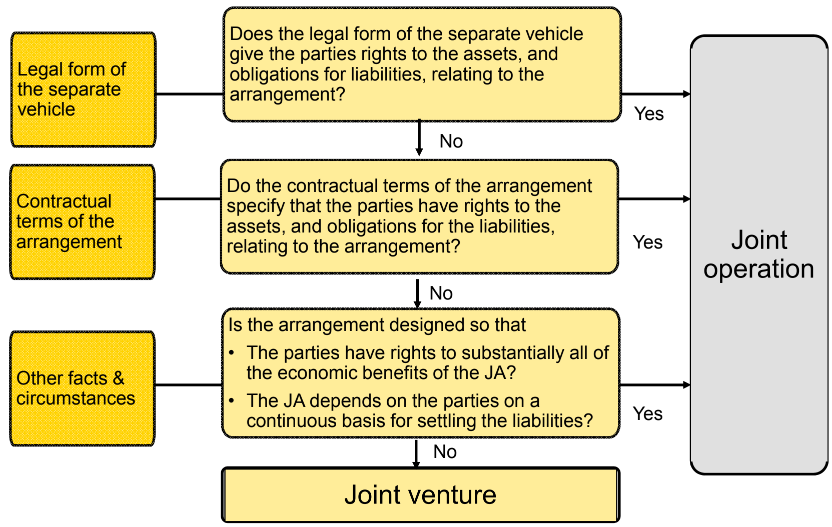
Classification of a joint arrangement



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Classification of a joint arrangement
Legal form

- Legal form is no longer the sole factor, but is still very important in classifying a joint arrangement

Joint Operations	Joint Ventures
Parties have rights to the assets and obligations for the liabilities of the arrangement	Parties have rights to the net assets of the arrangement
Without a separate vehicle, the joint arrangement is a joint operation	To be a joint venture, there must be a separate vehicle
The legal form of the separate vehicle does not confer separation between the parties and the separate vehicle (e.g., general partnership)	The legal form of the separate vehicle causes it to be considered in its own right (e.g., corporation)

- 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

Classification of a joint arrangement
Legal form - Example

- Fact pattern:
  - A and B jointly establish a new corporation (C) in which each party has a 50% ownership interest
  - C's Board consist of Director from A and B.
  - The unanimous consent of the directors is required for any resolution, and the Board makes all decisions over the relevant activities of C
  - The purpose of this arrangement is to manufacture the materials required by both parties for their own individual manufacturing processes
- Analysis:
  - Incorporation enables the separation of C from A and B
  - Assets and liabilities of C are the assets and liabilities of the incorporated entity
  - Legal form of the separate vehicle indicates that the parties have rights to the net assets of the arrangement
  - Therefore – Joint Venture

Classification of a joint arrangement
Examples of contractual terms

	Joint Operations	**Joint Ventures**
Assets	• Share all interests in the assets in a specified proportion • Hold assets of the arrangement as tenants in common in a specified proportion • Have rights to all of the economic benefits generated by the assets	Do **not** have interests (i.e., no rights, title, or ownership) in the assets of the arrangement
Liabilities	• Share all liabilities, obligations, costs and expenses in a specified proportion • Have liabilities for claims raised by third parties or to customers of the arrangement	• Are not liable for the debts and obligations of the arrangement • Liabilities to the arrangement do not exceed the parties' investment in the arrangement • Creditors do not have any recourse against any party in for debts or obligations

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Classification of a joint arrangement
Contractual terms - Example

(Continued)

- Fact pattern:
  - A and B modify the features of C through their contractual arrangement so that each has an interest in the assets of C and each is liable for the liabilities of C in a specified proportion
- Analysis:
  - Legal form of the separate vehicle indicates that the parties have rights to the net assets of the arrangement
  - However, contractual modifications to the features of C cause the arrangement to be a joint operation

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Classification of a joint arrangement
Facts and circumstances

- Facts and circumstances might indicate a joint operation if they result in the parties having:
  - Rights to the assets
  - Obligations for the liabilities
- Examples:
  - Restrictions on customers
  - Commitments to purchase all the output produced
  - Expectations to fund losses
- Consider purpose and design
- Commitment upon default or guarantee is not determinative of being a joint operation

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Classification of a joint arrangement

Facts and circumstances - Example

(Continued)

- Fact pattern:
  - A and B agreed to purchase all the output produced by C in a ratio of 50:50
  - C cannot sell any of the output to third parties, unless this is approved by A and B (expected to be uncommon)
  - Price of the output sold is designed to cover expenses incurred by C (intended to operate at break-even level)
- Analysis:
  - Joint operation

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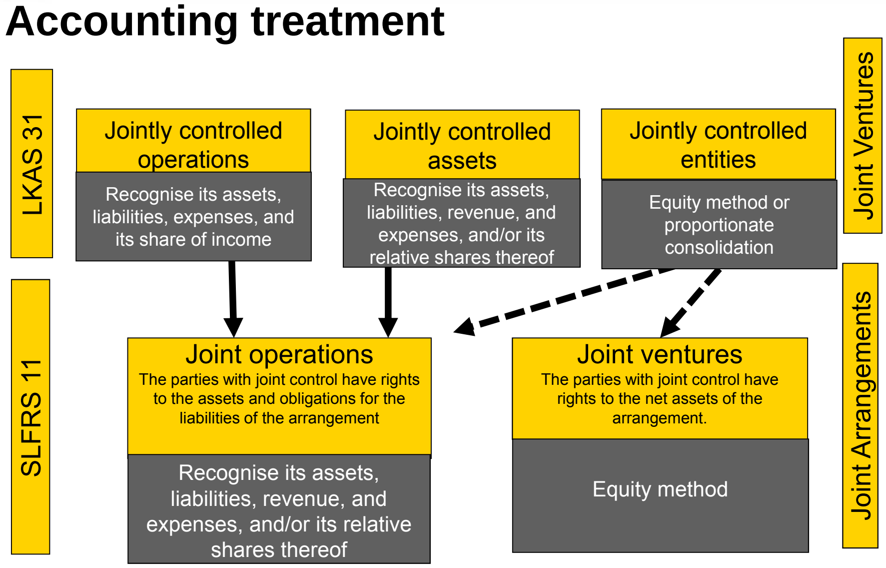
Accounting treatment



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Accounting treatment

Proportionate consolidation vs. joint operation

- When is accounting for a joint operation the same as 'proportionate consolidation'?
  - Equal rights to all assets all liabilities – probably same
  - Rights to a specified percentage of certain assets and differing rights (and percentages) to other assets, and different obligations for various liabilities – likely to be a difference
  - Nature of assets and liabilities might change
    - Assets - same nature as recognised by joint operator OR (for example) reimbursement right?
    - Liabilities - same nature as recognised by joint operator OR (for example) cash due to joint operation?

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Accounting treatment

Parties without joint control

- Joint operation:
  - Account for rights to assets, and obligations for liabilities, relating to the joint operation (same as accounting by a joint operator)
  - Or, if no rights or obligations, account for interest in joint operation according to applicable SLFRS
- Joint venture:
  - Financial instrument – SLFRS 9
  - Significant influence – use equity method (same as joint venturer)

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Continuous assessment

- Reassess if change in:
  - Joint control
  - Type of joint arrangement
    - Legal form
    - Contractual terms
    - Facts and circumstances

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Transition

Proportionate consolidation to the equity method

- Recognise investment in the joint venture for earliest period presented
- Measure investment as the aggregate of the carrying amounts of the assets and liabilities that were previously proportionately consolidated
  - Including any goodwill arising from acquisition
  - Investment becomes ‘deemed cost’ for equity method
- Test the investment for impairment
- Disclose aggregated assets and liabilities

Transition

Equity method to joint operation

- Derecognise the equity method investment for earliest period presented (“A”)
- Recognise share of assets and liabilities, including goodwill that formed part of the carrying amount of the equity method investment (“B”)
- Any difference between above:
  - If B > A, first reduce goodwill, then retained earnings
  - If A > B, recognise in retained earnings
- Disclose reconciliation

Disclosures

- For individually material joint arrangements:
  - Nature of the relationship with the joint arrangement
  - Proportion of the ownership interest vs. voting shares
- For individually material joint ventures:
  - Method of accounting
  - Summarised financial information
  - Fair value of (if quoted market price is available)
- Aggregate information for immaterial JVs
- Summarised financial information is also required if the fair value option is used

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Example 1 – Construction
Fact pattern

- A and B enter into a contract to design and construct a road for a government
  - A and B set up Z to conduct the arrangement
  - Z enters into the contract with the government
  - However, the legal form of Z is such that A and B have rights to the assets and liabilities for the obligations of Z based on their participation shares
  - Profit or loss resulting from the arrangement is shared by A and B based on their participation shares
  - A and B assign an operator, who will be an employee of either A or B, activities executed on a ‘no gain or loss’ basis

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Example 1 – Construction
Analysis

- Joint operation
  - Separate vehicle – Yes (Z)
  - Legal form – Does not confer separation between A and B and the separate vehicle (Z), because assets and liabilities in Z are A and B’s assets and liabilities
  - Terms – A and B have rights to the assets, and obligations for the liabilities, relating to Z
  - Facts & circumstances – Do not need to be considered, because legal form and terms indicate joint operation
  - Accounting – A and B each recognise their share of the assets, liabilities, revenue and expenses based on their participation share in Z

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Example 2 – Real estate
Fact pattern

- A and B (real estate companies) enter into a contract to acquire and operate a shopping centre
  - A and B set up X to own the shopping centre
  - Legal form of X is such that X has rights to the assets and liabilities for the obligations (not A and B)
  - Activities include: rental of retail units, managing the car park, maintaining the centre and its equipment (such as lifts), and building the reputation and customer base
  - The parties are not liable for the debts or liabilities of X (liability limited to unpaid capital contribution)
  - A and B have the right to sell or pledge interests in X
  - A and B receive share of the net rental income

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Example 2 – Real estate
Analysis

- Joint venture
  - Separate vehicle – Yes (X)
  - Legal form – Confers separation between A and B and the separate vehicle (X); that is, the assets and liabilities in X are <u>not</u> A and B's assets and liabilities
  - Terms – A and B have rights to the net assets of X
  - Facts & circumstances – None that indicate that A and B have rights to substantially all the economic benefits of the assets relating to the arrangement, or obligations for the liabilities relating to the arrangement
  - Accounting – Account for interests in X using equity method

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Thoughts & Comments

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Thank You.