CHAPTER 7

Joint Arrangements (IFRS 11)

Objective

The objective of this IFRS is to establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly (i.e. joint arrangements).

Meeting the objective

To meet the objective in paragraph 1, this IFRS defines joint control and requires an entity that is a party to a joint arrangement to determine the type of joint arrangement in which it is involved by assessing its rights and obligations and to account for those rights and obligations in accordance with that type of joint arrangement.

Scope

This IFRS shall be applied by all entities that are a party to a joint arrangement.

Definitions

Joint arrangement: - An arrangement of which two or more parties have joint control.

Joint control: - 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.

Joint operation: - A joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement.

Joint operator: - A party to a joint operation that has joint control of that joint operation.

Joint venture: - A joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

Joint venturer: - A party to a joint venture that has joint control of that joint venture.

Party to a joint arrangement: - An entity that participates in a joint arrangement, regardless of whether that entity has joint control of the arrangement.

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.

Joint arrangements

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.

A joint arrangement is either a joint operation or a joint venture.

Joint control

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.

An entity that is a party to an arrangement shall assess whether the contractual arrangement gives all the parties or a group of the parties, control of the arrangement collectively. All the parties, or a group of the parties, control the arrangement collectively when they must act together to direct the activities that significantly affect the returns of the arrangement (i.e. the relevant activities).

Types of joint arrangement

Types of Joint Arrangements

An entity shall determine the type of joint arrangement in which it is involved. The classification of a joint arrangement as a joint operation or a joint venture depends upon the rights and obligations of the parties to the arrangement.

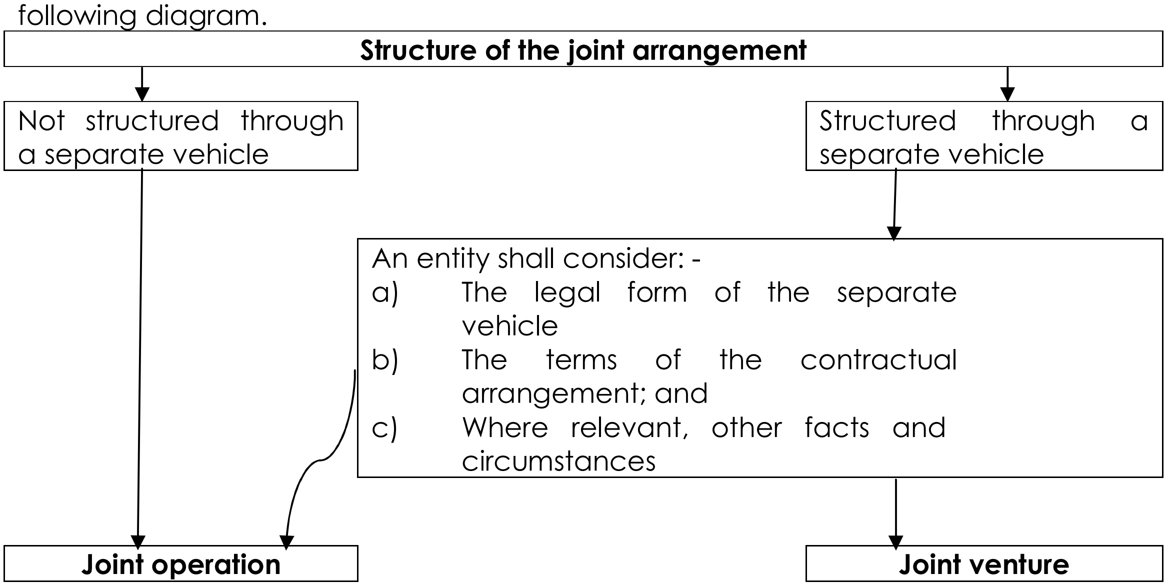
A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Those parties are called joint operators.

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Those parties are called joint venturers.

Classification of a joint arrangement

An entity applies judgment when assessing whether a joint arrangement is a joint operation or a joint venture. An entity shall determine the type of joint arrangement in which it is involved by considering its rights and obligations arising from the arrangement.

An entity assesses its rights and obligations by considering the structure and legal form of the arrangement, the terms agreed by the parties in the contractual arrangement and, when relevant, other facts and circumstances. Consider the following diagram.



The legal form of the separate vehicle

The legal form of the separate vehicle is relevant when assessing the type of joint arrangement. The legal form assists in the initial assessment of the parties' rights to the assets and obligations for the liabilities held in the separate vehicle, such as whether the parties have interests in the assets held in the separate vehicle and whether they are liable for the liabilities held in the separate vehicle.

For example, the parties might conduct the joint arrangement through a separate vehicle, whose legal form causes the separate vehicle to be considered in its own right (i.e. the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties). In such a case, the assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle indicates that the arrangement is a joint venture.

However, the terms agreed by the parties in their contractual arrangement and, when relevant, other facts and circumstances can override the assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle.

The assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle is sufficient to conclude that the arrangement is a joint operation only if the parties conduct the joint arrangement in a separate vehicle whose legal form does not confer separation between the parties and the separate vehicle (i.e. the assets and liabilities held in the separate vehicle are the parties' assets and liabilities).

Assessing the terms of the contractual arrangements

In many cases, the rights and obligations agreed to by the parties in their contractual arrangements are consistent, or do not conflict, with the rights and obligations conferred on the parties by the legal form of the separate vehicle in which the arrangement has been structured.

In other cases, the parties use the contractual arrangement to reverse or modify the rights and obligations conferred by the legal form of the separate vehicle in which the arrangement has been structured The following table compares common terms in contractual arrangements of parties to a joint operation and common terms in contractual arrangements of parties to a joint venture. The examples of the contractual terms provided in the following table are not exhaustive.

Assessing the terms of the contractual arrangement		
	Joint operation	**Joint venture**
The terms of the contractual Arrangement	The contractual arrangement provides the parties to the joint arrangement with rights to the assets, and obligations for the liabilities, relating to the arrangement.	The contractual arrangement provides the parties to the joint arrangement with rights to the net assets of the arrangement (ie it is the separate vehicle, not the parties, that has rights to the assets, and obligations for the liabilities, relating to the arrangement).
Rights to assets	The contractual arrangement establishes that the parties to the joint arrangement share all interests (e.g. rights, title or ownership) in the assets relating to the arrangement in a specified proportion (e.g. in proportion to the parties' ownership interest in the arrangement or in proportion to the activity carried out through the arrangement that is directly attributed to them)	The contractual arrangement establishes that the assets brought into the arrangement or subsequently acquired by the joint arrangement 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 contractual arrangement establishes that the parties to the joint arrangement share all liabilities, obligations, costs and expenses in a	The contractual arrangement establishes that the joint arrangement is liable for the debts and obligations of the arrangement.

	specified proportion (e.g. in proportion to the parties' ownership interest in the arrangement or in proportion to the activity carried out through the arrangement that is directly attributed to them).	
		The contractual arrangement establishes that the parties to the joint arrangement are liable to 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 contractual arrangement establishes that the parties to the joint arrangement are liable for claims raised by third parties.	The contractual arrangement states that creditors of the joint arrangement do not have rights of recourse against any party with respect to debts or obligations of the arrangement.
Revenues, expenses, profit or loss	The contractual arrangement establishes the allocation of revenues and expenses on the basis of the relative performance of each party to the joint arrangement. For example, the contractual arrangement might establish that revenues and expenses are allocated on the basis of the capacity that each party uses in a plant operated jointly, which could differ from their ownership interest in the joint arrangement. In other instances, the parties might have agreed to share the profit or loss relating to the	The contractual arrangement establishes each party's share in the profit or loss relating to the activities of the arrangement.

	arrangement on the basis of a specified proportion such as the parties ownership interest in the arrangement. This would not prevent the arrangement from being a joint operation if the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement.	
Guarantees	The parties to joint arrangements are often required to provide guarantees to third parties that, for example, receive a service from, or provide financing to, the joint arrangement. The provision of such guarantees, or the commitment by the parties to provide them, does not, by itself, determine that the joint arrangement is a joint operation. The feature that determines whether the joint arrangement is a joint operation or a joint venture is whether the parties have obligations for the liabilities relating to the arrangement (for some of which the parties might or might not have provided a guarantee	

Assessing other facts and circumstances

When the terms of the contractual arrangement do not specify that the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement, the parties shall consider other facts and circumstances to assess whether the arrangement is a joint operation or a joint venture.

A joint arrangement might be structured in a separate vehicle whose legal form confers separation between the parties and the separate vehicle. The contractual terms agreed among the parties might not specify the parties' rights to the assets and obligations for the liabilities, yet consideration of other facts and circumstances can lead to such an arrangement being classified as a joint operation. This will be the case when other facts and circumstances give the parties rights to the assets, and obligations for the liabilities, relating to the arrangement.

When the activities of an arrangement are primarily designed for the provision of output to the parties, this indicates that the parties have rights to substantially all the economic benefits of the assets of the arrangement. The parties to such arrangements often ensure their access to the outputs provided by the arrangement by preventing the arrangement from selling output to third parties.

The effect of an arrangement with such a design and purpose is that the liabilities incurred by the arrangement are, in substance, satisfied by the cash flows received from the parties through their purchases of the output. When the parties are substantially the only source of cash flows contributing to the continuity of the operations of the arrangement, this indicates that the parties have an obligation for the liabilities relating to the arrangement.

Contractual arrangements

Sometimes the parties are bound by a framework agreement that sets up the general contractual terms for undertaking one or more activities.

The framework agreement might set out that the parties establish different joint arrangements to deal with specific activities that form part of the agreement. Even though those joint arrangements are related to the same framework agreement, their type might be different if the parties' rights and obligations differ when undertaking the different activities dealt with in the framework agreement. Consequently, joint operations and joint ventures can coexist when the parties undertake different activities that form part of the same framework agreement.

If facts and circumstances change, an entity shall reassess whether the type of joint arrangement in which it is involved has changed

Financial statements of parties to a joint arrangement

Joint operations

A joint operator shall recognize in relation to its interest in a joint operation:

(a) its assets, including its share of any assets held jointly;

(b) its liabilities, including its share of any liabilities incurred jointly;

(c) its revenue from the sale of its share of the output arising from the joint operation;

(d) its share of the revenue from the sale of the output by the joint operation; and

(e) its expenses, including its share of any expenses incurred jointly

Accounting for sales or contributions of assets to a joint operation

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 recognize 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 realizable value of the assets to be sold or contributed to the joint operation, or of an impairment loss of those assets, those losses shall be recognized fully by the joint operator

Accounting for purchases of assets from a joint Operation

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 recognize 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 realizable value of the assets to be purchased or of an impairment loss of those assets, a joint operator shall recognize its share of those losses.

Joint ventures

A joint venturer shall recognize its interest in a joint venture as an investment and shall 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.

A party that participates in, but does not have joint control of, a joint venture shall account for its interest in the arrangement in accordance with IFRS 9 Financial Instruments, unless it has significant influence over the joint venture, in which case it shall account for it in accordance with IAS 28

Separate financial statements

In its separate financial statements, a joint operator or joint venturer shall account for its interest in:

(a) a joint operation in accordance with above paragraphs;

(b) a joint venture in accordance with paragraph 10 of IAS 27 Separate Financial Statements.

In its separate financial statements, a party that participates in, but does not have joint control of, a joint arrangement shall account for its interest in:

(a) a joint operation in accordance with paragraph 23;

(b) a joint venture in accordance with IFRS 9, unless the entity has significant influence over the joint venture, in which case it shall apply IAS 27.

Example 1

A and B (the parties) are two companies whose businesses are the provision of many types of public and private construction services. They set up a contractual arrangement to work together for the purpose of fulfilling a contract with a government for the design and construction of a road between two cities. The contractual arrangement determines the participation shares of A and B and establishes joint control of the arrangement, the subject matter of which is the delivery of the road.

The parties set up a separate vehicle (entity Z) through which to conduct the arrangement. Entity Z, on behalf of A and B, enters into the contract with the government. In addition, the assets and liabilities relating to the arrangement are held in entity Z. The main feature of entity Z's legal form is that the parties, not entity Z, have rights to the assets, and obligations for the liabilities, of the entity.

The contractual arrangement between A and B additionally establishes that:

(a) the rights to all the assets needed to undertake the activities of the arrangement are shared by the parties on the basis of their participation shares in the arrangement;

(b) the parties have several and joint responsibility for all operating and financial obligations relating to the activities of the arrangement on the basis of their participation shares in the arrangement; and

(c) the profit or loss resulting from the activities of the arrangement is shared by A and B on the basis of their participation shares in the arrangement.

For the purposes of coordinating and overseeing the activities, A and B appoint an operator, who will be an employee of one of the parties. After a specified time, the role of the operator will rotate to an employee of the other party. A and B agree that the activities will be executed by the operator's employees on a 'no gain or loss' basis

In accordance with the terms specified in the contract with the government, entity Z invoices the construction services to the government on behalf of the parties.

Analysis

The joint arrangement is carried out through a separate vehicle whose legal form does not confer separation between the parties and the separate vehicle (i.e. the assets and liabilities held in entity Z are the parties' assets and liabilities). This is reinforced by the terms agreed by the parties in their contractual arrangement, which state that A and B have rights to the assets, and obligations for the liabilities, relating to the arrangement that is conducted through entity Z. The joint arrangement is a joint operation.

A and B each recognize in their financial statements their share of the assets (e.g. property, plant and equipment, accounts receivable) and their share of any liabilities resulting from the arrangement (eg accounts payable to third parties) on the basis of their agreed participation share. Each also recognizes its share of the revenue and expenses resulting from the construction services provided to the government through entity Z.

Example 2

Two real estate companies (the parties) set up a separate vehicle (entity X) for the purpose of acquiring and operating a shopping centre. The contractual arrangement between the parties establishes joint control of the activities that are conducted in entity X. The main feature of entity X's legal form is that the entity, not the parties, has rights to the assets, and obligations for the liabilities, relating to the arrangement. These activities include the rental of the retail units, managing the car park, maintaining the centre and its equipment, such as lifts, and building the reputation and customer base for the centre as a whole.

The terms of the contractual arrangement are such that:

(a) entity X owns the shopping centre. The contractual arrangement does not specify that the parties have rights to the shopping centre.

(b) the parties are not liable in respect of the debts, liabilities or obligations of entity X. If entity X is unable to pay any of its debts or other liabilities or to discharge its obligations to third parties, the liability of each party to any third party will be limited to the unpaid amount of that party's capital contribution.

(c) the parties have the right to sell or pledge their interests in entity X.

(d) each party receives a share of the income from operating the shopping centre (which is the rental income net of the operating costs) in accordance with its interest in entity X.

Analysis

The joint arrangement is carried out through a separate vehicle whose legal form causes the separate vehicle to be considered in its own right (ie the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties). In addition, the terms of the contractual arrangement do not specify that the parties have rights to the assets, or obligations for the liabilities, relating to the arrangement. Instead, the terms of the contractual arrangement establish that the parties have rights to the net assets of entity X.

On the basis of the description above, there are no other facts and circumstances that indicate that the parties have rights to substantially all the economic benefits of the assets relating to the arrangement, and that the parties have an obligation for the liabilities relating to the arrangement. The joint arrangement is a joint venture.

The parties recognize their rights to the net assets of entity X as investments and account for them using the equity method.

Example -1

Parachute has a 50% interest in Jump, an entity set up and controlled jointly with a third party. The statements of financial positions of the two companies as at 31 December 20X5 are as follows:

	Parachute Rs. (000)	Jump Rs. (000)
Non—current assets		
Property, plant and equipment	406	160
Investment in Jump	10	--
	416	160
Current assets		
Inventories	100	50
Others	200	110
	300	160
	716	320
Equity		
Share capital	200	20
Retained earnings	366	180
	566	200
Current liabilities	150	120
	716	320

Their respective income statements for the year ended 31 December 20X5 are as follows:

	Parachute Rs. (000)	Jump Rs. (000)
Revenue	490	312

Cost of sales	(280)	(200)
Gross profit	210	112
Dividend from Jump	20	--
Profit before tax	230	112
Tax expense	(100)	(32)
Profit after tax	130	80
Dividend charged to earnings	60	40

During December 20X5 Parachute transferred goods to Jump for Rs.50,000. Parachute sells goods at a mark-up of 25%. Jump had not paid Parachute's invoice or sold any of the goods to third parties by the year end.

There was no goodwill arising on Parachute's original investment. No dividends from Jump are outstanding in the Parachute's books.

Required

Prepare a consolidated balance sheet and income statement as at 31 December 20X5 using Equity accounting?

PAST PAPERS

Q-1

The following information has been extracted from statements of financial position and the comprehensive income of Parent Limited (PL), Subsidiary Limited (SL) and Jointly Controlled Entity Limited (JCEL) for the year ended December 31, 2009.

Statement of financial position

	PL	**SL**	**JCEL**
	Rs. (millions)	**Rs. (millions)**	**Rs. (millions)**
Assets			
Non-current assets			
Property, plant and equipment	120	40	74
Investment in SL at cost	35	--	--
Investment in JCEL at cost	25	--	--
Current assets			
Stock in trade	20	17	16
Trade and other receivables	25	5	8
Cash and bank balances	3	1	2
	228	**63**	**100**
Equity and Liabilities			
Equity			
Ordinary share capital (Rs. 10 each)	50	15	50
Retained earnings	78	18	28
Long term loans	75	12	--
Current liabilities	25	18	22
	228	**63**	**100**

Statement of comprehensive income

	PL	**SL**	**JCEL**
	Rs. (million)	**Rs. (million)**	**Rs. (million)**
Sales	1267	276	654
Cost of sales	(928)	(161)	(469)
Gross profit	**339**	**115**	**185**
Selling expenses	(174)	(68)	(100)
Administrative expenses	(88)	(30)	(57)

Other income	10	--	--
Financial charges	(12)	(4)	--
Taxation	(26)	(5)	(10)
Net profit	**49**	**8**	**18**

Following additional information is available:

(i) PL owns 80% equity of SL which was acquired on January 1, 2009. JCEL is a jointly controlled entity in which 50% equity is held by PL since inception.

(ii) On the date of acquisition, the book values of all the assets of SL were approximately equal to their fair values except for the following:

	Fair value	**Book value**
	Rs. in million	
Equipment	15	12
Inventory	12	10

The remaining useful life of the above equipment on the date of acquisition was 3 years. The entire inventory acquired prior to acquisition was sold during 2009.

(iii) JCEL measures inventory using the weighted average method whereas PL uses first in first out (FIFO) method. On December 31, 2008 the cost of JCEL's inventory using either methods was approximately the same. However, on December 31, 2009 the value of its inventory using the FIFO method was Rs. 14 million.

(iv) PL sells goods at cost plus 25%. During 2009 invoices raised by PL against sales made to SL and JCEL amounted to Rs. 10 million and Rs. 20 million respectively. Out of these, inventories worth Rs. 2 million and Rs. 4 million were held by SL and JCEL respectively as on December 31, 2009.

(v) PL uses proportionate consolidation method for recognizing its interest in JCEL.

(vi) There is no impairment in the value of goodwill.

(vii) It is the policy of PL to value the non-controlling interest at its proportionate share of the fair value of the subsidiary's identifiable net assets.

Required:

Prepare the consolidated statements of financial position and comprehensive income of PL for the year ended December 31, 2009 in accordance with the International Financial Reporting Standards. ***(Ignore deferred tax implications)***

Q-2

Millennium Enterprises Limited (MEL) has 80% shareholding in Century Petroleum Limited (CPL) which it had acquired on April 1, 2003. On April 1, 2005, it acquired whole of A Limited's equal (50%) share in the joint venture A Limited had with B Limited in a pipeline project. The operations of the project are jointly controlled.

The purchase was made at book value.

The statements of financial position of the above entities are as at March 31, 2006 are given hereunder:

	MEL Rs. (000)	**CPL Rs. (000)**	**JV Rs. (000)**
Non-current assets			
Property, plant and equipment	416,250	153,600	63,000
Investments	160,000	12,800	--
	576,250	166,400	63,000
Current assets			

Inventory	41,440	20,480	21,000
Accounts receivables	35,150	12,160	11,200
Bank	6,660	--	9,800
	83,250	32,640	42,000
Total assets	**659,500**	**199,040**	**105,000**
Equity and liabilities			
Equity			
Ordinary shares of Rs. 10 each	185,000	64,000	35,000
Reserves			
Accumulated profits	405680	76,800	52,500
	590,680	140,800	87,500
Current liabilities			
Accounts payable	48,100	43,200	14,000
Taxation	20,720	11,200	3,500
Overdraft	--	3,840	--
	68,820	58,240	17,500
Total equity and liabilities	**659,500**	**199,040**	**105,000**

The following information is relevant:

(i) CPL was acquired at a cost of Rs.120 million. Its accumulated profits at that date were Rs. 28 million. At the date of acquisition, i.e. April 1, 2003, CPL owned an item of plant that had a fair value of Rs.20.0 million in excess of its book value. The plant had a remaining useful life of five years. All plant and equipment is depreciated on the straight-line basis. The fair value of CPL's remaining net assets and all of the Joint Venture's net assets were equal to their book values at the relevant dates of acquisition.

(ii) On October 1, 2005 MEL purchased some equipment from the Joint Venture for a consideration of Rs.7.0 million. It was sold at a mark- up of 25% on cost. The equipment is in use by MEL and is included in property plant and equipment and being depreciated over a four-year life.

(iii) During the year ended March 31, 2006, the books of account of the Joint Venture showed a profit of Rs.15.0 million.

(iv) The share of profit for the year in CPL and the Joint Venture has not yet been recorded in the books of MEL.

(v) All inter- company current account balances were settled prior to the year-end.

Required:

Prepare the consolidated balance sheet of MEL as at March 31, 2006?