



# **IFRS IN PRACTICE 2016**

*IFRS 11 Joint Arrangements*



# TABLE OF CONTENTS

<b>1.</b>	<b>Background – the joint arrangement project</b>	<b>5</b>
<b>2.</b>	<b>Scope</b>	<b>6</b>
<b>3.</b>	<b>Content of the standard</b>	<b>7</b>
3.1.	Definition of a joint arrangement	8
3.2.	Joint control under IFRS 11 (the 'Two-Step Model')	10
3.3.	Joint de-facto control	16
3.4.	Substantive rights in joint arrangements	21
3.5.	Protective rights in joint arrangements	21
3.6.	Joint arrangement classifications	27
<b>4.</b>	<b>Presentation, recognition, and measurement by joint controllers</b>	<b>41</b>
4.1.	Joint operators	42
4.2.	Joint venturers	45
<b>5.</b>	<b>Other parties to a joint arrangement (i.e. non-joint controlling parties)</b>	<b>46</b>
<b>6.</b>	<b>Disclosure requirements</b>	<b>48</b>
6.1.	Significant judgements and assumptions	48
6.2.	Nature, extent and financial effects of interests in joint arrangements	49
6.3.	Commitments for joint ventures	51
<b>7.</b>	<b>Appendix A – Tool for IFRS 11 Analysis</b>	<b>54</b>
<b>8.</b>	<b>Appendix B – Definitions</b>	<b>56</b>



# 1. BACKGROUND – THE JOINT ARRANGEMENT PROJECT

In May 2011 the International Accounting Standard Board (IASB) issued IFRS 11 *Joint Arrangements*, which superseded IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*.

The project to replace the existing guidance in respect of joint arrangements was undertaken for the following reasons:

- Under IAS 31, the accounting treatment for jointly controlled entities was primarily dependent on the structure or legal form of the arrangement, rather than the substance of the arrangement. Investors in those entities were given a choice between two subsequent accounting treatments:
  - Equity accounting
  - Proportionate consolidation.

Because this treatment was rules-based, rather than principles-based, the treatment of jointly controlled entities under IAS 31 was open to potential abuse through structuring arrangements. This meant that financial statements for economically identical entities could be significantly different.

IFRS 11 established principles for financial reporting by parties to a joint arrangement.

A binding contractual arrangement that results in two or more of parties having joint control over the investee's relevant activities gives rise to a joint arrangement, and this is subsequently classified into one of two classifications, being either:

- A joint operation, or
- A joint venture.

A *joint operation* is a joint arrangement whereby the joint controlling parties ('joint operators') have rights to the assets, and obligations for the liabilities, relating to the arrangement.

A *joint venture* is a joint arrangement whereby joint controlling parties ('joint venturers') have rights to the **net assets** of the arrangement.

In terms of joint arrangements structured through a separate vehicle (e.g. an incorporated entity), under IFRS 11 the legal structure of the arrangement is not the only factor in determining the classification of the arrangement. Instead, the rights and obligations specified in the joint arrangement agreement must be analysed to determine whether the parties with joint control have either:

- Rights to the assets, and obligations for the liabilities, or
- Rights to the **net assets**.

The disclosure requirements for joint arrangements are incorporated into IFRS 12 *Disclosure of Interests in Other Entities*.

There are a wide variety of industries where joint arrangements are common, either through strategic alliances, or having separate vehicles. IFRS 11 has many implications in practice for these industries, which include:

- Business services
- Software
- Wholesale trade – durable and non-durable goods
- Investment and commodity firms
- Electronics
- Telecommunications
- Extractives – mining, oil & gas
- Real estate.

IFRS 11 was mandatorily effective for reporting periods beginning on or after **1 January 2013** and endorsed for use in the EU at the end of 2012 with a mandatory effective date of 1 January 2014.

## 2. SCOPE

IFRS 11 *Joint Arrangements* applies to all entities that are a party to a *joint arrangement*, and only those entities. Investors with investees under arrangements that do not result in an interest that meets the definition of a *joint arrangement* are not permitted to apply the recognition and measurement principles of IFRS 11.

IFRS 11 contains specific criteria and definitions which are applied in determining whether an arrangement is or is not a *joint arrangement*.

The definition of a *joint arrangement* is discussed in further detail in section 3.1.

### **BDO comment**

*An arrangement requires two key factors in order to meet the definition of a 'joint arrangement':*

1. *A binding contractual agreement; and*
2. *Each party must have 'joint control' over the relevant activities of the arrangement.*

*The requirements of 'joint control' have their own criteria, which are discussed in detail in this publication.*

*In practice, entities are more likely to fail the 'joint arrangement' definition due to 'joint control' not being established. This may be for a number of reasons, but broadly speaking this occurs where:*

- *Unanimous agreement of specified investors regarding the investee's relevant activities is not required. This may be due to a number of factors, including (but not limited to):*
  - *More than one combination of parties being capable of making decisions regarding the investee's relevant activities*
  - *A dispute resolution process gives power to one party*
  - *The rights of one or more parties are only protective in nature (refer to section 3.5. for further detail discussion on this point).*
- *Decisions made by the parties (unanimous or otherwise) are not in respect of the investee's **relevant activities**.*

*These and other scenarios are discussed in more detail in the relevant sections of this publication.*

### 3. CONTENT OF THE STANDARD

Overall, the approach to the application of IFRS 11 *Joint Arrangements* is broken into two key assessments:

1. Does a joint arrangement exist? (refer to sections 3.1. and 3.2.)
2. If a joint arrangement does exist, how is the joint arrangement classified? (refer to section 3.6.)

This is summarised below:

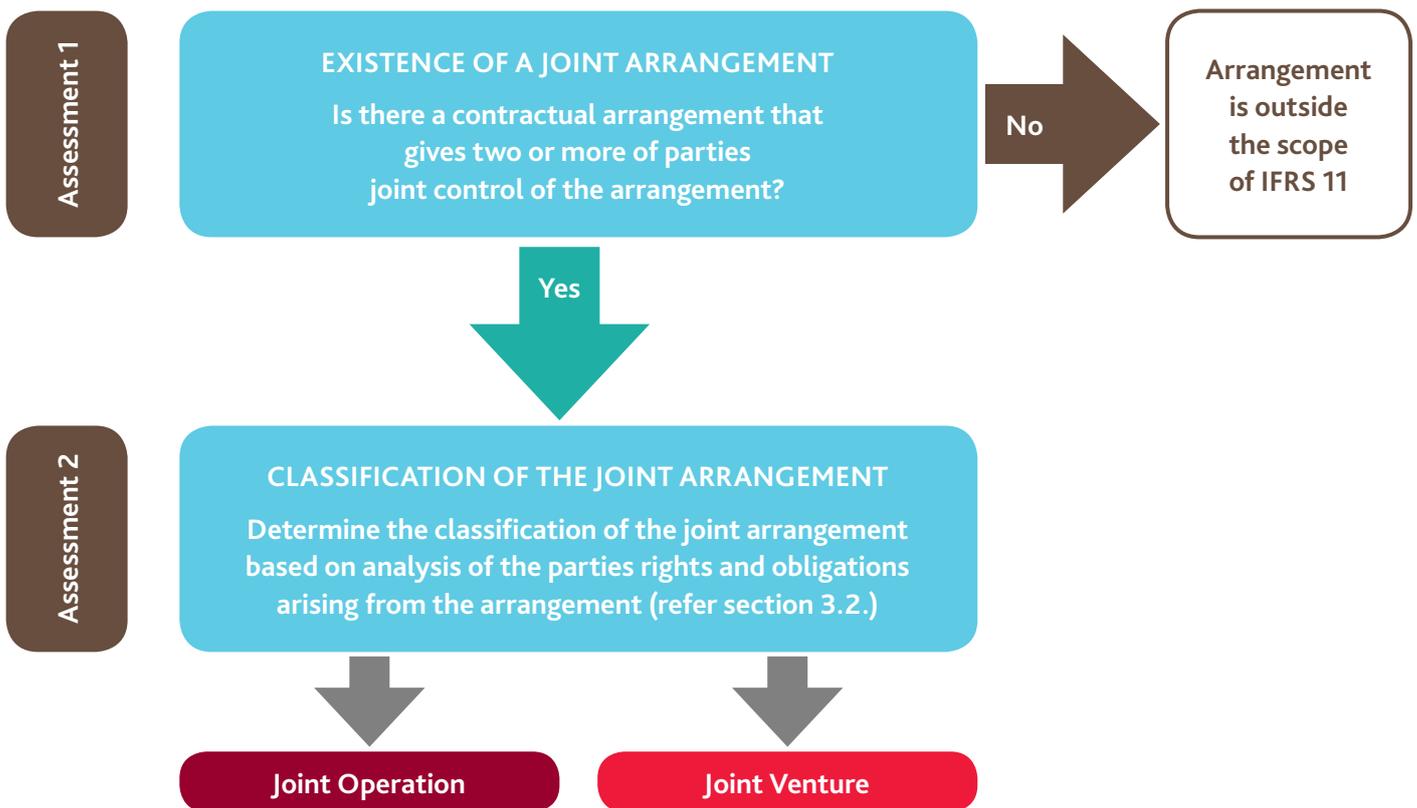


Figure 1: IFRS 11 – Summary of overall approach

### 3.1. Definition of a joint arrangement

A joint arrangement has both the following characteristics (IFRS 11.5):

- The parties are bound by a contractual agreement
- The contractual arrangement gives two or more of those parties joint control over the arrangement (refer section 3.2.).

#### What is a contractual arrangement?

While most enforceable contractual arrangements are in writing (usually in the form of a contract or documented discussions between the parties) IFRS acknowledges that this may not always be the case (IFRS 11.B2).

Therefore, determination of whether a contractual arrangement exists is based on the substance of the dealings between the parties. Specifically, IFRS 11 requires investors to consider other factors which, either on their own or in conjunction with others, result in joint control. These may include:

- Statutory mechanisms
- Terms incorporated into the investee's articles of association
- Other arrangements.

Contractual arrangements are usually easily identifiable, as they would generally deal with such items as (IFRS 11.B4):

- The purpose, activity and duration of the joint arrangement
- How the members of the board of directors, or equivalent governing body, of the joint arrangement, are appointed
- The decision-making process: the matters requiring decisions from the parties, the voting rights of the parties and the required level of support for those matters. The decision-making process reflected in the contractual arrangement is key in determining whether there is joint control over the arrangement
- The capital or other contributions required of the parties
- How the parties share assets, liabilities, revenues, expenses or profit or loss relating to the joint arrangement.

### Interaction with IFRS 10

IFRS 11 is based on the same control principle as IFRS 10 *Consolidated Financial Statements* (see BDO publication *IFRS in Practice 2016 – IFRS 10 Consolidated Financial Statements*).

In summary the control model in IFRS 10 requires **three key elements** to be present:

1. Power
2. Exposure to variable returns
3. Linkage between power & variable returns.

Each of the three elements of the control model has separate components to consider in determining whether the element is satisfied under the definition:

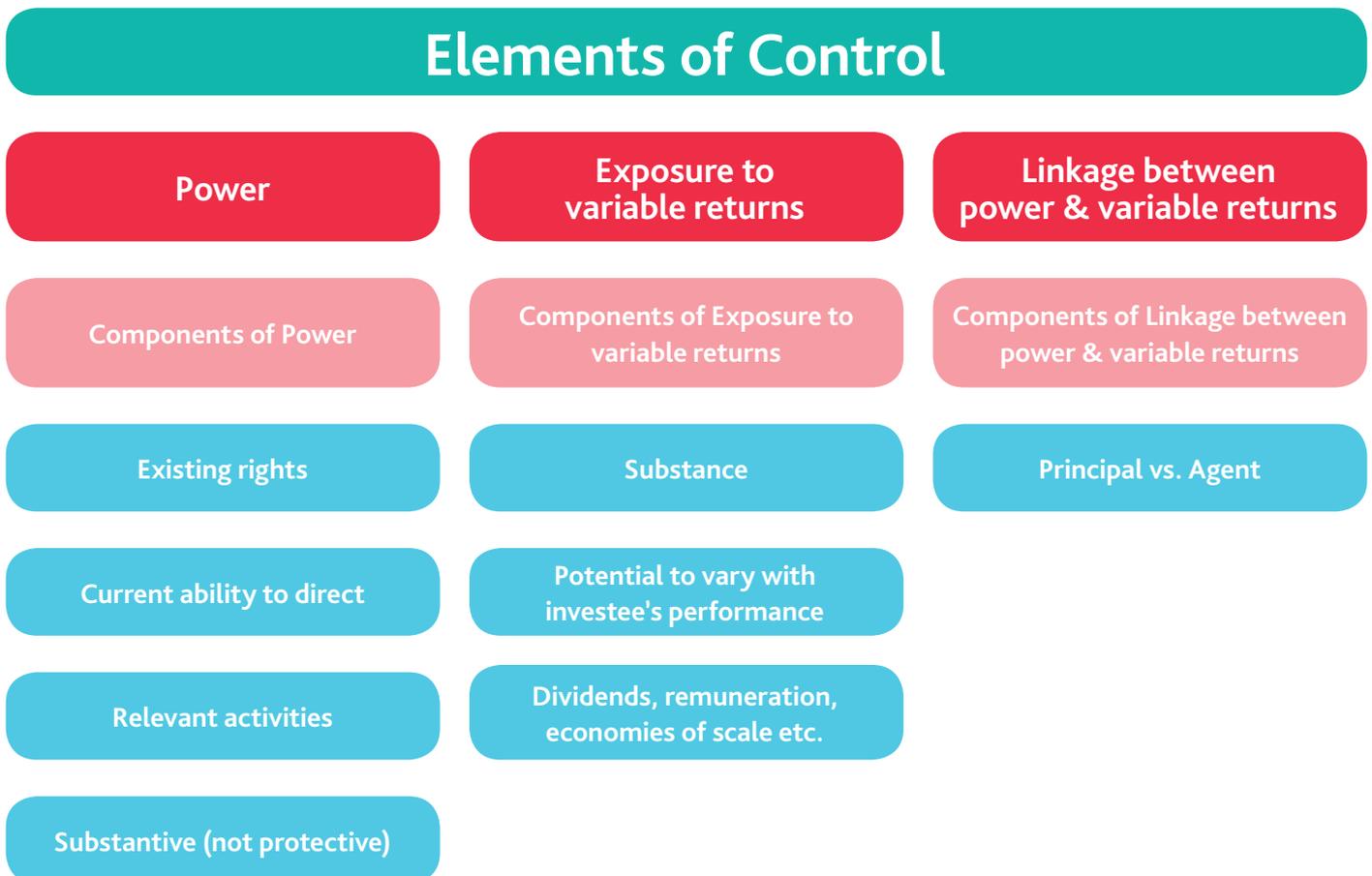


Figure 2: Control model (IFRS 10)

As a result, IFRS 10 and IFRS 11 cannot be viewed independently of each other. An understanding of the control principle and terminology of IFRS 10 is required when dealing with the requirements of IFRS 11.

## 3.2. Joint control under IFRS 11 (the 'Two-Step Model')

Under IFRS 11, joint control:

- Is the contractually agreed sharing of control of an arrangement
- Exists only when decisions about the **relevant activities** of the arrangement require the **unanimous consent** of the parties sharing the control of the arrangement.
  - **Relevant activities** are the activities of the arrangement that significantly affect returns to investors, and may include (IFRS 10.B11):
    - i. Selling and purchasing of goods or services
    - ii. Managing financial assets during their life (including upon default)
    - iii. Selecting, acquiring or disposing of assets
    - iv. Researching and developing new products or processes
    - v. Determining a funding structure or obtaining funding.
  - **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. Put simply, all parties with joint control have to agree in order for decisions relating to relevant activities to be made. This excludes protective rights (see section 3.5).

Therefore, an arrangement can be a joint arrangement even when not all of its investors (or parties) have joint control of the arrangement. IFRS 11 distinguishes between parties that:

- Have joint control of a joint arrangement (i.e. joint operators and joint venturers)
- Participate in, but do not have joint control of, a joint arrangement (those parties hold an investment which is accounted for in accordance with IAS 28 *Investments in Associates and Joint Ventures* or IAS 39 *Financial Instruments: Recognition and Measurement*/IFRS 9 *Financial Instruments*).

In order to determine whether an arrangement contains parties with joint control (and is therefore a joint arrangement is within the scope of IFRS 11), an investor adopts a **two-step approach**.

**Step 1** Firstly, an entity assesses whether all the parties, or a subset of the parties, control the arrangement (based on the control definition in IFRS 10).

When all the parties, or a subset of the parties, considered collectively, are able to direct the activities that significantly affect the returns of the arrangement (i.e. the relevant activities), they control the arrangement collectively.

**Step 2** Secondly, an entity assesses whether it has joint control of the arrangement.

Joint control exists only when decisions about the relevant activities require the unanimous consent of the parties that collectively control the arrangement.

The two-step joint control model is illustrated in the figure below:

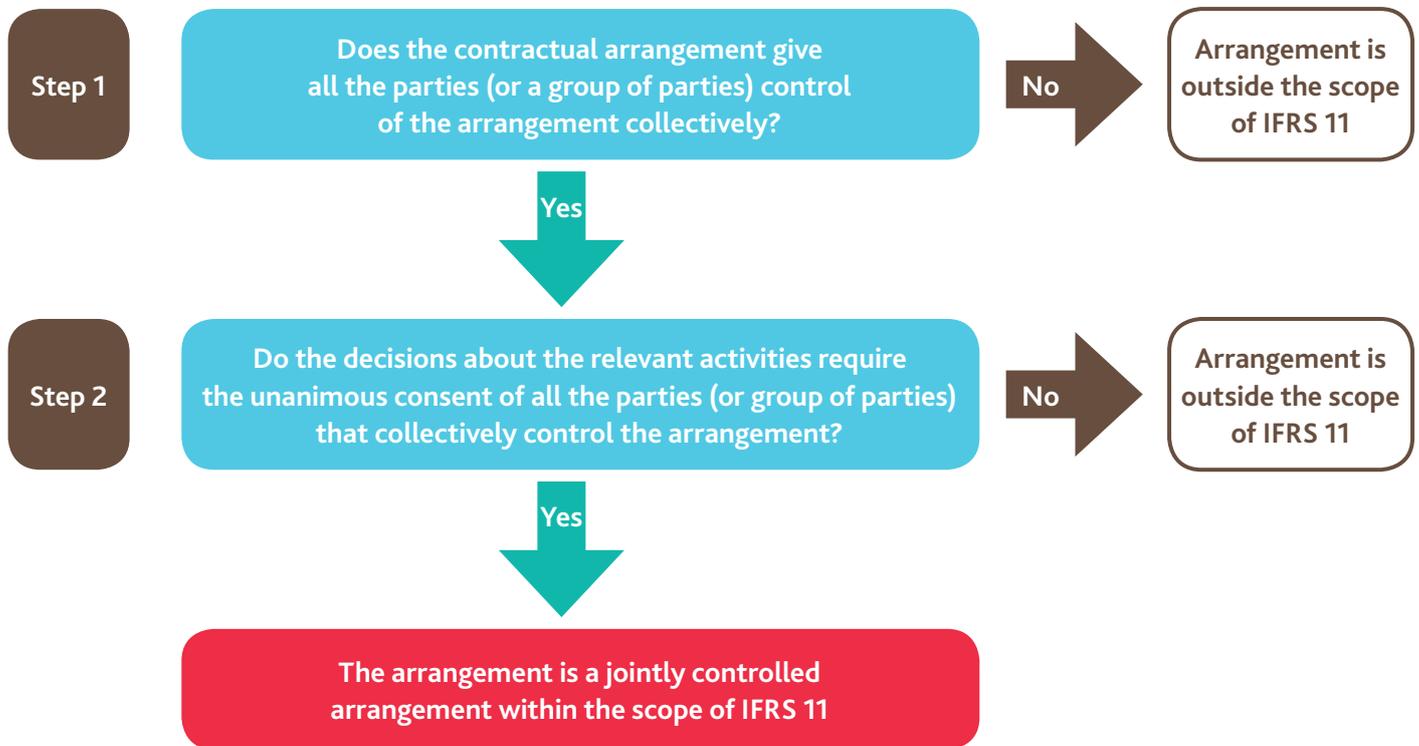


Figure 3: Joint control – Two-Step Model

Normally, control arises from the parties (or a group of parties) holding a majority of voting rights. However, in some cases, control may still exist where less than a majority of voting rights are held ('de-facto' control).

Joint de-facto control is covered in section 3.3. below.

In some cases, the decision-making process that is agreed upon by the parties in their contractual arrangement **implicitly** leads to joint control.

**Example 1**

Two parties establish a separate legal entity in which each has 50% of the voting rights (and equivalent power) over the investee's relevant activities. The separate legal entity's activities constitute a business (as defined in IFRS 3 *Business Combinations*).

The contractual arrangement between the two parties specifies that at least 51% of the voting rights are required to make decisions about the separate legal entity's relevant activities.

**Assessment**

In this case, the parties have implicitly agreed that they have joint control of the separate legal entity because decisions regarding its relevant activities cannot be made without both parties agreeing.

Application of the two-step model shows that there is joint control, meaning that the two parties must apply the requirements of IFRS 11.

**Summary – Two-Step Model**

- **Step 1** **Yes**, there is an (implicit) contractual arrangement to co-ordinate voting to achieve control.
- **Step 2** **Yes**, unanimous consent is required **by only a single combination** of parties for decisions over the investee's relevant activities.

**Example 2**

Two investors, A and B, invest in company Z, a mine which is currently in production.

Each party owns 50% of the issued share capital of Z and appoint 2 members each to the board of directors.

All mining operations are managed by the 'operator', party A.

The terms of the operating agreement state that the operator can only be replaced by the unanimous consent of the investors.

The operating agreement also states that unanimous approval is required for:

- Cessation of mining
- Any disposal of the mine
- The acquisition of any capital equipment above CU X million.

The relevant activity of the arrangement is determined to be the rate at which mining activities are carried out, as the amount of ore extracted in a given period will affect the amount of profit or loss generated by company Z.

**Assessment**

From the above analysis, it would appear that the relevant activity is controlled solely by A in its capacity as the operator (from which A cannot be removed unless it unanimously decides to do so with B).

Although B can 'block' or prevent A from replacing the operator, such rights do not automatically give joint control.

As a result, A would be required to consolidate Company Z under IFRS 10.

Application of the two-step model shows that there is not joint control, meaning that the transaction is outside of the scope of IFRS 11.

**Summary – Two-Step Model**

- **Step 1 Yes**, there is an (implicit) contractual arrangement to co-ordinate voting to achieve control.
- **Step 2 No**, unanimous consent is not required **by both** parties for decisions over the investee's relevant activities.

In other circumstances, the contractual arrangement might require a minimum proportion of the voting rights to make decisions.

When a minimum required proportion of the voting rights can be achieved by more than one combination of shareholders, that arrangement is not a joint arrangement (unless, a contractual arrangement exists that specifies which parties, or combination of parties, must agree about decisions regarding the relevant activities of the investee).

**Example 3**

Three parties establish a separate legal entity (entity Z) in which they have different shares of voting rights. Entity Z's activities constitute a business (as defined in IFRS 3).

Entity A	50%
Entity B	30%
Entity C	20%

A contractual arrangement entered into by the three parties specifies that at least 75% of the voting rights are required to make decisions about the entity Z's relevant activities.

**Assessment**

In this case, although Entity A can block any decision, it does not control entity Z alone because it always needs the agreement of B in order for decisions to be taken about entity Z's relevant activities.

Under this structure, the contractual terms mean entities A and B have joint control over entity Z.

This is because the combination of A and B voting together is the only single combination of parties that can control decisions about the relevant activities of entity Z:

Combination of A and B	80%	Control
Combination of A and C	70%	No control
Combination of B and C	50%	No control

Application of the two-step model shows that there is joint control, meaning that entities A and B must apply the requirements of IFRS 11.

**Summary – Two-Step Model**

- **Step 1** Yes, there is an (implicit) contractual arrangement to co-ordinate voting to achieve control.
- **Step 2** Yes, unanimous consent is required **by only a single combination** of parties (entities A and B) for decisions over the relevant activities.

**Example 4**

Three parties establish a separate legal entity (entity X) in which the three entities have different shares of voting rights. Entity X's activities constitute a business (as defined in IFRS 3).

Entity A	50%
Entity B	25%
Entity C	25%

A contractual arrangement entered into by the three parties specifies that at least 75% of the voting rights are required to make decisions about the relevant activities.

**Assessment**

In this case, although entity A can block any decision, it does not control the arrangement alone because it needs the agreement of either entity B or C.

Entities A, B and C collectively control the arrangement; however, there is more than one combination of parties that can agree in order to reach the 75% threshold:

Combination of A and B	75%	Control
Combination of A and C	75%	Control
Combination of B and C	50%	No control

Consequently, because there is more than one combination of parties that could control entity X (i.e. either entities A and B, or entities A and C), joint control does not exist.

Therefore the combination of shareholder interests and the contractual arrangement does not give rise to a joint arrangement, and the arrangement falls outside of the scope of IFRS 11.

**Summary – Two-Step Model**

- **Step 1 Yes**, there is an (implicit) contractual arrangement to co-ordinate voting to achieve control.
- **Step 2 No**, there are **multiple combinations** of parties that can co-ordinate voting to achieve control.

Each of the three entities needs to consider whether it has significant influence over entity X. If so, it would account for its investment as an associate in accordance with IAS 28 (2011) *Investments in Associates and Joint Ventures* and, if not, account for its investment as a financial asset in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*/IFRS 9 *Financial Instruments*.

As a variation to the above fact pattern, assume that there is also a contractual arrangement among the parties that specifies a single combination of parties which must agree in respect of decisions about entity X's relevant activities (for example, entities A and B). In this case, **Step 2** (above) would be met and there would be joint control.

### 3.3. Joint de-facto control

IFRS 10 explicitly covers the principle of de-facto control. This applies in circumstances in which decisions about an investee's relevant activities are determined through shareholder votes alone, with there being no contractual or other arrangements in place that determine which party (or group of parties) has control.

This is relevant to IFRS 11, because IFRS 11 includes a cross reference to a number of the defined terms in IFRS 10, including control. Consequently, because IFRS 10 incorporates the concept of de-facto control, as well as an assessment of whether an arrangement gives rise to joint control, it is necessary to consider whether it gives rise to joint de-facto control.

Under IFRS 10, de-facto control arises when an investor with less than a majority of the voting rights in another entity has control over that entity. This is when the investor has the practical ability to direct the other entity's relevant activities unilaterally (IFRS 10.B41).

In determining whether an investor has de-facto control, the investor assesses the size of its own holding of voting rights relative to the size and dispersion of holdings of the other vote holders.

The following key factors need to be considered:

- The more voting rights an investor holds, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities
- The more voting rights an investor holds relative to other vote holders, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities
- The more parties that would need to act together to outvote the investor, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities (IFRS 10.B42).

Consequently, if the criteria set out below are met, it would be clear that that the investor has control and no further analysis is needed:

- Direction of relevant activities is determined by majority vote
- Investor holds significantly more voting rights than any other vote holder or organised group of vote holders
- Other shareholdings are widely dispersed (IFRS 10.B43/B44).

IFRS 10.7 notes that an investor controls an investee if it has all of the following:

- Power over the investee (whether or not that power is used in practice)
- Exposure, or rights, to variable returns from its involvement
- The ability to use its power to affect the amount of the investors returns.

However, it is necessary to make a careful distinction between *de-facto joint control* and *joint de-facto control*, as only *joint de-facto control* results in a joint arrangement within the scope of IFRS 11. The following table illustrates the difference between the two concepts:

De-facto type	Description	Within the scope of IFRS 11?
<b>De-facto joint control</b>	<p>There is past history of the parties voting together over the relevant activities of the arrangement, even though there is no contractual agreement to do so.</p> <p>Due to the remaining investors being numerous and dispersed the decisions of the parties in effect become the final decisions.</p>	<p><b>No.</b></p> <p>With no contractual agreement this situation automatically fails <b>Step 1</b> of the two-step model.</p> <p>IFRS 11 requires a contractual or implicit agreement to be in place between or among parties before there is joint control.</p>
<b>Joint de-facto control</b>	<p>Where there is a large block of voting power held by a number of investors that have a <b>contractual agreement</b> to always vote together in relation to the relevant activities of the investee.</p> <p>The remaining shares are held by many other small and dispersed independent investors.</p>	<p><b>Yes.</b></p> <p>Joint de-facto control is considered under IFRS 11.</p>

Figure 4: *De-facto joint control vs. joint de-facto control*

**Example 5**

Entities A and B hold interests in a separate legal entity, together with other investors (dispersed in scenarios 1 and 2, and Entity C in scenario 3).

Three scenarios are set out below, in which the contractual arrangement for each specifies that at least a majority (i.e. more than 50%) of the voting rights are required to make decisions about the relevant activities.

<b>Scenario 1</b>		<b>Scenario 2</b>		<b>Scenario 3</b>	
Entity A	35%	Entity A	24%	Entity A	24%
Entity B	35%	Entity B	24%	Entity B	24%
Dispersed	30%	Dispersed	52%	Entity C	52%

*Additional information:*

**Scenario 1** – There is no contractual agreement between A and B to vote together.

**Scenario 2** – There is a contractual agreement between A and B to vote together.

**Scenario 3** – There is a contractual agreement between A and B to vote together. Entity A and B also have a substantive option to each acquire 10% of the shares that entity C owns in the separate legal entity.

**Assessment****Scenario 1**

In this case, as there is no contractual agreement or other implicit arrangement between A and B to vote together, there is no joint control.

Entities A and B would then need to consider whether each of them has significant influence. If so, the investment would be accounted for as an associate in accordance with IAS 28 (2011) and, if not, the investment would be accounted for as a financial asset in accordance with IAS 39/IFRS 9.

**Summary – Two-Step Model**

- **Step 1** **No**, there is no (implicit) contractual arrangement to co-ordinate voting to achieve control.
- **Step 2** N/A (**Step 1** failed).

**Example 5 (continued)****Assessment (continued)****Scenario 2**

In this case, there is *joint de-facto control* due to:

- There being a contractual agreement between A and B to vote together
- The interaction between A's and B's combined voting share, the 50% hurdle, and the remaining dispersed investors, which results in the practical ability of A and B to direct the relevant activities unilaterally.

*Practical ability of A and B to direct the relevant activities unilaterally*

In practice, the decisions that A and B take jointly will ultimately be the final decision in either of the following scenarios:

- At least 4% of the dispersed investors do not vote
- More than 2% of the dispersed investors vote the same way as A and B.

Both of these scenarios are sufficiently likely, and would therefore result the decisions of A and B ultimately determining the decisions over the relevant activities of the arrangement.

Therefore A and B are deemed to have the practical ability to direct the relevant activities unilaterally and have *joint de-facto control*.

**Summary – Two-Step Model**

- **Step 1 Yes**, there is an (implicit) contractual arrangement to co-ordinate voting to achieve control.
- **Step 2 Yes**, because the 48% block is considered to result in control, unanimous consent is required **only by a single combination** of parties who have a contractual agreement to vote the same way regarding decisions in relation to relevant activities.

***BDO comment***

*In this scenario, where entities A and B hold a significant minority block of shares (48%), it is relatively simple to determine that joint de-facto control exists.*

*However, as IFRS 11 (and IFRS 10) are designed as principles-based standards, the question in practice will be at which point a significant minority block of voting rights does not result in de-facto joint control. There are no 'bright lines', meaning that this question does not depend on whether a specified threshold is met, such as a combined total of 45%, 40%, or 35%.*

*The assessment of joint de-facto control will therefore require careful judgement by investors, so as to ensure that they determine appropriately whether arrangements are required to be accounted for in accordance with IFRS 11. This judgement will typically require disclosure in the investor's financial statements in accordance with IAS 1 Presentation of Financial Statements paragraph 122.*

**Example 5 (continued)****Assessment (continued)****Scenario 3**

In this case, there is *joint de-facto control*, due to:

- There being a contractual agreement between A and B to vote together
- The options to acquire additional shareholdings from C being substantive (refer to section 3.4.), resulting in a block of voting rights that exceed the hurdle required for decisions to be taken about the investee's relevant activities.

The arrangement is accounted for in accordance with IFRS 11 by A and B.

Entity C would then need to consider whether it has significant influence, and if so, account for its investment as an associate in accordance with IAS 28 (2011) and, if not, as an investment in accordance with IAS 39/IFRS 9.

**Summary – Two-Step Model**

- **Step 1** **Yes**, there is an (implicit) contractual arrangement to co-ordinate voting to achieve control.
- **Step 2** **Yes**, unanimous consent is required **only by a single combination** of parties for decisions over relevant activities.

**BDO comment**

*This scenario is perhaps most significant from the perspective of Entity C.*

*Prima facie C holds 52 % of the voting shares, and, instead of accounting for its investment in accordance with IAS 28 Investments in Associates and Joint Ventures or IAS 39 Financial Instruments: Recognition and Measurement/ IFRS 9 Financial Instruments as appropriate, may incorrectly determine (without considering the substantive options held by A and B) that it needs to consolidate the entity as a subsidiary and recognise a non-controlling interest for the 48% it does not own.*

### 3.4. Substantive rights in joint arrangements

Substantive rights should be considered in determining control, in the form of share options held by investors. (see BDO publication *IFRS in Practice 2016 – IFRS 10 Consolidated Financial Statements*).

Substantive rights are considered within the *Power* component of the new control model – see Figure 2 in section 3.1.

IFRS 10 considers a right is substantive, if the holder has the practical ability to exercise the right. The standard requires an investor to consider and assess the effect of both substantive rights held by itself and those held by others.

IFRS 10 acknowledges that the assessment of substantive rights requires judgment. It provides potential facts and circumstances that should be considered, such as:

- Barriers to exercise
- Whether the agreement of other parties is required
- Whether the exercise of the rights would benefit the holder.

### 3.5. Protective rights in joint arrangements

A key aspect of determining whether an arrangement is a joint arrangement and is therefore within the scope of IFRS 11 is determining who controls the arrangement's relevant activity (or activities). From a practical perspective, for many arrangements it is unlikely that relevant activities are operationally undertaken by two or more entities, with one of the parties instead being appointed as operator. In these circumstances it is important to determine whether the operator is acting as principal and therefore controls the relevant activities, or is acting as agent for the joint arrangement.

This determination rests largely on whether the rights of the non-operating party are substantive in nature meaning that there is joint control over the arrangement's relevant activities, or are merely protective rights typically given to a non-controlling investor.

Protective rights are defined in IFRS 10 as 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 (IFRS 10 *Appendix A*).

#### **BDO comment**

*The first step in determining whether an arrangement is within the scope of IFRS 11 is to determine what the arrangement's relevant activities are and then to determine which parties control those relevant activities.*

*In circumstances in which an operator is appointed to run the arrangement, this typically involves determining the extent of power given to the arrangement's operator, consideration as to whether the non-operator's rights are only protective and consideration of dispute resolution procedures which apply should the parties to the arrangement disagree and fail to agree on the direction of the arrangement's relevant activity.*

**Step 1** *Determine the arrangement's relevant activity or activities*

**Step 2** *Determine which entity controls the relevant activity or (if there is more than one relevant activity) which entity controls the most significant relevant activities.*

The appointment of an operator is very common in the creation of joint arrangements, regardless as to whether the arrangement is structured through an incorporated entity or through a contractual arrangement.

Operators are typically appointed in the following roles:

- Developer in a real estate project
- Head contractor in a construction project
- Real estate manager, managing a portfolio of investment properties
- Researcher developing biotech or pharmaceuticals
- Operator in exploration and evaluation activities
- Operator of a mine, or operating oil and gas field.

The operator is typically one of the investors to the joint arrangement, and by the nature of the power granted to the operator, that party will have day-to-day control of all the activities of the arrangement. It is essential then to determine whether the entity is undertaking the role of operator as an agent or as principal.

Determination of the principal/agent relationship under IFRS 10 often arises in the context of fund managers/investment managers who are exposed to variable returns arising from the entity they manage. Under the IFRS 10 analysis, emphasis is placed on considering whether the fund manager can be easily replaced, and is paid a market rate for its services, together with the degree to which the fund manager is exposed to variable returns.

Restrictions over the ability of investors to remove the fund manager, a non-market rate of return for management services, and exposure to large variable returns, are all indicators that the manager is acting as principal and hence controls (and is required to consolidate) the fund.

In practice, some arrangements that are described as being joint arrangements, but include the appointment of one of the investors as operator, are not joint arrangements at all. This is because the IFRS 10 control test can identify the operator as being a principal and therefore the sole controlling party (see example 2 above). Careful review and consideration of all facts and circumstances is needed; features that require particular consideration include where the operator cannot be changed (other than for circumstances such as inadequate performance), and where the operator's remuneration approximates the recovery of costs associated with being operator with the operator's principal return being derived from exposure to a significant variable return from an investment in the arrangement.

Consequently, it is very important to determine how the contractual arrangements affect the operator and other investors, and whether the effect is that the operator has complete power over the arrangement's relevant activity/activities.

Decision requiring unanimous consent of joint arrangement investors	Substantive	Protective	Comment/examples
Major capital expenditure		X	
Decision to divest of material assets		X	
Approval of transactions with operator		X	
Decisions are raising financing, including selling a stake in the joint arrangement		X	Examples include: <ul style="list-style-type: none"> <li>– Changing development from residential to wholesale</li> <li>– Changing business model from developer to holder of investment property.</li> </ul>
Significant changes to project		X	
Acquiring additional assets projects		X	
Approval of annual budget	X		Determination will depend upon the level of detail contained in the annual budget, and what the requirement to approve actually means.
Speed of development	X		Examples include speed of developing a land bank and speed of depleting a mineral resource.
Key pricing decisions	X		
Hiring of key management personnel	X		
Hiring of major sub-contractors	X		

Figure 5: Substantive vs. protective decisions requiring unanimous consent of joint arrangement investors

**BDO comment**

*At its May 2013 meeting the IFRS Interpretations Committee (IC) received a request regarding the effect of protective rights on an assessment of control.*

*The submitter asked whether the control assessment should be re-assessed when facts and circumstances change such that rights, previously determined to be protective, change (for example upon the breach of a covenant in a borrowing arrangement that causes the borrower to be in default) or whether, instead, such rights are never included in the re-assessment of control upon a change in facts and circumstances.*

*The IFRS IC decided not to add this issue to its agenda since it concluded that it did not expect significant diversity in practice. The Committee observed that IFRS 10.8 requires an investor to re-assess all rights to establish whether it controls an investee whenever facts and circumstances change.*

*The IFRS IC also observed that if the breach of a covenant resulted in the rights becoming exercisable, that did constitute such a change, and noted that IFRS 10 does not include an exemption for any rights from this need for re-assessment.*

*The IFRS IC noted that the IASB had re-deliberated this topic during the development of IFRS 10 and concluded that the intention was that protective rights should be included in a re-assessment of control when facts and circumstances change.*

*Accordingly, the IFRS IC considered that the conclusion about who controlled the investee would need to be re-assessed after the breach occurred.*

As discussed below, another key element to determining whether the relevant activity/activities is/are jointly controlled is to determine what happens in the event that the investors fail to agree.

**BDO comment**

*It is essential for entities carefully to review the key terms of their Joint Operating Agreements (JOAs) so as to determine whether the rights of any non-operating investors are protective or substantive, and to carefully review any dispute resolution mechanisms that are in place.*

**(i) Clauses on the resolution of disputes**

Most arrangements involving two or more parties will contain dispute resolution clauses, which may or may not confer power to one of the investors (for example, in the event of dispute one of the parties may have a casting vote). Because the effect of certain of these clauses is to give ultimate decision-making powers to one of the investors, they can mean that the arrangement is outside of the scope of IFRS 11 as there is not joint control.

Examples of dispute resolution clauses which can result in arrangements being outside the scope of IFRS 11 include:

### **Scenario 1**

Company A and Company B enter into arrangement Z which is structured through a separate legal entity. Company A owns 70% of the voting rights, and Company B owns 30%. Decisions over relevant activities are governed by majority vote, other than those that are dealt with by a separate agreement.

Company A is the operator, with the arrangement being governed by an operations committee (OC), made up of four appointed committee members (two from Company A, and two from Company B).

The OC is responsible for approving the annual budget and any variances to the approved project plan and must agree unanimously on these decisions.

Should there be deadlock, all resolutions are resolved by reference to the parties' ultimate holdings in the arrangement.

As a result, the dispute resolution process gives A control over the relevant activities of the arrangement. Consequently, A will consolidate Z in accordance with IFRS 10.

### **Scenario 2**

Company A and Company B enter into arrangement Z which is structured through a separate legal entity. Company A owns 70% of the voting rights, and Company B owns 30%. Decisions over relevant activities are governed by majority vote, other than those that are dealt with by a separate agreement.

Company A is the operator, with the arrangement being governed by an operations committee (OC), made up of four appointed committee members (two from Company A, and two from Company B).

The OC is responsible for approving the annual budget and any variances to the approved project plan and must agree unanimously on these decisions.

Should there be deadlock, Company A has the option to acquire all of Company B's interest, and Company B has the option to put all of its interest to Company A. The option exercise price is market value on the date of exercise.

As a result, the dispute resolution process gives Company A control over the relevant activities of the arrangement. Consequently, Company A will consolidate Z in accordance with IFRS 10.

### **Scenario 3**

Company A and Company B each hold a 50% interest in an incorporated entity Z.

Company A is the operator, with the arrangement being governed by the board of entity Z.

The board of entity Z is made up of four appointed board members (two from Company A and two from Company B).

The Board is responsible for approving the annual budget and any variances to the approved project plan and must agree unanimously on these decisions. Company A's representative is given the position of chairman.

Should there be deadlock the chairman has the casting vote.

As a result, the dispute resolution process gives Company A control over the relevant activities of the arrangement. Consequently, Company A will consolidate Z in accordance with IFRS 10.

**(ii) Arbitration**

A contractual agreement may include clauses on the resolution of disputes such as arbitration (arbitration is where, in the event of a dispute, the issue is referred to a third party who will determine the outcome which will be binding on all parties).

These arbitration provisions may allow for decisions to be made in the absence of unanimous consent among the parties that have joint control. The existence of such provisions does not automatically prevent the arrangement from being jointly controlled. This is because such provisions do not give one of the parties a casting vote over relevant activities, instead they provide a mechanism under which deadlock among the parties can be resolved.

## 3.6. Joint arrangement classifications

### The model under IFRS 11

IFRS 11 has two classifications of joint arrangements:

- Joint operations
- Joint ventures.

#### *Joint operation*

- A joint arrangement whereby the parties that have joint control of the arrangement (termed joint operators) have rights to the assets, and obligations for the liabilities, relating to the arrangement.

#### *Joint venture*

- A joint arrangement whereby the parties that have joint control of the arrangement (termed joint venturers) have rights to the **net** assets of the arrangement.

It is the substance (i.e. the contractual and other rights) of the arrangement that determine the classification in accordance with IFRS 11.

If a joint arrangement is not structured through a separate legal entity, it is always accounted for as a joint operation. However, if a joint arrangement is structured through a separate legal entity, then depending on the rights and obligations of the parties to the joint arrangement, each party will either:

- Apply equity accounting, or
- Recognise its share of assets, liabilities, income and expenses.

Consequently, when assessing the IFRS 11 classification of a joint arrangement structured through a separate legal entity, the assessment of the rights and obligations of the parties in the joint arrangement is key.

#### *Classification – assessing each party's rights*

To determine the correct classification of a joint arrangement structured through a separate legal entity (and therefore the correct initial and subsequent accounting) an entity needs to assess the rights and the obligations of the parties arising from the arrangement in the normal course of business, specifically considering (IFRS 11.17):

- The structure
- The legal form
- The contractual arrangement
- Other facts and circumstances.

This assessment must be performed on a **continuous** basis (i.e. an entity must re-assess the joint arrangements classification as facts and circumstances change) (IFRS 11.19).

Ultimately, the assessment needs to consider and conclude whether:

- A right to assets and obligations for liabilities exists (in which case the joint arrangement is classified as a joint operation), or;
- A right or exposure to only the net assets exists (in which case the joint arrangement is classified as a joint venture).

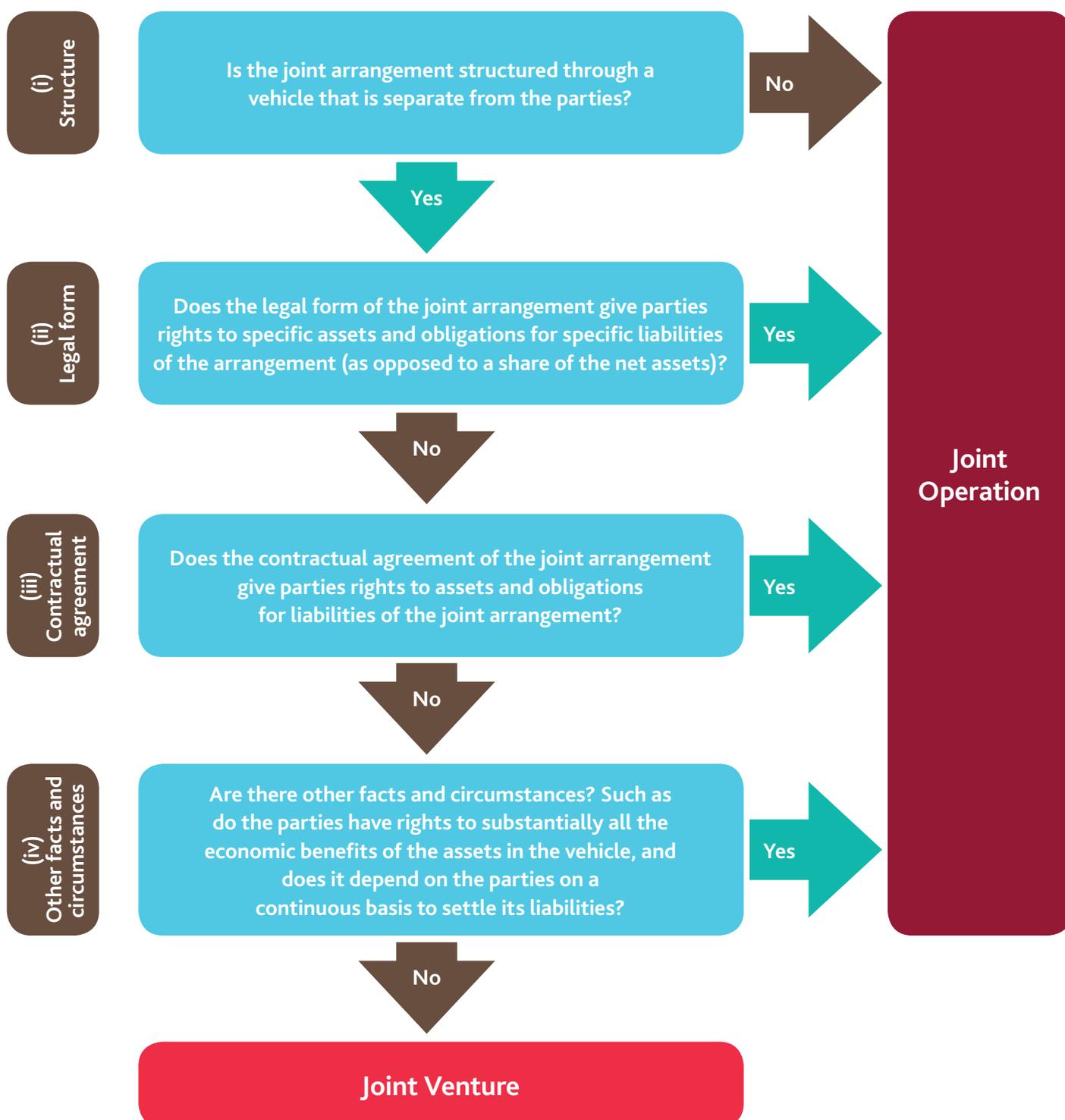


Figure 6: Flowchart – Joint arrangement classification assessment

**(i) Structure*****(a) Joint arrangement not structured through a separate vehicle***

A joint arrangement that is not structured through a separate vehicle is a joint operation.

In such cases, it is the arrangement's contractual terms that will establish the parties' rights to the assets, and obligations for the liabilities, relating to the arrangement, and their rights to the corresponding revenues and obligations for the corresponding expenses.

***(b) Joint arrangement structured through a separate legal entity***

A joint arrangement in which the assets and liabilities relating to the arrangement are held in a separate legal entity can be either a joint venture or a joint operation. That is, a separate legal entity is a necessary (but not a sufficient) condition for a joint venture. If there is a separate legal entity, then the remaining tests are applied.

When the arrangement is structured through a separate legal entity, the structure itself is not determinative, although in many cases the contractual arrangements are consistent with the legal form. However, it is still a significant factor as, in order for an arrangement structured through a separate legal entity to be classified as a joint operation, the effect of other arrangements must be to 'strip away' the (often protective) effect of the legal structure.

**(ii) Legal form**

The legal form of the separate vehicle can be relevant when assessing the type of joint arrangement. 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 each of the parties to the joint arrangement).

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 arrangements and, when relevant, other facts and circumstances can override the legal form of the separate vehicle and result in it being accounted for as a joint operation. This is particularly the case when parties have obligations to purchase part or all of the output from a joint arrangement.

Careful assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle is therefore required. In order for it to be concluded that the arrangement is a joint operation, there must not be separation of rights and obligations between the parties and the separate vehicle (that is, as noted above, the effect of the overall arrangements must be to 'strip away' the legal structure). This might also be achieved through the terms of a contractual arrangement.

**Example 6**

Parties A and B provide many types of construction services, and jointly enter into a contractual arrangement to design/build a road. The parties set up a separate vehicle (entity Z) to facilitate this arrangement.

Entity Z enters into a contract with the government for the road, and holds the assets and liabilities relating to the road contract, as well as invoicing the government for the construction services.

The main feature of entity Z's legal form is that the parties (not entity Z in its own right) have rights to the assets, and obligations for the liabilities, of entity Z.

Entities A and B appoint an operator, who will be an employee of one of the parties.

**Assessment**

Entity Z is a separate vehicle with its own legal form.

However, the legal form does not confer separation between the parties and the separate vehicle, as it is entities A and B that have the rights to entity Z's assets and obligations for entity Z's liabilities.

Therefore, the arrangement is classified as a **joint operation**.

Entities A and B subsequently recognise their share of revenue, expenses, assets and liabilities (i.e. line-by-line accounting).

**Example 7**

Real Estate developers A and B set up a jointly controlled separate entity (Entity Y) to develop a specified real estate project. Each developer owns 50% of the separate entity. Entity Y has no purpose other than the specific project and will be liquidated once the project is completed.

Each developer is liable for its own portion of the debt corresponding to its interest in the entity. By law the creditors of the Entity Y do have right of recourse against developers A and B with respect to their share of debt and obligations of Entity Y but if and only if all the claims against Entity Y were finally unsuccessful.

The project financing is generally provided through a combination of inter-company loans from the developers and bank loans granted to Entity Y.

Each developer is entitled to receive its share of Entity Y's net income as well as any fees for services they provide to Entity Z. Both developers A and B have each an interest in the net assets of Entity Y.

Management is carried out by a manager who has the ability to act on behalf of the entity and will be the legal representative of the company for all purposes. All relevant activities of a real estate development project are performed by Entity Y including buying land, making payments for entering into construction contracts, and receiving payment from entering into sales agreements.

**Assessment**

The structure of the joint arrangement conveys separation between the developers and the separate entity. In the normal course of operations, the developers have no direct obligation to settle the liabilities of Entity Y (Entity Y has the primary obligation to pay) and no direct access to its assets. The developers' exposure to the liabilities of Entity Y on its default is similar to a guarantee. This feature alone, according to IFRS 11.B27 does not mean that the arrangement is a joint operation; only the actual rights on assets and obligations for liabilities are relevant. Furthermore, Entity Y primarily assumes demand, inventory and credit risks which also indicate a joint venture arrangement.

Therefore, the arrangement is classified as a **joint venture**.

Developer A and Developer B apply equity accounting.

### **BDO comment**

*At its March 2015 meeting, the IFRS International Committee (IC) clarified that two arrangements can be classified differently if one is structured as a separate vehicle and the other is not because the legal form of the separate vehicle affects the rights and obligations of the parties to the joint operation.*

### **Partnerships and Unlimited liability vehicles**

Under IFRS 11, partnerships would be classified as a joint operation or joint venture depending on the parties' rights to the assets, and obligations for the liabilities, or rights solely to the net assets of the arrangement. This would be assessed by reviewing the terms of the partnership agreement and the specific laws of the jurisdiction.

It is possible for a vehicle to have a separate legal personality, but for the parties to have ultimate unlimited liability for any amounts owing that the vehicle cannot cover on its own. These are termed unlimited liability companies in some jurisdictions.

Such vehicles do not automatically result in a joint operation, even though at first glance it appears that the parties have obligations for the vehicles liabilities.

The rationale for this is as follows:

1. The primary responsibility for the unlimited liability vehicle's liabilities in the first instance is the unlimited liability vehicle itself. The parties would only cover the liabilities of the unlimited liability vehicle if it was not capable of settling its liabilities on its own. In essence and from an economic perspective this amounts to a guarantee, rather than a direct contractual obligation to settle the obligations, which on its own does not result in classification as a joint operation.
2. unlimited liability vehicle does not give the parties rights to assets – which is a requirement to qualify as a joint operation (IFRS 11.15).

**Example 8**

Entity A and B enter into a joint arrangement to develop an oil and gas property. The arrangement calls for the use of a limited partnership structure which provides for two classes of unit holders – limited partner units (LPU) and general partnership units (GPU). Limited partner units provides legal liability protection to the limited partners (LPs) while conveying all decisions, liability and responsibility for the operations to the general partners (GPs) via the general partnership units.

AB LLP is a limited partnership arrangement.

Entity A and Entity B each own 100% of GP Co A and GP Co B respectively.

Entity A and Entity B each own 49.9% of AB LLP through LPUs.

GP Co A and GP Co B each own 0.01% of AB LLP through GPUs.

AB LLP will be selling output on its own behalf and not on behalf of the individual partners.

**Assessment**

Although IFRS 11 indicates that the legal form of an entity is relevant to the classification of an arrangement, IFRS 11.B14 says that classification of a joint arrangement should depend upon the parties' rights and obligations arising from the arrangement in the normal course of business. In the normal course of business the limited partnership's creditors would look to the limited partnership to settle its obligations. Only in cases where the limited partnership could not settle its obligations (e.g. upon insolvency of the limited partnership) would creditors look to the general partners for satisfaction. That is, the general partners are not the primary obligor. Furthermore, the guidance in IFRS 11.B24 speaks to vehicles that do not confer separation between the parties of the arrangement and the "assets and liabilities" of the arrangement. In the normal course of business, the general or limited partners would not have access to the assets of the limited partnership.

The partnership structure conveys separation between the investor and the investee.

Therefore, the arrangement is classified as a **joint venture**.

Entity A and Entity B apply equity accounting.

**Example 9**

Parties A and B are real estate companies, and set up a separate vehicle (entity X) for the purpose of acquiring and operating a shopping centre.

According to entity X's legal form it has rights to its own assets, and obligations for its own liabilities, relating to the arrangement. Entity X also owns the shopping centre.

Parties A and B are not liable in respect of the individual debts, liabilities or obligations of entity X.

Parties A and B each receive a share of the income from operating the shopping centre.

**Assessment**

Entity X is a separate vehicle with its own legal form, and also holds the rights and obligations of its own assets and liabilities. This confers separation between parties A and B, and entity X.

In the absence of any other relevant facts and circumstances, the arrangement is classified as a **joint venture**.

Entities A and B apply equity accounting.

### (iii) Contractual arrangement

The contractual arrangement often describes the nature of the activities that are the subject of the arrangement and how the parties intend to undertake those activities together.

For example, the parties to a joint arrangement could agree to manufacture a product together, with each party being responsible for a specific task and each using its own assets and incurring its own liabilities. The contractual arrangement could also specify how the revenues and expenses that are common to the parties are to be shared among them. In such a case, each joint operator recognises in its financial statements the assets and liabilities used for the specific task, and recognises its share of the revenues and expenses in accordance with the contractual arrangement.

In other cases, the parties to a joint arrangement might agree to share and operate an asset together. In such a case, the contractual arrangement establishes the party's rights to the asset that is operated jointly, and how output or revenue from the asset and operating costs are shared among the parties. Each of the parties accounts for its share of the joint asset and its agreed share of any liabilities, and recognises its share of the output, revenues and expenses in accordance with the contractual arrangement.

In many cases, the rights and obligations agreed in the 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. However, parties might 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.

It should be noted that the following contractual arrangements, on their own, do not result in the arrangement being classified as a joint operation:

- Guarantees provided to third parties (e.g. for service, financing etc.). Guarantees do not provide the parties with primary rights to assets and obligations for liabilities
- Obligations for unpaid or additional capital.

**Example 10****Scenario 1**

Two parties enter into a joint arrangement which is structured through an incorporated entity in which each party has a 50% ownership interest.

There are no other contractual arrangements in place between the parties.

**Scenario 2**

Two parties enter into a joint arrangement which is structured through an incorporated entity in which each party has a 50% ownership interest.

The parties have also modified the features of the corporation through a separate contractual arrangement so that each has an interest in the assets of the incorporated entity and each is responsible for settling its liabilities in a specified proportion.

**Assessment****Scenario 1**

The incorporation of a separate entity results in the legal separation of the entity from its owners and, in consequence, the assets and liabilities held in the incorporated entity are that separate entity's own assets and liabilities.

The assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle indicates that the parties have rights to the net assets of the arrangement.

Therefore, in the absence of any other contractual arrangement between the parties, the joint arrangement would be classified as a **joint venture**.

**Scenario 2**

The incorporation of a separate entity results in the legal separation of the entity from its owners and, in consequence, the assets and liabilities held in the incorporated entity are the separate entity's own assets and liabilities.

However, the parties have also modified the features of the corporation through a separate contractual arrangement so that each has an interest in the assets of the incorporated entity and each is liable for its liabilities in a specified proportion. Consequently, the parties do not have rights to the net assets of the arrangement, and instead have rights to assets and obligations for liabilities.

Therefore the joint arrangement would be classified as a **joint operation**.

**BDO comment**

*When a contractual arrangement specifies that the parties have rights to the assets and obligations for the liabilities relating to the arrangement, they are considered to be parties to a joint operation and do not need to consider other facts and circumstances for the purposes of classifying the joint arrangement.*

**Example 11**

Entities A and B (the parties) set up a separate vehicle (entity X) together with a JOA.

Shareholders' agreement and JOA establish rights and obligations and expressly specify that:

- Each party has a 50% interest in entity X and appoints one director
- Unanimous consent is required for all resolutions to be passed
- The rights and obligations arising from the activities of entity X are to be allocated directly to parties A and B in specified proportions.

**Assessment**

The joint arrangement is structured through a separate vehicle. However, the terms of the JOA result in the parties having direct rights to entity X's assets and direct obligations for its liabilities.

Therefore the contractual arrangement between the parties results in each party classifying the arrangement as a **joint operation**.

**(iv) 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, it is still necessary to consider other facts and circumstances in order to determine the appropriate classification of the joint arrangement, such as those that (IFRS 11. B31-B33):

- Give the parties rights to substantially all of the economic benefits relating to the arrangement
- Cause the arrangement to depend on the parties on a continuous basis for settling its liabilities.

It is particularly important to analyse all terms and conditions to an arrangement that is designed primarily to provide its output to the parties to a joint arrangement. The effect of these may indicate that:

- The parties have substantially all the benefits of the joint arrangement's assets
- The liabilities of the joint arrangement are only satisfied by the cash flows received from the parties for the purchase of the output, and therefore the parties in-turn are considered to have an obligation for these liabilities.

The analysis of these other facts and circumstances may result in a joint operation classification. However, the legal form of contractual arrangements can still be critical to the analysis, as illustrated by the examples below.

**Example 12**

Two parties enter into a joint arrangement which is structured through an incorporated entity in which each party has a 50% ownership interest.

The purpose of the arrangement is to manufacture materials required by the parties for their own, individual manufacturing processes. The arrangement ensures that the parties operate the facility that produces the materials to their quantity and quality specifications.

The contractual arrangement between the parties specifies the following aspects of the arrangement:

- Under the terms of the arrangement, the parties have agreed to purchase all the output produced by the entity in a ratio of 50:50
- The entity is not permitted to sell any of the output to third parties, unless this is approved by the two parties to the arrangement. Because the purpose of the arrangement is to provide the parties with output they require, such sales to third parties are expected to be uncommon and insignificant in volume and value
- The price of the output sold to the parties is set by both parties at a level that is designed to cover the costs of production and administrative expenses incurred by the entity. On the basis of this operating model, the arrangement is intended to operate at a break-even level.

**Assessment**

From the fact pattern above, it can be concluded that:

- The obligation of the parties to purchase all the output produced by the entity reflects the exclusive dependence of the entity upon the parties for the generation of cash flows and, thus, the parties have an obligation to fund the settlement of the liabilities of the entity
- The fact that the parties have rights to all the output produced by the entity means that the parties have rights to all the economic benefits of the assets of the entity.

These facts and circumstances indicate that the arrangement is a **joint operation**.

The conclusion about the classification of the arrangement in these circumstances would not change if, instead of the parties (the joint operators) using their share of the output themselves in a subsequent manufacturing process, they sold their share of the output to third parties.

If the parties changed the terms of the contractual arrangement so that the joint arrangement incorporated entity was able to sell more than an insignificant amount of its output to third parties, this would result in the entity assuming demand, inventory and credit risks. In that scenario, such a change in the facts and circumstances would require re-assessment of the classification of the joint arrangement. Such facts and circumstances might indicate that the joint arrangement should be classified as a **joint venture**.

**Example 12 (continued)*****Alternative scenario 1 (Options to purchase output)***

Same details as above, except that:

- Each party has the option to purchase the output from the joint arrangement
- If the option is not exercised then the joint arrangement is free to sell the output to the market.

**Assessment**

The option to purchase the output from the joint arrangement does not create a contractual obligation for the parties to fund the liabilities of the joint arrangement, irrespective of how likely the parties are to exercise the option. The question of whether the parties might be economically compelled to purchase the output (for example, because it could be sold immediately to third parties for a substantial profit) is irrelevant and is not considered in the IFRS 11 analysis.

Therefore the joint arrangement cannot be a joint operation, and is instead classified as a **joint venture**.

***Alternative scenario 2 (Joint operator is the only customer)***

Same details as above, except that:

- Each party has no contractual right or option to purchase all of the output from the joint arrangement
- However one of the parties (i.e. party A) is the joint arrangement's only customer.

**Assessment**

There is no contractual obligation for the parties to purchase the output of the joint arrangement and, in consequence, fund the liabilities of the joint arrangement. The fact that party A is the joint arrangement's only customer does not alter this.

Therefore the joint arrangement cannot be a joint operation.

Instead the joint arrangement is therefore classified as a **joint venture**.

### Example 13 – Use of joint operator assets

#### Scenario 1

Parties A and B establish an incorporated joint arrangement (entity Z) to operate a gold mine, in which each party has a 50% ownership interest.

Entity Z utilises a nearby processing plant, owned by party A, to extract the gold as part of a *Toll Manufacturing Arrangement*<sup>1</sup> (TMA).

After processing, entity Z sells the gold on the open market.

Entity Z subsequently pays dividends to parties A and B based on their ownership interest.

#### Assessment

The TMA does not result in either party having specific rights to assets of the joint arrangement (i.e. the specialised assets of entity A remain under the control of entity A).

The joint arrangement is therefore classified as a **joint venture**.

#### Scenario 2

Parties A and B establish an incorporated joint arrangement (entity Z) to operate a gold mine, in which each party has a 50% ownership interest.

The terms of the joint arrangement state that all of entity Z's output is sold to each party at a price reflective of the costs of production. Entity Z is prohibited from selling any of its output to any other party.

The parties then utilise a nearby processing plant, owned by party A, to process the gold as part of a *Toll Manufacturing Arrangement*<sup>1</sup> (TMA).

After processing entities A and B sell the gold on the open market.

Entity Z subsequently pays dividends to parties A and B based on their ownership interest.

#### Assessment

The key difference between scenario 1 and scenario 2 is that in scenario 2 the parties are required to purchase all of the output of entity Z, and (as noted above) the effect is that the parties have a direct obligation to settle the liabilities of entity Z.

Therefore the arrangement is classified as a **joint operation**.

<sup>1</sup> A TMA is an arrangement in which a company, with specialised equipment, processes raw materials or semi-finished goods for another company.

### Example 14 – Separate phases

Two parties enter into a joint arrangement which is structured through a separate incorporated entity. The legal form of the incorporated entity confers separation between the jointly controlling entities and the incorporated entity's assets and liabilities.

The terms of the arrangement between the parties do not specify the two parties' rights to the assets or their obligations to the liabilities.

The purpose of the arrangement is to develop and sell luxury apartments in a single building. The project is financed by the two parties until the sale of the apartments commences.

Any cash received from the sale of apartments is used first to fund the additional development of the building with any excess remaining being allocated to the two parties.

Following the finalisation of the development of the building and the sale of the apartments any remaining cash is allocated to the parties and the arrangement will be terminated.

#### Assessment

The arrangement might be seen as having two phases:

1. A *development stage* in which the incorporated entity depends on the parties to settle its obligations
2. The *commercial sale phase* in which the incorporated entity generates independent cash inflows that are used to settle its liabilities.

This may lead to the determination that the arrangement is a **joint operation** since the parties are considered to have the obligation to settle the arrangement's liabilities in the development phase.

In our view this analysis is not appropriate. Instead, the arrangement needs to be analysed as a whole, and not as two 'components'.

In this scenario, the incorporated entity ultimately funds its own operations through sales of the properties to third parties. The funding that is initially made available by the parties is similar in nature to funding that an entity might require to fund its capital expenditure, rather than being dependent on the parties on an on-going basis throughout the life of the project. The fact that the parties will be the source of cash flows in the early stages of the project is not conclusive in the determination of whether the parties have rights to assets, or obligations for liabilities. In this case, it would appear that, ultimately, the two parties will not have obligations for the arrangement's liabilities and that their ultimate interest is in the residual net assets. Consequently, the arrangement would be likely to be classified as a **joint venture**.

## BDO comment

At its March 2015 meeting, the IFRS International Committee (IC) was asked to clarify the assessment of 'other facts and circumstances' (IFRS 11.B31-B33) with regard to the classification of a joint arrangement as either a joint operation or a joint venture in accordance with IFRS 11.17. Due to the guidance in existing IFRS, the Interpretations Committee decided not to add any these issues to its agenda. A summary of these discussions is provided in this chart below. For more information please refer to BDO's International Financial Reporting Bulletin (IFRB) 2015-07 IFRS Interpretations Committee – Agenda Rejections (March 2015).

Topic	Discussion
Should the assessment of 'other facts and circumstances' be based only on contractual and legally enforceable terms or also on the design and purpose of the joint arrangement, the entity's business needs and the entity's past practices?	Rights and obligations are, by nature, enforceable. The IC concluded that the assessment of the effect of 'other facts and circumstances' on the classification of a joint arrangement should be based on enforceable terms.
Does the sale of the output from the joint arrangement to the parties at a market price prevent classification as a joint operation?	Output sold at market price is not, by itself, a determinative factor for the classification of a joint arrangement; judgement needs to be exercised to consider if the parties have rights to assets and obligations for liabilities of the joint arrangement.
What factors might be less relevant when assessing other facts and circumstances?	<p><b>Nature of Output:</b> Nature of the output, whether fungible or bespoke, does not affect the assessment of other facts and circumstances. The focus when considering obligations for liabilities is on cash flows between the parties and the joint operation, rather than the nature of the output itself.</p> <p><b>Closely and fully involved parties:</b> Consideration of other facts and circumstances is not a test of whether the parties to the joint arrangement are closely or fully involved with the operation of the separate vehicle. It is an assessment of whether other facts and circumstances override rights and obligations conferred on the parties by the legal form of the separate vehicle.</p> <p><b>Financing from a third party:</b> Third party financing alone should not determine the classification of a joint arrangement. If the cash flows from operations are expected to be sufficient for repayments, it is not relevant if the financing is provided by third parties or by the parties to the joint arrangement.</p>
What is 'substantially all of the output'?	Parties to the joint arrangement should have rights to substantially all of the 'economic benefits' of the assets of the arrangement in order to have 'direct rights to the assets'. Economic benefits relate to the cash flows arising from the parties' rights and obligations for the asset. It is the monetary value of the output and not the physical quantities that are more relevant.

## 4. PRESENTATION, RECOGNITION, AND MEASUREMENT BY JOINT CONTROLLERS

The general requirements of IFRS 11 *Joint Arrangements* are summarised in the table below:

Joint Arrangement Classification	Consolidated/Individual <sup>2</sup> financial statements	Separate <sup>3</sup> financial statements
Joint operations	Recognise share of assets, liabilities, income and expenses on a line-by-line basis.	
Joint ventures	Equity accounting <sup>4</sup> (as prescribed by IAS 28 (2011) <i>Investments in Associates and Joint Ventures</i> ).	Choice between: <ul style="list-style-type: none"> <li>– Cost</li> <li>– Financial instrument in accordance with IFRS 9 <i>Financial Instruments</i> (IAS 39 <i>Financial Instruments: Recognition and Measurement</i>)</li> <li>– Equity method as described in IAS 28 <i>Investments in associates and joint ventures</i> (2011).</li> </ul>

Figure 7: Accounting requirements prescribed by IFRS 11

### BDO comment

*IFRS 11 applies only to the accounting by joint operators and not to the accounting by the separate vehicle that is the joint operation. Therefore the financial statements of the separate vehicle would be prepared in accordance with applicable standards.*

*At its March 2015 meeting, the IFRS Interpretations Committee concluded that it would be important to reflect the effect of the joint operators' rights and obligations in the accounting for the joint operation's assets and liabilities. This might affect the assets and liabilities reported by the joint operation.*

<sup>2</sup> When an investor has no subsidiaries (i.e. is not a 'parent'), the term used for the financial statements in which an investment is equity-accounted (i.e. associates and joint ventures) is 'Individual Financial Statements'. An entity that is not a parent, but has interests in associates and/or joint ventures, is required to prepare individual financial statements.

'Consolidated Financial Statements' are prepared by an entity that is a 'parent', which has at least one subsidiary. The accounting for joint ventures is the same in an entity's Consolidated or Individual Financial Statements.

<sup>3</sup> IFRS does not require the preparation of separate financial statements, although they are often prepared in accordance with an entity's local legal requirements. The accounting for joint operations is the same in an entity's separate, individual and consolidated financial statements.

<sup>4</sup> IAS 28 (2011).18 provides that when the interest is held (directly or indirectly) by an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity has the option to measure its interest at fair value through profit or loss in accordance with IAS 39/IFRS 9, rather than in accordance with the equity method. This option exists individually for each investment held (i.e. an entity need not be consistent in its classification).

## 4.1. Joint operators

### (a) Consolidated/Individual and Separate financial statements

Each joint operator accounts for its share of assets, liabilities, income and expenses on a line-by-line basis, as governed by other applicable IFRSs (e.g. IAS 2 *Inventories*).

In practice, joint operation agreements vary on an individual basis. Consequently, the share of assets, liabilities, income and expenses to be accounted for by each party to a joint operation will be dependent on the specific terms within each joint operation agreement. This is illustrated below:

Joint operation arrangement (Type)	Description	Treatment
<b>Shared rights to assets and obligations for liabilities, and for income and expenses.</b>	The arrangement establishes: <ul style="list-style-type: none"> <li>– Parties share and operate assets together, and how this is to be done</li> <li>– How income/output is to be shared.</li> </ul>	Each party's share of assets, liabilities, income and expenses in accordance with the terms of the agreement.
<b>Shared rights and obligations for income and expenses only.</b>	The arrangement establishes: <ul style="list-style-type: none"> <li>– Each party is responsible for a separate role</li> </ul>	Each party recognises its own assets and liabilities utilised in the joint operation.
<b>No specified rights and obligations for assets and liabilities. Each party contributes specified assets and liabilities to the joint operation.</b>	<ul style="list-style-type: none"> <li>– Each party uses its own assets and incurs its own liabilities</li> <li>– The common (e.g. corporate and administrative) income and expenses are shared based on a ratio/rate.</li> </ul>	Common income and expenses are shared in accordance with the terms of the agreement.

Figure 8: Illustrative treatments – different types of joint operations

### **BDO comment**

*At its March 2015 meeting, the IFRS Interpretations Committee (IC) discussed accounting by a joint operator for its interest in a joint operation in its separate financial statements. The joint operator is required to account for its rights and obligations in relation to the joint operation. Those rights and obligations are the same, whether separate or consolidated financial statements are prepared. Therefore the same accounting is required in the consolidated financial statements and in the separate financial statements of the joint operator.*

*The IC observed that the joint operator would not additionally account in its separate or consolidated financial statements for its shareholding in a joint operation in a separate vehicle; this is because it is required to account for the activity of the joint operation within its own financial statements.*

**(b) Accounting for transactions with a joint operation as a joint operator****(i) Accounting for sales or contributions of assets to a joint operation**

These transactions (e.g. a sale or contribution of assets) are regarded as being transactions with the other parties to the joint operation (IFRS 11.B34 and B35). Therefore the joint operator recognises any resulting gains and losses to the extent of the other parties' interests in the joint operation.

**Note:** *If the transaction with the joint operation provides evidence of an impairment loss in respect of the assets sold or contributed, those losses should be recognised in full by the joint operator.*

**(ii) Accounting for purchases of assets from a joint operation**

A joint operator's share of gains and losses resulting from these transactions are not recognised until the joint operator resells those assets to a third party (IFRS 11.B36 and B37).

**Note:** *If the transaction with the joint operation provides evidence of an impairment loss in respect of the assets purchased, the joint operator is required to recognise its share of those losses immediately.*

**Example 15**

Entity A and B (the parties) establish an arrangement through a separate legal entity X in which each has 60% and 40% share of the voting rights over the relevant activities of the arrangement respectively.

Entity X is required to sell its entire produced inventory to only the two joint operators. Sales to any other parties are prohibited.

During the period:

- Total revenues of entity X from sales to parties A and B are CU18,000 and CU12,000 respectively
- Cost of sales of entity X are CU16,000.

As at reporting date:

- Entity A has sold the produced inventory acquired from the joint operation entity to a third party for CU21,600
- There are no outstanding trade payable/receivable balances between entity X and the parties as at reporting date
- Entity X's only asset is cash of CU30,000 and liabilities are nil.

**Assessment**

IFRS 11 requires joint operators to recognise their share of rights to and obligations for assets, liabilities, income, and expenses of joint arrangements classified as *joint operations*.

IFRS 11 does not provide any further guidance in respect of joint operations that are structured through a separate vehicle.

Neither party would recognise its share of revenue from the sale of output by the joint operation; to do so would mean that it would be recognising revenue from output sold to itself. Entities A and B only recognise revenue when they sell their share of output taken from the joint operation to a third party.

**BDO comment**

*At the March 2015 IFRS Interpretations Committee meeting a scenario was discussed where the contractual terms are such that parties A and B are each required to purchase 50% of the output from Entity X. However parties A and B each own 40% and 60% respectively. The Interpretations Committee noted that there are various factors that might need to be considered. These include, for example, varying shares of output purchased by each entity over time and the time period to consider in assessing the share of output. Significant investments by the joint operator that differ from the ownership interest might explain the difference in the share of ownership and share of output, as might other features of the arrangement. Due to the various possible scenarios, it was noted that it is important to understand each the nature of each case to understand why the share of ownership interest differs from the output share purchased. Judgement would therefore be required in determining the appropriate accounting approach. The development of additional guidance on this issue would require a broader analysis than could be achieved by the Interpretations Committee and the issue was therefore not added to its agenda.*

## 4.2. Joint venturers

### (a) Consolidated/individual financial statements

Each joint venturer accounts for its interest in the joint venture by applying the equity method as set out in IAS 28 (IFRS 11.24).

Under the equity method, the joint venturer's interest in a joint venture is measured as:



Figure 9: Equity method – illustration

IAS 28.17 sets out a number of exemptions from applying the equity method (See IAS 28 *Investments in Associates and Joint Ventures At a Glance*).

IAS 28.18 also permits a joint venturer that holds its interest in a joint venture (directly or indirectly) through a venture capital organisation (or unit trust, mutual fund, or certain similar entities) not to apply equity accounting. Instead, the joint venturer would recognise its investment as a financial asset that is measured at fair value through profit or loss (in accordance with IAS 39/IFRS 9).

### (b) Separate financial statements

Each joint venturer accounts for its interest in the joint venture in accordance with paragraph 10 of IAS 27 (2011) *Separate Financial Statements*, which is either:

- At cost (less any subsequent impairment)
- As a financial asset in accordance with IFRS 9 or IAS 39 as applicable
- Using the equity method in accordance with IAS 28.

**Note:** *If the joint venturer is a venture capital organisation (refer above) then the same accounting must be applied in the separate financial statements as was applied in the consolidated/individual financial statements (IAS 27.11).*

<sup>5</sup> Note: the joint venturer's share of profit or loss and other comprehensive income of the joint venture is included in its profit or loss and other comprehensive income, respectively.

## 5. OTHER PARTIES TO A JOINT ARRANGEMENT (I.E. NON-JOINT CONTROLLING PARTIES)

IFRS 11.23 and 25 provide guidance for the accounting treatment of a joint arrangement by those parties which do not have joint control over the joint arrangement (non-joint controlling parties).

The accounting treatment by non-joint controlling parties is dependent on:

- The classification of the joint arrangement
- Whether non-joint controlling parties have rights and obligations for assets, liabilities, expenses, and revenues (joint operations only)
- Whether the non-joint controlling parties have significant influence<sup>6</sup> (i.e. the interest is accounted for as an associate).

In summary:

- Non-joint controlling parties to a joint operation that have (contractual) rights to and obligations for assets, liabilities, income and expenses, recognise their share of any assets, liabilities, income and expenses in accordance with the terms of the agreement, in both their consolidated/individual and separate financial statements
- Non-joint controlling parties to a joint operation that **do not** have (contractual) rights to and obligations for assets, liabilities, income and expenses determine whether they have significant influence (in accordance with IAS 28 (2011)) and account for their interest in their consolidated/individual and separate financial statements accordingly.
- Non-joint controlling parties to a joint venture determine whether they have significant influence (in accordance with IAS 28 (2011)) and account for their interest in their consolidated/individual and separate financial statements accordingly.

### <sup>6</sup> Significant influence

Significant influence is defined by IAS 28 (2011) *Investments in Associates and Joint Ventures* paragraph 3 as:

*'the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.'*

IAS 28 (2011).5 includes a rebuttable presumption that significant influence:

- Exists when an entity holds more than 20% of the voting power
- Does not exist when an entity holds less than 20% of the voting power.

Further guidance surrounding determining and assessing significant influence is provided in IAS 28.6-9.

The following table summarises the treatment to be adopted by non-joint controlling parties in their consolidated/individual and separate financial statements.

*Joint operations (see section 4.1.)*

Classification	Consolidated/Individual financial statements		Separate financial statements			
<b>Joint operations</b> (contractual rights and obligations to assets, liabilities, income and expenses)	Recognises share of any assets, liabilities, income and expenses in accordance with the terms of the agreement.					
<b>Joint operations</b> (No contractual rights and obligations to assets, liabilities, income and expenses)	Assess for significant influence		Assess for significant influence			
	If present	If not present	If present – choose either (IAS 27 (2011).10)			If not present
	Equity method <sup>7</sup> (IAS 28 (2011))	Financial instrument (IFRS 9/IAS 39)	Cost (Less impairment)	Financial instrument (IFRS 9/IAS 39)	Equity method (IAS 28)	Financial instrument (IFRS 9/IAS 39)

Figure 10: Summary: Non-joint controlling party treatment of interests in an arrangement which is jointly controlled by other parties

*Joint ventures (see section 4.2.)*

Classification	Consolidated/Individual financial statements		Separate financial statements			
<b>Joint ventures</b>	Assess for significant influence		Assess for significant influence			
	If present	If not present	If present – choose either (IAS 27 (2011).10)			If not present
	Equity method <sup>7</sup> (IAS 28 (2011))	Financial instrument (IFRS 9/IAS 39)	Cost (Less impairment)	Financial instrument (IFRS 9/IAS 39)	Equity method (IAS 28)	Financial instrument (IFRS 9/IAS 39)

Figure 11: Summary: Non-joint controlling party treatment of interest in an arrangement which is jointly controlled by other parties

<sup>7</sup> IAS 28.18 provides that when the interest is held (directly or indirectly) by an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity has the option to measure its interest at fair value through profit or loss in accordance with IAS 39/IFRS 9, rather than in accordance with the equity method.

## 6. DISCLOSURE REQUIREMENTS

The disclosure requirements for joint arrangements are set out in IFRS 12 *Disclosure of Interests in Other Entities*.

The more significant disclosure requirements for entities with interests in joint arrangements are:

- Significant judgements and assumptions
- Nature, extent and financial effects of an entity's interests in joint arrangements
- Commitments in respect of joint ventures.

### 6.1. Significant judgements and assumptions

Disclosure requirements in respect of significant judgements and assumptions are set out in IFRS 12.7-9.

An entity with a joint arrangement is required to provide information about significant judgements and assumptions it has made (and changes to those judgements and assumptions) in determining:

- That it has joint control of an arrangement
- The classification of joint arrangement (i.e. joint operation or joint venture) when the arrangement has been structured through a separate vehicle.

These disclosures essentially incorporate the disclosures that were previously required by IAS 1.122 (disclosure within the accounting policies of judgements (other than estimation) that have been made in applying those accounting policies and that have the most significant effect on amounts reported in the financial statements), but with more prescriptive requirements.

## 6.2. Nature, extent and financial effects of interests in joint arrangements

Disclosure requirements in respect of the nature, extent and financial effects of an entity's interests in joint arrangements are set out in IFRS 12.21-22.

### (i) Qualitative disclosures

For each (material) joint arrangement an entity is required to disclose the following **qualitative** information:

- Name of the joint arrangement
- Nature of the investor's relationship with the joint arrangement
- Place of business
- The proportion owned and, if different, the proportion of voting rights held.

### (ii) Quantitative disclosures

For each material joint arrangement that is a joint venture, an entity is required to disclose the following **quantitative** information:

- Whether the investment in the joint venture is accounted for under the equity method or at fair value (see section 4.2.)
- Summarised financial information (see below)
- If the joint venture is accounted for using the equity method, the fair value of the joint venture if there is a quoted market price for the investment.

IFRS 12.B12 and B13 set out requirements for the summarised financial information that is to be disclosed for all material joint ventures. These are:

#### Statement of financial position

- Cash and cash equivalents
- Current assets
- Current financial liabilities (excluding trade and other payables and provisions)
- Current liabilities
- Non-current assets
- Non-current financial liabilities (excluding trade and other payables and provisions)
- Non-current liabilities.

#### Statement of comprehensive income

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

**(iii) Aggregation of summarised financial information**

IFRS 12.B2-B6 permit the aggregation of disclosures where:

- The information is for interests in similar entities (for example, separately for joint ventures, joint operations and associates)
- The aggregation is consistent with the disclosure objective in IFRS 12, including the need to strike a balance between a large amount of information that may be too detailed and a level of aggregation that obscures information that should be provided.

Aggregation is not permitted for joint ventures that are individually material to the reporting entity.

**(iv) Source of summarised financial information**

The summarised financial information is sourced directly from the joint venture's IFRS compliant financial statements (IFRS 12.B14).

The summarised financial information is not adjusted to reflect the entity's share of the amounts, except where adjustments were made in applying the equity method, including:

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

If the summarised financial information is adjusted in accordance with the above, a reconciliation needs to be provided between the amounts included in the joint venture's IFRS compliant financial statements and the adjusted summarised financial information that is being disclosed.

Ultimately, it is necessary to present a full reconciliation of the summarised financial information presented in the notes to the carrying amount of the equity-accounted interest in the statement of financial position.

**(v) Disclosure requirements for individually immaterial joint ventures**

IFRS 12.B16 sets out requirements for reduced summarised financial information disclosures for individually immaterial joint ventures. These are only in respect of the statement of comprehensive income:

- Profit or loss from continuing operations
- Post-tax profit or loss from discontinued operations
- Other comprehensive income
- Total comprehensive income.

### 6.3. Commitments for joint ventures

Total commitments that may give rise to an outflow of cash (or other resources) are required to be disclosed, which includes commitments to contribute funding and commitments to acquire other parties' ownership interests.

#### Example 16 – Example Disclosure – Joint Venture

The Group has a 33% (2014: 33%) interest in joint venture, Garden Plastic Toys Limited, a separate structured vehicle incorporated and operating in the United Kingdom. The primary activity of Garden Plastic Toys is the manufacture of outdoor games and toys, which is in line with the Group's strategy to expand the outdoor games division.

The contractual arrangement provides the group with only the rights to the net assets of the joint arrangement, with the rights to the assets and obligations for liabilities of the joint arrangement resting primarily with Garden Plastic Toys Limited. Under IFRS 11 this joint arrangement is classified as a joint venture and has been included in the consolidated financial statements using the equity method.

Summarised financial information in relation to the joint venture is presented below:

As at 31 December	2015	2014
	CU'000	CU'000
Current assets	1,800	1,750
Non-current assets	349	300
Current liabilities	500	600
Non-current liabilities	500	600
Included in the above amounts are:		
Cash and cash equivalents	230	300
Non-current financial liabilities (excluding trade payables)	645	600
Net assets (100%)	1,149	850
Group share of net assets (33%)	383	283

**Example 16 – Example Disclosure – Joint Venture (continued)**

Period ended 31 December	2015	2014
	CU'000	CU'000
Revenues	2,200	1,960
Profit from continuing operations	300	331
Post-tax profit or loss from discontinued operations	-	-
Other comprehensive income	-	-
Total comprehensive income (100%)	300	331
Group share of total comprehensive income (33%)	100	110
Included in the above amounts are:		
Depreciation and amortisation	90	100
Interest income	10	25
Interest expense	50	50
Income tax expense (income)	21	26

The Group's share of Garden Plastic Toys Limited's contingent liabilities and capital commitments is CUnil (2014: CUnil) and CU500,000 (2014: CU750,000) respectively.

A supplier has licensed the use of certain intellectual property to Garden Plastic Toys Limited. The supplier has agreed to defer receipt of the amount due until Garden Plastic Toys Limited begins to sell a product being developed with the use of that intellectual property, but not beyond 31 December 2015. The joint venturers have jointly and severally agreed to underwrite the amount owed. At 31 December 2015, the cumulative amount owed by Garden Plastic Toys Limited to the supplier was CU645,000 (2014: CU321,000). The Group's share of this liability is therefore CU215,000 (2014: CU107,000), although it could be liable for the full amount in the unlikely event that the other two venturers were unable to pay their share.

The joint venturers have each agreed to inject a further CU2,000,000 (2014: CU2,000,000) of capital if Garden Plastic Toys Limited successfully develops a prototype by 31 December 2015, the money to be used principally for marketing and Garden Plastic Toys Limited's working capital needs.

**Example 17 – Sample Disclosure – Joint Operation**

ABC Company, the Company, is a 50% partner in Pharmatgether, a joint arrangement formed with XYZ Company to develop a new drug. Pharmatgether's principal place of business is the UK.

Although Pharmatgether is legally separated from the companies, the Company has classified it as a joint operation. This is because the companies are legally obliged to take the entire output produced by Pharmatgether and will be the only source of funding to settle its liabilities.

Under IFRS 11 this joint arrangement is classified as a joint operation and has been included in the consolidated financial statements by recognising its share of assets, liabilities, revenues and expenses in accordance with its contractually conferred rights and obligations.

## 7. APPENDIX A – TOOL FOR IFRS 11 ANALYSIS

This tool can be used to analyse joint arrangements and determine their classification.

	In Practice IFRS 11 Page Reference	Analysis
<p>Does the contractual arrangement give all the parties, or a group of the parties, joint control? (B2-B11)</p> <p>Consider:</p> <ul style="list-style-type: none"> <li>– Non-written agreements</li> <li>– Statutory mechanisms</li> <li>– How decisions are made for relevant activities.</li> </ul> <p>(See IFRS 10 <i>In Practice</i>)</p>	10-26	
<p>Is the joint arrangement structured through a separate entity?</p> <p>If not structured through a separate entity the arrangement will be a joint operation.</p> <p>If structured through a separate entity other factors will have to be considered to determine the classification.</p>	27	
<p>For agreements structured through a separate vehicle, consider (B16-B21):</p> <ul style="list-style-type: none"> <li>– Legal form of the separate vehicle;</li> <li>– The terms of the contractual arrangement; and</li> <li>– Other facts and circumstances.</li> </ul>	28	
<p>When assessing the legal form of the separate vehicle, consider (B22-B24):</p> <ul style="list-style-type: none"> <li>– Do 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? (B22)</li> <li>– Does the legal form cause the separate vehicle to be considered 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)? (B23)</li> <li>– Are the assets and liabilities held in the separate vehicle the parties' assets and liabilities? (B24)</li> </ul>	29-33	

	In Practice IFRS 11 Page Reference	Analysis
<p>When assessing the terms of the contractual arrangement, consider (B25-B28):</p> <ul style="list-style-type: none"> <li>– Whether the terms of the contractual arrangement provide the parties or the separate vehicle the rights to the assets, and obligations for the liabilities relating to the arrangement (B27)</li> <li>– Whether the parties to the joint arrangement or the arrangement itself has interests (eg rights title or ownership) in the assets</li> <li>– Whether the parties to the joint arrangement or the arrangement itself is liable for the debts and obligations of the arrangement</li> <li>– Whether the parties to the joint arrangement have limited liability for any obligations of the arrangement</li> <li>– Whether revenue and expenses are allocated to each party on the basis of relative performance.</li> </ul>	33-35	
<p>When the terms of the contractual arrangement are not conclusive, the parties shall consider other facts and circumstances to assess whether the arrangement is a joint operation or a joint venture. (B29-B33)</p> <p>Consider:</p> <ul style="list-style-type: none"> <li>– Whether the arrangement is primarily designed for the provision of output to the parties (B31-B32); and</li> <li>– Whether the arrangement's purpose and design is such 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.</li> </ul>	35-40	

## 8. APPENDIX B – DEFINITIONS

Definitions of various terms within IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests in Other Entities*, IAS 24 *Related Party Disclosures*, IAS 27 (2011) *Separate Financial Statements*, and IAS 28 (2011) *Investments in Associates and Joint Ventures*.

<b>Associate</b> (IAS 28)	An associate is an entity over which the investor has significant influence.
<b>Consolidated financial statements</b> (IFRS 10)	The financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.
<b>Control of an investee</b> (IFRS 10)	An investor controls an investee when 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.
<b>Decision maker</b> (IFRS 10)	An entity with decision-making rights that is either a principal or an agent for other parties.
<b>Equity method</b> (IAS 28)	The equity method is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income.
<b>Group</b> (IFRS 10)	A parent and its subsidiaries.
<b>Income from a structured entity</b> (IFRS 12)	For the purpose of this IFRS, income from a structured entity includes, but is not limited to, recurring and non-recurring fees, interest, dividends, gains or losses on the remeasurement or derecognition of interests in structured entities and gains or losses from the transfer of assets and liabilities to the structured entity.
<b>Interest in another entity</b> (IFRS 12)	For the purpose of this IFRS, an interest in another entity refers to contractual and non-contractual involvement that exposes an entity to variability of returns from the performance of the other entity. An interest in another entity can be evidenced by, but is not limited to, the holding of equity or debt instruments as well as other forms of involvement such as the provision of funding, liquidity support, credit enhancement and guarantees. It includes the means by which an entity has control or joint control of, or significant influence over, another entity. An entity does not necessarily have an interest in another entity solely because of a typical customer supplier relationship.
<b>Joint arrangement</b> (IFRS 11)	An arrangement of which two or more parties have joint control.
<b>Joint control</b> (IFRS 11)	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.
<b>Joint operation</b> (IFRS 11)	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.

<b>Joint operator</b> (IFRS 11)	A party to a joint operation that has joint control of that joint operation.
<b>Joint venture</b> (IFRS 11)	A joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.
<b>Joint venturer</b> (IFRS 11)	A party to a joint venture that has joint control of that joint venture.
<b>Key management personnel</b> (IAS 24)	Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.
<b>Non-controlling interest</b> (IFRS 10)	Equity in a subsidiary not attributable, directly or indirectly, to a parent.
<b>Parent</b> (IFRS 10)	An entity that controls one or more entities.
<b>Party to a joint arrangement</b> (IFRS 11)	An entity that participates in a joint arrangement, regardless of whether that entity has joint control of the arrangement.
<b>Power</b> (IFRS 10)	Existing rights that give the current ability to direct the relevant activities.
<b>Protective rights</b> (IFRS 10)	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.

**Related party**  
(IAS 24)

A related party is a person or entity that is related to the entity that is preparing its financial statements (in this Standard referred to as the reporting entity):

- (a) A person or a close member of that persons family is related to a reporting entity if that person:
  - (i) Has control or joint control of the reporting entity
  - (ii) Has significant influence over the reporting entity; or
  - (iii) Is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.
- (b) An entity is related to a reporting entity if any of the following conditions applies:
  - (i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others)
  - (ii) One entity is an associate or 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)
  - (iii) Both entities are joint ventures of the same third party
  - (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity
  - (v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity
  - (vi) The entity is controlled or jointly controlled by a person identified in (a)
  - (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

**Relevant activities**  
(IFRS 10)

For the purpose of this IFRS, relevant activities are activities of the investee that significantly affect the investee's returns.

**Removal rights**  
(IFRS 10)

Rights to deprive the decision maker of its decision-making authority.

**Separate financial statements**  
(IAS 27)

Separate financial statements are those presented by a parent (i.e. an investor with control of a subsidiary) or an investor with joint control of, or significant influence over, an investee, in which the investments are accounted for at cost or in accordance with IFRS 9 *Financial Instruments*.

**Separate vehicle**  
(IFRS 11)

A separately identifiable financial structure, including separate legal entities or entities recognised by statute, regardless of whether those entities have a legal personality.

**Significant influence**  
(IAS 28)

Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

**Structured entity**  
(IFRS 12)

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.

**Subsidiary**  
(IFRS 10)

An entity that is controlled by another entity.

## CONTACT

For further information about how BDO can assist you and your organisation, please get in touch with one of our key contacts listed below.

Alternatively, please visit

[www.bdointernational.com/Services/Audit/IFRS/IFRS Country Leaders](http://www.bdointernational.com/Services/Audit/IFRS/IFRS%20Country%20Leaders)

where you can find full lists of regional and country contacts.

### EUROPE

Caroline Allouët	France	caroline.allouet@bdo.fr
Jens Freiberg	Germany	jens.freiberg@bdo.de
Teresa Morahan	Ireland	tmorahan@bdo.ie
Ehud Greenberg	Israel	ehudg@bdo.co.il
Ruud Vergoossen	Netherlands	ruud.vergoossen@bdo.nl
Reidar Jensen	Norway	reidar.jensen@bdo.no
Maria Sukonkina	Russia	m.sukonkina@bdo.ru
René Krügel	Switzerland	rene.kruegel@bdo.ch
Brian Creighton	United Kingdom	brian.creighton@bdo.co.uk

### ASIA PACIFIC

Wayne Basford	Australia	wayne.basford@bdo.com.au
Zheng Xian Hong	China	zheng.xianhong@bdo.com.cn
Fanny Hsiang	Hong Kong	fannyhsiang@bdo.com.hk
Khoon Yeow Tan	Malaysia	tanky@bdo.my

### LATIN AMERICA

Marcelo Canetti	Argentina	mcanetti@bdoargentina.com
Luis Pierrend	Peru	lpierrend@bdo.com.pe
Ernesto Bartesaghi	Uruguay	ebartesaghi@bdo.com.uy

### NORTH AMERICA & CARIBBEAN

Armand Capisciolto	Canada	acapisciolto@bdo.ca
Wendy Hambleton	USA	whambleton@bdo.com

### MIDDLE EAST

Arshad Gadit	Bahrain	arshad.gadit@bdo.bh
Antoine Gholam	Lebanon	agholam@bdo-lb.com

### SUB SAHARAN AFRICA

Nigel Griffith	South Africa	ngriffith@bdo.co.za
----------------	--------------	---------------------

This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Please contact your respective BDO member firm to discuss these matters in the context of your particular circumstances. Neither BDO IFR Advisory Limited, Brussels Worldwide Services BVBA, BDO International Limited and/or BDO member firms, nor their respective partners, employees and/or agents accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

Service provision within the international BDO network of independent member firms ('the BDO network') in connection with IFRS (comprising International Financial Reporting Standards, International Accounting Standards, and Interpretations developed by the IFRS Interpretations Committee and the former Standing Interpretations Committee), and other documents, as issued by the International Accounting Standards Board, is provided by BDO IFR Advisory Limited, a UK registered company limited by guarantee. Service provision within the BDO network is co-ordinated by Brussels Worldwide Services BVBA, a limited liability company incorporated in Belgium with its statutory seat in Zaventem.

Each of BDO International Limited (the governing entity of the BDO network), Brussels Worldwide Services BVBA, BDO IFR Advisory Limited and the member firms is a separate legal entity and has no liability for another such entity's acts or omissions. Nothing in the arrangements or rules of the BDO network shall constitute or imply an agency relationship or a partnership between BDO International Limited, Brussels Worldwide Services BVBA, BDO IFR Advisory Limited and/or the member firms of the BDO network.

BDO is the brand name for the BDO network and for each of the BDO member firms.

© 2016 BDO IFR Advisory Limited, a UK registered company limited by guarantee. All rights reserved.

[www.bdointernational.com](http://www.bdointernational.com)

1601-01