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IFRS® Standard 11 Joint Arrangements

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IFRS® Standard 11 Joint Arrangements

SCOPE

IFRS® Standard 11 Joint Arrangements specifically regulates reporting rules of entities which is part of the arrangements controlled jointly. Entities' part of joint arrangements must comply with these rules.

IFRS 11 was first issued in May 2011 and it was amended in May 2014. This standard is effective for annual periods beginning on or after January 1, 2016. The required disclosures for interests in joint arrangements are provided in IFRS Standard 12 Disclosure of Interests in Other Entities.

This standard defines the two types of joint arrangements, namely, joint operations and joint ventures.

In some instances, entities form a joint arrangement to share risks and rewards with other entities, combine complementary businesses of different entities, and to fund a business operation in an effective manner. This arrangement has a less formal structure and it is beneficial in many cases.

In order to form a joint arrangement, there must be a contractual arrangement. Contractual arrangement includes the purpose, duration, and activity of the joint arrangement, decision-making processes, the capital and contributions from related parties.

KEY DEFINITIONS

In Appendix A of IFRS 11, detailed definitions of key terms such as joint arrangement, joint control, joint operation, joint venture, party to a joint arrangement and separate vehicle are given (see Table 1).

Table 1: Key Definitions of IFRS 11

Joint arrangement	An arrangement on which two or more parties have joint control.
Joint control	The contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.
Joint operation	A joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement.
Joint venture	A joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.
Joint venturer	A party to a joint venture that has joint control of that joint venture.
Party to a joint arrangement	An entity that participates in a joint arrangement, regardless of whether that entity has joint control of the arrangement.

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

Joint Arrangements and Joint Control

In order for an arrangement to be considered as a joint arrangement, joint control must exist. In IFRS 11, joint control is defined clearly.

Joint control exists when none of the parties has a control power and when operational decisions can be taken only upon the unanimous consent of two or more parties.

Before assessing whether an entity has joint control, we must first assess whether the related parties control the arrangement (in accordance with the definition of control in IFRS Standard 10 Consolidated Financial Statements).

Under IFRS Standard 10 Consolidated Financial Statements, an investor is supposed to control an investee when it is exposed to or has rights to variable returns through its power over an investee. An investor controls an investee if it has three basic elements of control:

- power over the investee – the existing rights that give it the current ability to direct the activities which affect the investee's returns significantly (relevant activities)
- exposure or rights to variable returns from its involvement with an investee
- ability to use its power over the investee to affect the amount of investor's returns

After assessing that all the related parties collectively control the arrangement, the entity should determine which type of joint arrangement it is.

EXAMPLE 1: Interpreting Joint Control

A joint arrangement was drawn up by D, E, and F entities. Entity D holds 50 % of the voting rights, E holds 40 % of the voting rights and F holds 10 % of the voting rights. In this joint arrangement, a minimum % of 70 voting rights is required in order to make decisions about related operations. Which entities have joint control in terms of IFRS 11?

SOLUTION 1

In order for an arrangement to become a joint arrangement, two or more parties should have joint control. In this example, even though Entity D has the power to prevent operational decisions, it needs other companies' voting rights about operational decisions. Entities D and E have joint control because operational decisions cannot be made without the mutual agreement of Entity D and E.

Types of Joint Arrangements

There are two types of joint arrangements: Joint operations and Joint Ventures. Regardless of the purpose, structure, or form of the arrangement, the classification of joint arrangements depends upon the parties' rights and obligations arising from the arrangement.

If a joint arrangement includes having rights to assets and obligations for liabilities related to the agreement, then this is a Joint Operation. In joint operations, parties do not usually establish another entity. In joint operations, every joint operator uses its own properties and inventories, covers the operating expenses and liabilities on its own behalf, and provides independent financing for the obligations it incurs on its behalf in relation to the activity. However, revenue from the sales is divided among joint operators.

If parties of a joint arrangement have rights to the net assets, then this is a joint venture, and parties to this type of arrangement are called joint ventures. Joint ventures are usually structured through separate vehicles. The separate vehicle has the rights to the assets and obligations for the liabilities based on the arrangement.

When a joint arrangement is considered a joint operation that means this arrangement is not made via a separate vehicle. In such cases, the contractual arrangement establishes the parties' rights to the assets, obligations for the liabilities, relating to the arrangement, and the parties' rights to the corresponding revenues and obligations for the corresponding expenses (IFRS 11.B16). On the other hand, if a joint arrangement is structured via a separate vehicle, this arrangement can be a joint operation or a joint venture. In this case, identification of the party's rights to the assets, and obligations for the liabilities, relating to the arrangement that is held in the separate vehicle is vital. As mentioned before, if related parties have rights to the assets, then this joint arrangement is a joint venture, otherwise it is a joint operation.

Figure 1 sums up how to classify joint arrangements through an assessment of parties' rights and obligations (IFRS11.B21).

Figure 1: Classification of joint arrangements

	Is the arrangement conducted through a separate vehicle?	NO	Joint Operation
	YES		
Legal form of separate vehicle	Does legal form give parties rights/obligations to assets/liabilities?	YES	
	NO		
Terms of contractual arrangement	Do terms of arrangement give parties rights/obligations to assets/liabilities?	YES	
	NO		
Other facts and circumstances	Is the design of the arrangement such that parties in effect have rights/obligations to assets/liabilities?	YES	
	NO		
	Joint Venture		

Financial Statements of Parties to a Joint Arrangement

Joint operators recognize their assets, liabilities, revenue from sales, and expenses in a joint operation in line with their interests. The acquirer of an interest in a joint operation in which the activity constitutes a business, as defined in IFRS Standard 3 Business Combinations, is required to apply all of the principles on business combinations accounting in IFRS 3 and other IFRSs with the exception of those principles that conflict with the guidance in IFRS 11. These requirements apply both to the initial acquisition of an interest in a joint operation, and the acquisition of an additional interest in a joint operation (in the latter case, previously held interests are not remeasured).

On the other hand, joint ventures shall recognize their interest as an investment by applying the equity method which is explained in detail in IAS Standard 28 Investment in Associates and Joint Ventures unless it is exempt from using the equity method. If a party participates in a joint venture and does not have joint control, then it recognizes this in accordance with IFRS Standard 9 Financial Instruments standards. On the other hand, if a party has a significant influence over a joint venture then it shall recognize it in line with IAS 28.

EXAMPLE 2

Of the 500 km of road construction work opened by the highways, 200 km of it will be done by Entity Z and 300 km of it will be done by Entity Y. Two companies established an entity to provide the required asphalt. All income and loss will be divided based on the trading volume made to the asphalt entity. First-year, a total of CU300,000 asphalt was sold. Entity Z purchased CU120,000 whereas Entity Y purchased CU150,000. The remaining amount consists of sales to other companies. At the end of the first year, the total cost is CU250,000. Based on this information calculate Entity Z's and Y's share of total income and cost. The amortization ratio of the prefabricated construction sites is %10.

SOLUTION 2

To find both entities' shares, the distribution ratio should be calculated. Of the total CU270,000 purchase, Entity Z have the CU120,000 part while Entity Y have the other CU150,000. Therefore the distribution ratio for Entity Z is 12/27 whereas 15/27 for Entity Y. We applied this ratio to the income and cost and find these numbers. As a result, the following table is formed.

	Distribution Ratio	Income	Cost
Entity Z	12/27	CU133,333	CU111,111
Entity Y	15/27	CU166,667	CU138,889
Asphalt Entity	27/27	CU300,000	CU250,000

Separate Financial Statements

The accounting for joint arrangements in an entity's separate financial statements depends on the involvement of the entity in that joint arrangement and the type of the joint arrangement:

If an entity is a joint operator it shall recognize its interest in line with paragraphs 20-22 and 23. On the other hand in the case that an entity is a joint venture, then it shall recognize its interest in line with paragraph 10 of IAS Standard 27 Separate Financial Statements and with IFRS Standard 9 Financial Instruments unless the entity has significant influence over the joint venture.

Disclosure

There are no disclosures specified in IFRS 11. If the entity is subject to IFRS 11, then this entity should outline the disclosure requirements as mentioned in the IFRS Standard 12 Disclosure of Interests in Other Entities.

EXAMPLE 3

C-day Construction Co. and Island Construction Co. have made an equal share joint venture agreement for completing a construction project. For this project, C-day Construction Co. purchased CU160,000 construction material and it is used in this project. Two companies purchased a prefabricated construction site (property) which costs CU400,000 and both companies have equal shares of this property. In addition, Island Construction Co. has made CU120,000 personnel cost for the construction workers. The depreciation ratio for the prefabricated construction site is %10. How do C-day Construction Co. and Island Construction Co. recognize these transactions?

SOLUTION 3

- Journal Entries of C-Day Construction Co. are as follows:

Recognition of Prefabricated Construction Site

Dr. Property, Plant and Equipment	CU200,000	
Cr. Cash		CU200,000

Recognition of Construction Materials

Dr. Stock or Inventory	CU160,000	
Cr. Cash		CU160,000

Recognition of transferring inventory to service work-in-progress

Dr. Service work-in-progress	CU160,000	
Cr. Inventory		CU160,000

Recognition of Amortization

Dr. Service work-in-progress	CU20,000	
Cr. Accumulated Depreciation		CU20,000

- Journal Entries of Island Construction Co. are as follows:

Recognition of Prefabricated Construction Site

Dr. Property, Plant and Equipment	CU200,000	
Cr. Cash		CU200,000

Recognition of transferring inventory to service work-in-progress

Dr. Service work-in-progress	CU120,000	
Cr. Wages Payable		CU120,000

Recognition of Amortization

Dr. Service work-in-progress	CU20,000	
Cr. Accumulated Depreciation		CU20,000