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cutting through complexity

IFRS Institute Webcast – IFRS 11, *Joint Arrangements*

March 11, 2013

Administrative

- CPE regulations require online participants take part in online questions. Participants are required to respond to a minimum of four questions in order to be eligible for CPE credit.
- Results will be reviewed in aggregate and may be published as a “pulse survey” of the marketplace in the aggregate. Please note that no responses will be tracked back to any individual or organization.
- Send questions via the “Ask a Question” button.
- Help Desk: 1-877-398-1471 or outside the United States at 1-954-969-3342

Today's presenters

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Learning objectives

1) Understand the types of joint arrangements under IFRS 11
2) Be able to explain the key principles including an understanding of selected application examples when applying the joint arrangements accounting model under IFRS 11
3) Understand the transition provisions under IFRS 11

A new suite of consolidation standards

	Accounting	Disclosure
Subsidiaries	**IFRS 10 *Consolidated Financial Statements***	**IFRS 12 *Disclosure of Interests in Other Entities***
Associates	**IAS 28 *Investments in Associates and Joint Ventures***	
Joint ventures (JV)	**IFRS 11 *Joint Arrangements (JA)***	
Joint operations (JO)		
Unconsolidated structured entities		

IFRS 11 *Joint Arrangements*

- Under IFRS 11, a joint arrangement is an arrangement in which two or more parties have joint control with the following characteristics:
  1) The parties are bound by a contractual arrangement; and
  2) The contractual arrangement gives two or more of those parties joint control of the arrangement through unanimous consent.
- Control is used as defined in IFRS 10.

IFRS 11 *Joint Arrangements* – Effective date and transition

- IFRS 11 *Joint Arrangements* is effective for annual periods beginning on or after January 1, 2013.
- Transition is generally through retrospective application on adoption.
- However, depending on the extent of comparative information provided in the financial statements, there are simplifications and additional relief from disclosures.

Polling question 1

How many joint arrangements does your company participate in?

a) None

b) 1–5

c) 6–20

d) 21–100

e) More than 100

f) I don't know/not applicable

Old versus new requirements

IAS 31				IFRS 11
Line-by-line accounting	JCO/ JCA	No separate vehicle	JO	Line-by-line accounting of the underlying assets and liabilities
Choice: equity accounting or proportionate consolidation	JCE	A separate vehicle, but separation overcome by form, contract or other facts and circumstances	JO	Line-by-line accounting of the underlying assets and liabilities
Choice: equity accounting or proportionate consolidation	JCE	A separate vehicle with separation maintained	JV	Equity accounting

Joint venture vs. joint operation

1 Structure: Is the arrangement structured through a vehicle that is separate from the parties? N → Joint Operation; Y ↓

2 Legal form: Does the legal form of the vehicle give the parties rights to the assets and obligations for the liabilities of the arrangement? Y → Joint Operation; N ↓

3 Contractual arrangement: Do the contractual arrangements give the parties rights to the assets and obligations for the liabilities of the arrangement? Y → Joint Operation; N ↓

4 Other facts and circumstances: Do the parties have rights to substantially all the economic benefits of the assets of arrangement? Does the arrangement depend on the parties on a continuous basis for settling its liabilities? Y → Joint Operation; N ↓

Joint Venture

Knowledge check 2

What is the sequence of steps in assessing the classification of a joint arrangement under IFRS 11?

a) Contractual arrangement, other facts and circumstances, structure, legal form

b) Legal form, structure, contractual arrangement, other facts and circumstances

c) Structure, legal form, contractual arrangement, other facts and circumstances

d) Other facts and circumstances, legal form, contractual arrangement, structure

Knowledge check 2 debrief

a) **Incorrect.** The sequence is structure, legal form, contractual arrangement, other facts and circumstances.

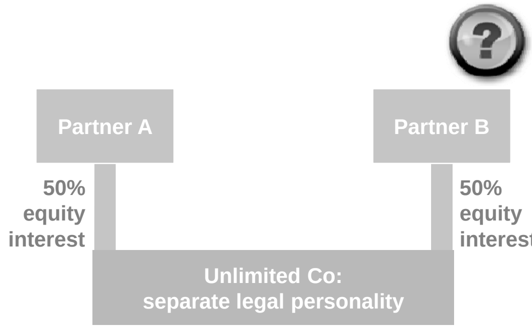
b) **Incorrect.** Assessing the structure is the first step and assessing the legal form is the second step.

c) **Correct.** This is the sequence in assessing a joint arrangement: structure, legal form, contractual arrangement, other facts and circumstances.

d) **Incorrect.** Assessing structure is the first step and other facts and circumstances is the last step.

Legal form

- A and B set up Unlimited Co.
- A and B have unlimited liability for the liabilities of Unlimited Co.



JO or JV?

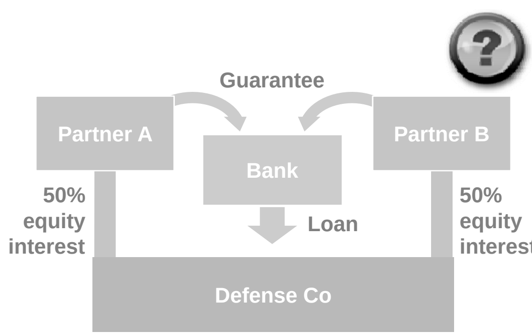
Based only on this information, does the legal form of the vehicle give the parties rights to the assets and obligations for the liabilities of the arrangement?

a) Yes

b) No

Knowledge check 3 – Contractual arrangements

- A and B each sell their defense contracting businesses to a new, jointly controlled, legally separate vehicle, Defense Co, for fair value.
- Defense Co funds the payment with bank debt guaranteed by A and B.



JO or JV?

Based on this information, do the contractual arrangements give the parties rights to the assets and obligations for the liabilities of the arrangement?

a) Yes

b) No

Knowledge Check 3 debrief: Contractual arrangement

Answer: No.

Learning points:

- A guarantee does not, in itself, determine that the parties have obligations for the liabilities of a separate vehicle.
- In this example, the recourse of the bank to the parties is only in the event of a default of the loan by Defense Co.
- Only a primary, not a secondary obligation, would meet the “obligation for the liabilities” criterion.
- Rights to the assets are also required for joint operation classification.

Evaluation of “other facts and circumstances” when determining that arrangement is a JO

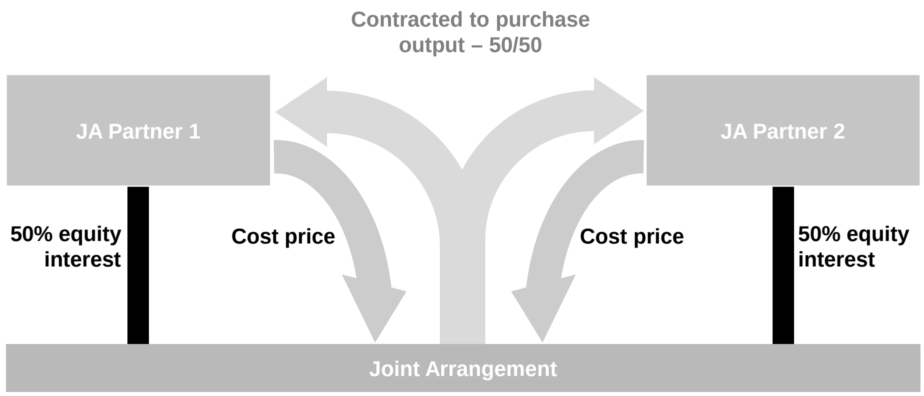
Structure → **Legal form** → **Contractual arrangement** → **Other facts and circumstances**

Asset side ✓ + **Liability side** ✓ = **Joint Operation**

JA must give parties rights to substantially all economic benefits relating to arrangement **(asset side)**.

JA must cause arrangement to depend on parties on a continuous basis for settling its liabilities **(liability side)**.

Basic example: JO classification



Polling question 4

Of the joint arrangements your company participates in, what portion do you expect would be classified as a joint operation?

a) 0%

b) <20%

c) 20%–50%

d) >50%, but less than 100%

e) 100%

f) Don't know/not applicable

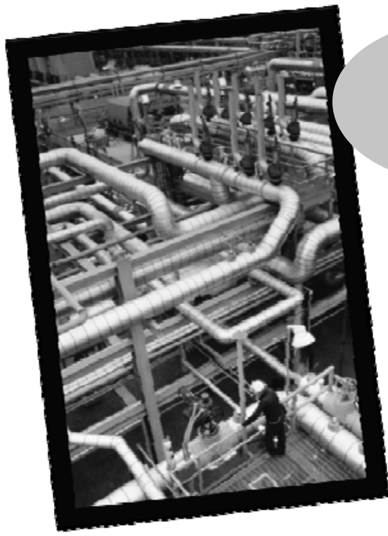
IFRS 11: Asset side requirement

- When activities of arrangement are designed to provide output to the parties:
  - This indicates that parties have rights to substantially all economic benefits of the assets of the arrangement.
  - Parties to such arrangements often ensure their access to outputs by preventing arrangement from selling output to third parties.

IFRS 11: Liability side requirement

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

Common application issues identified

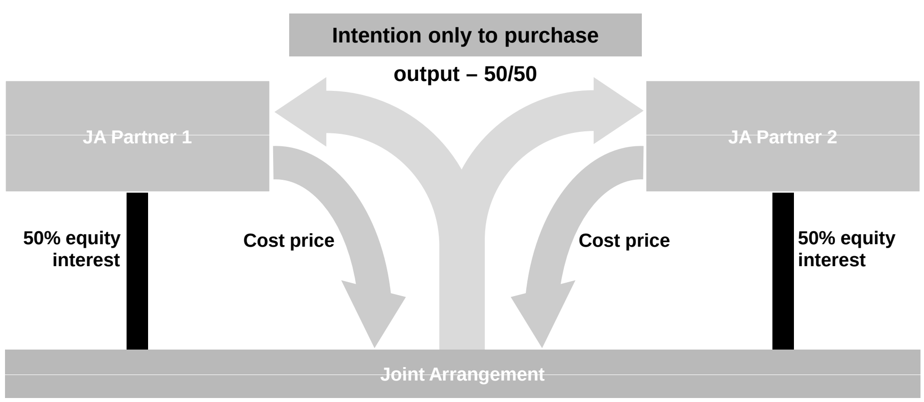


In what proportion do parties need to take output?

What level is "substantially all" the output?

Is a contractual right/obligation required?

Knowledge check 5 – Asset (and liability) side: Intention vs. obligation

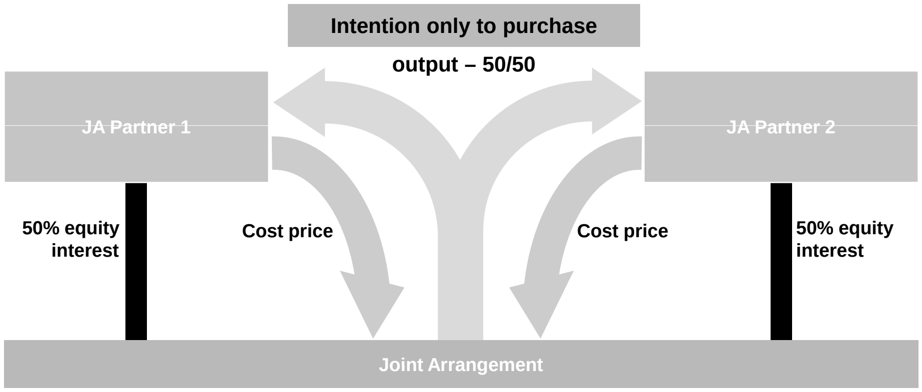


Question: If there is only an intention to purchase the output (i.e., partners not obliged), would this meet the requirement for JO classification?

a) *Yes*

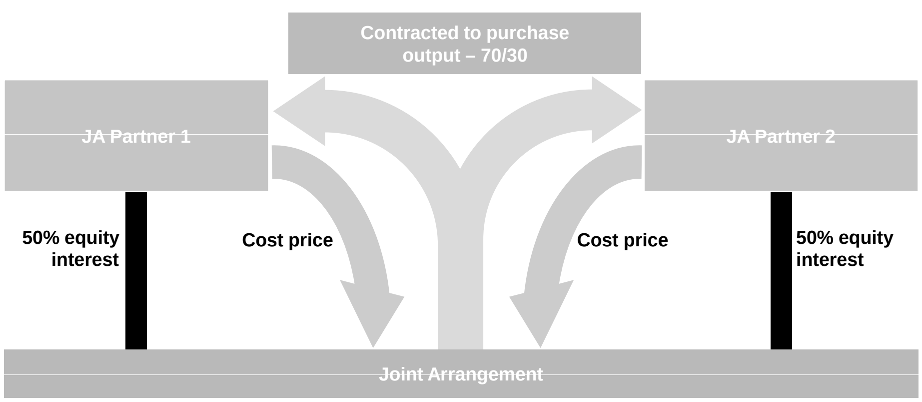
b) *No*

Knowledge check 5 debrief: Asset (and liability) side: Intention vs. obligation



No. Without a contract for the output, there is no enforceable right to the output. The parties cannot have an obligation in substance for the liabilities unless they have an obligation to take substantially all of the output.

Knowledge check 6: Asset side: Disproportionate basis

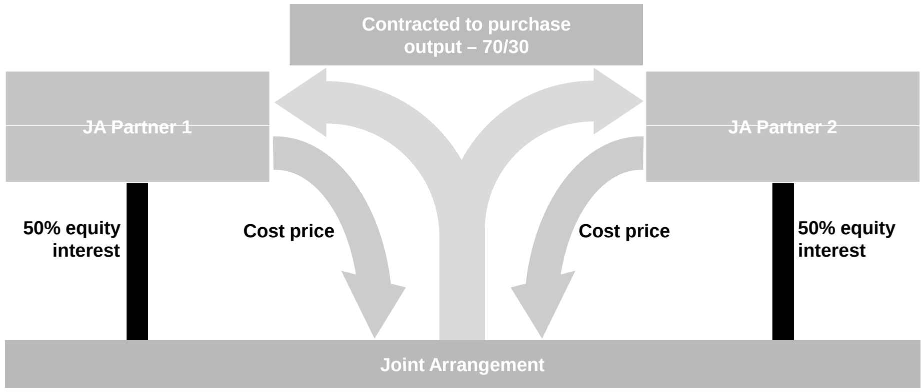


Question: If output taken on basis disproportionate to parties' interests, could this meet the requirement for JO classification?

a) Yes

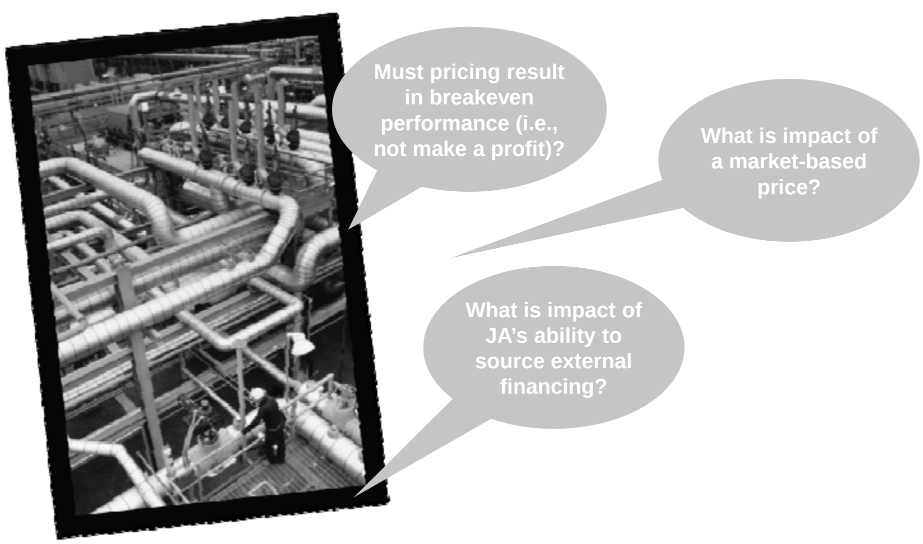
b) No

Knowledge check 6 debrief: Asset side: Disproportionate basis

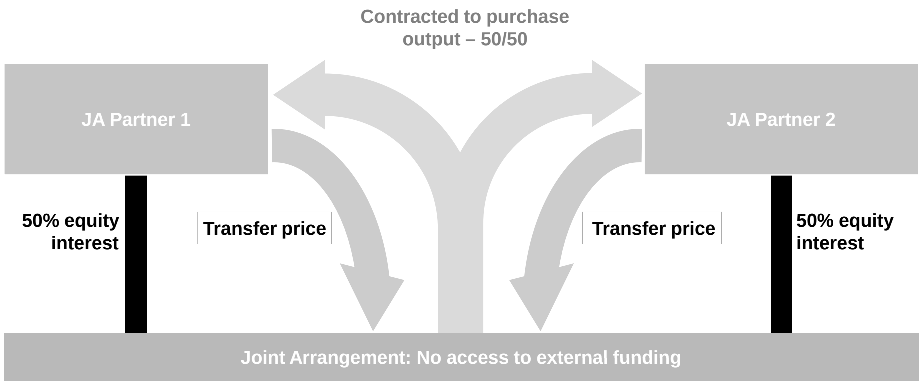


Yes. IFRS 11 refers to "the parties" having rights to substantially all of the output. It refers to the parties collectively, as a single unit, and does not address the relative rights of the parties.

Common application issues identified



Knowledge check 7: Liability side: Cost-plus transfer pricing



Question: If price paid was transfer price agreed at cost plus a fixed margin, could this meet the requirement for JO classification?

a) *Yes*

b) *No*

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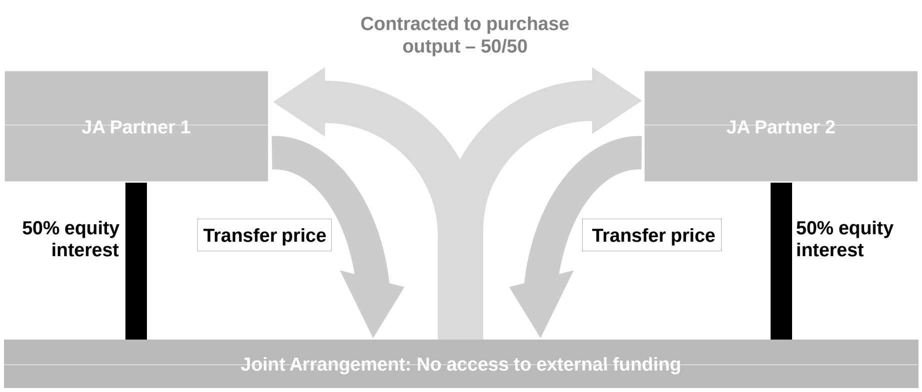
Knowledge check 7 debrief: Liability side: Cost-plus transfer pricing



Yes

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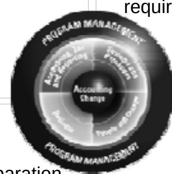
Practical considerations: Joint Arrangements

Accounting and reporting

- Significant accounting considerations and documentation of the following:
  - Determining whether a joint arrangement exists
  - Determining whether a joint arrangement is a joint operation or joint venture
- Additional disclosure requirements

Systems and processes

- Assessing existing operation technology systems and other automated tools and potential gaps
- Processes related to the new accounting and disclosures preparation could require modifications to accommodate IFRS disclosure requirements



Business

- Additional disclosure requirements could require planning, data-gathering and preparation from the business
- Effort to gather additional data
- Any end-user tools that are used to prepare and present disclosures would need to be modified to accommodate additional disclosures required

People

- Training may be needed for those professionals involved in the disclosures preparation (i.e., financial reporting, risk management/ valuation, etc.)

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