SA | ACCOUNTING ACADEMY

Connect. Partner. Succeed.

IFRS 11 *Joint Arrangements*

Presenter:
Anton van Wyk M. Com CA (SA)

Presenter

Anton van Wyk M. Com CA (SA)

Anton van Wyk is a **chartered accountant** and independent consultant in International Financial Reporting Standards (IFRS and IFRS for SMEs). As former subject head of Financial Accounting at various higher education providers (including the University of Johannesburg and Monash University South Africa), he has gained valuable insights into and understanding of the important principles underlying the International Financial Reporting Standards (IFRS). Anton is a well-known and popular presenter who has presented numerous IFRS updates for several accounting bodies across South Africa. He is known for his ability to simplify and highlight the most important principles contained in IFRS, whilst keeping the learning process enjoyable for attendees.

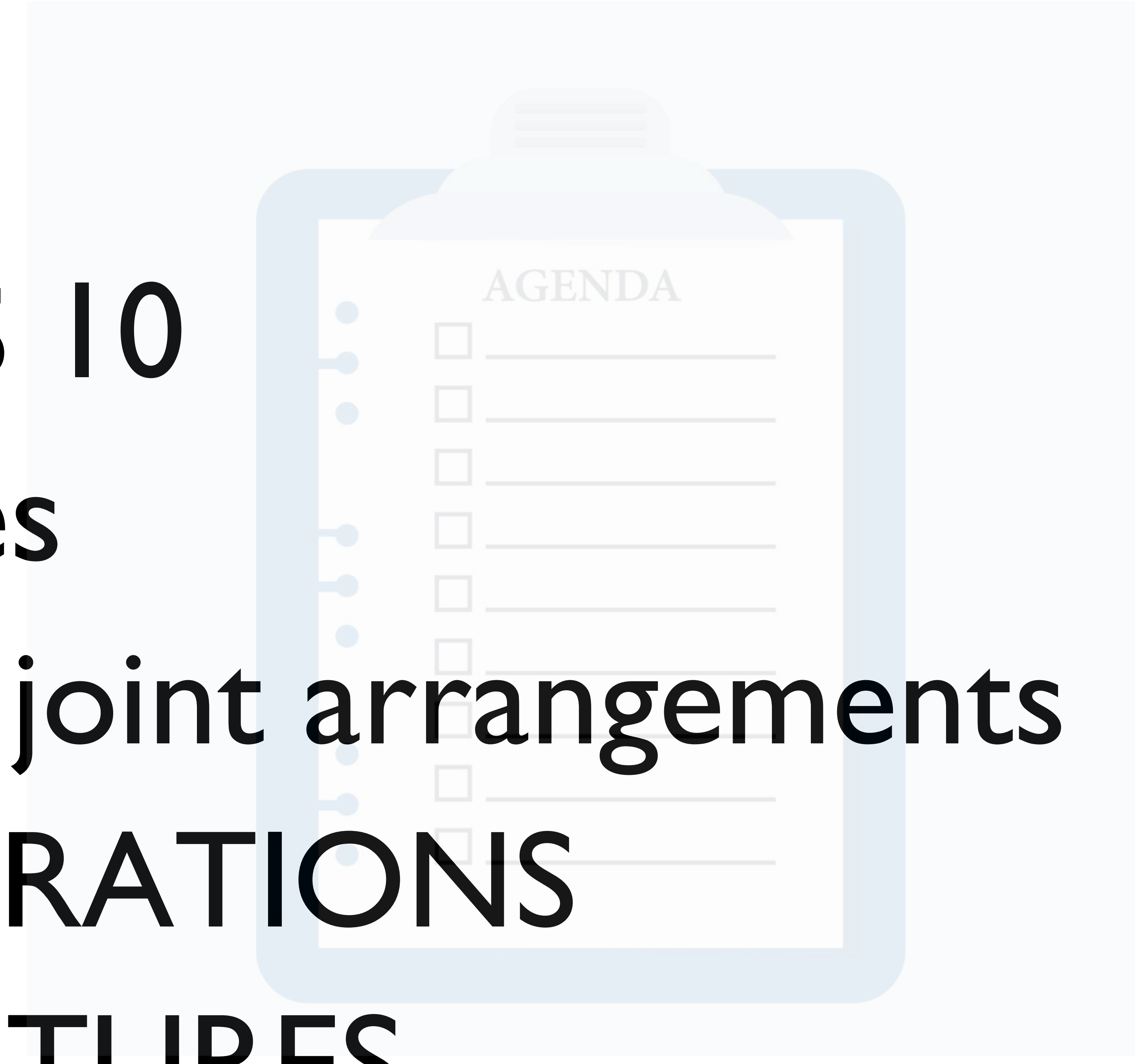
Welcome to the webinar

SA ACCOUNTING ACADEMY
Connect. Partner. Succeed

- IFRS 11 *Joint Arrangements*

- <u>Agenda</u>

1. Quick recap on **control** from IFRS 10
2. Introduction to IFRS 11 – objectives
3. Classification and understanding of joint arrangements
4. Accounting treatment: JOINT OPERATIONS
5. Accounting treatment: JOINT VENTURES



IFRS 11

IFRS 11 *Joint Arrangements*

A quick recap of IFRS 10 i.r.o. “control” only

IFRS 10 and other IFRSs

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- IFRS 10 *Consolidated Financial Statements*
- IAS 27 *Separate Financial Statements*
- IFRS 11 *Joint Arrangements*
- IFRS 12 *Disclosure of Interests in Other Entities*
- IFRS 3 *Business Combinations*
- IAS 28 *Investments in Associates and Joint Ventures*
- IFRS 9 *Financial Instruments*

IFRS 10 is inextricably linked to the other IFRSs and IASs

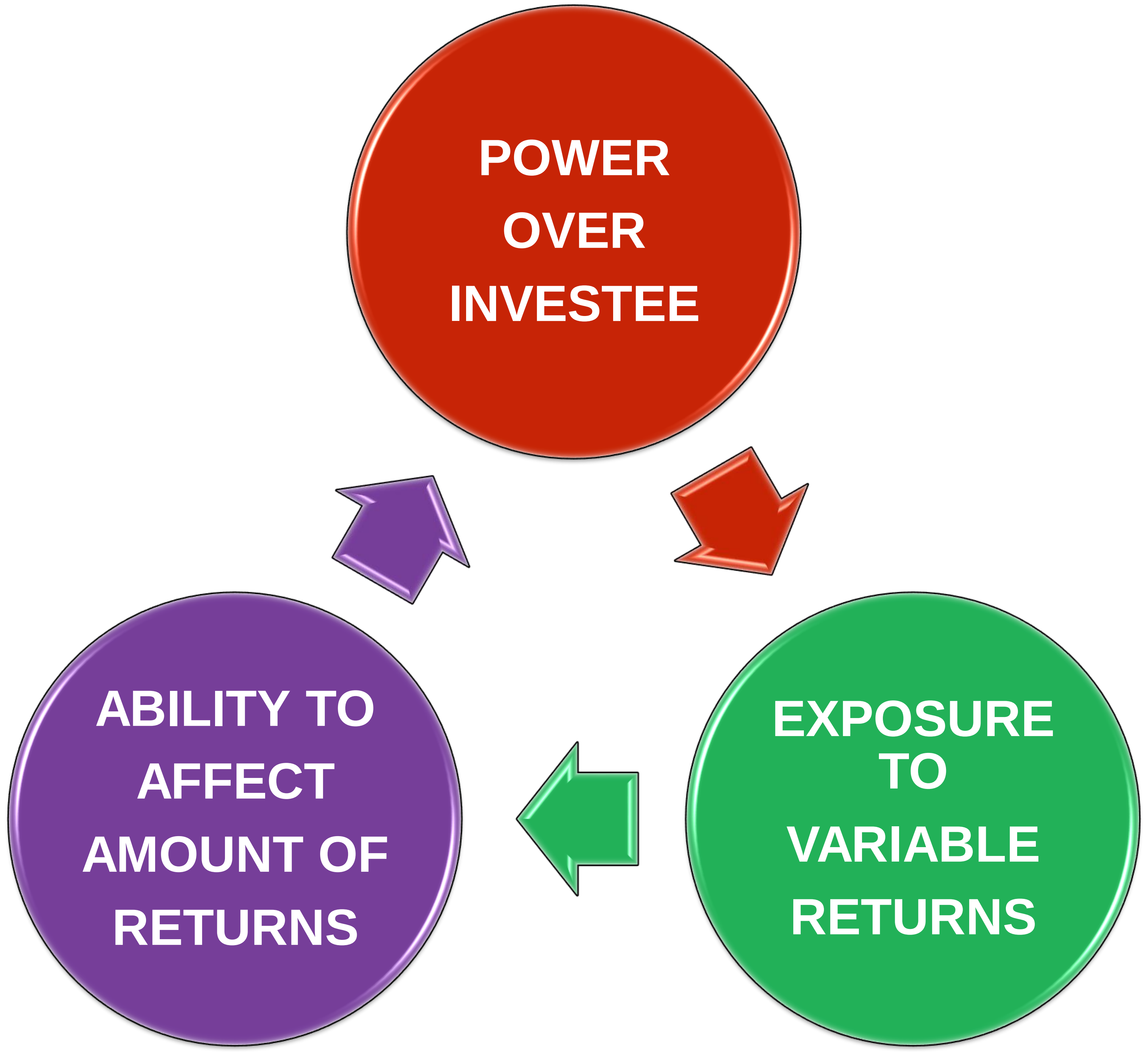
Control – what is it now?

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

An investor **controls** an investee when:

- it is **exposed** to (*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

POWER
EXPOSURE
ABILITY



Control assessment

- **5 questions need to be considered:**

1. What is the purpose and design of the investee?
2. What are the relevant activities of the investee and how are decisions made about those relevant activities?
3. Do the rights that the investor holds, give the investor the current ability to direct the relevant activities?
4. Is the investor exposed, or does the investor have rights to, variable returns from its involvement with the investee?
5. Does the investor have the ability to use its power over the investee to affect the amount of the investor's returns?

Conclusion

- Once **control** has been identified, the question to be asked is:

Who exercises the control?

One party?

Parent

~~IFRS 11~~

Two or more parties?

Contractual sharing?

Joint arrangement

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

IFRS 11

Introduction – objectives of IFRS 11

IFRS 11 *Joint Arrangements*

Focus points

- IFRS 11 *Joint Arrangements* has two major focus points

- Focus point 1: CLASSIFICATION
  - What is a joint arrangement, a joint venture, a joint operation etc.? How to identify these correctly…
- Focus point 2: ACCOUNTING TREATMENT
  - How to account for each type of joint arrangement correctly

IFRS 11

Classification and understanding

IFRS 11 *Joint Arrangements*

IFRS 11 – objectives

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- IFRS 11 is to be applied by ANY entity that is a party to a joint arrangement
- What is a "joint arrangement" (JA)?
  - An arrangement of which two or more parties have joint control
  - JA has two characteristics (very important):
    - The parties are bound by a contractual arrangement; and
    - The contractual arrangement gives two or more of those parties joint control of the arrangement

Joint arrangements (JAs)

- A **joint arrangement** is either:

A joint operation

A joint venture

Aspect 1: What is joint control?

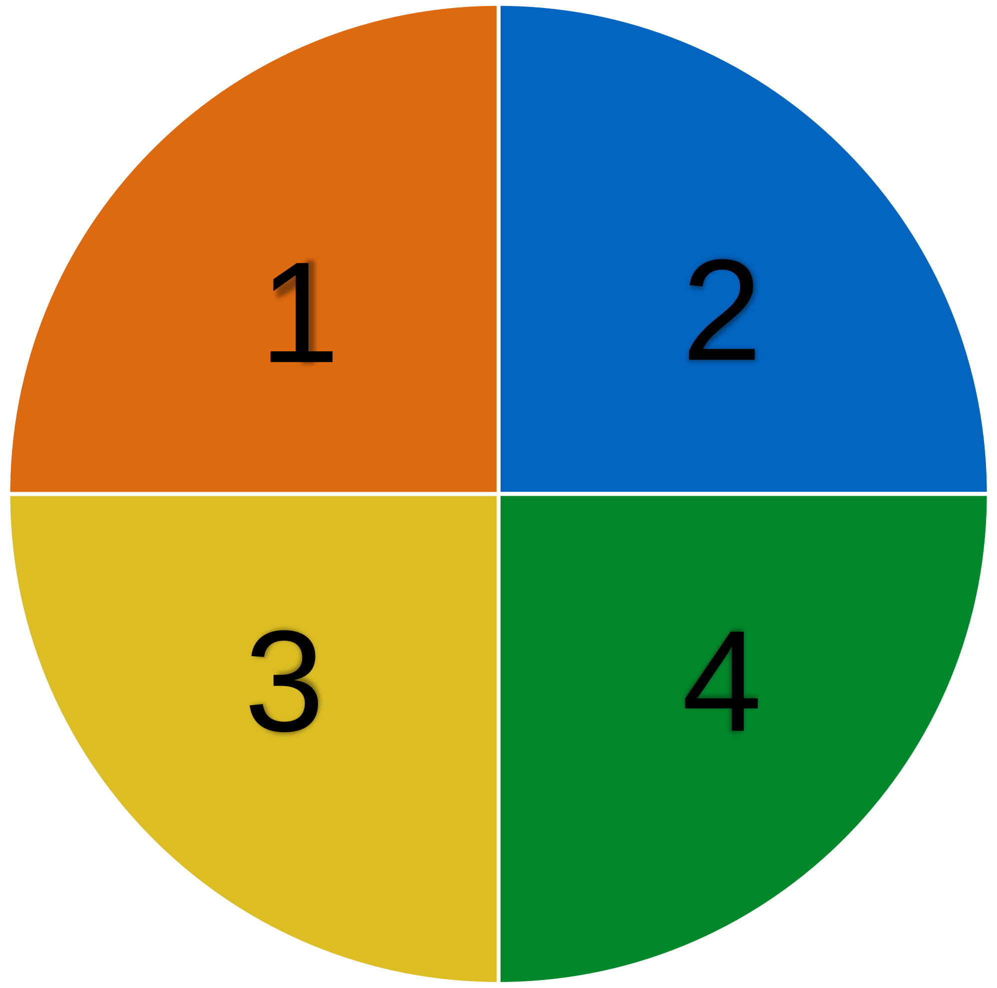
- **Joint control is:**

> - **the contractually agreed**
> - **sharing of control of an arrangement,**
> - **which exists only when decisions about the *relevant activities* require the <u>unanimous</u> consent of the parties sharing control**

IFRS 10

“Joint control”

- A party to an arrangement (e.g. P1) must assess the contractual arrangement to determine whether the latter gives all the parties (P1 to P4), or a group of the parties (P1 & P2), collective control of the arrangement
- All the parties, or a group of parties, control the arrangement collectively when they must act together to direct the activities that significantly affect the returns of the arrangement (i.e. the relevant activities)



"Joint control"

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Once collective control has been established (contractually) for either two, or ALL, of the parties to the arrangement, a further assessment needs to be done to ensure that those parties, collectively controlling the arrangement, are required to ACT TOGETHER to direct the relevant activities of the arrangement

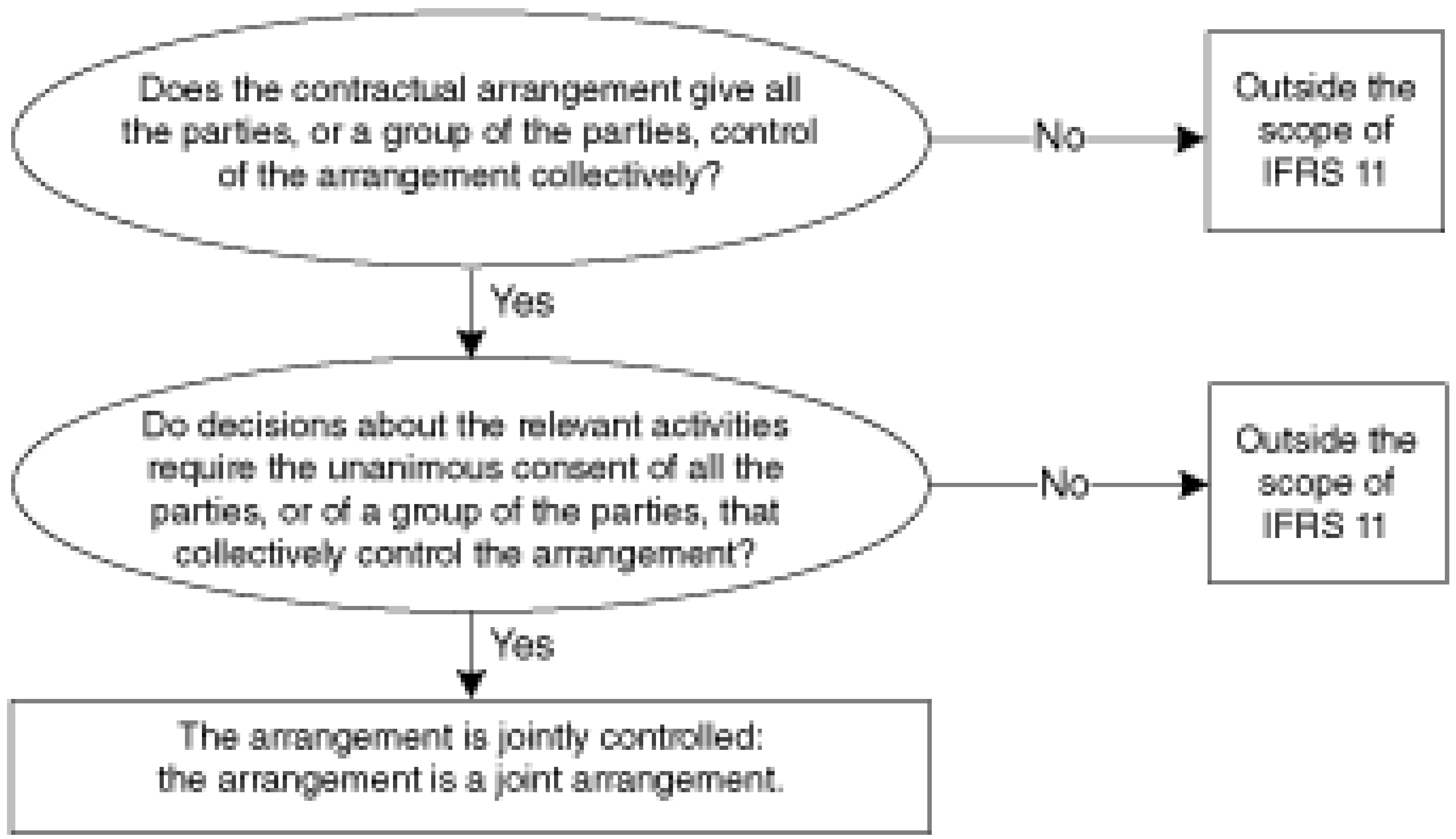
- Only when decisions about the relevant activities of the joint arrangement require UNANIMOUS CONSENT of the parties controlling the arrangement

"Joint control"

- In a joint arrangement, no single party can control the arrangement on its own, but can prevent other parties (or groups of other parties) from controlling the arrangement
- Not all parties in a joint arrangement are required to control the arrangement, and there may be one/more parties that only participates in the arrangement without directing the relevant activities of the arrangement collectively
- Parties that have joint control are either joint venturers or joint operators
- IFRS 11 distinguishes between joint venturers/operators <u>and</u> parties participating in a joint arrangement without having joint control

In summary…

Assessing joint control



Use IFRS 10, IAS 28 or IFRS 9 etc.

Use IFRS 10, IAS 28 or IFRS 9 etc.

Aspect 2: Types of JA's?

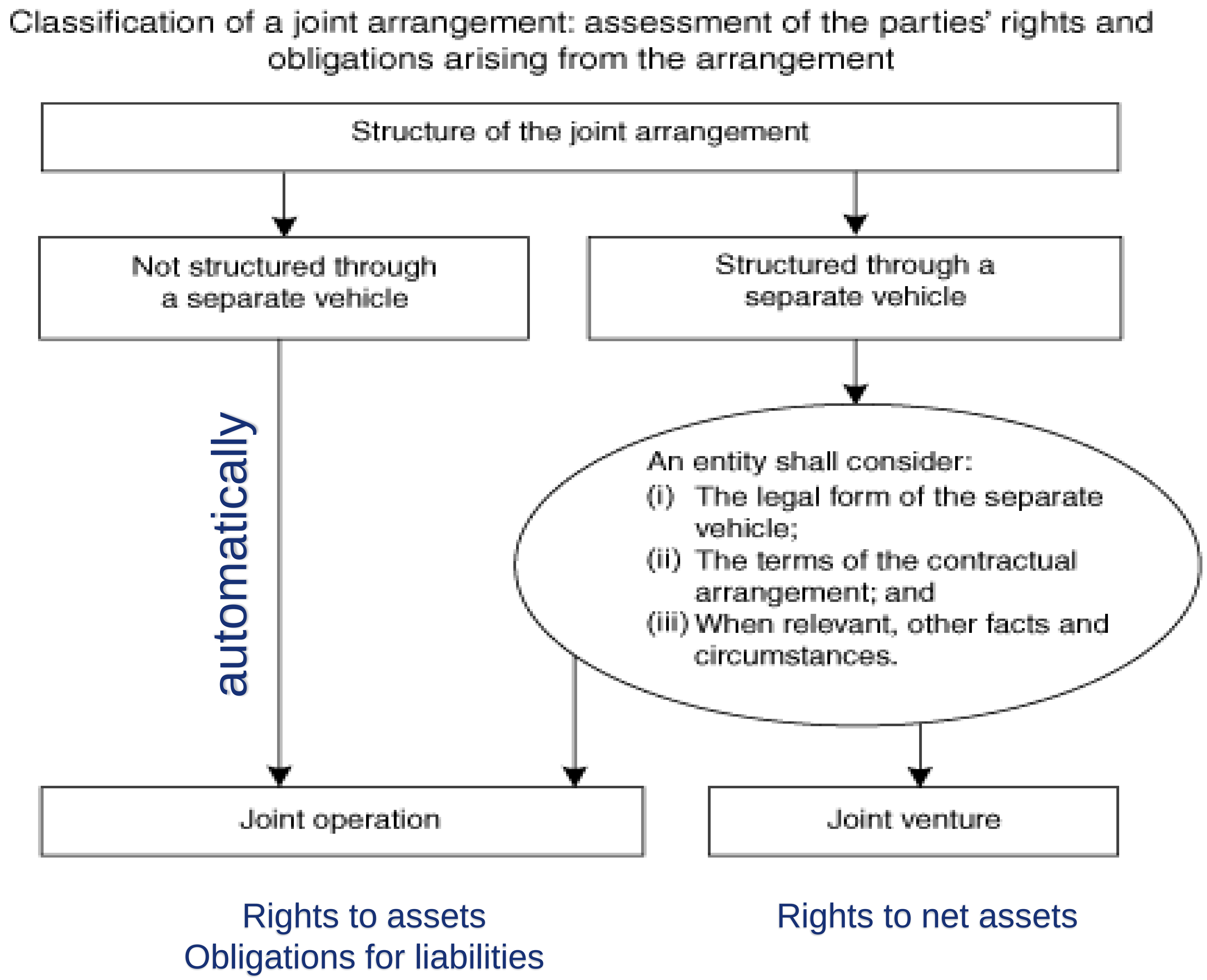
SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Every joint arrangement needs to then be **classified** as either a JOINT VENTURE or a JOINT OPERATION
- Classification of the JA is based on the rights and obligations of the parties to the JA
- A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. *Those parties are called 'joint operators'.*
- A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. *Those parties are called 'joint venturers'.*

Classifying the JA

- First ask: what are the rights and obligations of the parties to the JA?
- Two aspects to consider in particular:
  - The structure of the JA – separate vehicle, or not?
  - If the JA is structured through a separate vehicle:
    - The *legal form* of the separate vehicle
    - The *terms* of the contractual arrangement
    - *Other facts and circumstances*, where relevant

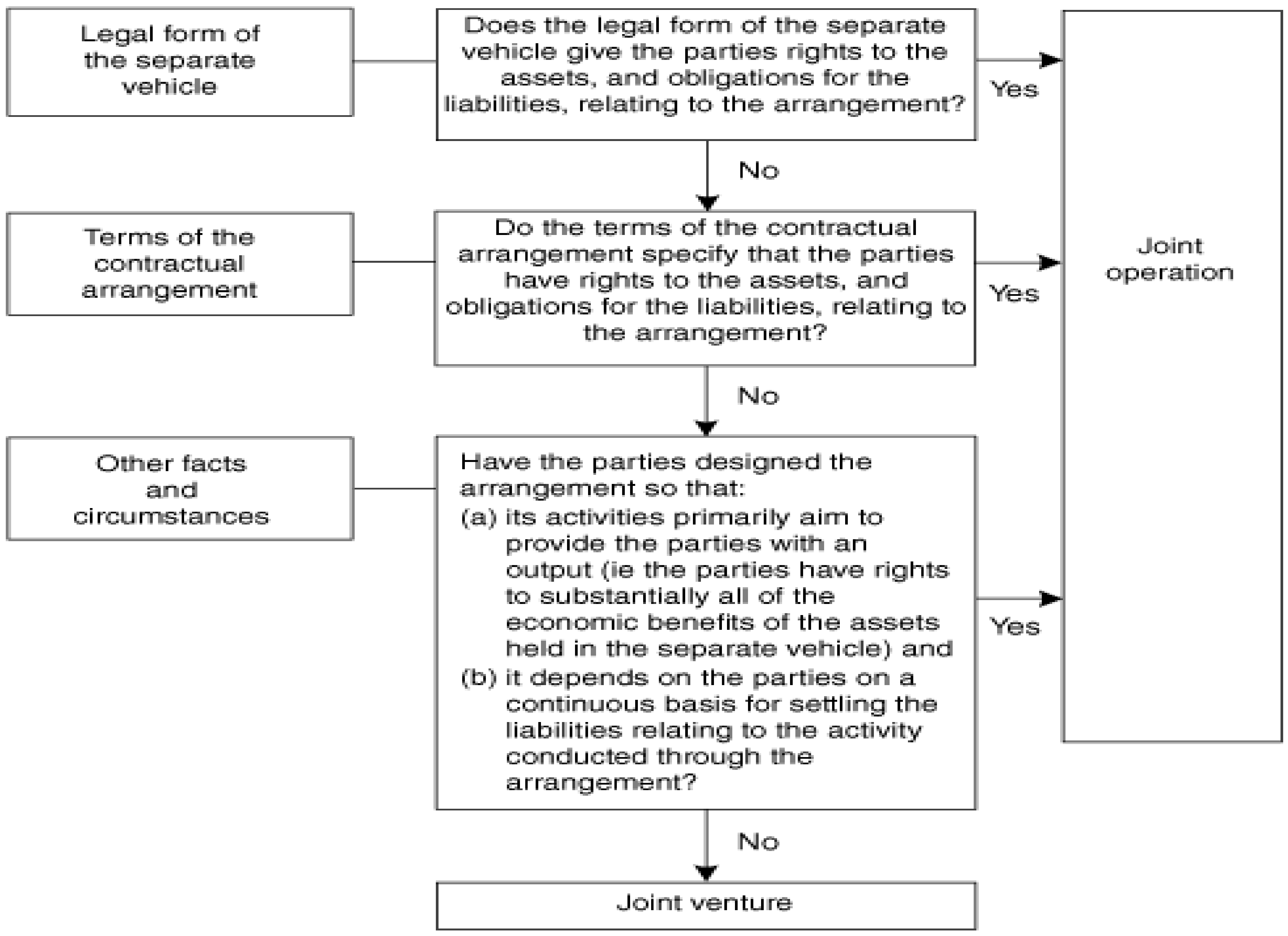
Classifying the JA



Separate vehicle

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

Classification of a joint arrangement structured through a separate vehicle



Application examples
(is there a JA?)

SA ACCOUNTING ACADEMY
Connect. Partner. Succeed

Example 1

Three parties establish an arrangement: A has 50% of the voting rights in the arrangement, B has 30% and C has 20%. The *contractual arrangement* between A, B and C specifies that at least 75% of the voting rights are required to make decisions about the relevant activities of the arrangement.

Notes:

Application examples
(is there a JA?)

Example 2

An arrangement has three parties: A has 50% of the voting rights in the arrangement and B and C each have 25%. The contractual arrangement between A, B and C specifies that at least 75% of the voting rights are required to make decisions about the relevant activities of the arrangement.

Notes:

What if A and C agreed contractually to share control? Does B have joint control too?

Application examples

(is there a JA?)

Example 3

An arrangement exists in which A and B each have 35% of the voting rights in the arrangement, with the remaining 30% being widely dispersed. Decisions about the relevant activities require approval by a majority of the voting rights (i.e. >50%).

Notes:

Application examples

(type of JA?)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

Example 4

(a) Assume that two parties contractually structure a joint arrangement in an incorporated legal entity. Each party has a 50% ownership interest in the incorporated entity. What type of JA?

Notes:

(b) However, the parties modify the features of the corporation through their contractual arrangement so that each has an interest in the assets of the incorporated entity and each is liable for the liabilities of the incorporated entity in a specified proportion. What type of JA?

Notes:

Application examples
(type of JA?)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

Example 5

Assume that two parties structure a joint arrangement in an incorporated entity (entity C) in which each party has a 50 per cent 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 the quantity and quality specifications of the parties.

The legal form of entity C (an incorporated entity) through which the activities are conducted initially indicates that the assets and liabilities held in entity C are the assets and liabilities of entity C. The contractual arrangement between the parties does not specify that the parties have rights to the assets or obligations for the liabilities of entity C. Accordingly, the legal form of entity C and the terms of the contractual arrangement indicate that the arrangement is a **joint venture**.

The parties also consider the following aspects of the arrangement:

The parties agreed to purchase all the output produced by entity C in a ratio of 50:50. Entity C cannot 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 not material.

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 entity C. On the basis of this operating model, the arrangement is intended to operate at a break-even level.

Notes:

IFRS 11

<u>Accounting treatment: JOINT OPERATIONS (JO's)</u>

IFRS 11 *Joint Arrangements*

AFS of the parties to JO's

- **Joint operators** recognise, in relation to their interest in a joint operation:
  - Its (own) assets, including its share of assets held jointly
  - Its (own) liabilities, including its share of liabilities incurred jointly
  - Its (own) revenue from the sale of its share of the output arising from the joint operation
  - Its share of the revenue from the sale of the output <u>by</u> the joint operation
  - Its (own) expenses, including its share of expenses incurred jointly

AFS of the parties to JO's

- **Party to a joint operation, BUT with no control**:
  - Account for its interest in the arrangement the same as the joint operator (previous slide) **<u>if</u>** that party has rights to the assets, and obligations for the liabilities, relating to the joint operation
  - If such party does not have rights to the assets, and obligations for the liabilities, relating to that joint operation, it shall account for its interest in the joint operation in accordance with the IFRSs applicable to that interest (e.g. IFRS 9)

Example: JO's

On 1 January 2020, T-oil Ltd, B-oil Ltd and C-oil Ltd agreed to acquire an oil pipeline to be utilised jointly through a newly formed **partnership**, TBC. The voting and participation rights of each of the partners reflect the **contribution** they made to the acquisition of the pipeline and are as follows:

	Interest	Contribution
T-oil Ltd	40%	R4 000 000
B-oil Ltd	30%	R3 000 000
C-oil Ltd	30%	R3 000 000
		R10 000 000

Example: JO's (continued)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

The constituting document of the partnership determines that all decisions relating to its relevant activities are taken by majority vote. T-oil Ltd and B-oil Ltd entered into a *separate contractual agreement* in terms of which they exercise their voting rights jointly whenever a decision about the relevant activities is to be taken.

TBC used the entire R10 million received from the partners to acquire the oil pipeline, which constitutes its only physical asset. TBC generates its revenue through charging a usage fee on a day-to-day basis for use of its pipeline by one of its three partners or third parties. Any expenses are paid from the partnership's separate bank account.

Example: JO's (continued)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

TBC's SPLOCI for the year ended 31 December 2020, is as follows:

Revenue	R9 000 000
T-oil Ltd	R4 200 000
B-oil Ltd	R800 000
C-oil Ltd	R500 000
Third parties	R3 500 000
Cost of sales	-R2 600 000
Depreciation	-R400 000
Profit for the year	**R6 000 000**

TBC made all its sales in cash, apart from R1 200 000 of the third party revenue, which was still outstanding at 31 December 2020. All expenses were paid in cash.

Example: JO's (continued)

TBC's statement of financial position at 31 December 2020, is as follows:

Assets		
Oil pipeline	R9 600 000	*(R10 000 000 - R400 000)*
Accounts receivable	R1 200 000	
Bank	R5 200 000	
	R16 000 000	
Equity and liabilities		
Partner's interest	R10 000 000	
Retained earnings	R6 000 000	
	R16 000 000	

Example: JO's (continued)

Assessment of joint arrangement

It is clear from the information that T-oil Ltd and B-oil Ltd have **joint control** of TBC, due to the following:

- A majority vote is required in order for a decision regarding the relevant activities of TBC to be taken
- T-oil Ltd and B-oil Ltd have contractually agreed to vote together when such decisions are made
- As C-oil Ltd only has a 30% holding, T-oil Ltd and B-oil Ltd can reach a majority vote without the consent of C-oil Ltd

However, due to the contractual agreement, neither T-Ltd nor B-Ltd can make decisions independently of each other. Unanimous consent is required.

As TBC is a partnership, the partners accordingly have direct rights to the assets and obligations for the liabilities (i.e. there is no legal limitation of liability).

Thus, the partnership would be considered a **joint operation** in terms of IFRS 11.

The joint operators, T-oil Ltd and B-oil Ltd, would each **recognise their share of the assets, liabilities, revenue and expenses** in TBC in accordance with IFRS 11 as for joint operators.

As C-oil Ltd is a participant to the joint operation and has rights to the assets and obligations for the partnership, it would account for its share in the partnership in the same way as the joint operators T-oil and B-oil, despite the fact that it does not have joint control, in terms of IFRS 11.

Example: JO's (continued)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

Journal entries in T-oil's individual financial statements, BEFORE applying IFRS 11:

Dr	Investment in TBC (SFP)	R4 000 000	
Cr	Bank (SFP)		R4 000 000

Contribution to joint operation

B-oil and C-oil to process similar j/e's, even though C-oil is not a joint operator

Dr	Pipeline usage fee (P/L)	R4 200 000	
Cr	Bank (SFP)		R4 200 000

Fees paid to TBC for use of pipeline

Example: JO's (continued)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

Journal entries that T-oil will process in their individual AFS to apply IFRS 11

Dr	Oil pipeline (SFP)	R4 000 000 *(R10 000 000 x 40%)*	
Dr	Cost of sales (P/L)	R1 040 000 *(R2 600 000 x 40%)*	
Dr	Depreciation (P/L)	R160 000 *(R400 000 x 40%)*	
Dr	Accounts receivable (SFP)	R480 000 *(R1 200 000 x 40%)*	
Dr	Bank (SFP)	R2 080 000 *(R5 200 000 x 40%)*	
Cr	Accumulated depreciation (SFP)		R160 000 *(R400 000 x 40%)*
Cr	Revenue (P/L)		R3 600 000 *(R9 000 000 x 40%)*
Cr	Partner's interest (Equity)		R4 000 000 *(R10 000 000 x 40%)*

Recognition of share of joint operation's trial balance

Dr	Partner's interest (Equity)	R4 000 000	
Cr	Investment in TBC (SFP)		R4 000 000

Elimination of investment in joint operation against JO's equity

Dr	Revenue (P/L)	R1 680 000 *(R4 200 000 x 40%)*	
Cr	Pipeline usage fee (P/L)		R1 680 000

Elimination of intragroup portion of transaction with joint operation

NOTE:

The final journal entry is processed as IFRS 11 dictates that T-oil Ltd may only recognise the transactions with TBC to the extent that they relate to other parties' interests in the joint operation (i.e. T-oil Ltd is only permitted to recognise 60% of the transaction as the remaining portion is considered to be intragroup.)

All journal entries above both occur in the individual financial statements of T-oil and are NOT PFJEs.

Unless T-oil Ltd has other interests in subsidiaries, associates or joint ventures, group financial statements would NOT be prepared.

IFRS 11

Accounting treatment: JOINT VENTURES (JV's)

IFRS 11 *Joint Arrangements*

AFS of the parties to JV's

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- **Joint venturers** recognise their interest in a joint venture, as follows:
  - Its interest in a joint venture as an investment and shall account for that investment using the **equity method** in accordance with IAS 28 *Investments in Associates and Joint Ventures* unless the entity is exempted from applying the equity method as specified in that standard
  - A party that participates in, but does not have joint control of, a joint venture shall account for its interest in the arrangement in accordance with IFRS 9 *Financial Instruments*, unless it has significant influence over the joint venture, in which case it shall account for it in accordance with IAS 28

Example: JV's

Same facts and contributions as per previous example , except that the parties set up TBC as a **private company** (not a partnership), to own and manage the oil pipeline on behalf of the contributors.

Example: JV's (continued)

Assessment of joint arrangement

It is clear from the information that T-oil Ltd and B-oil Ltd have **joint control** of TBC, due to the following:

- A majority vote is required in order for a decision regarding the relevant activities of TBC to be taken

- T-oil Ltd and B-oil Ltd have contractually agreed to vote together when such decisions are made

- As C-oil Ltd only has a 30% holding, T-oil Ltd and B-oil Ltd can reach a majority vote without the consent of C-oil Ltd

However, due to the contractual agreement, neither T-Ltd nor B-Ltd can make decisions independently of each other - unanimous consent is required.

As TBC is a company, the contributors do not have direct rights to the assets and obligations for the liabilities. There is legal limitation of liability and the entity is recognised in its own right with regard to the control of its assets and obligations for its liabilities.

The contributors merely have a residual claim to the net assets of the company.

Thus, the company would be considered a **joint venture** in terms of IFRS 11.

The joint venturers, T-oil Ltd and B-oil Ltd, would **equity account** their share of the increases in equity in TBC in accordance with IFRS 11.

C-oil Ltd is a participant to the joint venture but, like T-oil Ltd and B-oil Ltd, it does not have rights to the assets and obligations for the liabilities of TBC. Thus, C-oil Ltd would evaluate whether it has significant influence over TBC, in which case it would also equity account its investment in the venture. However, if C-oil Ltd does not have significant influence over TBC, it would account for its investment in the company in terms of IFRS 9.

Example: JV's (continued)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

Journal entries in T-oil's individual financial statements, BEFORE applying IFRS 11:

Dr	Investment in TBC (SFP)	R4 000 000	
Cr	Bank (SFP)		R4 000 000

Contribution to joint venture

B-oil and C-oil to process similar j/e's, even though C-oil is not a joint venturer

Dr	Pipeline usage fee (P/L)	R4 200 000	
Cr	Bank (SFP)		R4 200 000

Fees paid to TBC for use of pipeline

Example: JV's (continued)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

Journal entries that T-oil will process in their individual AFS to apply IFRS 11

Dr	Investment in TBC (SFP)	R2 400 000 *(R6 000 000 x 40%)*	
Cr	Share of profit of JV (P/L)		R2 400 000

Equity accounting of 2020 earnings

"The equity method"

Thank you for your participation

SA | ACCOUNTING ACADEMY

Your source for accounting knowledge