

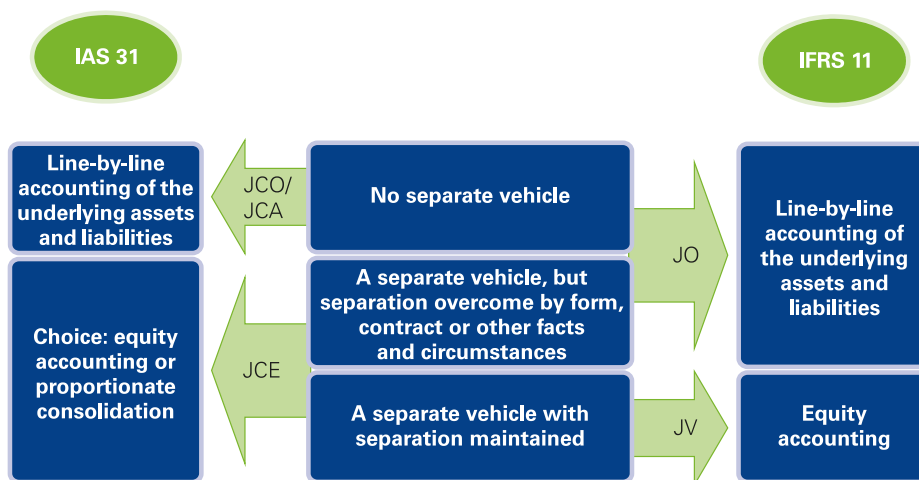
## No more proportionate consolidation for joint ventures



IFRS 11 *Joint Arrangements* overhauls the accounting for joint ventures (now called joint arrangements). It was issued by the IASB<sup>1</sup> on 12 May 2011 as part of its new suite of consolidation and related standards, also replacing existing requirements for subsidiaries. Here we focus on IFRS 11 and the amendments to IAS 28 (2011) *Investments in Associates and Joint Ventures*.

### From IAS 31 to IFRS 11

The following chart illustrates the differences between the joint arrangement classification and accounting models of the existing IAS 31 *Interests in Joint Ventures* and the new IFRS 11.



**Key:**  
JCO/JCA: Jointly controlled operation/jointly controlled asset  
JCE: Jointly controlled entity  
JO: Joint operation  
JV: Joint venture

### Highlights

- Classification of the joint arrangement depends on whether parties have rights to and obligations for underlying assets and liabilities
- Joint ventures equity accounted
- New requirements effective in annual periods beginning on or after 1 January 2013

Our forthcoming publication *First Impressions: IFRS 11 Joint Arrangements* will provide more detail about the new requirements and discuss some of the potential application issues. Speak to your usual KPMG contact if you would like copies.

Put simply, IFRS 11 does two things.

- Firstly, it carves out, from IAS 31 jointly controlled entities, those cases in which although there is a separate vehicle, that separation is ineffective in certain ways. These arrangements are treated similarly to jointly controlled assets/operations under IAS 31 and are now called joint operations.
- Secondly, the remainder of IAS 31 jointly controlled entities, now called joint ventures, are stripped of the

free choice of using the equity method or proportionate consolidation; they must now always use the equity method.

## How this could affect you

The main changes from IAS 28 *Investments in Associates* (2008), IAS 31 and SIC-13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*, and the related potential impacts, are summarised below.

Key changes from IAS 28 (2008), IAS 31 and SIC-13	Potential impacts
<p><b>The structure of the joint arrangement is no longer the main factor in determining the accounting</b></p>	<p>Notwithstanding the change in principles between IAS 31 and IFRS 11, we expect that in practice, many, but not all, jointly controlled entities under IAS 31 will be classified as joint ventures under IFRS 11.</p> <p>Although there may be relatively few joint arrangements that change classification, all joint arrangements will need to be re-assessed on transition to IFRS 11. As the classification of a joint arrangement requires identification and assessment of the structure, legal form, contractual arrangement and other facts and circumstances, this is expected to be an area of judgement that requires careful consideration in practice.</p>
<p><b>A single method of accounting for joint ventures</b></p>	<p>The transition from proportionate consolidation to the equity method will affect all of an entity's financial statement line items, notably decreasing revenue, gross assets and gross liabilities. If the joint venture is profitable and a taxable entity, then the transition will also decrease profit before tax as tax expenses of the joint arrangement no longer will be included in the tax line.</p> <p>There also may be other consequential accounting effects resulting from the cessation of proportionate consolidation. For example, when a venturer has hedged a joint venture's asset or liability (e.g. hedge of interest rate risk on the joint venture's debt), there is no case for hedge accounting once equity accounting is applied. Similarly, a venturer's interest expense may no longer be capitalised into a joint venture's asset.</p> <p>This change is expected to be widespread as, in our experience, currently around half of the entities use proportionate consolidation while the other half use the equity method to account for jointly controlled entities.</p> <p>As a consequence of this transition, entities may need to:</p> <ul style="list-style-type: none"> <li>• consider the effect on existing contracts, e.g. debt agreements and remuneration agreements, and performance measures; and</li> <li>• communicate the expected effects of transition to shareholders and other stakeholders, including managing analysts' expectations.</li> </ul>

## Key requirements of IFRS 11

### Scope

A *joint arrangement* is an arrangement over which two or more parties have *joint control*, i.e. the contractually agreed sharing of control of an arrangement. *Control* is defined in IFRS 10 *Consolidated Financial Statements* (see our publication *In the Headlines: Consolidation: a single new control model*). Joint control exists only when the unanimous consent of those parties sharing control is required to make decisions about the relevant activities, i.e. those that significantly affect the returns of the arrangement.

IFRS 11 does not introduce substantive changes to the overall definition of an arrangement subject to joint control, although the definition of control, and therefore indirectly of joint control, has changed due to IFRS 10. In general, we expect that arrangements that were considered joint ventures under IAS 31 will be considered joint arrangements under IFRS 11 and *vice versa*.

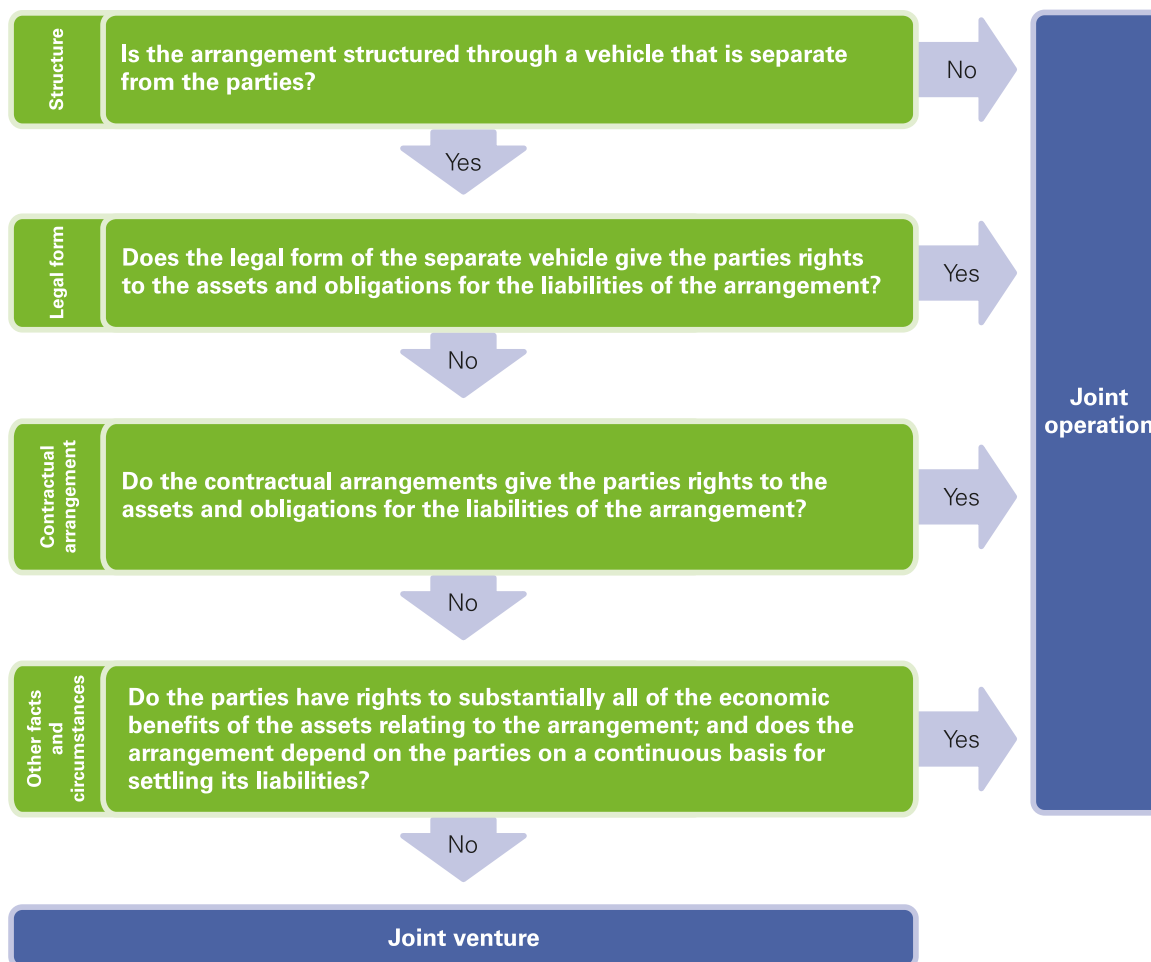
### The type of arrangement

After determining that joint control exists, joint arrangements are divided into two types, each having its own accounting model.

- A *joint operation* is one whereby the jointly controlling parties, known as the *joint operators*, have rights to the assets, and obligations for the liabilities, relating to the arrangement.
- A *joint venture* is one whereby the jointly controlling parties, known as the *joint venturers*, have rights to the net assets of the arrangement.

The key to determining the type of arrangement, and therefore the subsequent accounting, is the rights and obligations of the parties to the arrangement.

An entity determines the type of joint arrangement by considering the structure, the legal form, the contractual arrangement and other facts and circumstances. The relevant requirements of IFRS 11 in respect of classification are shown in the following flowchart.



## Accounting for the arrangement

The following table outlines the accounting model for parties to a joint arrangement. The accounting differs for those parties

sharing joint control (i.e. joint operators or joint venturers) and those parties that participate in, but do not have joint control over, a joint arrangement (i.e. other parties).

	Consolidated financial statements	Separate financial statements
<b>Joint operator</b>	Recognises its own assets, liabilities and transactions, including its share of those incurred jointly.	
<b>Other party to a joint operation</b>	Recognises its own assets, liabilities and transactions, including its share of those incurred jointly, if it has rights to the assets and obligations for the liabilities.  Otherwise, it accounts for the joint operation in accordance with the IFRS applicable to that interest, e.g. IAS 28 (2011) or IFRS 9 <i>Financial Instruments</i> /IAS 39 <i>Financial Instruments: Recognition and Measurement</i> , as the case may be.	
<b>Joint venturer</b>	Equity method in accordance with IAS 28 (2011).	Choice between cost or in accordance with IFRS 9/IAS 39.
<b>Other party to a joint venture</b>	If significant influence exists, then equity method in accordance with IAS 28 (2011); otherwise, in accordance with IFRS 9/IAS 39.	If significant influence exists, then choice between cost or in accordance with IFRS 9/IAS 39; otherwise, in accordance with IFRS 9/IAS 39.

The application of the equity method is subject to the following two exemptions carried forward from IAS 28 (2008) and IAS 31.

- If the joint venturer is a parent that is exempt from preparing consolidated financial statements in accordance with IFRS 10 or it is an intermediate company meeting certain requirements, then it may elect not to prepare consolidated financial statements and therefore not to equity account. The requirements are: the entity is unlisted and is not in the process of listing; its owners do not object; and a higher parent produces IFRS financial statements that are available for public use.
- If the joint venturer is a venture capital organisation or similar entity, then the joint venturer may elect to measure its investment in the joint venture at fair value through profit or loss in accordance with IFRS 9/IAS 39.

## Amendments to IAS 28 (2011)

There are limited amendments made to IAS 28 (2011).

- **Associates and joint ventures held for sale.** IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* applies to an investment, or a portion of an investment, in an associate or a joint venture that meets the criteria to be classified as held for sale. For any retained portion of the investment that has not been classified as held for sale, the entity applies the equity method until disposal of the portion held for sale. After disposal, any retained interest is accounted for using the equity method if the retained interest continues to be an associate or a joint venture.
- **Changes in interests held in associates and joint ventures.** Previously, IAS 28 (2008) and IAS 31 specified

that the cessation of significant influence or joint control triggered remeasurement of any retained stake in all cases, even if significant influence was succeeded by joint control, or *vice versa*. IAS 28 (2011) now requires that in such scenarios the retained interest in the investment is not remeasured.

## Adoption in periods beginning on or after 1 January 2013

IFRS 11 and IAS 28 (2011) are effective for annual periods beginning on or after 1 January 2013. Early adoption is permitted provided that the entire suite of consolidation standards is all adopted at the same time. Entities are encouraged to provide information required by IFRS 12 before the effective date, but this early disclosure would not compel the entity to apply either IFRS 12 in its entirety or the other new standards.

IAS 28 (2011) is applied retrospectively. IFRS 11 is also applied retrospectively, although there are specific restatement requirements for certain transitions – aiming at simplifying them – as discussed below.

## Consolidated financial statements

### Joint venture: proportionate consolidation to the equity method

The entity collapses the proportionately consolidated net asset value (including any allocation of goodwill) into a single investment balance at the beginning of the earliest period presented. The investment's opening balance is tested for impairment in accordance with IAS 28 (2011) and IAS 36 *Impairment of Assets*; any impairment losses are recognised

as an adjustment to opening retained earnings at the beginning of the earliest period presented.

If the investment balance is negative, then the entity recognises the corresponding liability only if it has a legal or constructive obligation related to the negative net assets. If no liability is recognised, then an adjustment is made to retained earnings at the beginning of the earliest period presented.

**Joint operation: equity method to accounting for the underlying assets/liabilities**

The entity opens up the equity method investment to recognise its share of individual assets and liabilities, including any goodwill, based on the amounts underlying the previous equity accounting, in accordance with its participation share in the contractual arrangement.

Any difference between the net assets recognised and the investment derecognised is applied either against the joint operation’s goodwill (if net assets recognised exceed the investment derecognised) or against retained earnings (if any remaining amount or if net assets recognised are less than the investment derecognised) at the beginning of the earliest period presented. Such differences may arise due to recognised but unallocated impairment losses or when an entity does not hold the same interest in all of the underlying assets and liabilities recognised using the equity method.

**Separate financial statements**

**Joint operation: IFRS 9/IAS 39 or cost to accounting for the underlying assets/liabilities**

The entity derecognises the investment held at cost or in accordance with IFRS 9/IAS 39 and recognises its interest in the underlying assets and liabilities arising from the joint operation at the amounts determined in accordance with the transitional requirements for transitioning from the equity method to accounting for the underlying assets/liabilities

in the consolidated financial statements (as discussed immediately above).

Any difference is recognised as an adjustment to retained earnings at the beginning of the earliest period presented.

**The new suite of consolidation standards**

The diagram below shows the five new or amended standards issued and their respective scopes.

	Accounting	Disclosure	Separate financial statements
Subsidiaries	IFRS 10	IFRS 12	IAS 27 (2011)
Associates	IAS 28 (2011)		
Joint ventures			
Joint operations	IFRS 11		IFRS 11
Unconsolidated structured entities	Generally IFRS 9/IAS 39		IFRS 12

Our publication *In the Headlines: Consolidation: a new single control model* provides an overview of IFRS 10; and our publication *In the Headlines: Extensive disclosures about interests in other entities* provides an overview of IFRS 12.

**Abbreviations**

- 1 IASB: International Accounting Standards Board

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***In the Headlines* is KPMG’s update on International Financial Reporting Standards (IFRSs) and financial reporting related regulatory developments.**

If you would like further information on any of the matters discussed in this issue of *In the Headlines*, please talk to your usual local KPMG contact or call any of KPMG firms’ offices.