Project **Joint Venture**

Topic **Parties to Joint Arrangements that do not share in 'joint control'**

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1. The topic of this Agenda Paper was initially included in item *(e) Participants that do not have joint control in a joint arrangement: 'investors'* of Agenda Paper 8A presented to the Board at its May 2009 meeting. The Board discussed the item but asked the staff to return to the Board with additional analysis.

2. This Agenda Paper analyses whether the final standard should include a term to designate parties to a joint arrangement that do not share in 'joint control' and if so, which the accounting requirements for these parties should be.

3. The Agenda Paper is structured as follows:

   (a) Accounting requirements in IAS 31 *Interests in Joint Ventures* and current divergence in practice [paragraphs 4-9];

   (b) Why we think the final standard should acknowledge that not all parties to a joint arrangement might have joint control [paragraphs 10-15];

   (c) Accounting proposed for the interests of parties to joint arrangements that do not share in 'joint control' [paragraphs 16-22].

Accounting requirements in IAS 31 and current divergence in practice

4. IAS 31 defines an *investor in a joint venture* as a party to a joint venture that does not have joint control over the joint venture. IAS 31 outlines the accounting requirements for such parties as follows:

> 51. An investor in a joint venture that does not have joint control shall account for that investment in accordance with IAS 39 or, if it has significant influence in the joint venture, in accordance with IAS 28.

5. One of the audit firms responding to the Invitation to Comment of ED 9 sent us the following comment relating the divergence in practice under the current requirements in IAS 31:

> 'There is currently a lot of uncertainty as to how parties to jointly controlled operations and jointly controlled assets (as defined in IAS 31) that do not share in 'joint control' should account for their interest in those joint ventures. Because the existing IAS 31 has a stronger emphasis on the 'legal form' of joint venture arrangements, the wording of paragraph 51 is commonly only applied to joint ventures where the joint venture is operated through an incorporated joint venture and so each investor has a legal 'investment' in the form of shares or other ownership interest.
>
> Accordingly, there is effectively no guidance on how non-jointly controlling parties to a jointly controlled operation or jointly controlled asset should account for their interests in the unincorporated joint venture. From our experience, **some entities account for their interest as a financial asset, others as an intangible asset and others as an 'undivided interest' in the underlying assets.** The accounting outcome often depends on the exact facts and circumstances surrounding the joint venture agreement.'

6. We have been told that those entities reporting *'undivided interests in the underlying assets'* generally relate to interests in unincorporated arrangements. The Oil & Gas industry provides good examples of this type of accounting outcome. The agreements between the parties establish the share of the assets and the share of the liabilities the parties in the arrangement are entitled and obliged to. These arrangements would be 'joint operations' if ED 9 was applied. The parties to such arrangements have rights to oil production, rights to oil inventory, etc. and have obligations to satisfy cash calls to fund capital or operational expenses, etc., independently of whether some or all of these parties share in 'joint control' over the joint operation.

7. We have also been told that entities reporting an *'intangible asset'* generally relate to interests in arrangements whereby these parties receive their returns in the form of product produced. Parties to those arrangements generally have an interest in a share of the assets and liabilities of the arrangement. Again, this type of arrangement would be a 'joint operation' if ED 9 was applied.

8. In both cases we think that the accounting for parties in these types of arrangements that do not share in 'joint control' should follow the same accounting requirements as the parties that do share in 'joint control'. We discuss this issue further in paragraphs 18-20 of this Agenda Paper.

9. Those entities, that are parties to a joint arrangement but do not share in 'joint control', that report their interest as a *'financial asset'* tend to receive their returns in the form of cash. We have been told that these arrangements do not generally entitle their parties to a share of assets or to a share of the liabilities. Such arrangements would normally be classified as 'joint ventures' by ED 9. We think that the accounting for parties in this type of arrangements that do not share in 'joint control' should follow the same accounting requirements as the one stated in paragraphs 21-22 of this Agenda Paper.

Inclusion of a term in the final standard to designate parties to a joint arrangement that do not share in 'joint control'

10. Arrangements within the scope of the final IFRS on *Joint Arrangements* will be arrangements that will need to fulfil the following features[1]:

    (a) the existence of an agreement between the parties to the arrangement, and

    (b) the agreement establishes that the activities that are the subject of the arrangement are jointly controlled.

11. Joint control exists when no party to the arrangement can make a strategic decision without another party(ies)'s consent. Joint control will exist in the following circumstances:

    (a) all parties to the arrangement share in 'joint control' (ie, strategic decisions require the unanimous consent of all parties in the arrangement);

[1] Please note that these features do not represent any scope change from IAS 31, which in paragraph 9 stated: 'Activities that have no contractual arrangement to establish joint control are not joint ventures for the purposes of this Standard.'

(b) a fixed majority of the parties (ie a contractual majority) or specific parties to the arrangement share in 'joint control'. The other parties to the arrangement not sharing in 'joint control', whilst being able to participate in the decision-making process, are unable to change the outcome of any strategic decision.

12. ED 9 does not include the term *'investors in a joint arrangement'* or any other terms to designate parties in a joint arrangement that do not share in 'joint control'. In addition, ED 9 defines:

(a) a ***joint arrangement*** as 'a contractual arrangement whereby two or more **parties** undertake an economic activity together and share decision-making relating to that activity', and

(b) a ***party to a joint arrangement*** as 'an entity that participates in shared decisions relating to the joint arrangement'.

Some respondents expressed concerns that arrangements in which, for example, two of the parties exercise joint control while other parties do not share in that control would not be in the scope of the new standard since not 'all the parties' to the arrangement share in 'joint control'.

13. Respondents that have interpreted that joint arrangements under the proposals require **all parties** to be involved in 'shared decision making' believe that this requirement is too restrictive and that it is likely to exclude a large number of arrangements from the scope of the new standard. [2]

14. We understand their concerns and propose clarifying in the final standard that not all parties to a joint arrangement have to have joint control over the arrangement. We also propose including the following terms:

[2] Please note that the Board decided at its May 2009 meeting to replace 'shared decision-making' by 'joint control' in the final standard.

(a) ‘party to a joint arrangement’ to be any party to the joint arrangement agreement; [3]

(b) ‘joint operators’ / ‘joint venturers’ to designate parties to a joint operation or joint venture, respectively, that do have ‘joint control’ of the corresponding arrangements, and

(c) ‘participants in joint operations’ / ‘investors in joint ventures’ to designate parties to a joint operation or a joint venture, respectively, that do not have ‘joint control’ of the corresponding arrangements.

15. If the Board agrees with the terms in paragraph 14, those would need to be included accordingly in the definition of ‘joint control’.

Question 1
Does the Board agree with acknowledging in the final standard that a party to a joint arrangement might not have joint control? Does the Board agree with the new terms to differentiate those parties that have joint control (*‘joint operators’* or *‘joint venturers’*) from those that do not have joint control (*‘participants in joint operations’* or *‘investors in joint ventures’*)? If the Board does not agree, does the Board have any other suggestions?

Accounting proposed for the interests of parties to joint arrangements that do not share in ‘joint control’

16. How different should be the accounting for a ‘participant in a joint operation’ or ‘investor in a joint venture’ from that of a ‘joint operator’ or ‘joint venturer’?

17. We think that the accounting of a party in a joint arrangement that does not share in ‘joint control’ would need to differentiate between:

(a) a ‘participant in a joint operation’, as defined in paragraph 14 above, and

(b) an ‘investor in a joint venture’, as defined in paragraph 14 above.

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[3] As a result of the outreach activities, one of the constituents informed us that for most lawyers the term ‘party’ would normally mean any one that signs the agreement, so they found confusing to reserve the term ‘party’ to only those parties that have joint control over the arrangement.

Participants in a joint operation

18. We assume that, as any other party in a joint operation, a participant would have interests in the assets, liabilities, revenues and expenses related to the arrangement. A participant in a joint operation does not share in 'joint control', however, it will still have assets it uses in the arrangement or an interest in a share of the assets held by the arrangement and the corresponding economic benefits generated by these assets or share of assets and any liabilities it has incurred or an interest in a share of the liabilities of the arrangement and the corresponding obligations from these liabilities or share of liabilities.

19. In the case of a joint operation, we think that those rights and obligations established in the agreement generally are not reinforced or diluted if the parties have or have not joint control over the arrangement. In other words, each of the parties in a joint operation has rights and obligations to assets and liabilities independently from whether the party is a party sharing in 'joint control' in the joint operation or not.

20. Accordingly, we propose that the accounting of 'participants in joint operations' reflects the rights they have in the assets and the obligations they have in the liabilities of the arrangement as 'joint operators' would do, and therefore the corresponding accounting requirements for 'participants in joint operations' to be:

    (a) Participants in a joint operation shall account for their assets, liabilities, revenues and expenses, including their share of any assets, liabilities, revenues and expenses arising from the joint operation.

Investors in a joint venture

21. IAS 31.51 states that an investor in a joint venture with no joint control shall account for the investment in accordance with IAS 39. However, if the investor has significant influence over the arrangement it should account for the investment in accordance to IAS 28.

22. We think that the accounting requirements in IAS 31.51 should be kept to account for the interests of 'investors in joint ventures', as defined in paragraph 14 above.

Question 2
Does the Board agree with the accounting proposed in the financial statements of a 'participant in a joint operation' [Paragraphs 18-20]? Does the Board agree with the accounting proposed in the financial statements of 'investors in a joint venture' [Paragraph 21-22]?