Project **Joint Venture**

Topic **Main changes to the final standard**

1. As noted in Agenda Paper 8, the objective of this Agenda Paper is to describe and provide rationale for the main modifications proposed to the following sections of the final standard: *Joint arrangements, Types of joint arrangement and Financial statements of parties to a joint arrangement*.

2. The changes to ED 9 *Joint Arrangements* proposed in this Agenda Paper are the result of the feedback obtained from the comment letters and the broad consultation performed subsequently to the comment letter presentation to the Board. The changes proposed in this Agenda Paper additionally reflect the analysis of real contractual arrangements carried out by the staff during the last months. Appendix 1 provides a summary of the areas discussed and the changes proposed in this Agenda Paper.

3. We would like to focus the discussion on the areas listed below:

   (a) 'Joint Control' instead of 'Shared decision-making'

   (b) Two types of joint arrangement ('joint operations' and 'joint ventures') instead of three ('joint operations', 'joint assets' and 'joint ventures')

   (c) Hybrids (ie two different types of joint arrangement within the same joint arrangement)

   (d) Determining the type of joint arrangement: 'rebuttable presumption' or 'open assessment'?

   (e) Participants that do not have joint control in a joint arrangement: 'investors'

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

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(f) Clarification of the accounting requirements for 'joint operations/assets'

Joint Control instead of *Shared decision-making*

4. ED 9 introduces the term 'shared decisions' and defines it as 'decisions that require the consent of all of the parties to a joint arrangement'. The term 'shared decisions' was presented as a feature of all types of joint arrangement in ED 9, while 'joint control'[1] was only referred to a specific type (ie it was only referred to 'joint ventures'). The initial intention to associate 'joint control' only to 'joint ventures' was due to the fact that the definition of 'control' in IAS 27 *Consolidated and Separate Financial Statements* referring to the 'power to govern the financial and operating policies of an entity so as to obtain benefits from its activities' was found to not translate well to an 'asset' or 'operation'. This is stated in ED9.BC17 as follows: 'control is defined in IAS 27 in the context of having power over financial and operating policies of an entity. This definition of control does not translate well to an asset or operation'.

5. The comment letter analysis presented to the Board in April 2008 stated that some respondents believed the draft standard did not place enough emphasis on 'joint control'. These respondents observed that the term had disappeared from the definition of 'joint arrangement' and that 'joint control' was no longer related to the other types of arrangement (ie it was not referred to 'joint asset' and 'joint operation'). Some respondents raised their concerns about how 'shared decision-making' was intended to operate and about the fact that both terms 'shared decisions' and 'joint control' as defined in ED 9 did not include the term 'strategic' in their definitions.

6. Some staff prefer to retain this distinction because control of an entity is different from control of an asset. It is difficult to point to IAS 27 if we treat assets and entities as being different. However, some staff think that it is confusing to introduce two terms (ie 'shared decisions' and 'joint control') with

[1] 'Joint Control' is defined in ED 9 as 'the contractually agreed sharing of the power to govern the financial and operating policies of a venture so as to obtain benefits from its activities'.

similar meaning (ie, requirement of unanimous consent for strategic decisions) depending on whether the arrangement is a 'joint operation/asset' or a 'joint venture'. They also think that there are strategic operating and financing decisions related to arrangements that are joint assets or operations such as approving the budget, designing employment contracts, approving external borrowing, etc.

7. They think that 'joint control' is a term that expresses better than 'shared decision-making' that the 'control' over the activities that are the subject of the arrangement is shared among the parties of the arrangement. The matters that give the parties 'control' over the activities of the arrangement need to be determined based on the requirements of IAS 27. Their proposal is summarised in the table below:

	ED 9	**Proposed**
Joint Arrangements	Share decision-making	Joint Control
Joint Operations / Joint Assets	Shared decisions	Joint Control
Joint Ventures	Joint Control	Joint Control
Definition of 'joint arrangements'	A contractual arrangement whereby two or more parties undertake an activity together and share decision-making relating to that activity.	Agreements that establish the terms by which two or more parties agree to undertake and jointly control an activity.
Definition of 'joint control'	The contractually agreed sharing of the power to govern the financial and operating policies of a venture so as to obtain benefits from its activities.	The agreed sharing of control by all parties to undertake an activity together.

Question 1
Does the Board agree with the proposed changes relating to replacing 'Shared decision-making' with 'Joint control' for all types of joint arrangement?

Two types of joint arrangement instead of three

8. ED 9 proposes 3 types of joint arrangement: *'joint operations', 'joint assets'* and *'joint ventures'*. These 3 different types of joint arrangement are recognised by the parties as follows:

   (a) *Joint operation / joint asset:* an entity accounts for assets, liabilities, revenues and expenses arising from the joint arrangement;

   (b) *Joint venture:* an entity accounts for an investment in the joint arrangement.

9. We think that it would be better if the Standard described two types of joint arrangement (ie, *'joint operations' and 'joint ventures'*) instead of three, as stated in ED 9 (ie, *'joint operations', 'joint assets', 'joint ventures'*), because:

   (a) In many instances, joint arrangements have elements of both types of arrangements (ie, joint assets that are jointly operated by the parties of the joint arrangement). The classification of this type of arrangements between 'joint operations' or 'joint assets' is difficult since elements from both types of arrangement are present;

   (b) 'Joint operations' and 'joint assets' are types of joint arrangement that share common features: the parties to both types of arrangements have interests in assets, liabilities, revenues and expenses. Therefore, from an accounting point of view, both arrangements result in the same accounting outcome.

10. Because of the facts mentioned above, we propose to merge 'joint operations' and 'joint assets' into a unique type of arrangement, which could receive the name of 'joint operation'.

11. This will allow aligning the number of different types of joint arrangement (ie, 'joint operation' and 'joint venture') with the two possible accounting requirements (ie, recognition of assets, liabilities, revenues and expenses or recognition of an investment in the joint arrangement).

Question 2
Does the Board agree with the proposal of having two types of joint arrangement (ie 'joint operations' and 'joint ventures') instead of three types (ie 'joint operations', 'joint assets' and 'joint ventures')?

Hybrids (ie two different types of joint arrangement within the same joint arrangement)

12. The different types of joint arrangement are defined in ED 9 as being a joint arrangement or part of a joint arrangement, as follows:

    (a) ED 9.8 states 'A *joint operation* is a joint arrangement, or part of a joint arrangement, that […]'

    (b) ED 9.15 states 'A *joint venture* is a joint arrangement, or part of a joint arrangement, that […]'

13. Although our enquiries suggest that such circumstances are rare, the Illustrative Examples in the exposure draft implied that this would be a commonly observed situation. The problem was compounded by the implication in the flowchart of Appendix B of the ED that a joint venture is 'any remaining assets and liabilities…'. In other words, any assets or liabilities not identifiable as joint assets or joint liabilities default into a joint venture.

14. It was not our intention to define a joint venture as a residual and we understand the concerns expressed by respondents. Accordingly, we are proposing that the Standard clarify that each type of arrangement would need to meet the relevant definition in its own right.

15. The advantages that we perceive are as follows:

    (a) It will improve the understanding of the accounting requirements of the final standard for joint arrangements by simplifying the concepts and

making it clear that ancillary or residual activities are not, by default, a joint venture;

(b) The final standard would still allow to have more than one type of joint arrangement related to different activities that are under the umbrella of an agreement.

Question 3
Does the Board agree with the proposals of describing the different types of joint arrangements as complete units of arrangements?

Determining the type of joint arrangement: 'rebuttable presumption' or 'open assessment'?

ED 9

16. Paragraph 18 of ED 9 introduces the term 'business' to describe 'joint ventures' as follows: 'A *business* usually involves assets and resources working together to achieve an outcome, which requires decisions of a financial and operating nature. A business that is subject to joint control is, therefore, a joint venture, unless circumstances indicate otherwise. Such circumstances would indicate that the parties have contractual rights to the assets of the business and have contractual obligations for the expenses of the business'.

17. Many respondents to the comment letters stated it is unclear why the exposure draft includes the reference of 'business' and how it is intended to be interpreted. The most common doubt that the term cast is whether 'business' in paragraph 18 of ED 9 is providing an example of a joint venture or whether an entity would only have an interest in a joint venture when that joint venture is a 'business'.

18. The term 'business' is defined in IFRS 3 *Business Combinations* as follows 'an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants'.

19. We think that a ‘business’ as defined in IFRS 3 can be found in all types of joint arrangements and that, therefore, the existence of a ‘business’ as such is not a distinctive feature of a specific type of joint arrangement.

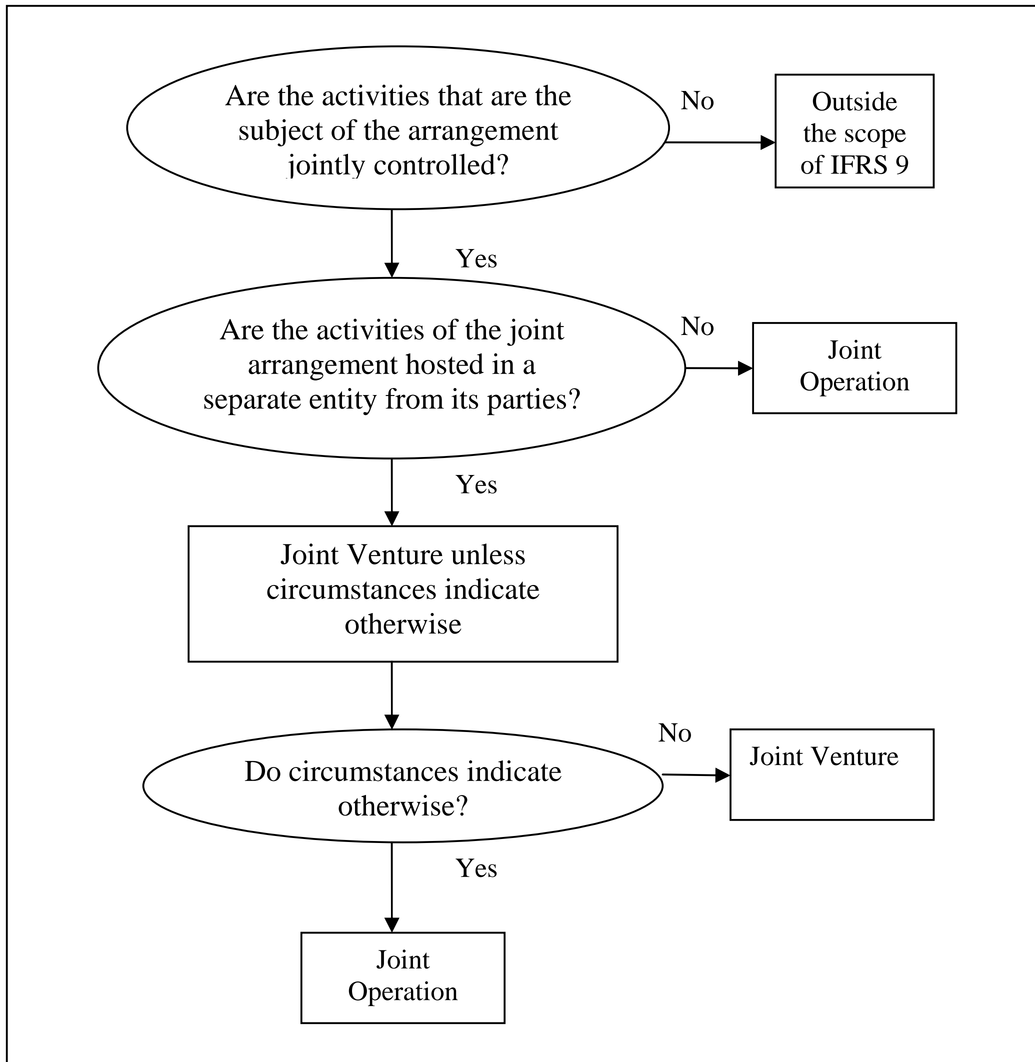
20. ED 9.17 introduces another feature when it describes joint ventures, as follows: ‘A joint venture often involves the establishment of a legal entity, such as a corporation’. Our view is that when joint arrangements are not structured through an entity (ie, joint arrangements do not involve the establishment of a structure that is separate from the parties themselves) these arrangements will be ‘joint operations’ because the needed assets and liabilities to carry out the activities are recognised in each of the financial statements of the parties.

21. The decision surrounding the classification of the joint arrangement is therefore critical and can require judgement when the arrangement is set up through an entity that is separate from the parties themselves. To carry out this decision, we foresee two possible options: to set a ‘*rebuttable presumption*’ or an ‘*open assessment*’.

22. Because any type of joint arrangements can host a ‘business’ we think that this will not be a helpful indicator to determine the classification of joint arrangements. We think that the rebuttable presumption should be related to the existence of not of a separate entity from the parties themselves, as shown in the figure below.

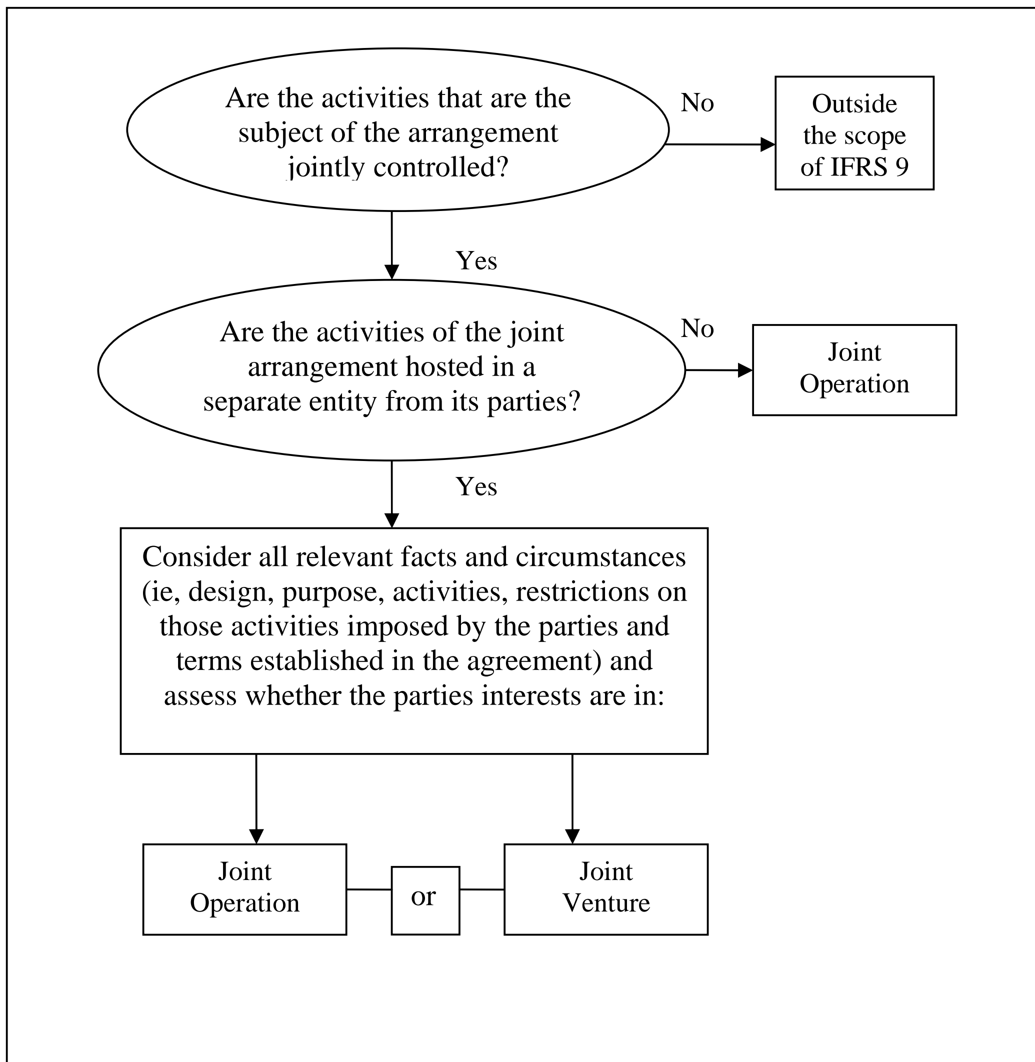
Option 1: Rebuttable presumption

23. The ‘rebuttable presumption’ option is represented in the figure below:



Option 2: Open assessment

24. The ‘open assessment’ option is represented in the figure below:



25. Both options **should** lead a party in a joint arrangement to the same conclusion relating the type of joint arrangement in which it has an interest. In both options it will be key to provide clear guidance on which are ‘the circumstances’ that could indicate the existence of a joint operation (option 1) or the ‘relevant facts and circumstances’ to be assessed in option 2.

26. The following are the ‘pros and cons’ of the two options in which the determination of the type of joint arrangement can be addressed.

Option 1 – Rebuttable presumption

Pros

27. The process surrounding the decision of the type of joint arrangement can be easier to operationalise for parties in a joint arrangement, and therefore the cost of the assessment can be lower with this option;

28. The application guidance as a result of this option would focus on providing clarity of which are the 'circumstances' that would indicate the arrangement is a joint operation which should be comparatively easier to produce than the application guidance required for option 2.

Cons

29. The rebuttable presumption option is biased towards a specific type of arrangement (ie joint ventures);

30. The rebuttable presumption can provide incentives to parties not to analyse thoroughly 'other circumstances' that could indicate the arrangement is a joint operation, especially when those arrangements are suffering losses.

Option 2 – Open assessment

Pros

31. The process surrounding the decision of the type of joint arrangement will require more effort from the parties to joint arrangements and therefore the evidence gathered to support the conclusions might be stronger;

32. The decision process is not biased toward a specific type of arrangement, the assessment is open to any possible result. It is a more 'principle based' approach.

Cons

33. The process surrounding the decision of the type of joint arrangement could be more difficult to operationalise for parties in joint arrangements;

34. The guidance will need to provide relevant 'facts and circumstances' to assist identifying both types of joint arrangements which can result to be a more

difficult exercise than just providing the 'circumstances' that would indicate the arrangement is a joint operation (option 1).

35. The staff prefers option 2. It is a more holistic approach and should ensure that conclusions are more firmly based on one direction or on the other, but it requires a more comprehensive guidance from our side and higher efforts by the parties when assessing its interests in the joint arrangements.

36. If the Board prefers option 1 (a rebuttable presumption), the staff would recommend the rebuttable presumption not to be related to the term 'business' since it is not an indicator of any specific arrangement but to be related to the existence or not of a separate entity from the parties themselves.

Question 4
Does the Board agree with the assumption that joint arrangements that are not established through a separate entity will be 'joint operations'? The staff prefers an indicator approach (open assessment) rather than a rebuttable presumption when assessing arrangements that are established in separate entities from the parties themselves. Does the Board agree with this approach?

Participants that do not have joint control in a joint arrangement: 'investors'

37. IAS 31 *Interests in Joint Ventures* defines *investors in a joint venture* as a party to a joint venture with no joint control over the joint venture. We did not carry these words into ED 9.

38. We propose to include the term *investor* in the final standard to designate participants in a joint arrangement that do not have joint control over the activities that are the subject of the joint arrangement.

39. In respect of its interest in joint arrangements:

    (a) Investors in a joint operation shall account for its share of the assets, liabilities, revenues and expenses arising from the arrangement;

    (b) Investors in a joint venture shall account its investment in accordance with IAS 39 or, if they have significant influence in the joint venture, in accordance with IAS 28.

Question 5
Does the Board agree with incorporating 'investors' in the final standard? If so, does the Board agree with the accounting proposed in the financial statements of the investors [Paragraph 39]?

Clarification of the accounting requirements for 'joint operations/assets'

40. As discussed in the comment letter analysis in April 2008, many respondents raised their concerns relating to the fact that the exposure draft lacked clarity in the articulation of the accounting requirements. Many respondents believed there is insufficient guidance in the exposure draft around the nature of the assets and liabilities that might be recognised on application of the proposals.

Rights of use

41. One of the points raised by many respondents is whether a party to a joint asset should recognise its 'rights to use'(as referred in the Illustrative Examples) or its 'right to a share'(ED 9.12) or whether it should directly recognise 'its share of the joint asset'(ED 9.22). The concern raised by this uncertainty is the different accounting implications of these two possible interpretations of the accounting requirements in the draft standard—ie rights or shares of assets. Additionally, the requirement to account for 'rights to use in accordance with applicable IFRSs' has led many respondents to enquire which would be the applicable standard in the case 'rights to use' should be the final accounting requirement.

42. In drafting ED 9 we used the term 'right of use' to illustrate that an entity could report individual assets even if the assets were hosted in an incorporated entity. We borrowed the words 'right of use' from the *Framework*, because the *Framework* acknowledges that the right of ownership is not essential for an entity to recognise an asset.[2] However, comments from respondents suggest that this concept is not clear to them.

43. Accordingly, we are proposing to remove references to 'rights to use' and simply refer to assets, liabilities, revenues and expenses arising from the arrangement.

[2] *Framework* paragraph 57

Classified 'according to the nature of the asset'

44. We propose that the Standard state that the accounting requirements for 'joint operations' shall be consistent with the requirement already stated in ED9.22, where a party shall recognise 'its share of the joint asset, classified according to the nature of the asset'. These words were carried forward from IAS 31.

45. Some comments from respondents suggested that they did not know how to apply the requirement to recognise assets, liabilities, revenues and expenses arising from joint operations. However, we think that this uncertainty was caused more by the use of the term 'right of use' than the reference to the nature of the asset. In other words, the term 'right of use' caused respondents to conclude that the nature of the asset changes to when it is part of a joint operation.

46. We think it would be helpful to give an example in the Standard clarifying that if the asset is property, plant and equipment then it would be classified as property, plant and equipment in the financial statements of the joint operator.

47. Some entities that have been accounting for jointly controlled entities will be required to account for those arrangements as joint operations. We think it would be helpful to explain that, in such cases, the accounting for their proportionate interests in each asset, liability, revenue and expense will be similar to proportionate consolidation.

Question 6
Does the Board agree with the proposed clarification of the accounting requirements for 'joint operations' [Paragraph 43-44]?

Appendix - Summary of the changes proposed

Summary of main changes to be discussed by the Board		
	Exposure Draft 9	**Proposed**
Shared decisions	Decisions that require of all of the parties to a joint arrangement.	Replaced by 'joint control'
Types of joint arrangement	ED 9 presents 3 types of joint arrangements: 'joint operations', 'joint assets' and 'joint ventures'	We propose 2 types: 'joint operations' (subsuming joint assets and joint operations) and 'joint ventures'
Hybrids	ED 9 introduces the possibility that within the same joint arrangement more than one type of joint arrangement could exist.	We propose each type of joint arrangement to be defined in its own right rather than as a residual.
Determining the type of joint arrangement	Rebuttable presumption based on the existence of a jointly controlled 'business'.	Rebuttable presumption to be based on the existence or not of a separate entity from the parties themselves. or 'Open assessment' as the preferred option to determine the type of joint arrangement.
Investors	Silent	Participants in a joint arrangement that do not have joint control over the activities that are the subject of the arrangement.
Accounting requirements for joint operations/assets	The accounting requirements are referred as to 'a right to use' (Illustrative Examples), 'right to a share' [ED9.12] or 'a share of an asset' [ED9.22]	The wording in the accounting requirements of the final standard to be consistent with ED 9.22 (ie, 'a party shall recognise its share of a joint asset classified according to the nature of the asset').