July 2011

Effect analysis

IFRS 11 *Joint Arrangements* and disclosures for joint arrangements included in IFRS 12 *Disclosure of Interests in Other Entities*

IFRS™

Effect analysis—IFRS 11 *Joint Arrangements* and disclosures for joint arrangements included in IFRS 12 *Disclosure of Interests in Other Entities*

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The IASB's approach to effect analysis

Before we issue new requirements, or make amendments to existing IFRSs, we consider the costs and benefits of the new pronouncements. This includes assessing the costs incurred by preparers of financial statements and the costs incurred by users of financial statements when information is not available. We also consider the comparative advantage that preparers gain by developing information that would otherwise cost users to develop.

One of the main objectives of developing a single set of high quality global accounting standards is to improve the allocation of capital. We therefore take into account the benefits of economic decision-making resulting from improved financial reporting.

We expect our standards to have economic effects, and we expect those effects to be beneficial for some entities and detrimental to others. For example, a change in financial reporting requirements might affect the cost of capital for individual entities by changing the absolute or relative level of information asymmetry associated with those entities.

Our evaluations of costs and benefits are necessarily qualitative, rather than quantitative. This is because quantifying costs and, particularly, benefits, is inherently difficult. Although other standard-setters undertake similar types of analysis, there is a lack of sufficiently well-established and reliable techniques for quantifying this analysis. We see this effect analysis document as being part of an evolving process. It is embedded in our standard-setting process, and we are committed to improving it as we develop new requirements.

We also assess the likely effect of new requirements, although the actual effects will not be known until after the new requirements have been applied.

We encourage academic researchers to perform empirical research into the way our standards are incorporated into economic decisions. Some studies focus on the role of accounting information in the capital markets, thereby providing us with insights into how accounting information is incorporated into share prices. Other studies focus on how changes to IFRSs affect the behaviour of parties, such as management. We expect to consider relevant research as part of our post-implementation review.

Some jurisdictions incorporating IFRSs into their legal framework require, or elect to prepare, some form of regulatory impact assessment before a new IFRS, or an amendment to an existing IFRS, is brought into law. The requirements vary between jurisdictions and, in some cases, introduce broad policy changes that have little effect on preparers and users.

It is unlikely that we could prepare an assessment that meets the needs of every jurisdiction. What we can do, however, is to provide jurisdictions with input to their processes. For example, we can document what we learned during the development of an IFRS about the likely costs of both implementing a new requirement and continuing to apply it. We gain insight on the costs and benefits of standards through our consultations, by both consultative publications (discussion papers, exposure drafts etc) and communications with interested parties (outreach activities, meetings etc).

Our expectation is that the assessment that follows will assist jurisdictions in meeting their requirements.

Summary

Joint ventures and alliances are an important form of international co-operation. However, over the last twenty years the number of international joint venture transactions worldwide has fallen from a high of around 8,000 deals in 1995 to fewer than 1,000 in 2009. This contraction in joint venture activity has been attributed mainly to the liberalisation of foreign investment regimes in various host countries, but also reportedly to 'managerial failure and frustration' with that type of arrangement.

The accounting for interests in joint ventures and alliances when they are governed through joint control was formerly covered by IAS 31 *Interests in Joint Ventures*. The accounting in that standard was driven by the structure of the arrangements and, when those were structured in an entity, IAS 31 allowed preparers to have an accounting option. About half of the preparers with an interest in a jointly controlled entity apply the equity method, with the other half applying proportionate consolidation. Such a split varies according to jurisdictions: for example, France and Spain predominantly use proportionate consolidation and Germany and the United Kingdom predominantly use the equity method. This diversity justified the project to replace IAS 31. The result was the publication of IFRS 11 *Joint Arrangements* in May 2011.

IFRS 11 establishes a principle-based approach for the accounting for joint arrangements, in which the parties recognise their rights and obligations arising from the arrangements. We believe that the recognition of rights and obligations ensures that the accounting for joint arrangements captures the economic substance of the arrangements, thereby providing consistency in the accounting and resulting in enhanced comparability of financial statements.

This report presents a comprehensive analysis of the effects of IFRS 11. This effect analysis includes our expectations of how the IFRS will affect the accounting for current and new arrangements according to their structure and legal forms. It also analyses the effects upon the financial statements of those preparers that are affected by the changes and the costs and benefits that the most significant changes introduced by the IFRS will introduce for those with the closest interest in the IFRS: preparers and users.

On the basis of the data gathered, our assessment is that IFRS 11 will not lead to a change for a large number of the arrangements within the scope of the IFRS. This is because most joint arrangement activity is dealt with through arrangements that do not involve the establishment of an entity and, as a result, parties will continue recognising assets, liabilities, revenues and expenses arising from those arrangements as they did when applying IAS 31. We expect that most of the arrangements structured through separate vehicles will be 'joint ventures'. This is because, in most cases, the separate vehicles will confer separation between the parties and the vehicles and, as a result, the assets, liabilities, revenues and expenses held in those separate vehicles will be the separate vehicles' assets, liabilities, revenues and expenses, with the parties having only an investment in the net assets of those arrangements. Parties to those arrangements will have an interest in a 'joint venture' and will account for it using the equity method.

As a result, IFRS 11 will lead to changes for those entities currently using proportionate consolidation when accounting for those arrangements, which we have estimated as being half of the entities with interests in jointly controlled entities. To a lesser extent, IFRS 11 will also lead to changes for entities with interests in those jointly controlled entities that will be classified as 'joint operations' in accordance with IFRS 11 and that are currently being accounted for using the equity method.

Our assessment is that IFRS 11 will bring significant and sustained improvements to the reporting of joint arrangements. The principles for classifying joint arrangements in IFRS 11 reflect the underlying economics of the arrangements, and the disclosure requirements in IFRS 12 *Disclosure of Interests in Other Entities* will help to provide users with better information about an entity's involvement with joint arrangements.

The most significant costs for preparers will occur at transition, when they will be required to assess the classification of their joint arrangements. They will also incur costs in explaining the changes to their reports to those who use their financial statements. However, our assessment is that the significant improvements in terms of comparability and transparency outweigh those costs.

Effect analysis

We have considered the various effects that the new requirements will have on the entities that will need to implement them (eg effects on financial statements, cost and benefits arising from the implementation of the new pronouncement and the degree of convergence that the new requirements achieve with US generally accepted accounting principles (GAAP)).

When undertaking the effect analysis of IFRS 11, our analysis has considered the following aspects:

Joint venture activity overview

(a) Joint venture activity for the period 1990-2010.

(b) Incidence of joint ventures by country.

(c) Incidence of joint ventures by industry.

(d) Joint venture structures.

Financial statement effects

(a) Accounting methods used by different jurisdictions.

(b) The effects of IFRS 11 on the accounting of current and new joint arrangements and on entities' main financial ratios.

(c) Backing up our assessments: outreach activities.

Cost-benefit analysis (CBA)

(a) Classification of the types of joint arrangement.

(b) Transition provisions.

(c) Additional disclosures.

Convergence with US GAAP

(a) Differences in the definitions of 'joint arrangement' and 'joint control'.

(b) Differences between US GAAP and IFRS 11.

Joint venture activity overview

The aim of this section is to provide a broad overview of joint venture formation activity and the main features of the joint ventures that have been established during the last two decades. We think that an understanding of general trends and features, such as the countries and industries where joint ventures have had a higher corporate demand, as well as an awareness of the most common structures used by entities when undertaking these arrangements, will help to establish the boundaries of the potential effects of the new requirements in IFRS 11.

Joint venture activity for the period 1990–2010[1, 2]

Joint ventures are an important form of inter-organisational co-operation because they allow firms 'to gain fast access to new technologies or new markets, to benefit from economies of scale in joint research and/or production, to tap into sources of know-how located outside the boundaries of the firm, and to share the risks for activities that are beyond the scope of the capabilities of a single organization'.[3]

Despite the relevance of joint ventures as 'an essential tool for managers seeking a competitive advantage through collaboration', the data available shows a decline in the use of joint ventures in recent years.[4] The number of new joint ventures has declined particularly from its peak in 1995, when there were more than 8,000 joint ventures.

1 The data used in this section of the document are from the Thomson Financial SDC Platinum Alliances/Joint Ventures database. The database's scope consists of all worldwide joint ventures transactions from filings with the SEC and its counterparts in other jurisdictions, from trade publications, news wires and other news sources. The database is updated daily, and covers the period 1988 to the present. Data relating to the period 1990–2000 was obtained from the following paper: Sviatoslav A Moskalev, R Bruce Swensen. *Joint ventures around the globe from 1990-2000: Forms, types, industries, countries and ownership patterns*. Review of Financial Economics 16 (2007), 29-67.

2 The population of joint ventures referred to in this section might not necessarily refer to arrangements that would be within the scope of IFRS 11. IFRS 11 defines joint arrangements as arrangements of which two or more parties have joint control. However, the population of joint ventures included in the database might not always be governed by means of joint control. Additionally, the database covers international joint ventures whose parties might not be applying IFRSs. As a result, the reader needs to consider that the population that IFRS 11 will potentially affect is likely to be smaller than the population referred to in this section.

3 Powell, W (1990). *Neither market not hierarchy: Network forms of organization*. Research in Organizational Behavior, vol. 12:295-336.

4 Dieter Turwoski. *The Decline and Fall of Joint Ventures: How JVs Became Unpopular and Why That Could Change*. Journal of Applied Corporate Finance, Volume 17, Number 2. A Morgan Stanley Publication, Spring 2005.

This contraction in joint ventures activity has mainly been attributed to the liberalisation of foreign investment regimes in various host countries, but other authors also attribute the decrease to 'managerial failure and frustration', rather than to changes in the external environment.[1, 4] The sharp decline in joint venture activity in the last couple of years is most likely related to the effect of the global financial crisis on corporate combinations (see Chart I).

Incidence of joint ventures by country

In relation to the geographical presence of joint ventures, ten countries account for 66.1 per cent of all worldwide joint venture transactions.
The United States and China represent 37.1 per cent and 7.1 per cent, respectively, of the joint venture activity in the period 1990-2010 (see Table I).

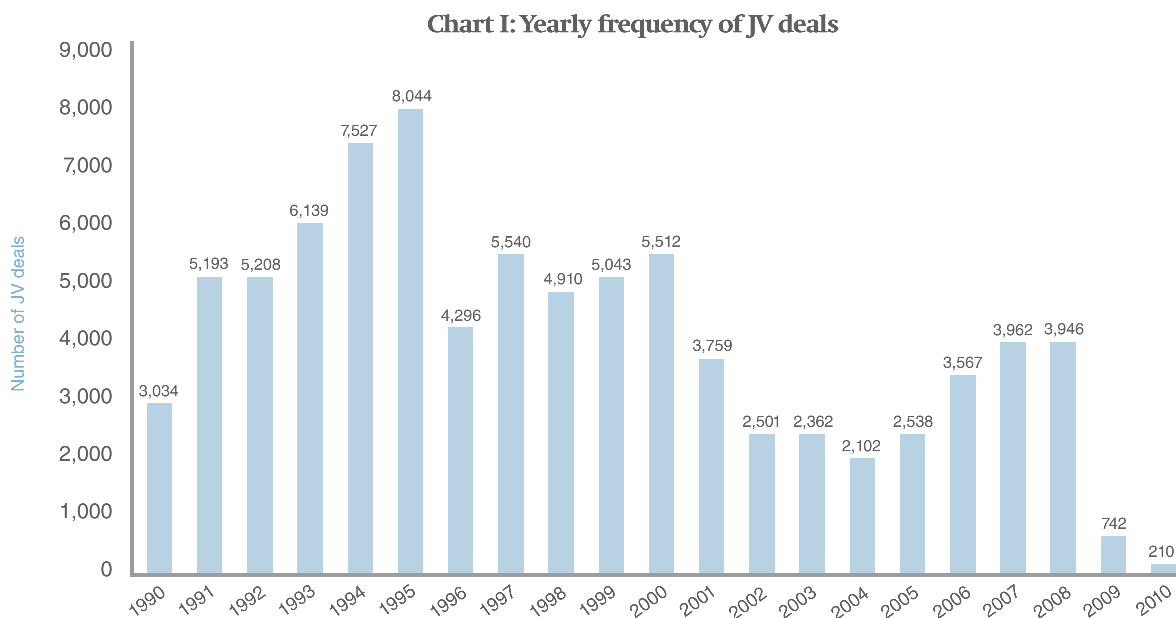


Table I: JV deals by country (1990–2010)

Country	JV deals	Relative relevance
United States	31,952	37.10%
China	6,078	7.05%
Japan	4,840	5.62%
United Kingdom	3,112	3.61%
Canada	2,610	3.03%
Australia	2,477	2.88%
India	2,093	2.43%
Germany	1,541	1.79%
Malaysia	1,303	1.51%
Russian Federation	914	1.06%
Others	29,215	33.92%
Total number of JV deals	**86,135**	**100.00%**

Incidence of joint ventures by industry

Based on the data for the period 1990–2010, joint ventures are also concentrated in a relatively small number of industries. The ten main industries account for 57.5 per cent of all joint venture transactions for the period 1990–2010. The main ten industries and their relative relevance in terms of joint venture deals during the period 1990–2010 are shown in Table II.[5, 6]

Table II: JV deals by industry (1990–2010)

Industry	JV deals	Relative relevance
Business services	17,610	20.45%
Software	6,718	7.80%
Wholesale trade: durable goods	5,840	6.78%
Investment and commodity firms	4,980	5.78%
Electronic	3,321	3.86%
Telecommunications	2,545	2.95%
Wholesale trade: non-durable goods	2,300	2.67%
Mining	2,297	2.67%
Oil and gas	2,166	2.51%
Real estate	1,781	2.07%
Others	36,577	42.46%
Total number of JV deals	**86,135**	**100.00%**

5 'Business Services' is a broad industry category that entails: Adjustment and collection services; Credit reporting services; Direct mail advertising services; Photocopying and duplicating services; Commercial photography; Commercial art and graphic design; Secretarial and court reporting services; Disinfecting and pest control devices; Building cleaning and maintenance services; Medical equipment rental and leasing; Heavy construction equipment rental and leasing; Equipment rental and leasing; Employment agencies; Help supply services; Personnel supply services; Computer programming services; Computer integrated systems design; Data processing services; Information retrieval services; Computer facilities management services; Computer rental and leasing; Computer maintenance and repair; Computer related services; Detective, guard, and armoured car services; Security systems services; News syndicates; Photo-finishing laboratories; Business services; Engineering services; Architectural services; Surveying services; Accounting, auditing, and bookkeeping services; Commercial physical and biological research; Commercial non-physical research; Non-commercial research organisations; Testing laboratories; Management services; Management consulting services; Public relations services; Facilities support management services; Business consulting services.

6 The industry category 'Investment and commodity firms' entails: Management investment offices, open-end; Educational, religious, and charitable trusts; Trusts, excluding educational, religious, and charitable; Oil royalty traders; Patent owners and lessors; Investors; Security brokers, dealers, and flotation companies; Commodity contracts brokers and dealers; Security and commodity exchanges; Investment advice; Security and commodity services; Investment offices; Special purpose finance company; Real estate investment trusts.

Joint venture structures

Joint ventures can be established using different structures. Depending upon the form, the Joint Ventures database (see footnote 1) classifies joint ventures as 'strategic alliances' and 'independent firms'. The database defines a strategic alliance as 'a cooperative business activity, formed by two or more separate organizations for strategic purpose(s), which does not create an independent business entity, but allocates ownership, operational responsibilities, and financial risks and rewards to each member, while preserving each member's separate identity/autonomy'.

Joint venture deals formed as independent firms are defined as 'a cooperative business activity, formed by two or more separate organizations for strategic purpose(s), which creates an independent business entity, and allocates ownership, operational responsibilities, and financial risks and rewards to each member, while preserving each member's separate identity/autonomy. The new entity can either be newly formed or the combination of pre-existing units and/or divisions of the members. Even if the members' stake in the new entity varies, the members are all considered owners/parents of the new entity. Also, the strategic purpose(s) of the new entity may or may not be the same as the individual members' strategic business purpose(s)'.

The data indicates that most of the joint ventures formed during 1990-2010 took the form of strategic alliances (63.4 per cent) (see Table III). Even though the predominance of strategic alliances as the most frequent form for joint ventures also holds when joint venture deals are analysed by country or by industry, the predominance of a specific form changes slightly for specific countries or specific industries (see Charts II and III).

Table III: JV deals by form (1990–2010)

	Strategic alliances	Independent firms	**Total**
Total number of JV deals	54,567	31,568	86,135
Relative relevance	63.4%	36.6%	100.0%

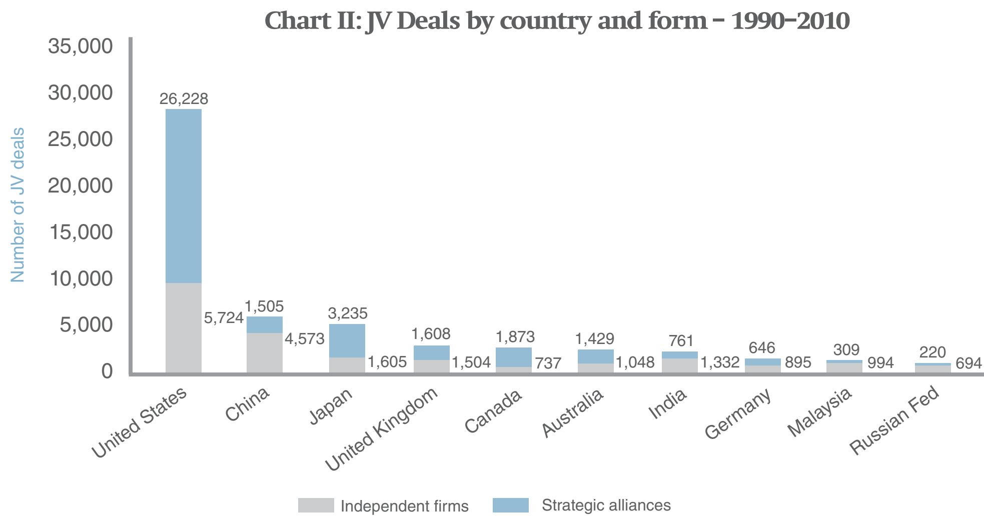


Chart II: JV Deals by country and form – 1990–2010

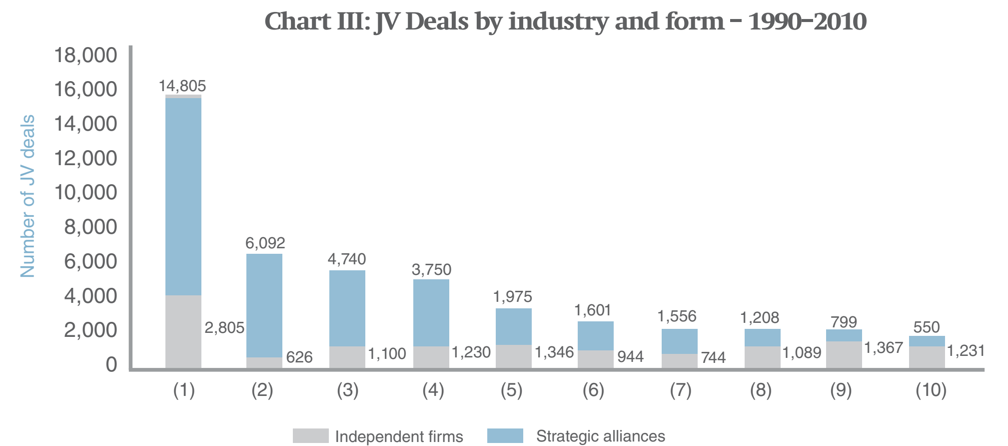


Chart III: JV Deals by industry and form – 1990–2010

Industries:

(1) Business services
(2) Software
(3) Wholesale trade: durable goods
(4) Investment and commodity firms
(5) Electronic
(6) Telecommunications
(7) Wholesale trade: non-durable goods
(8) Mining
(9) Oil and gas
(10) Real estate

Based on the data available, we observe that:

(a) Joint ventures structured through strategic alliances represent the majority of arrangements in countries such as United States, Japan, Canada and Australia. This contrasts with the predominance of joint ventures structured through independent firms in countries such as China, India, Malaysia and the Russian Federation (see Table IV).

(b) In eight out of the ten main industries in terms of joint venture activity, there is a predominance of joint ventures structured through strategic alliances. Oil and gas and real estate are the only two industries in which there is a clear predominance of joint ventures structured through independent firms (see Table V).

Table IV: JV deals by country and form

Country	Strategic alliances	Independent firms	Total
United States	26,228 82.1%	5,724 17.9%	31,952 100%
China	1,505 24.8%	4,573 75.2%	6,078 100.0%
Japan	3,235 66.8%	1,605 33.2%	4,840 100.0%
United Kingdom	1,608 51.7%	1,504 48.3%	3,112 100.0%
Canada	1,873 71.8%	737 28.2%	2,610 100.0%
Australia	1,429 57.7%	1,048 42.3%	2,477 100.0%
India	761 36.4%	1,332 63.6%	2,093 100.0%
Germany	646 41.9%	895 58.1%	1,541 100.0%
Malaysia	309 23.7%	994 76.3%	1,303 100.0%
Russian Federation	220 24.1%	694 75.9%	914 100.0%
Supranational	10,139 93.3%	732 6.7%	10,871 100.0%
Others	6,614 36.1%	11,730 63.9%	18,344 100.0%
Total number of JV deals	**54,567 63.4%**	**31,568 36.6%**	**86,135 100.0%**

Table V: JV deals by industry and form			
Industry	**Strategic alliances**	**Independent firms**	**Total**
Business services	14,805 84.1%	2,805 15.9%	17,610 100%
Software	6,092 90.7%	626 9.3%	6,718 100.0%
Wholesale trade: durable goods	4,740 81.2%	1,100 18.8%	5,840 100.0%
Investment and commodity firms	3,750 75.3%	1,230 24.7%	4,980 100.0%
Electronic	1,975 59.5%	1,346 40.5%	3,321 100.0%
Telecommunications	1,601 62.9%	944 37.1%	2,545 100.0%
Wholesale trade: non-durable goods	1,556 67.7%	744 32.3%	2,300 100.0%
Mining	1,208 52.6%	1,089 47.4%	2,297 100.0%
Oil and gas	799 36.9%	1,367 63.1%	2,166 100.0%
Real estate	550 30.9%	1,231 69.1%	1,781 100.0%
Others	17,491 47.8%	19,086 52.2%	36,577 100.0%
Total number of JV deals	**54,567** **63.4%**	**31,568** **36.6%**	**86,135** **100.0%**

Financial statement effects

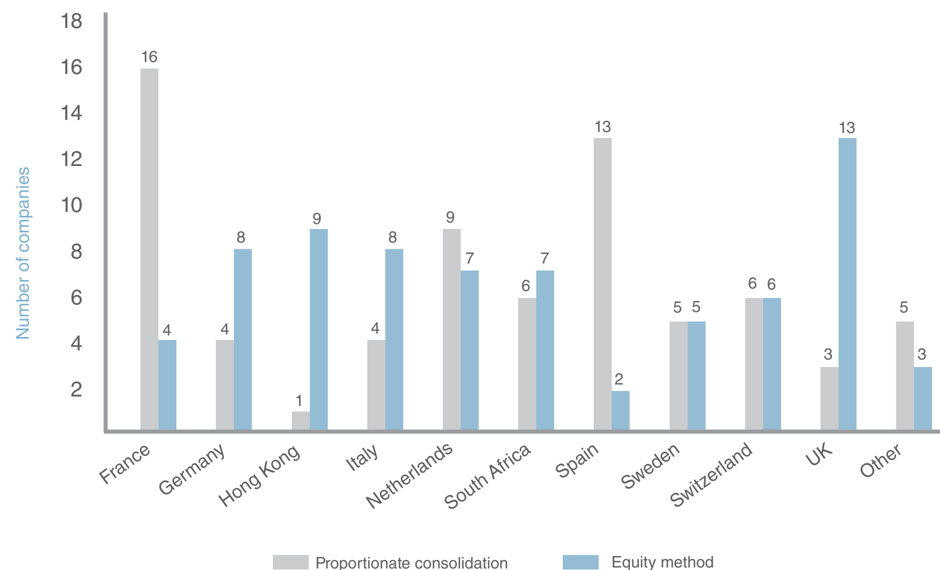
Accounting methods used by different jurisdictions

IAS 31 *Interests in Joint Ventures* permitted entities to account for their interests in jointly controlled entities by using either proportionate consolidation or the equity method.

The use of proportionate consolidation or equity method varies across jurisdictions. In many cases, it has been observed that, on adoption of IFRSs in 2005, a company's country of domicile, and its previous national accounting standards, appeared to have the greatest influence on the choices that companies made. With the exception of financial institutions, cross-border industry consistency lags as a secondary influence at best. In a survey of the first IFRS consolidated financial statements for annual periods ending on or before 31 December 2005, of the 199 companies selected, 144 included jointly controlled entities in their consolidated financial statements. The ratio expressing the use of proportionate consolidation versus the equity method was exactly 50:50.[7]

By countries and industries, the landscape is displayed in Charts IV and V.[8]

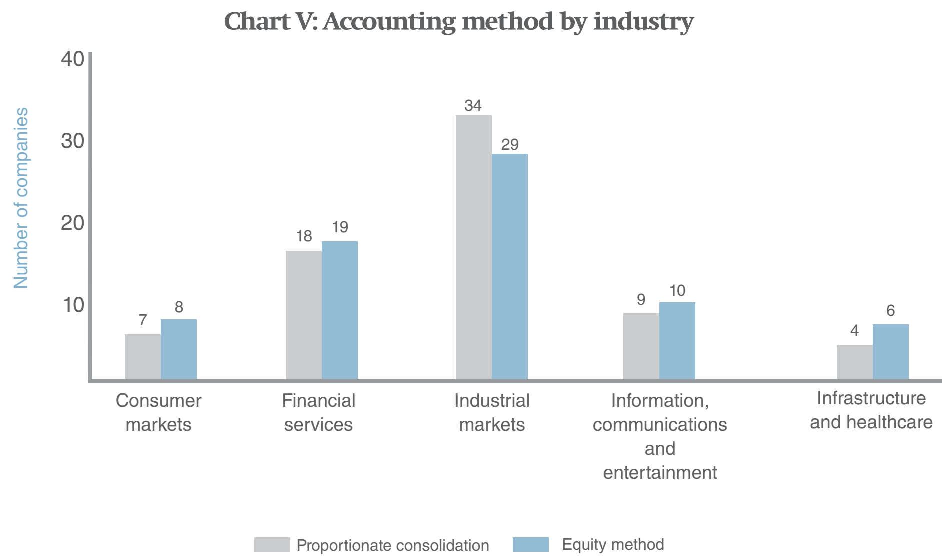
Chart IV: Accounting method by country



7 KPMG IFRG Limited and Dr Isabel von Keitz. *The Application of IFRS: Choices in Practice* – December 2006.

8 Countries in which companies had not yet prepared their first IFRS consolidated financial statements for an annual period ending on or before 31 December 2005, such as Australia, were excluded from the survey. 'Other' countries in Chart IV include Austria, Belgium, Demark, Finland, Luxembourg and Norway.

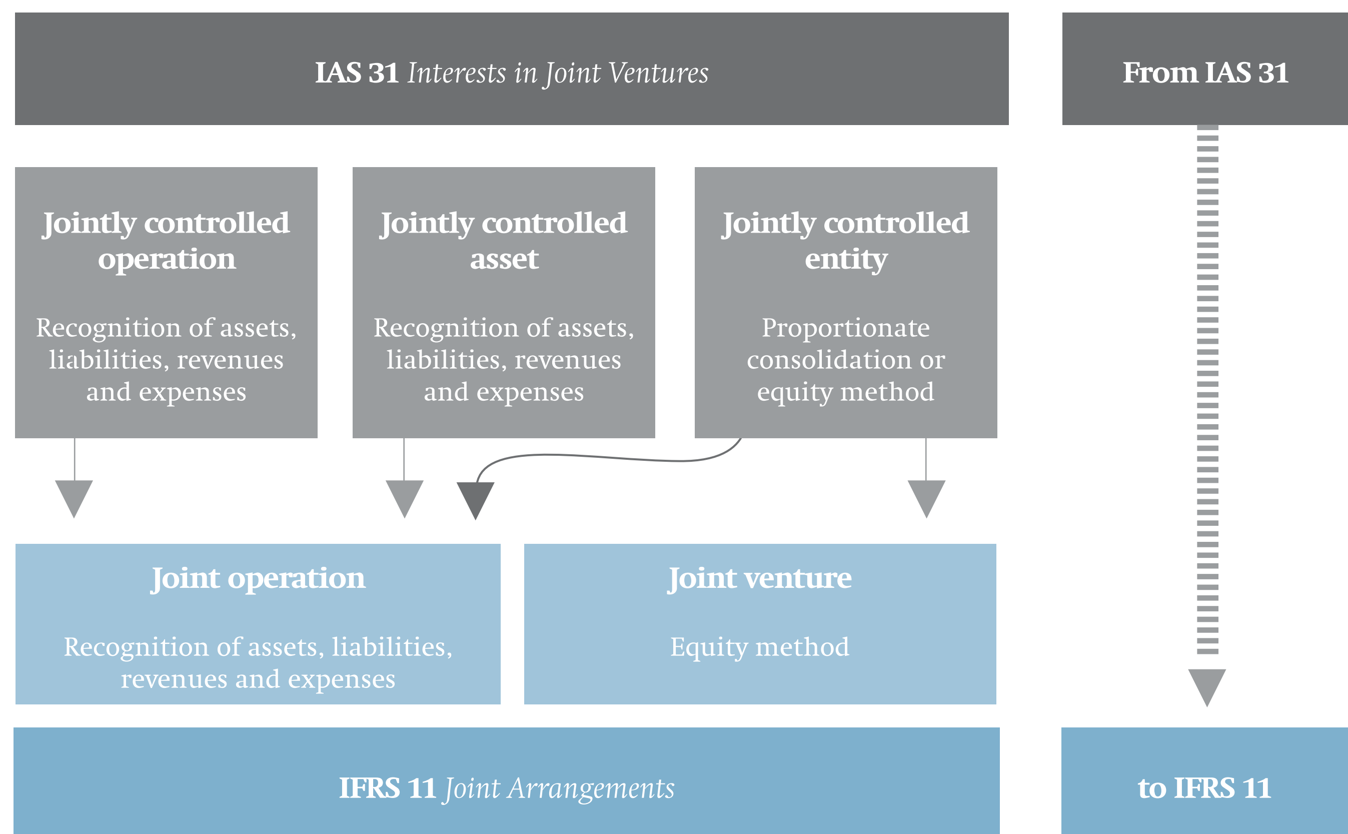
Chart V: Accounting method by industry



The effects of IFRS 11 on the accounting of current and new joint arrangements and on entities' main financial ratios

Figure I illustrates the changes that IFRS 11 will introduce in the accounting for joint arrangements, depending on the type of arrangement that they were in accordance with IAS 31 and the type of arrangement that they will be in accordance with IFRS 11.

Figure I: From IAS 31 to IFRS 11



As shown in Figure I, IFRS 11 might only represent a change in the accounting for those arrangements that were classified in IAS 31 as 'jointly controlled entities'. The significance of the change will mainly depend upon the accounting method used by entities when accounting for its 'jointly controlled entities' in accordance with IAS 31 and on the classification of those arrangements in accordance with IFRS 11 (ie 'joint operations' or 'joint ventures').

We expect that most 'jointly controlled entities' in IAS 31 will be 'joint ventures' in accordance with IFRS 11. This is because we expect that, in most cases, if the arrangement is structured in a separate vehicle that can be considered in its own right, neither the terms of the contractual arrangement nor the consideration of other facts and circumstances will reverse the rights and obligations that the legal form of the separate vehicle confers on the parties.[9] However, the contractual arrangement between the parties and, when relevant, other facts and circumstances, might establish that the parties have rights to the assets and obligations for the liabilities held in the separate vehicle in which the arrangement has been structured. In this case the former 'jointly controlled entity' in IAS 31 could be a 'joint operation' in accordance with IFRS 11.

Consequently, the most fundamental change, which might potentially affect a larger number of arrangements, consists of those 'jointly controlled entities' that were proportionately consolidated in IAS 31 that will now be 'joint ventures' and, in accordance with IFRS 11, will be accounted for using the equity method. The following paragraphs assess the population of arrangements that will be affected by this particular accounting change as well as the extension of that accounting change to the financial statements of the parties to these arrangements.

On the basis of the Joint Ventures database (see footnote 1), approximately 37 per cent of the total number of joint venture deals in the last two decades were structured through independent firms. Assuming that that population of joint venture deals coincided with the population of arrangements within the scope of IAS 31, this would mean that only 37 per cent of all joint arrangements in IAS 31 were 'jointly controlled entities'. When combining this information with the information from the survey (see page 16), half of the 'jointly controlled entities' were proportionately consolidated in accordance with IAS 31. This data is reflected in Figure II.

9 IFRS 11 defines a separate vehicle as a separately identifiable financial structure, including separate legal entities or entities recognised by statute, regardless of whether those entities have a legal personality.

As mentioned previously, we expect that when arrangements are structured in separate vehicles that can be considered in their own right, the consideration of the terms of the contractual arrangements and other facts and circumstances will, in most cases, be aligned with the initial conclusion on the type of joint arrangement arising from the assessment of the legal form of the separate vehicle in which those arrangements were established. Consequently, we expect that the majority of the jointly controlled entities that were proportionately consolidated will change their accounting to the equity method because these arrangements will more likely be 'joint ventures'. This estimate might vary significantly when specific industries and jurisdictions are assessed.

Despite the statements above, the requirements of IFRS 11 might, to a lesser extent, also lead to accounting changes for 'jointly controlled entities' that were accounted for using the equity method in accordance with IAS 31 and will be 'joint operations' in accordance with IFRS 11.

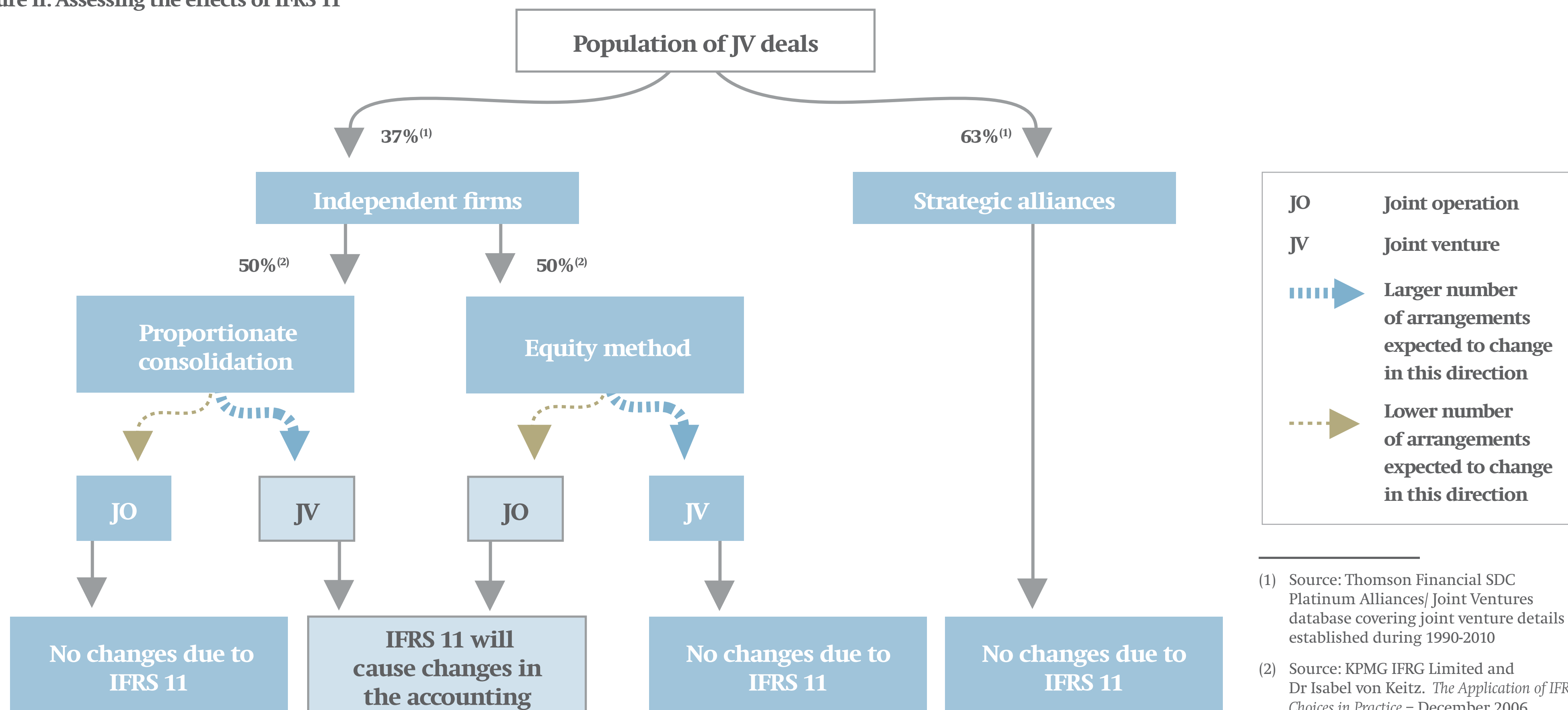
We expect that fewer 'jointly controlled entities' in IAS 31 will be classified as 'joint operations' in IFRS 11. This is because when arrangements are structured in separate vehicles that convey separation between the parties and the separate vehicles (ie the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties) there are only two ways in which those arrangements can be 'joint operations'. The first way is when the parties have been able to reverse or modify the rights and obligations conferred by the legal form of the separate vehicles through their contractual arrangements (which we do not expect to happen very often). The second way is when the arrangements are designed to undertake an activity that is primarily aimed to provide the parties with an output that the parties have committed themselves to purchase at a price that covers the liabilities incurred by the arrangements when producing that output.

As a result we consider that arrangements that are structured through separate vehicles that confer separation between the parties and the separate vehicles will become 'joint operations' in IFRS 11 only in a very limited number of situations.

Our assessment is that the majority of such arrangements will most probably be arrangements in capital-intensive industries. We identified arrangements in the oil and gas, pharmaceutical and automotive industries that will probably change from the equity method to the accounting for assets and liabilities. We also observed that the preparers affected by those changes are either preparers in jurisdictions where the equity method is the predominant method for accounting for jointly controlled entities or preparers that, although they are located in jurisdictions where the predominant method for accounting is proportionate consolidation, had previously prepared their financial statements under US GAAP before applying IFRSs.

As a result, the most affected sub-group will be the majority of arrangements that are structured through separate vehicles and that are currently being proportionately consolidated but will be classified as 'joint ventures' by IFRS 11.

Figure II: Assessing the effects of IFRS 11



(1) Source: Thomson Financial SDC Platinum Alliances/ Joint Ventures database covering joint venture details established during 1990-2010

(2) Source: KPMG IFRG Limited and Dr Isabel von Keitz. *The Application of IFRS Choices in Practice* – December 2006

Tables VI and VII show the effects on financial statements and on return on capital and its components for entities changing from proportionate consolidation to the equity method, which, as mentioned previously, we have identified as being the sub-group of arrangements most affected by the issue of IFRS 11. On the basis of the information displayed in Tables VI and VII, and excluding those items where no changes are expected from the accounting change, the reversed effects are generally expected for those arrangements changing from the equity method to the accounting for assets and liabilities.

It is worth noting that analysts do not expect these accounting changes to cause share prices to move for those entities with interests in joint arrangements.[10]

Table VI: Effects on financial statements of entities changing from proportionate consolidation to the equity method

Financial statements	Effects due to the accounting change
Statement of financial position	• Reported figures will decline to the extent of the entity's previously recognised share in the individual assets and liabilities of the joint venture and therefore total assets and total liabilities will decrease. • The investment in the joint venture will be captured in a single line item.
Statement of comprehensive income	• Reported figures will decline to the extent of the entity's previously recognised share revenue and expenses of the joint venture and therefore total revenue and total expenses will decrease. • No changes in net income.
Statement of changes in equity	• No changes in the statement of changes in equity.
Statement of cash flows	• Reported operating, investing and financing cash flow figures will decline to the extent of the entity's previously recognised share in the cash flows of the joint venture. • Dividends received from joint ventures will be presented as cash flows.

10 UBS Investment Research. Valuation and Accounting Footnotes. Global Equity Research, 24 March 2010.

Table VII shows the effect of the accounting change (ie from proportionate consolidation to the equity method) on return on capital and its components (ie profitability, assets turnover and financial leverage).

Table VII: Effect of the accounting change on return on capital and its components

Ratios	Effects due to the accounting change
Return on capital (eg Net income/Shareholders' equity)	• The accounting change will not affect this ratio.
Profitability (eg Net income/Revenue)	• The removal of the proportionate share of revenue will cause profitability to increase.
Total assets turnover (eg Revenue/Assets)	• The accounting change will cause reported revenue and total assets to be smaller. The final effect on this ratio will depend upon the absolute and relative changes of revenue and assets.
Financial leverage (eg Net debt/Capital employed, Debt/Shareholders' equity)	• The removal of the entities' proportionate share of debt will cause the leverage ratio to be smaller.

We have also analysed the effect of the requirements on a sample of the respondents to the exposure draft ED 9 *Joint Arrangements*, assuming their currently proportionate consolidated jointly controlled entities will be 'joint ventures' in accordance to IFRS 11. The sample was determined as follows: we classified all respondents to ED 9 according to the industries to which they belonged. On the basis of this initial classification, we selected all respondents belonging to industries from which the number of comment letters received was two or more.[11]

Table VIII summarises our findings. The industries in which the number of respondents was two or more were: banking, energy[12], telecommunications, industrial engineering and food and beverages. The total number of respondents belonging to those industries was thirty, which approximately represented 27 per cent of all the comment letters received on ED 9. Nineteen out of the thirty respondents used proportionate consolidation.

For the respondents that used proportionate consolidation, Table VIII shows the relevance of the assets and the revenues relating to their interests in jointly controlled entities out of the total consolidated assets and total consolidated revenues, as of the latest consolidated financial statements publicly available. The table also shows the effect on profitability (measured by the basis points increase in the net income to revenues ratio) that the removal of proportionate consolidation would have in the financial statements of those respondents if their interests in jointly controlled entities were 'joint ventures' in accordance with IFRS 11. Please note that Table VIII shows the extreme cases (ie respondents in the sample for which the elimination of proportionate consolidation would have the minimum and maximum effects for each of the aspects analysed) and the median of all cases.

Caveat:

This analysis focuses on the financial statements of those entities that commented on the proposals. Entities are more likely to have responded if they believe that their financial reporting will be affected and, therefore, the data displayed in Table VIII is **not** representative of all entities.[13] Additionally, this analysis assumes that all proportionate consolidated jointly controlled entities will be 'joint ventures' in accordance with IFRS 11. As a result, this analysis is likely to significantly **overstate** the average effect of IFRS 11.

11 The selection excluded respondents that were individuals, regulators, representative bodies, accounting firms and users.

12 Energy includes entities carrying out the following activities: oil and gas exploration and production, mining, electricity generation and distribution or a combination of both.

13 For example, based on the UBS Valuation and Accounting Footnotes' report dated 24 March 2010, the effect on the EBITDA margin resulting from the change from proportionate consolidation to the equity method for companies in the telecommunications industry is expected to be an increase of between 100 to 400 basis points. This is significantly less than the 980-basis-point increase as a result of the accounting change in the net income to revenues ratio for the respondent in the telecommunications industry analysed in Table VIII.

Table VIII: Effects of IFRS 11 on a sample of respondents to ED 9 *Joint Arrangements*											
Industry	**Number of respondents to ED 9**	**Respondents that use proportionate consolidation**	**Jointly controlled entities' assets/consolidated assets**			**Jointly controlled entities' revenues/consolidated revenues**			**Profitability increase as an eliminating proportionate consolidation (basis points)***		
			Min	**Median**	**Max**	**Min**	**Median**	**Max**	**Min**	**Median**	**Max**
Banking**	9	3		3.9%			14.3%			98	
Energy	14	11	2.0%	10.9%	26.3%	2.8%	15.8%	35.5%	50	190	400
Telecommunications	3	1		13.7%			28.1%			980	
Industrial engineering	2	2	8.6%	9.1%	9.6%	7.6%	11.6%	15.5%	30	39	50
Food and beverages	2	2	1.7%	2.0%	2.3%	2.6%	2.9%	3.1%	20	56	90
Total	**30**	**19**									

The main observations from Table VIII are as follows:

Energy industry: this is the industry where the 'maximum' ratios in terms of assets and revenues from the respondents' interests in jointly controlled entities compared to total consolidated assets and revenues are the largest. We have observed that the extreme cases are where a significant part of the respondents' businesses are carried out through joint arrangements (a few joint arrangements that are individually material or many joint arrangements that are material in aggregate).

Telecommunications industry: the respondent that uses proportionate consolidation has some significant joint ventures, especially in terms of total consolidated revenues. The elimination of proportionate consolidation in this case would result in an increase in profitability (980 basis points).

* Profitability is measured by the basis points increase in the net income to revenues ratio.

** Only one of the three respondents using proportionate consolidation prepared consolidated financial statements with enough information to perform the analysis shown in Table VIII.

Backing up our assessments: outreach activities

Our outreach activities after the comment period allowed us to develop and provide further guidance in the final version of IFRS 11, test that the principles and requirements introduced by the IFRS are enforceable, give consistent conclusions regarding the classification of joint arrangements and assess that the effects of any changes brought by the new requirements are appropriate.

The outreach activities also provided us access to contractual information or documentation supporting real arrangements from a variety of industries and geographical locations. The paragraphs below summarise what we have learnt with the aim of both illustrating those elements of the analysis we considered in order to determine the types of arrangements and to support our assessments relating to the effects of the changes brought about by the IFRS. We have structured the following paragraphs by the industries to which the different constituents contacted belonged.

Banking

We received a wide range of examples from the banking industry. The first category of examples comprised special purpose vehicles, with decisions and activities substantially predefined and determined in contractual agreements that all parties sign up to. When analysing these examples we concluded that, from the fact patterns received, it was not obvious that those arrangements were within the scope of IFRS 11 (ie it was not obvious that those arrangements were joint arrangements). These examples needed to be examined by first taking into consideration the guidance on assessing control in IFRS 10 *Consolidated Financial Statements*. The examples required special care to identify the relevant activities undertaken in those special purpose vehicles and the nature of the parties' decisions-making rights about the relevant activities (ie whether parties had protective rights or whether parties had rights that gave them power).

Our assesment was that those arrangements were more likely to be within the scope of IFRS 10 as it was not evident that all parties involved shared control and that all decisions about the relevant activities required the unanimous consent of the parties sharing control.

The second category of examples comprised the establishment of legal entities by two or more parties in order to undertake financial services jointly. We based one of the illustrative examples accompanying IFRS 11 (illustrative example 4) on a real case. This type of arrangement is frequently structured through incorporated legal entities and, as such, using the terminology of IFRS 11, through 'separate vehicles' that can be considered in their own right. The parties to these arrangements have neither rights to the assets nor obligations for the liabilities held in the separate vehicle. The parties have rights to the net assets of the arrangements.

As a result, the parties are parties to 'joint ventures' and account for their interest using the equity method. In many of those arrangements the parties are required to commit themselves to providing the necessary funds to ensure fulfilment by the arrangement of banking regulations. This commitment does not in itself determine that the parties have an obligation for the liabilities of the arrangement.

Energy

Joint arrangements are common arrangements in this industry and we received a wide range of examples. When undertaking the outreach activities we observed that a significant number of arrangements in this industry are not structured through separate vehicles. IAS 31 classifies these arrangements as either jointly controlled operations or jointly controlled assets. These arrangements will be classified as 'joint operations' in accordance with IFRS 11 and their accounting will remain unchanged.

We expect that the majority of arrangements structured in separate vehicles that can be considered in their own right will be classified as 'joint ventures' in accordance with IFRS 11. A survey conducted by KPMG of the IFRS financial statements of 33 companies in the oil and gas sector across 14 countries found that just over half of the companies accounted for jointly controlled entities using the equity method, with the remainder applying proportionate consolidation.[14] This might initially indicate that for over half of those companies the new requirements in IFRS 11 might not cause any change if those arrangements are classified as 'joint ventures' in accordance with IFRS 11.

However, energy is one of the industries where we found more examples of arrangements structured in separate vehicles that can be considered in their own right that will, however, be classified as 'joint operations'. We based one of the illustrative examples accompanying IFRS 11 (illustrative example 5) and an application example (example 5 of the application guidance) on real cases in the energy industry, where arrangements structured in separate vehicles are classified as 'joint operations', either because the contractual terms agreed by the parties reversed the features of the legal form of the separate vehicle or because the consideration of other facts and circumstances led to the conclusion that parties had rights to the assets, and obligations for the liabilities, arising from the arrangement.

14 KPMG IFRG Limited. *The Application of IFRS: Oil and Gas*. October 2008.

Construction

We have seen examples where parties establish joint arrangements to undertake construction works by using different structures and a wide range of legal forms when those arrangements are structured through separate vehicles. Even though operationally the activities undertaken through those arrangements might be identical or very similar, the parties' rights and obligations will be, in most of the cases, determined by the features of the legal form of the separate vehicles through which those arrangements have been established as well as by the consideration of the contractual terms agreed to by the parties.

The use of specific structures or specific legal forms to undertake joint arrangements in the construction industry varies among jurisdictions. In some jurisdictions joint arrangements in the construction industry are undertaken through separate vehicles that cannot be considered in their own right. In those cases, the arrangements will be classified as 'joint operations' in accordance with IFRS 11.

We based one of the illustrative examples accompanying IFRS 11 (illustrative example 1) on a real case in the construction industry where the arrangement had been structured through a separate vehicle that could not be considered in its own right. As a result, the parties were the ones that had rights to the assets, and obligations for the liabilities, held in the separate vehicle. This arrangement was classified as a 'joint operation' in accordance with IFRS 11.

In some other cases, however, arrangements that deal with similar construction activities might be established through separate vehicles that can be considered in their own right. In those cases, it is the separate vehicle, and not the parties, that has rights to the assets and obligations for the liabilities. As a result, those arrangements will be 'joint ventures' in accordance with IFRS 11.

Other industries

We received examples of arrangements in a wide range of other industries such as pharmaceuticals, automotive, advertising, food and beverage, real estate, concession services and conglomerates.

In the examples analysed in those industries, the arrangements were established through separate vehicles that could be considered in their own right. The terms agreed by the parties did not reverse the features of the legal form of those separate vehicles and in the majority of those arrangements there were no other facts and circumstances that were relevant to conclude the parties to those arrangements had rights to the assets, and obligations for the liabilities, arising from those arrangements.

As a result, we would expect that a higher number of arrangements in those industries structured through separate vehicles will be classified as 'joint ventures'. We based one of the illustrative examples accompanying IFRS 11 (illustrative example 2) on a real case in the real estate industry where the arrangement had been structured through a separate vehicle that could be considered in its own right and, as a result, the separate vehicle, and not the parties, was the one that had rights to the assets and obligations for the liabilities, arising from the arrangement. The arrangement was classified as a 'joint venture' in accordance with IFRS 11.

Cost-benefit analysis (CBA)

The implementation of IFRS 11 will result in costs and benefits for those most closely affected (ie preparers and users). We have analysed where the costs and benefits of the main changes introduced by IFRS 11 are expected to be the most significant. We have also identified the costs and benefits relating to those changes from the preparers' and users' points of view. The analysis of those costs and benefits supports our conclusion on the final net effect of the particular change introduced by IFRS 11 being analysed.

The analyses in this section also support our assessment of the overall net effect of the costs and benefits relating to the implementation of IFRS 11 as a whole.

We have identified the following areas as being those that will represent the highest costs and benefits for those most closely affected:

(a) Classification of the types of joint arrangement.

(b) Transition provisions: from proportionate consolidation to the equity method or from the equity method to accounting for assets and liabilities.

(c) Additional disclosures.

The tables below show the main changes introduced by IFRS 11 and their related costs and benefits, as well as the nature of those costs and benefits for each of the areas mentioned. The nature of the costs and benefits aims to portray whether they occur at a single point in time or whether they are recurrent over the life of the IFRS. Lastly, with the help of a matrix we assess the final net effect in terms of costs and benefits for each area. The matrix summarises our conclusions on whether the costs and benefits identified are high, medium or low and helps to show whether benefits outweigh costs (ie the final net effect) in the areas under consideration.

Classification of the types of joint arrangement

IFRS 11 requires an entity to determine the type of joint arrangement in which it is involved (ie a 'joint operation' or a 'joint venture') by considering the structure of the arrangement and, when it is structured through a separate vehicle, the legal form of the separate vehicle, the terms of the contractual arrangements and, when relevant, other facts and circumstances. IAS 31 did not require an entity to assess the type of joint arrangement in which it was involved, because the classification of the arrangements was determined only by consideration of their structure.

Preparers		
Costs	**Nature of the costs**	**Analysis**
Education and training costs	These costs will be one-off because they will be incurred only on implementation of the IFRS.	Preparers will incur training and education costs to ensure appropriate implementation of the requirements.
Higher preparation costs due to the need for analysis of the arrangements	In most cases, these costs will be one-off (ie incurred on transition only and whenever new joint arrangements are established). Only when facts and circumstances change will an entity have to reassess the type of joint arrangement in which it is involved.	Preparers are likely to have higher preparation costs because IAS 31 does not require carrying out an assessment of the parties' rights and obligations to determine the classification of the arrangements. This assessment may require entities to exercise judgement. However, in most cases this assessment should be straightforward. Please note that such an assessment would be required only when the parties have structured their joint arrangements through a separate vehicle.
Actions taken to mitigate the costs	As it is the case whenever a new IFRS is issued, we are aware that implementing IFRS 11 would cause entities to incur educational and training costs, as well as costs to perform the assessment for the classification of the joint arrangements, which was not required by IAS 31. To lessen the costs of implementing IFRS 11, we have developed extensive application guidance and illustrative examples to help entities to apply the requirements.	

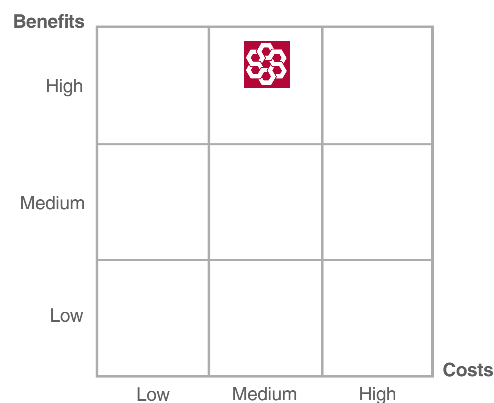
<table>
<tr><th colspan="3">Preparers (continued)</th></tr>
<tr><th>Benefits</th><th>Nature of the benefits</th><th>Analysis</th></tr>
<tr><td>Preparers will gain higher awareness of their rights and obligations arising from the arrangements</td><td>Permanent</td><td>Because of the assessment mentioned previously, entities should gain a better understanding of their rights and obligations arising from their arrangements.</td></tr>
<tr><th colspan="3">Users</th></tr>
<tr><th>Costs</th><th>Nature of the costs</th><th>Analysis</th></tr>
<tr><td>Education and training costs</td><td>These costs will be one-off because they will be incurred only on implementation of the IFRS.</td><td>Users will incur training costs to ensure appropriate understanding of the requirements.</td></tr>
<tr><td>Actions taken to mitigate the costs</td><td colspan="2">As it is the case whenever a new IFRS is issued, we are aware that implementing IFRS 11 would cause users to incur educational and training costs to gain an appropriate understanding of the new requirements. To lessen the costs to users for understanding the principles in IFRS 11, we have developed extensive application guidance and illustrative examples.</td></tr>
</table>

Users (continued)		
Benefits	**Nature of the benefits**	**Analysis**
Significant increase in comparability	Permanent	In accordance with IAS 31 a party may recognise its interest in a 'jointly controlled entity' using proportionate consolidation or the equity method, while when applying IFRS 11 the accounting will not be driven by a policy choice but by the application of a principle (ie parties recognise their rights and obligations arising from the arrangements).
Increased usefulness	Permanent	Users' decisions involve choosing between alternatives, for example investing in one entity or another. Consequently, information about an entity is more useful if it can be compared with other entities.
Enhanced verifiability and understandability	Permanent	The accounting for joint arrangements in accordance with IFRS 11 will reflect more faithfully the underlying substance of the arrangements (ie the accounting will reflect the parties' rights and obligations).
Increased consistency	Permanent	IFRS 11 promotes greater consistency by applying the same principle to all joint arrangements. As a result, arrangements that entitle the parties to similar rights and expose them to similar obligations will be accounted for similarly and arrangements that entitle the parties to different rights and expose them to different obligations will be accounted for differently.

In particular, we learnt that a major player in the construction industry with revenues amounting to approximately €12.2 billion has initiated the process of classifying its joint arrangements. This preparer has 577 joint arrangements. From its initial assessment it has estimated that approximately 500 of its joint arrangements are joint operations and that 66 are joint ventures. The classification for the remaining 11 joint arrangements will require further assessment and analysis. Only one of these 11 joint arrangements is material to the reporting entity.

Classification of the types of joint arrangement

On the basis of the previous analysis, we have assessed the net effect arising from all the costs and benefits identified in relation to the classification of the types of joint arrangement as follows:



Transition provisions: from proportionate consolidation to the equity method or from the equity method to accounting for assets and liabilities

Depending upon the method that an entity used when accounting for its interests in jointly controlled entities in accordance with IAS 31 (ie proportionate consolidation or the equity method) and the type of joint arrangement in which the entity is involved in accordance with IFRS 11 (ie a 'joint operation' or a 'joint venture'), an entity may need to change the accounting for its arrangements from proportionate consolidation to the equity method or from the equity method to accounting for assets and liabilities.

Preparers		
Costs	**Nature of the costs**	**Analysis**
Transition requirements might entail an entity to incur costs to adapt financial systems and internal procedures	These costs will be one-off because they will be incurred only on implementation of the IFRS.	Preparers are likely to incur costs to adapt financial systems and internal procedures when making the transition either from proportionate consolidation to the equity method, or from the equity method to accounting for assets and liabilities.
Actions taken to mitigate the costs	When developing IFRS 11, we were aware that preparers would have to incur costs to make the transition to the new requirements. To lessen the costs of transition to IFRS 11, when developing the final requirements we simplified the proposals in ED 9 by deciding: (a) not to require entities to adjust for differences between proportionate consolidation and the equity method retrospectively when changing from proportionate consolidation to the equity method. ED 9 had proposed retrospective application of the requirements. (b) not to require entities to remeasure their share of each of the assets and liabilities recognised when changing from the equity method to accounting for assets and liabilities. ED 9 did not include detailed requirements for this specific transition. (c) to permit early application of the IFRS. Early application will mainly benefit first-time adopters because it would give them flexibility in finding an effective and efficient way to apply IFRSs.	

Transition costs will vary across entities. During our outreach we learnt that these costs will not be exceptionally high for entities implementing IFRS 11 and that the procedures implied can be undertaken within the ordinary year-end closing process, without representing an undue burden. We have learnt this from preparers that have already changed their accounting for joint arrangements, taking advantage of the accounting option that IAS 31 offers to jointly controlled entities.

Transition provisions is an area that, for preparers, represents a cost whose associated benefits should be assessed along with those derived from the implementation of the IFRS as a whole. As a result, we do not present a cost-benefit matrix for this area.

Please note that the majority of the respondents to the Request for Views *Effective Date and Transition Methods* that was published in October 2010 had agreed with the tentative decisions that the Board had previously made at the time of the consultation on the transition requirements for the IFRSs included in that Request.

In particular, we learnt that, for a major player in the construction industry with revenues of the division where most of the transition work took place, amounting to approximately €900 million, changing from proportionate consolidation to the equity method needed about 130 hours of employees' time, mainly split between the reporting and systems areas. In some other instances, for preparers that simultaneously report under US GAAP, implementing IFRS 11 could represent even lower costs. A preparer from the mining industry with revenues amounting to approximately US $4,000 million estimated that it incurred 32 hours of employees' time when changing from proportionate consolidation to the equity method.

Additional disclosures

The disclosure requirements for parties with joint control of a joint arrangement are specified in IFRS 12 *Disclosure of Interests in Other Entities*.

The disclosure requirements in IFRS 12 represent an improvement to, and an increase in, the financial information provided for joint arrangements that are 'joint ventures'. The increase in requirements seeks to provide users with information to help them gain a better understanding of the extent of the activities that an entity carries out through its joint ventures. The new disclosure requirements will enable users to perform more thorough equity analysis and valuations.

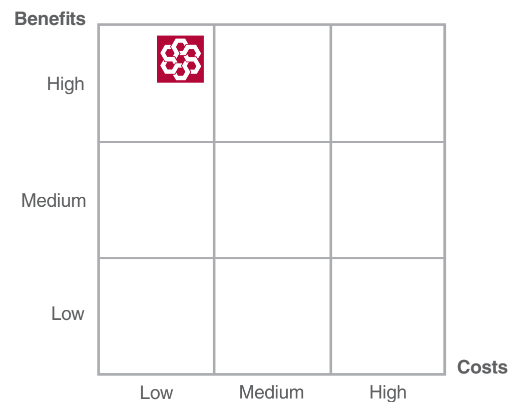
Preparers		
Costs	**Nature of the costs**	**Analysis**
Higher preparation costs due to additional disclosures	These costs will probably be higher only on implementation of the IFRS, but should be flat after that.	IFRS 12 will require preparers to provide more detailed summarised financial information.
Actions taken to mitigate the costs	When developing the disclosure requirements we considered the difficulties that a preparer would face to access information. We concluded that even though IFRS 12 requires preparers to present additional disclosures when compared to IAS 31, the costs for preparers to obtain the additional disclosures should be fairly low, because the information should already be available to entities if they were accounting for interests in jointly controlled entities using either the equity method or proportionate consolidation in accordance with IAS 31.	
Benefits	**Nature of the benefits**	**Analysis**
More detailed disclosures might result in increased credibility of entities' financial data and result in improved accessibility to capital markets	Permanent	As discussed below, IFRS 12 will require preparers to provide information that will help users in evaluating the nature, extent and financial effects of an entity's interests in joint arrangements. As a result of the enhanced disclosure requirements in IFRS 12, users will be able, for example, to assess the activities of each joint venture that is material to the reporting entity. A better understanding by the market of an entity's involvement with joint arrangements might represent for the entity an increase in its market value and and/or improved accessibility to capital markets.

Users (continued)		
Benefits	**Nature of the benefits**	**Analysis**
Increased usefulness	Permanent	The additional disclosures required by IFRS 12 should help users in evaluating the nature, extent and financial effects of their interests in joint arrangements, and the nature of the risks associated with those interests. For example, IFRS 12 enables users to assess the net debt position and profitability of each material joint venture and the EBITDA which, in some circumstances, is considered a rough estimate of operating cash flows. This type of assessment was impossible to perform with the disclosure requirements in IAS 31.
Reduction of information asymmetry among equity market participants	Permanent	The provision of supplementary information about joint ventures could reduce information asymmetry among participants in equity markets.[15]

15 Chee Yeow Lim, Gillian H H Yeo, Chao-Shin Liu (2003). *Information asymmetry and accounting disclosures for joint ventures*. The International Journal of Accounting 38, 23-39.

On the basis of the previous analysis, we have assessed the net effect arising from all the costs and benefits identified in relation to additional disclosure requirements as follows:

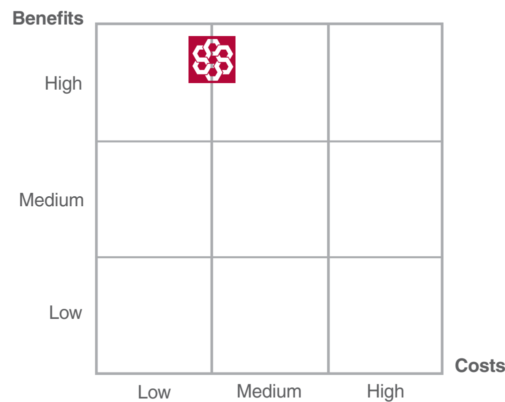
Additional disclosure requirements



Overall assessment

The consideration of the CBA in each of the areas where IFRS 11 will lead to considerable changes for those with the closest interest in the IFRS leads us to conclude that, overall, the benefits brought by IFRS 11 will outweigh its related costs. The matrix below is a tool for us to display our final conclusion on the net effect of the main costs and benefits identified of implementing IFRS 11.

Overall assessment



Convergence with US GAAP

IFRS 11 will achieve closer convergence with US GAAP than IAS 31 did but there will still be some differences. This is mainly because the accounting for joint arrangements under US GAAP depends very closely on the legal form of the entity in which the arrangements have been structured and it varies by industries. However, as shown in Table IX, differences in the definitions of terms such as 'joint arrangement' and 'joint control' will still be present after the publication of IFRS 11.

We expect that convergence will increase for arrangements structured in separate vehicles that can be considered in their own right such as corporations. In this case, US GAAP requires the use of the equity method. We expect the majority of such arrangements to be 'joint ventures' in accordance with IFRS 11 and, as a result, to be accounted for using the equity method. We expect such arrangements to be joint ventures because, as mentioned previously, the consideration of the terms of the contractual arrangements and other facts and circumstances will, in the majority of the cases, be aligned with the initial conclusion on the type of joint arrangement arising from the assessment of the legal form of the separate vehicle in which those arrangements were established.

There will, however, be some instances where parties to arrangements structured in corporations will have an interest in 'joint operations' under IFRSs and, consequently, parties will account for assets and liabilities under IFRS 11, whereas under US GAAP these parties would still account for their arrangement using the equity method. A more detailed analysis is shown in Table X.

Differences in the definitions of 'joint arrangement' and 'joint control'

The existence of a contractual arrangement to undertake an activity that is controlled jointly determines the definition of joint arrangements and, consequently, the scope of IFRS 11. The definitions of 'joint arrangement' and 'joint control' are the areas where divergence with US GAAP still exists, as shown in Table IX below.

Table IX: Differences in the definitions of joint arrangement and joint control

	IFRS 11	US GAAP
Joint arrangement (IFRSs)/Corporate joint venture (US GAAP)	A joint arrangement is an arrangement of which two or more parties have joint control. IFRS 11 classifies joint arrangements into two types—joint operations and joint ventures. Joint operations are joint arrangements whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Joint ventures are joint arrangements whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.	The term joint venture refers only to jointly controlled entities, where the arrangement is carried on through a separate entity. According to the US GAAP Glossary a 'corporate joint venture' is defined as follows:[16] 'A corporation owned and operated by a small group of entities (the joint venturers) as a separate and specific business or project for the mutual benefit of the members of the group. A government may also be a member of the group. The purpose of a corporate joint venture frequently is to share risks and rewards in developing a new market, product or technology; to combine complementary technological knowledge; or to pool resources in developing production or other facilities. A corporate joint venture also usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the joint venture. Joint venturers thus have an interest or relationship other than as passive investors. An entity that is a subsidiary of one of the joint venturers is not a corporate joint venture. The ownership of a corporate joint venture seldom changes, and its stock is usually not traded publicly. A noncontrolling interest held by public ownership, however, does not preclude a corporation from being a corporate joint venture.'

16 Formerly APB 18 *The Equity Method of Accounting for Investments in Common Stock*.

Table IX: Differences in the definitions of joint arrangement and joint control (continued)		
	IFRS 11	**US GAAP**
Joint control	The contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.	US GAAP does not have an authoritative, defined concept of 'joint control'. The term is, however, included in the US GAAP Glossary where it is defined as: 'Joint control occurs if decisions regarding the financing, development, sale, or operations require the approval of two or more of the owners.' Please note that the term 'joint control' is referred to only in the industry guidance for real estate Cod. 970-323- 20.[17]

The following observations are derived from Table IX:

- Joint arrangements are limited to 'corporate joint ventures' in accordance with US GAAP. The IFRS definition is broader and encompasses non-entity arrangements and arrangements structured through any type of entity (incorporated or unincorporated).
- The existence of a contractual arrangement and joint control of an arrangement are not required elements in the definition of 'corporate joint ventures' in accordance with US GAAP.
- The term 'joint control' is restricted to how specific decisions relating to real estate ventures are made. IFRS 11 extends the term 'joint control' to any activity that is the subject of a joint arrangement (ie joint control is not restricted to specific industries but is a feature that is common to all arrangements that are joint arrangements regardless of the industry).
- The definition of 'joint control' provided in US GAAP is potentially wider than the definition in IFRSs, because the nature of the decisions that might need the agreement of 'two or more of the owners' is not defined as necessarily being the decisions on the 'relevant activities'. Additionally, arrangements whereby the parties might collectively control the arrangement could potentially fulfil the definition of 'joint control' under US GAAP, because 'unanimous consent' is not required.

17 Formerly SOP 78-9 *Accounting for Investments in Real Estate Ventures.*

Differences between US GAAP and IFRS 11

Assuming that the activities of the arrangements (regardless of their structure) are jointly controlled, Table X summarises the potential differences between US GAAP and IFRS 11.

Table X: Differences between US GAAP and IFRS 11 (assuming that arrangements are jointly controlled)

	Joint arrangements structured through a separate vehicle			**Joint arrangements not structured through a separate vehicle**	
	Corporation	Unincorporated entities			
		Specialised industries	General requirements	Specialised industries	General requirements
US GAAP	Cod. 323-10-35-3[18]	Cod. 932-323-45-1 Cod. 810-10-45-14[19]	Cod. 323-30-25-1 Cod. 808-10-15-4[20]	Cod. 970-323-25-2 and 12[21]	Cod. 808-10-45-1[22]
	Equity method	Proportionate gross financial statement presentation is permitted only for an investment in an unincorporated legal entity in either the construction industry or the extractive industry 'where there is a longstanding practice of its use'.	'Investors in unincorporated entities such as partnerships and other unincorporated joint ventures generally shall account for their investments using the equity method.' '[...] The part of the collaborative arrangement that is conducted in a separate legal entity shall be accounted for under the guidance in Topic 810, Consolidation, Subtopic 323-10, *Investments—Equity Method and Joint Ventures*, or other related accounting literature [...]'	'If real property owned by undivided interests is subject to joint control by the owners, the investor-venturers shall not present their investments by accounting for their pro rata share of the assets, liabilities, revenues, and expenses of the ventures. Most real estate ventures with ownership in the form of undivided interests are subject to some level of joint control. Accordingly, such investments shall be presented in the same manner as investments in noncontrolled partnerships' (ie equity method).	'Participants in a collaborative arrangement shall report costs incurred and revenue generated from transactions with third parties (that is, parties that do not participate in the arrangement) in each entity's respective income statement pursuant to the guidance in Subtopic 605-45. An entity shall not apply the equity method of accounting under Subtopics 323-10 and 323-30 to activities of collaborative arrangements.'

18 Formerly APB 18 *The Equity Method of Accounting for Investments in Common Stock.*

19 Formerly EITF 00-01 *Investor Balance Sheet and Income Statement Display under the Equity Method for Investments in Certain Partnerships and Other Ventures.*

20 Formerly EITF 00-01 *Investor Balance Sheet and Income Statement Display under the Equity Method for Investments in Certain Partnerships and Other Venture*s and EITF 07-01 *Accounting for Collaborative Arrangements.*

21 Formerly SOP 78-9 *Accounting for Investments in Real Estate Ventures.*

22 Formerly EITF 07-01 *Accounting for Collaborative Arrangements.*

Table X: Differences between US GAAP and IFRS 11 (assuming that arrangements are jointly controlled) (continued)

	Joint arrangements structured through a separate vehicle			Joint arrangements not structured through a separate vehicle	
	Corporation	Unincorporated entities			
		Specialised industries	General requirements	Specialised industries	General requirements
IFRS 11	The accounting will depend upon the terms of the contractual arrangements and, when relevant, upon the consideration of other facts and circumstances. Arrangements structured through incorporated entities will probably be joint ventures (equity method), although joint operations (accounting for assets and liabilities) may also be possible.	The accounting will depend upon the terms of the contractual arrangements and, when relevant, the consideration of other facts and circumstances. Both types of joint arrangement are possible, although we expect most of the arrangements structured through unincorporated legal entities to be joint operations.		If the contractual arrangements determine that the parties have an undivided interest in the assets of the arrangement and have obligations for the liabilities of the arrangement, the arrangement is a joint operation, regardless of the industry in which the arrangement is being undertaken.	
Degree of convergence	Convergence will increase in a large number of arrangements, but there will still be differences in the accounting for arrangements that are structured through incorporated entities whereby the parties have rights to the assets and obligations for the liabilities of the arrangements (ie these arrangements will be equity accounted for under US GAAP, but an entity applying IFRSs will account for assets and liabilities).	The accounting for the specialised industries will most probably fully converge. The accounting for the rest of the industries might not converge in the case where the parties have rights to the assets, and obligations for the liabilities, arising from the arrangements (ie these arrangements will be equity accounted for under US GAAP, but an entity applying IFRSs will account for assets and liabilities).		The accounting for arrangements in which entities have undivided interests in assets and liabilities will continue to converge, but there will be no convergence for specific industries in which the parties having undivided interests in assets and liabilities may need to apply the equity method under US GAAP and account for share of assets and liabilities under IFRSs.	

Resources

Additional information about the project is available on the Joint Ventures project page of our website, at http://www.ifrs.org/Current+Projects/IASB+Projects/Joint+Ventures/Joint+Ventures.htm

The project page gives access to:

- the exposure draft published in September 2007.
- the letters we received in response to our request for comments on the exposure draft.
- audio recordings of the public meetings we held to discuss the project and written summaries of the decisions we made at those meetings.
- audio recordings of a podcast and a webcast introducing IFRS 11 *Joint Arrangements.*
- Feedback statement on IFRS 11.

Important information

This effect analysis has been compiled by the staff of the IFRS Foundation for the convenience of interested parties.

The views expressed within this document are those of the staff who prepared the document. They do not purport to represent the views of the IASB and should not be considered as authoritative. Comments made in relation to the application of IFRSs or US GAAP do not purport to be acceptable or unacceptable application of IFRSs or US GAAP.

Official pronouncements of the IASB are available in electronic form to eIFRS subscribers. Printed editions of IFRSs are available for ordering from the IASB website at www.ifrs.org.

International Accounting Standards Board (IASB)
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