May 2011

Project Summary and Feedback Statement

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IFRS 11 *Joint Arrangements*

IFRS™

At a glance

We, the International Accounting Standards Board (IASB), issued IFRS 11 *Joint Arrangements* in May 2011. IFRS 11 establishes principles for the financial reporting by parties to a joint arrangement. IFRS 11 supersedes IAS 31 *Interests in Joint Ventures* and SIC-13—*Jointly Controlled Entities—Non-Monetary Contributions by Venturers*.

IFRS 11 is effective from 1 January 2013. Early application is permitted.

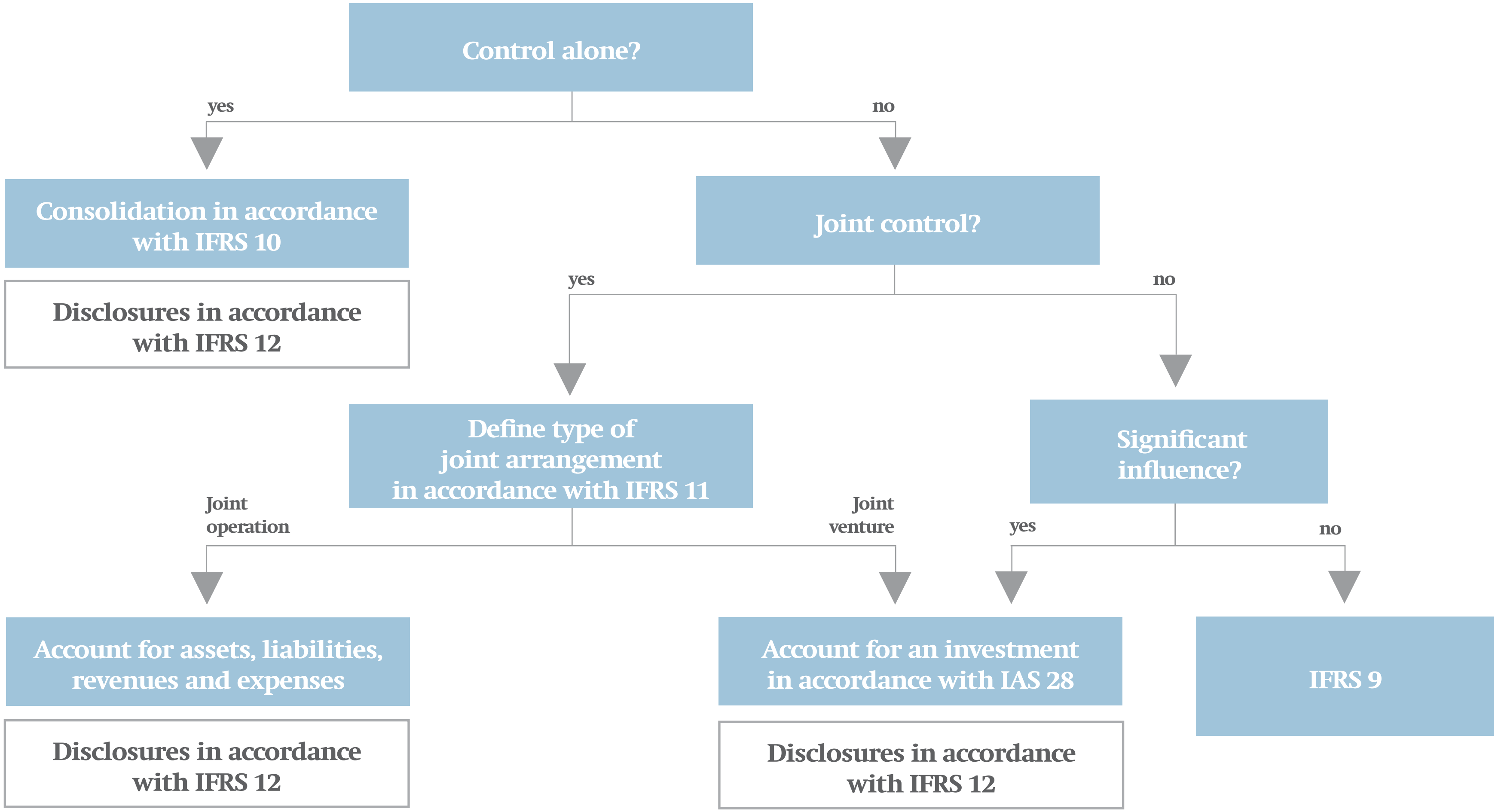
The project formed part of the Memorandum of Understanding (MoU) between the US national standard-setter, the Financial Accounting Standards Board (FASB), and the IASB. Even though the initial goal of the project was to focus on convergence differences that could be resolved in a relatively short time, our first concern was to improve the accounting for joint arrangements while taking into consideration convergence matters in our deliberations.

IFRS 11 improves the accounting for joint arrangements by introducing a principle-based approach that requires a party to a joint arrangement to recognise its rights and obligations arising from the arrangement. Such a principle-based approach will provide users with greater clarity about an entity's involvement in its joint arrangements by increasing the verifiability, comparability and understandability of the reporting of these arrangements.

As part of the joint ventures project, we developed disclosure requirements to allow users to gain a better understanding of the nature, extent and financial effects of the activities that an entity carries out through joint arrangements. The disclosure requirements for joint arrangements have been placed in IFRS 12 *Disclosure of Interests in Other Entities*. IFRS 12 is a comprehensive disclosure standard for subsidiaries, joint arrangements, associates and unconsolidated structured entities.

We issued IFRS 11 at the same time as IFRS 10 *Consolidated Financial Statements*, IFRS 12 and the amended IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*.

Interaction between IFRSs 10, 11, 12 and IAS 28



Why we undertook the project

When undertaking this project, we were mainly concerned with remedying two aspects of IAS 31 that we considered impediments to high quality reporting of joint arrangements.

The structure of the arrangement was the only driver for the accounting

The accounting requirements in IAS 31 may not have always reflected the rights and obligations of the parties arising from the arrangements in which they were involved.

Accounting option for jointly controlled entities (JCEs)

IAS 31 gave entities a choice to apply either proportionate consolidation or the equity method to all of their JCEs.

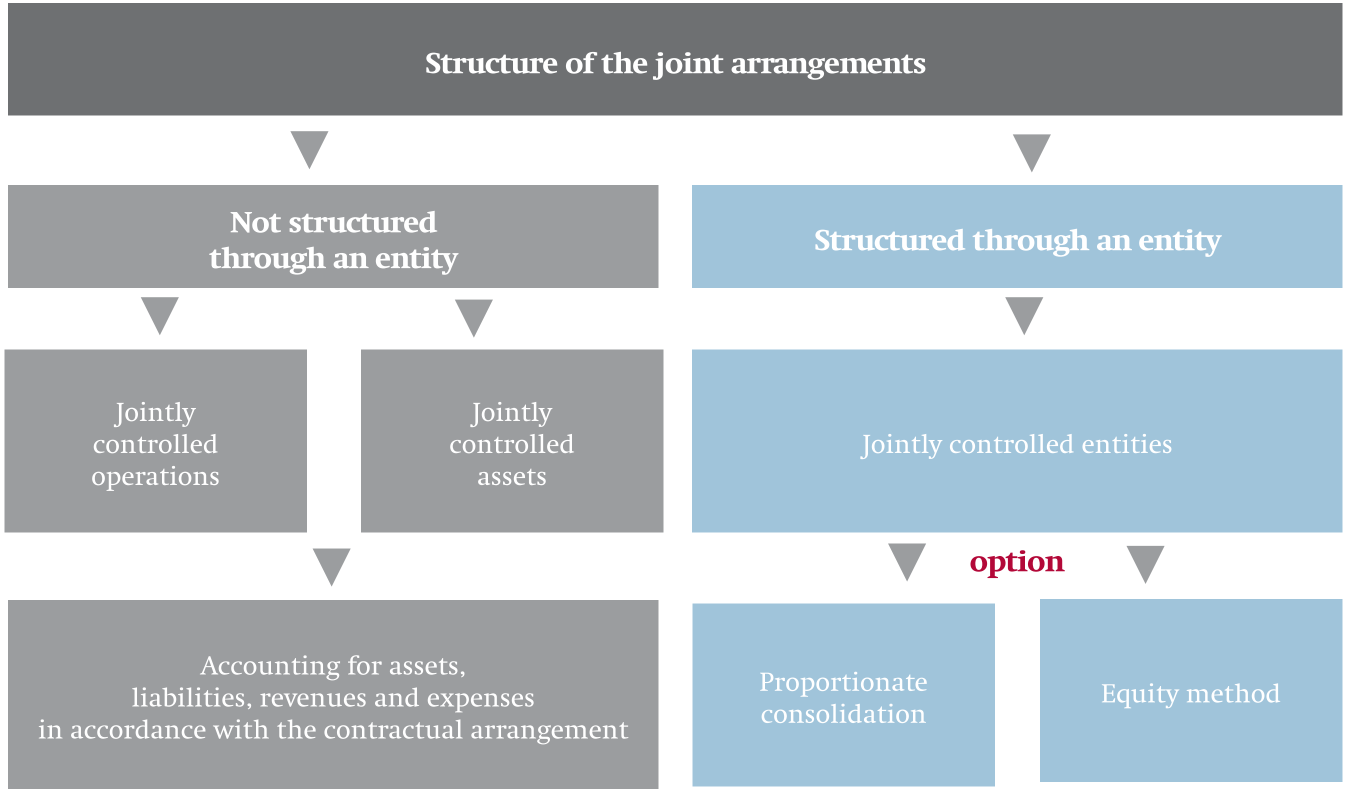
These two aspects of IAS 31 could create situations where:

- arrangements that entitle the parties to similar rights and obligations are accounted for differently and, conversely,
- arrangements that entitle the parties to different rights and obligations are accounted for similarly.

We observed examples of this in practice.

The weaknesses of IAS 31

The structure of the arrangement was the only driver for the accounting; this together with the existence of an accounting option for jointly controlled entities resulted in inconsistencies in the accounting.



The new IFRS: accounting that reflects the parties' rights and obligations

IFRS 11 is an improvement on IAS 31 because it establishes a clear principle that is applicable to the accounting for all joint arrangements.

The principle in IFRS 11 is that a party to a joint arrangement recognises its rights and obligations arising from the arrangement.

The application of this principle:

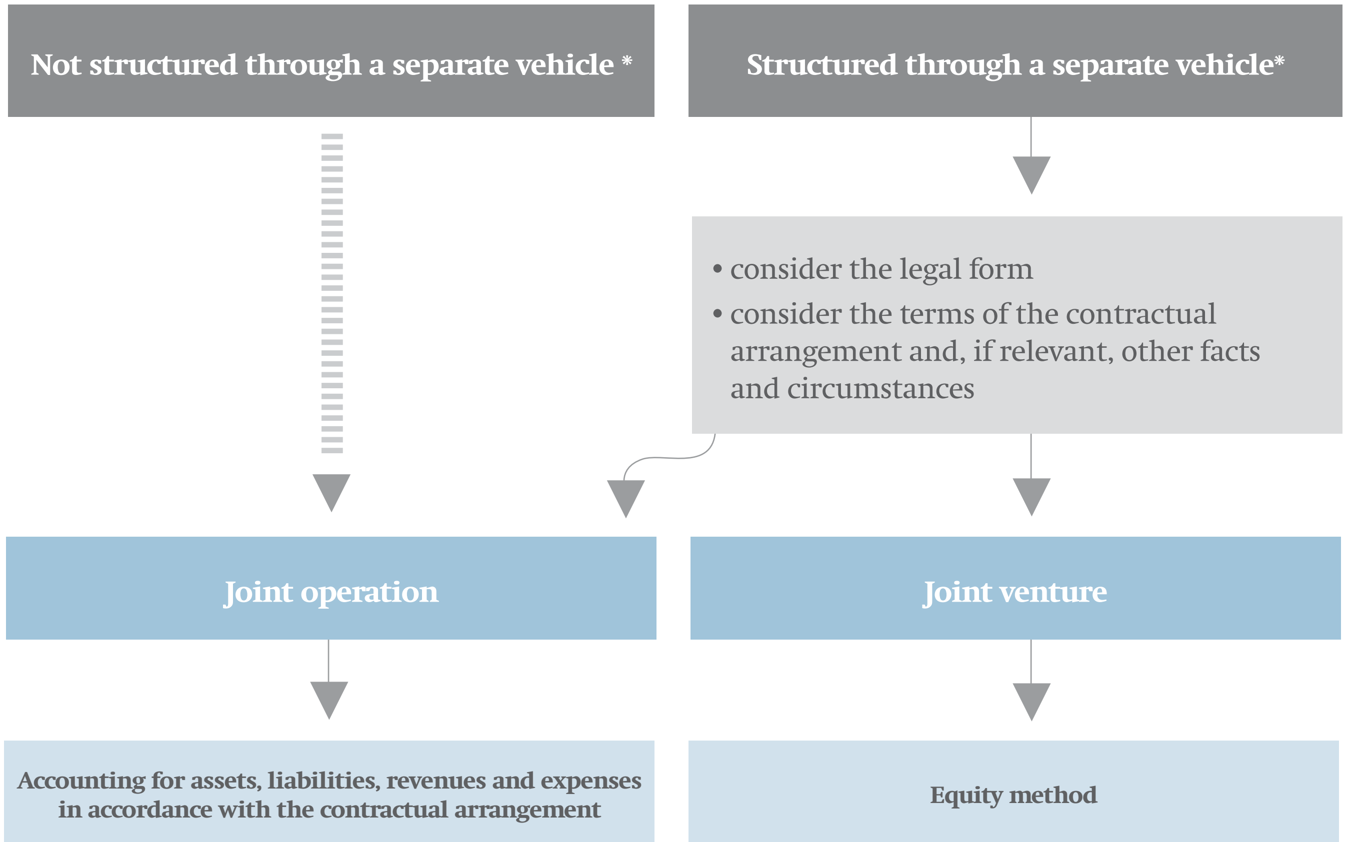
- enhances *verifiability* and *understandability* because the accounting reflects more faithfully the economic phenomena that it purports to represent (ie a party's rights and obligations arising from the arrangements);
- enhances *consistency* because it provides the same accounting outcome for each type of joint arrangement; and
- increases *comparability* among financial statements because it will enable users to identify and understand similarities in, and differences between, similar arrangements.

The application of the principle results in parties having:

- **Rights to the assets** and **obligations for the liabilities** relating to the arrangement. These are parties to *joint operations*. A joint operator accounts for **assets**, **liabilities** and corresponding **revenues** and **expenses** arising from the arrangement.
- **Rights to the net assets** of the arrangement. These are parties to *joint ventures*. A joint venturer accounts for an **investment** in the arrangement using the equity method.

IFRS 11

The classification of a joint arrangement is determined by assessing the rights and obligations of the parties arising from that arrangement.



* A separate vehicle is a separately identifiable financial structure, including separate legal entities or entities recognised by statute, regardless of whether those entities have a legal personality.

The new disclosure requirements

When developing IFRS 10 and IFRS 11 we identified an opportunity to integrate and make consistent the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities and to present those requirements in a single IFRS: IFRS 12.

The disclosure requirements for joint arrangements in IFRS 12 aim to include information that helps users of financial statements to evaluate the nature, extent and financial effects of an entity's interests in joint arrangements, and the nature of the risks associated with those interests.

The following disclosure requirements in IFRS 12 aim to fulfil this objective:

- A list of joint arrangements that are material for the entity, including a description of the nature of the entity's relationship with its joint arrangements.
- Summarised financial information on an individual basis for those joint ventures that are material to the entity. This disclosure requirement will enable users to understand the net debt position of the joint ventures and will give them information to help them value the entity's investments in joint ventures.

Due process and outreach activities

In 2003 we added to our agenda a project to improve the accounting for joint arrangements by replacing IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities-Non Monetary Contributions by Venturers* with a new IFRS. National standard-setters from Australia, Malaysia and New Zealand undertook the initial research on the project.

Development of IFRS 11

We wanted to eliminate the choice of accounting for jointly controlled entities in IAS 31 and to clarify the definitions of the different types of joint arrangements in order to improve consistency in application. Given the narrow scope of the project, we decided not to publish a discussion paper or set up a working group.

We published the exposure draft ED 9 *Joint Arrangements* in September 2007, with a four-month comment period. Eleven of the thirteen Board members at that time approved the exposure draft for publication. Two Board members abstained in view of their recent appointment to the Board. We received 111 comment letters in response to our proposals. The IASB technical staff presented a comment letter analysis to the Board at our meeting in April 2008.

We decided to delay further deliberations to align the deliberations with those on exposure draft ED 10 *Consolidated Financial Statements* and to give priority to the pressing issues related to the global financial crisis. The time was put to good use by undertaking a wide range of consultation activities that provided us with evidence that the new IFRS on joint arrangements was necessary and that the accounting model being introduced was both sensible and workable. We discussed additional issues at public Board meetings in 2009 and 2010.

We considered changes we had made from the exposure draft and decided that it was not necessary to re-expose any aspects of the proposals. The main changes included the addition of application guidance to assist entities in the classification of their joint arrangements, adjustments to terminology used and the number of types of joint arrangements narrowed from three to two.

Outreach and field testing

We undertook extensive outreach between April 2008 and May 2009, including discussions with the IFRS Advisory Council. Although formal public hearings were not held, we met more than 40 respondents to the exposure draft who shared actual examples and contractual documentation to test the application of the proposals in the exposure draft. We also met other interested parties, including preparers from a variety of industries and geographical locations, user groups and national standard-setters. We attended quarterly public meetings with the oil and gas industry and gave presentations at IFRS conferences and world standard-setters meetings.

Of particular help to us was the openness with which constituents shared examples of their joint arrangement contracts. Reviewing these contracts with the parties gave us comfort that we understood joint arrangements in a wide range of industries (eg construction, oil and gas, mining, real estate, environmental services, aerospace and defence, telecoms, banking and energy).

We discussed the contractual information with these respondents and assessed with them the classification of their arrangements and the impact that the new requirements would have upon their corresponding accounting. This provided us with additional input that helped us finalise the application guidance and illustrative examples that accompany the standard, most of which were based on actual contractual arrangements.

We analysed the comment letters and considered these comments, along with the feedback received in all other outreach activities, as the basis for our public discussions for the development of the IFRS. As the feedback statement shows, respondents raised some concerns relating to the need for further clarifications and guidance in the final IFRS.

We listened to these concerns and as a result simplified the types of joint arrangement, provided a clearer definition of the different types of joint arrangement based on the rights and obligations that the parties have, and provided additional guidance and examples to assist preparers in the classification of their arrangements on the basis of their rights and obligations and the clarification of the accounting for parties to a joint operation.

IFRS 11 was supported by all Board members.

Activities carried out with preparers when developing IFRS 11
Analysis of contractual information
We contacted respondents to the exposure draft and other constituents to understand their concerns on the proposals. We analysed contractual information shared by preparers, we discussed the main terms of those contracts and drafted illustrative examples that were further discussed and analysed with selected Board members in small group meetings.
Sharing of draft documents and analysis and consideration of feedback received
Our outreach activities helped us in the development of the requirements and application guidance remarkably. A draft of the requirements and application guidance was circulated to a selection of preparers from a variety of industries and geographical locations for their feedback during the development phase and at a later stage before balloting the documents.
Compilation of comments received from the analysis of contractual information with preparers, analysis of comment letters and comments received from circulation of draft documents were incorporated into the final IFRS.

Feedback received from investors

When developing IFRS 12 we contacted the user community to ensure that we considered their information needs. This included users that responded to the exposure draft, users that form our Analyst Representative Group, national standard-setters' users' groups as well as users participating in round tables and other user-specific outreach activities undertaken as part of the consolidation project.

Users told us on many occasions that they were interested in detailed disclosures about an entity's interests in other entities that are not consolidated but in which the entity has a significant shareholding, or is actively involved in the operations of the entity, or both. Users also considered the disclosure requirements in the proposals to be insufficient to assess basic aspects when valuing material joint ventures such as the joint ventures' net debt position, profitability and operating cash flows. Such supplementary disclosures would allow them to assess the value of these investments more accurately and would also allow them to separate the financial results of consolidated entities or to combine the results of unconsolidated entities, depending on the purpose of their analysis.

Feedback from other constituents

We also involved national standard-setters and accounting firms in our process. Their comments contributed to the refinement and drafting of the requirements.

IFRS 11 will be subject to a post-implementation review two years after it has become mandatory. We will also continue informal consultations throughout the implementation of the new IFRS.

Feedback statement

As a result of the information received in our consultation process, the contents of the final IFRS have changed in some respects, and have been clarified in others.

The sections that follow provide a more detailed explanation of the main matters raised with us and how we responded, including:

- Elimination of proportionate consolidation
- Accounting driven by the parties' rights and obligations
- Classification and accounting for joint arrangements
- Convergence with US GAAP
- Disclosure requirements

Elimination of proportionate consolidation

IFRS 11 eliminates proportionate consolidation as a method to account for joint arrangements. This is the most controversial change brought about by the new IFRS.

Respondents' comments

Many respondents were against the elimination of proportionate consolidation because, compared with the equity method, they believed that:

- proportionate consolidation provided a better reflection of the economic substance of the arrangements; and
- the elimination of proportionate consolidation would represent a loss of meaningful and useful information for users of financial statements.

Some respondents commented that the accounting for 'joint control' and 'significant influence' will be the same. These respondents perceived this to be inappropriate because they saw joint control as involving a higher degree of management involvement and influence on business decisions, which the accounting would no longer reflect.

In addition, some respondents said that the exposure draft did not offer compelling arguments to support the view that equity accounting is conceptually the best method to account for joint ventures and to support the elimination of proportionate consolidation.

Our response

We think that the economic substance of the arrangements is defined by the rights and obligations assumed by the parties when carrying out the activity of the arrangement. The recognition of the rights and obligations of the parties to the joint arrangement is the principle in IFRS 11.

In the case of an interest in a joint venture, none of the individual venturers has control of the activities of the venture. They have joint control and must act together to direct the activities of the venture.
In such cases the parties have rights to the net assets of the arrangement. The equity method is a way of accounting for such an interest.

Not all jointly controlled entities will be classified by IFRS 11 as joint ventures. Some jointly controlled entities will be classified as joint operations because of the parties' related rights and obligations.

The requirement to account for an interest in a joint venture using the equity method does not purport to assert that joint control and significant influence represent the same type of involvement. The differences in disclosure requirements for interests in joint ventures and associates reflect this.

The disclosure requirements included in IFRS 12 improve the quality of the information provided to users. This is because entities are required to provide summarised financial information in greater detail for each of their individually material joint ventures. The new disclosure requirements will help users to gain a better understanding of the magnitude and relevance of the activities that entities undertake through their joint ventures.

Accounting driven by the parties' rights and obligations

The accounting for joint arrangements follows a principle-based approach. The application of a principle provides the same accounting for each type of interest in a joint arrangement.

The accounting for joint arrangements required by IFRS 11 reflects the rights and obligations arising from the arrangement. In contrast, IAS 31 provided a free choice between proportionate consolidation and the equity method. IFRS 11 thus promotes greater comparability and focuses on the economic and contractual nature of the investment.

Respondents' comments

Many respondents agreed with the approach being proposed, but questioned whether, as proposed, the principle would capture the substance of the arrangements and its ability to be applied in practice. This is because 'accounting for contractual rights and obligations' was perceived by some respondents as being more complicated than the requirements in IAS 31.

Our response

IFRS 11 introduces a principle for the accounting for joint arrangements. By aligning the accounting to the parties' rights and obligations arising from their arrangements, the accounting is capturing the underlying substance of the arrangements.

Applying a principle-based approach will require entities to perform an assessment to identify what are their rights and obligations relating to the arrangements. We think that in the majority of cases, the assessment will not be burdensome.

Classification and accounting for joint arrangements

The types of joint arrangement in which the parties are involved will be determined by the application of the principles in IFRS 11.

The exposure draft classified joint arrangements into three types—joint operations, joint assets and joint ventures.

Respondents' comments

Many respondents believed that there was a lack of clarity in the descriptions for the different types of joint arrangement provided in the proposals.

Some respondents stated that it is not immediately evident to them, from the proposals, how the different types of joint arrangements interact.

A few respondents stated that the proposals should clearly explain the difference between a joint asset and an asset held by a jointly controlled entity.

Our response

We defined the different types of joint arrangement (ie joint operations and joint ventures), rather than providing descriptions and examples that would not succeed in illustrating a specific type of joint arrangement.

In IFRS 11 we have delineated joint arrangements to refer to an activity that is jointly controlled by two or more parties. The classification of joint arrangements will depend upon the parties' rights and obligations arising from the activity undertaken under joint control. The IFRS clarifies that sometimes the parties might establish different types of joint arrangement to deal with different activities related to, for example, a framework agreement, for which the parties have different rights and obligations.

The exposure draft did not include application guidance addressing the classification of joint arrangements. IFRS 11 includes guidance to assist entities in the classification of their arrangements. Entities will be required to assess their rights and obligations by considering the structure of the arrangement, the legal form of the separate vehicle in which the arrangement might have been structured, the terms of the contractual arrangements and, when relevant, other facts and circumstances.

During the development of the IFRS we decided to simplify the types of joint arrangement presented by IFRS 11 (ie joint operations and joint ventures) and align them with the two possible accounting outcomes that can arise from the recognition of the parties' rights and obligations (ie parties to a joint operation recognise assets, liabilities, revenues and expenses, wheras parties to a joint venture recognise an investment accounted for using the equity method).

Convergence with US GAAP

We added the joint ventures project to our agenda as a part of the project to reduce differences between IFRSs and US GAAP.

Although we kept convergence in mind, our main focus was on addressing the weaknesses identified in IAS 31. As well as addressing these weaknesses the result is that we have removed some differences between IFRSs and US GAAP.

Respondents' comments

Some respondents questioned whether the proposals would achieve further convergence with US GAAP. Respondents said that the proposals in exposure draft would not reduce differences between IFRSs and US GAAP but could lead to new differences.

One of the comments made most frequently was that EITF-Issue No. 00-1 *Investor Balance Sheet and Income Statement Display under the Equity Method for Investments in Certain Partnerships and Other Ventures* permits the use of proportionate gross financial statement presentation for unincorporated legal entities in the construction and extractive industries where there is a long-standing practice of using it. These respondents believed that the proposals to eliminate proportionate consolidation from IFRSs would create divergence for those arrangements that met the definition of a 'joint venture' under the proposals, but that under US GAAP would be permitted to be proportionately consolidated.

In addition, some respondents stated that differences would still exist for those arrangements that involve the establishment of a legal entity. In those cases, the equity method would be applied under US GAAP, while the assessment of the parties' rights and obligations in accordance with the proposals might lead to these arrangements being 'joint operations' for which the accounting would be the recognition of assets, liabilities, revenues and expenses.

Our response

The classification and accounting for joint arrangements in accordance with IFRS 11 is based on an assessment of the parties' rights and obligations. In contrast, the US GAAP requirements are very dependent on the legal form of the arrangements and, in some cases, are industry-specific.

Before we finalised IFRS 11 we were aware that application of the principles in IFRS 11 will not always result in convergence with US GAAP. However, we believe IFRS 11 will bring greater improvements to financial reporting than would be achieved by simply adopting US GAAP. For example, proportionate consolidation is permitted for unincorporated entities in the construction industry in the US. IFRSs do not provide accounting guidance to specific industries and consequently, depending on those requirements, the degree of convergence in the arrangements of specific industries might vary.

We expect that most of the arrangements established through unincorporated legal entities will enable the parties to have rights to the assets and obligations for the liabilities held in the unincorporated legal entity. In this case, those arrangements will be joint operations under IFRS 11 and, as a result, the requirements in IFRS 11 and US GAAP are likely to be the same for arrangements in the industries covered in EITF-Issue No. 00-1.

When arrangements are established through a legal entity, US GAAP requires the entity to use the equity method. IFRS 11 requires entities also to consider the rights and obligations reflected in the related contractual arrangements as well as other facts and circumstances. As a result, IFRS 11 will increase convergence in the case of arrangements that are being accounted for using proportionate consolidation under IAS 31 but which will be classified as 'joint ventures' under IFRS 11.

However, some arrangements established through legal entities will be classified as 'joint operations' under IFRS 11 with the parties accounting for assets, liabilities, revenues and expenses, while parties that report under US GAAP will account for them using the equity method. We think that the IFRS 11 requirements provide a more faithful representation of those arrangements and the benefits of providing better information outweigh the disadvantage of lack of convergence with US GAAP.

Disclosure requirements

When developing IFRS 10 and IFRS 11 we identified an opportunity to integrate and make consistent the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities and to present those requirements in a single IFRS. The exposure draft on joint arrangements had already proposed to align the disclosures of joint ventures and associates more closely.

IFRS 12 requires an entity to disclose information that helps users to evaluate the nature, extent and financial effects of its interests in joint arrangements and associates, including the nature and effects of its relationship with the other parties or investors in the joint arrangements and associates and the nature of the risks associated with those interests.

Respondents' comments

Most respondents supported the alignment between the disclosure requirements for joint ventures and associates.

Some respondents perceived the increase in disclosure requirements in the exposure draft as being a consequence of the removal of proportionate consolidation. These respondents believed that important operating information was being relegated to the notes, rendering the financial statements less relevant to users. Some of these respondents advocated requiring for joint ventures more extensive disclosure requirements (eg disclosure of revenues, expenses, assets and liabilities using the same classifications as are used in the main financial statements).

Users in particular highlighted the need to provide information to allow them to obtain a better understanding of the net debt position of those investments, their profitability and information on other items such as dividends paid, cash flow and tax allocation.

Our response

We developed the disclosure requirements for joint arrangements and associates by considering that the disclosure requirements for these two types of interest could share a common disclosure objective—to disclose information that helps users of financial statements to evaluate the nature, extent and financial effects of an entity's interests in joint arrangements and associates, and the nature of the risks associated with those interests.

IFRS 12 expands and improves the disclosure requirements for joint ventures to help users of financial statements to understand better the effect of material joint ventures on the activities of an entity. For example, the new requirements will enable users to assess the net debt position, the profitability and a rough estimation of the operating cash flows for each joint venture that is material to the entity.

The claims that proportionate consolidation provides more information about interests in a joint venture are misleading. Proportionate consolidation of joint ventures would mix revenues, expenses, assets and liabilities that are controlled by an investor with those that cannot be managed without the consent of other joint venturers. Just as IAS 31 does now, we would have required the same disclosures about joint ventures if proportionate consolidation was required so that users could identify the activities and resources not controlled by the reporting entity.

Effect Analysis

Joint arrangement activity

Joint arrangements are an important form of inter-organisational co-operation. However, over the last 20 years the number of international joint arrangement 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 arrangement 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.

Current practice

There is significant diversity in how jointly controlled entities are accounted for under IAS 31. Approximately half of those with an interest in a jointly controlled entity apply the equity method with the other half applying proportionate consolidation. This split is common within countries, with a few exceptions. French and Spanish companies predominantly use proportionate consolidation whereas Australasian and South African entities apply the equity method. This diversity justifies the project to replace IAS 31 and helps explain the main sources of comment letters. Of the preparers who sent us comment letters, most are currently applying proportionate consolidation.

Financial statement effect

Entities required to change from proportionate consolidation to the equity method when IFRS 11 takes effect will, generally, report lower amounts for assets and liabilities (although the net investment in joint ventures remains unaffected) and lower revenues and expenses (although net income remains unaffected).

We analysed the financial statements of entities that sent us comment letters. Around 15 per cent of the comment letters we received were from the energy sector. For those respondents, the median revenues from jointly controlled entities were 16 per cent of total revenue. Some of those respondents will not be permitted to include revenues from activities arising from jointly controlled entities when IFRS 11 takes effect. Others will continue to report such revenues because IFRS 11 will classify these activities as joint operations. The likely effect for respondents from the food and beverages sector is much smaller, with median revenue from jointly controlled entities being around 3 per cent of total revenue.

Costs and benefits

Our assessment is that IFRS 11 will bring significant and sustained improvements to the reporting of joint arrangement activity. The principles for classifying joint arrangements in IFRS 11 reflect the underlying economics of the arrangements and the disclosure requirements will help provide users with better information about joint arrangement activities.

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

A more complete effect analysis is provided in additional documentation, which is available on our website.

Notes

Notes

Important information

This Project Summary and Feedback Statement 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.

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