INTERESTS IN JOINT VENTURES: ASPE 3055

Definitions

- **Joint Venture** = is a contractual arrangement where two or more parties take on an economic activity that is subject to joint control
- **Joint control** = is the contractually agreed sharing of control over an economic activity, such that the strategic financial and operating decisions relating to the activity require the **unanimous consent** of the parties sharing control (the venturers)

Three types of Joint venture and Basis of Accounting

- There are three different types of joint ventures:
  1. **Jointly controlled operations**
     - Each venturer uses its own assets, incurs its own expenses and liabilities, and raises its own financing
     - The revenue from the sale of goods/services by the joint venture and expenses incurred in common are shares among the venturers
     - No corporation, partnership or other enterprise established

  2. **Jointly controlled assets**
     - The venturers jointly control one or more assets contributed or acquired for the joint venture and used for joint venture's business activities
     - Each venturer gets a share of the output generated by the assets and share certain expenses (such as equipment maintenance)
     - No corporation, partnership or other enterprise established

  3. **Jointly controller enterprise**
     - A joint venture that involves the establishment of a corporation, partnership or other enterprise; each venturer has an interest in the enterprise
     - There is joint control over the economic activity of the enterprise.

- Under ASPE, regardless of the type of joint venture, the venturer has a **policy choice of:**
  1. proportionate consolidation,
  2. equity method, or
  3. cost method
- Once the venturer chooses a method, they must use it for all joint venturers

Type of Joint Venture	Accounting Method	Description
Jointly controlled operations	Proportionate consolidation, Equity Method, or Cost Method	**If using Proportionate consolidation** The venturer includes: ▪ **On its balance sheet:** the assets that it controls and the liabilities that it incurs; and ▪ **On its income statement:** its share of the revenue/expenses of the joint venture
Jointly controlled assets	Proportionate consolidation, Equity	**If using Proportionate consolidation** The venturer includes:

	Method, or Cost Method	▪ **On its balance sheet:** its share of the jointly controlled assets/any liabilities incurred jointly with the other venturers ▪ **On its income statement:** any revenue from the sale or use of its share of the output of the joint venture, and expenses incurred by the joint venture.
Jointly controlled enterprise	Proportionate consolidation, Equity Method, or Cost Method	**If using Proportionate consolidation** The venturer includes: ▪ **On its balance sheet:** its share of the assets/liabilities of the jointly controlled enterprise ▪ **On its income statement:** its share of the revenue/ expenses of the jointly controlled enterprise

Transactions between a venturer and a joint venture:

Sale/Contributions to a joint venture

Case #1: No Equity Interests Received by the Venturer:

- Gain/loss recognized = (FMV-CV) * other venturer's interests

Case #2: Equity Interests Received by the Venturer:

- When a venturer transfers assets to a joint venture and receives shares of the joint venture, any **loss** recognized in income at the time of the transfer to the **extent of the interests of the other non-related venturers**

- When the venturer contributes an assets and in return it takes back equity interests (shares) in the joint venture, it can **only recognize a gain** when it receives **other assets (i.e. cash)** together with the equity interest

  (A) Other venturer's share of gain =(FMV – CV of assets contributed)* other venturer's interest
  (B) Gain immediately recognized = Cash – [(Cash/total FV)*BV]
  (C) Deferred gain = A – B ➔ this is amortized over the useful life of the contributed asset (when the JV sells the assets, recognize unamortized balance immediately in income)
  (D) Venturer's share of the gain = (FMV – CV of assets contributed)* venturer's interest ➔ is deducted from the value of the contributed asset when proportionate consolidating

- If no other assets are received the amount calculated in A (above) is deferred and amortized

Purchase of asset by the venturer from the joint venture (upstream):

- When a venturer purchases assets from a joint venture, it needs **to wait until it resells the assets to an independent party**, before recognizing its share of the gains or losses

    - But it needs to recognize its share of the losses **immediately** when it represents a reduction in the net realisable value of current assets or an impairment loss

- **Example**
    - Venturer who owns 40% of the joint venture buys inventory with BV=1000 and FMV=2000
    - Assume venturer has not sold this inventory to a third party
    - Assume the JV has total profits of $5,000
    - When venturer consolidates, it needs to remove the upstream gains such that consolidated NI = (5,000-1,000)*40% = $1,600
    - When venturer sells inventory to a third party, it can then recognize $1,000*40% = $400

Joint ventures accounted for using the equity or cost method

- Need to assess if indications of impairment at the end of every reporting period
- If there are indications of impairment; it needs to reduce the carrying value to the higher of:
    a) the present value of the cash flows expected to be generated discounted using the current market rate of interest appropriate to the asset; and
    b) the amount that could be realized by selling the interest at the balance sheet date
- If the situation improves, the previously recognized losses can be reversed

An investor in a joint venture that does not have joint control

- Account for the investment using rules for financial instruments