INTERESTS IN JOINT VENTURES: IAS 31

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 IFRS, the basis of accounting for a joint venture depends on the type of joint venture:

Type of Joint Venture	Accounting Method	Description
Jointly controlled operations	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	The venturer includes: ▪ **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 **or** Equity method	**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 **Equity method** – see investments in associates (IAS 28) notes

Transactions between a venturer and a joint venture:

Sale of asset from venturer to joint venture (downstream):

- When a venturer **contributes or sells assets** to a joint venture, and has **transferred the significant risks and rewards of ownership**, the venturer shall recognise only the **portion of the gain or loss that is attributable to the interests of the other venturers.**
  - But it needs to recognise the **full amount of any loss** when the contribution or sale provides evidence of a reduction in the net realisable value of current assets or an impairment loss

- **Example**
  - Venturer who owns 40% of the joint venture sells inventory with BV=1000 and FMV=2000
  - Venturer can recognize gain = (2000-1000)*60% = $600

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

Exemptions from Proportionate Consolidation and Equity Method

1. The Joint Venture is classified as held for sale (use IFRS 5 - non-current assets held for sale and discontinued operations)

2. An entity will be **exempt from JV accounting** if **all** the following apply:
    - Venturer is a wholly owned subsidiary, or partially owned subsidiary whose owners do not object to not using JV accounting; and
    - Venturer's debt or equity instruments are not traded publically not are they in the process of doing so; and
    - Ultimate parent prepared consolidated financial statements

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

- Account for the investment using with IAS 39 (financial instruments); or
- If it has significant influence in the joint venture use IAS 28.

SIC 13: jointly controlled entities — non-monetary contributions by venturers (advanced topic)

- Applies to situations where
    - non-monetary assets are contributed to a jointly controlled entity (JCE) in exchange for equity interest (shares); and
    - the JCE is accounted for using the proportionate consolidation method
- when non-monetary assets are contributed to a JCE in exchange for equity interest, the venturer recognises the portion of a gain or loss attributable to the equity interests of the other venturers **except when**:
    a) the **significant risks and rewards of ownership** of the contributed non-monetary assets have not been transferred to the JCE; or
    b) the gain or loss on the non-monetary contribution **cannot be measured reliably**; or
    c) the contribution transaction lacks **commercial substance**

- If any of these 3 exceptions apply, the venturer cannot recognize any gain or loss;
    - however, if the venturer receives **monetary assets or other non-monetary assets** alongside the equity interest, it can recognize a portion of the gain or loss.
    - SIC 13 doesn't provide guidance on how this portion is to be calculated; but the common approach (assuming cash is received alongside equity interests) is as follows:
        - **Other venturer's share of gain (A)=(**FMV – CV of assets contributed)* other venturer's interest
        - **Gain immediately recognized (B)** = Cash – [(Cash/total FV)*BV]
        - **Deferred gain** = A – B ➔ this is amortized to income over the useful life of the contributed asset (if asset is sold by the JV, take unamortized balance into income)
        - **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