

# Applying IFRS

Final joint arrangements and  
consolidation standards

Mining & Metals



## Impact of the new joint arrangements and consolidation standards

August 2011

# Introduction

## What you need to know

- ▶ IFRS 10 has a new definition of control and has additional requirements that could impact any previous assessment of control and joint control
- ▶ IFRS 11 describes the accounting for arrangements in which there is joint control; proportionate consolidation is not permitted for joint ventures (as newly defined)
- ▶ IFRS 12 requires new and expanded disclosures for joint arrangements, as well as for subsidiaries, associates and structured entities, which will impact processes and systems

The search for growth is leading mining and metals entities to increase their appetite for risk. This is manifesting itself by bringing in partners to source new projects, improve utilisation of expensive infrastructure, help manage technical or political risk, or comply with local regulations. To this end, joint arrangements have always been, and continue to be, a common structure in the mining and metals sector. The majority of mining and metals entities are party to at least one joint arrangement. In fact, in the five-month period ending May 2011, 49% of all M&A transactions within the sector involved projects with multiple parties.

However, for some joint arrangements, the accounting is about to change significantly, and not all arrangements commonly described as 'joint ventures' or 'joint arrangements' will continue to be accounted for as in the past, so careful assessment will be required.

## What's happened?

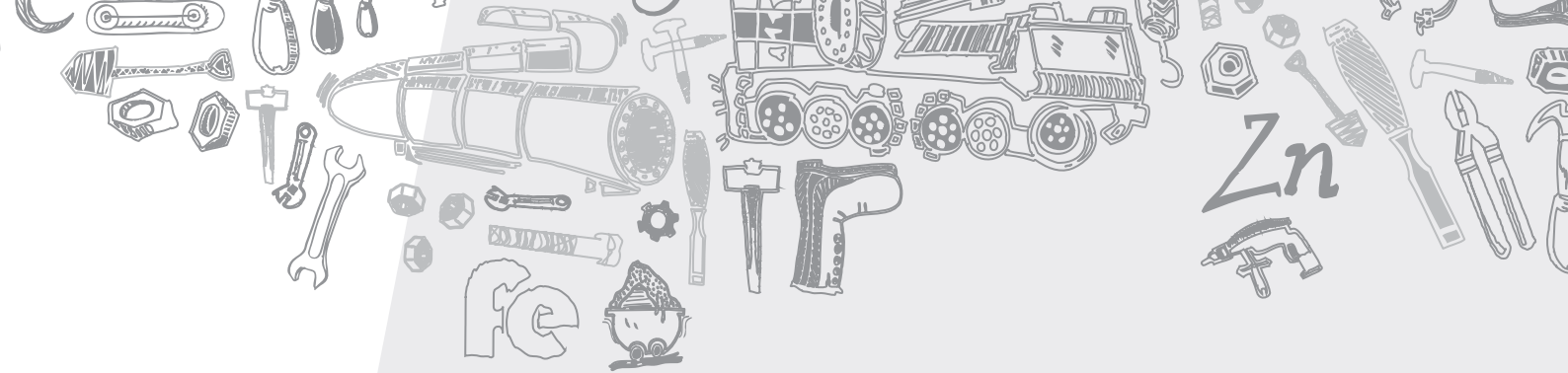
The International Accounting Standards Board (IASB) recently issued a new standard – IFRS 11 *Joint Arrangements*. They also issued two other new standards – IFRS 10 *Consolidated Financial Statements* and IFRS 12 *Disclosure of Interests in Other Entities*. These new standards are effective for annual periods beginning on or after 1 January 2013, and must be applied retrospectively.

In this publication, we concentrate on some of the implications of IFRS 10 and IFRS 11 that are specific to the mining and metals sector. For a more complete summary of these new standards and the impacts on your business, refer to our publication, *IFRS Developments – IASB issues three new standards: Consolidated Financial Statements, Joint Arrangements, and Disclosure of Interests in Other Entities*, Issue 1 (May 2011) and our publication *IFRS Practical matters – What do the new consolidation, joint arrangements and disclosures accounting standards mean to you?* (May 2011). These publications are available at [www.ey.com/IFRS](http://www.ey.com/IFRS).

## What's the impact?

- ▶ A confusing part of the changes is the use of terminology that is common in practice versus that within the new accounting standards. The way in which a number of common terms are now being defined may not be obvious
- ▶ Some proportionately consolidated jointly controlled entities (JCEs) may now be classified as joint ventures and will have to be accounted for using the equity method
- ▶ Conversely, some equity accounted JCEs may now be classified as joint operations and an entity will need to recognise its assets, liabilities, revenues and expenses and/or its relative share thereof
- ▶ These changes will impact the presentation of financial statements, and in some instances, there may also be measurement differences which will affect profit or loss and/or net assets
- ▶ Accounting and consolidation systems, business processes and controls may need to be updated, and there may be impacts on other areas of the business, such as covenants, remuneration structures, etc.





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Many read the headline “Proportionate consolidation is no longer permitted for joint ventures” and interpret this to mean that all interests in joint arrangements must now be accounted for using the equity method – this is not correct.

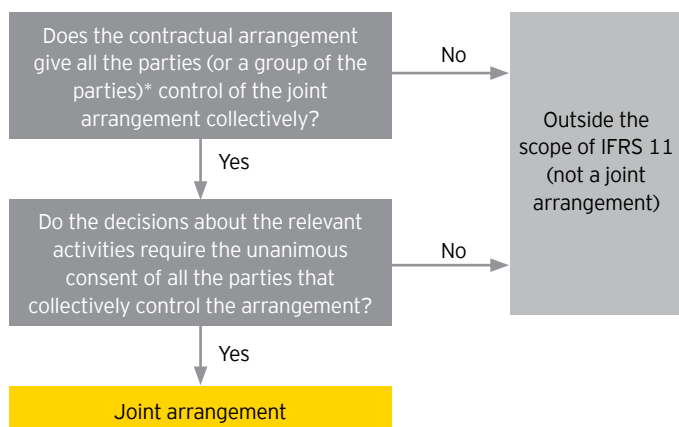


## 1. Overview

IFRS 11 prescribes the accounting for a ‘joint arrangement’, which is defined as a contractual arrangement over which two or more parties have joint control, as illustrated in diagram 1. It is important that entities understand the implications and interplay of both IFRS 10 and IFRS 11 to ensure the proper assessment of, and accounting for, current and future joint arrangements.

Diagram 1

Is it a joint arrangement?



*\*The reference to “a group of the parties” refers to a situation in which there is joint control between two or more parties, but other parties to the joint arrangement are passive investors (i.e., there are other parties in the arrangement who do not have joint control). While such investors are technically within the scope of IFRS 11, they account for their investment in accordance with the relevant standards.*

Although the title of the standard has changed (i.e., from ‘joint ventures’ to ‘joint arrangements’) and might indicate otherwise, IFRS 11 does not broaden the scope of the standard when compared with IAS 31. It still only applies to joint arrangements where there is **joint control**. However, the changes introduced by IFRS 10 and IFRS 11 may lead to a different conclusion as to which arrangements are considered to be under joint control and those which are not.

## 2. Clarifying the confusion ... new terms, new concepts

IFRS 11 has taken some commonly used terms and given them different meanings. This is already causing considerable confusion. For example, what many in the sector would refer to as joint ventures are now collectively referred to as ‘joint arrangements’; the term ‘joint venture’ is now narrowly defined in IFRS 11.

Likewise, the term ‘proportionate consolidation’ has been (and still is) used to casually describe all methods of joint venture accounting where an entity recognises its share of the assets and liabilities of the joint venture. However, from an accounting perspective, this term means something quite specific and is not reflective of the accounting treatment that currently applies to jointly controlled assets (JCAs) and jointly controlled operations (JCOs) under IAS 31, and that which will apply to joint operations under IFRS 11.

Due to the change in definitions and the misunderstanding of what proportionate consolidation and JCA/JCO accounting is, it may not be clear what the impact of this new standard is.



### 3. New definition of joint control

Joint control is defined as “... the contractually agreed sharing of control of an arrangement which exists only when the decisions about the relevant activities require the unanimous consent of the parties sharing control”. IFRS 11 describes the key aspects of joint control as follows:

- ▶ *Contractually agreed* – contractual arrangements are usually, but not always, written, and set out the terms of the arrangements
- ▶ *Control and relevant activities* – IFRS 10 describes how to assess whether a party has control, and how to identify the relevant activities
- ▶ *Unanimous consent* – exists when the parties to an arrangement have collective control over the arrangement, but no single party has control

The new requirements within this definition relate to the assessment of control and relevant activities. Unanimous consent is not new, however, additional guidance has been added to clarify when it exists.

#### 3.1 Determination of control – impact of changes to the consolidation standard

It is common in the mining and metals sector for one of the parties to be appointed as the operator or manager of the joint arrangement (“the operator”), to whom some of the decision-making powers might be delegated. Currently, many consider that the operator does not control a joint arrangement, but simply carries out the decisions of the parties under the joint venture (or operating) agreement (JOA), i.e., acts as an agent. Under the new standards, it may be concluded that the operator actually controls the arrangement. This is because when decision-making rights have been delegated, IFRS 10 now provides new requirements on how to assess whether an entity is acting as principal or agent, which is then used to determine which party has control.

Careful consideration will be required to assess whether an operator acts as a principal (and, therefore, may potentially control the arrangement) or as an agent. In the latter situation, the operator only recognises its interests in the joint arrangement (the accounting for which will depend upon whether it is a joint operation or joint venture) and its operator/management fee.

The factors to be considered in making this assessment include:

- ▶ Scope of the operator’s decision-making authority
- ▶ Rights held by others (e.g., protective, removal rights)
- ▶ Exposure to variability in returns through the remuneration of the operator
- ▶ Variable returns held through other interests (e.g., direct investments by the operator in the joint arrangement)

Below, we consider each of these factors. It is important to note that assessing whether an entity is a principal or an agent will require consideration of all factors collectively.

#### a) Scope of decision-making authority

The scope of an operator’s decision-making authority is evaluated by considering the range of activities it is permitted to direct and the discretion it has when making decisions about those activities.

An operator does not usually have discretion to make changes either to the activities it is permitted to direct, or to the decisions it is permitted to make without the prior approval of the non-operator parties. However, consideration must be given as to how broad or narrow its discretion is within the decision-making rights that have been delegated. In addition, consideration must also be given to the level of involvement the operator had in determining the scope of its authority. That involvement may indicate the operator had the opportunity and incentive to obtain the ability to direct the relevant activities, which could indicate the operator is acting as a principal.

For example, if the operator was the main party involved in setting up the joint arrangement and also the primary party in determining what decision-making rights it would have as operator, and these were designed to be quite broad, it may indicate that the operator is a principal.



#### **b) Rights held by others**

The operator also has to consider whether other parties hold rights that would affect any powers delegated to it. For example, a removal right held by non-operator parties might affect the operator's decision-making ability.

If a non-operator party holds a removal right (that is, a single non-operator party can decide to remove the operator), and that right is substantive (e.g., without cause), then the operator would be an agent. However, if the exercise of that removal right requires agreement by more than one of the non-operator parties, then it is not conclusive as to whether the operator is a principal or an agent. The more parties that would have to agree to remove the operator (and the more restrictive the conditions for removal), the less important that removal right is when determining if the operator is a principal.

#### **c) Remuneration of the operator**

IFRS 10 describes how to evaluate remuneration arrangements (including illustrative examples), but does not include any bright line indicators. The fee received by the operator must be commensurate with the services provided, and include only 'market' terms, for the operator to be considered an agent. However, the magnitude and variability of remuneration could still result in the operator being a principal, even if these two criteria are met. The greater the fee, and exposure to variability, relative to the expected returns from the joint arrangement, the more indicative it is that the operator is a principal.

However, the presence of a variable return does not automatically lead to a conclusion of an operator being a principal. An operator can receive a variable fee for providing services and still be considered an agent, so it may be difficult to distinguish an agency relationship from that of a principal. For example, an operator needs to evaluate whether its exposure to variability of returns is different from that of the other investors, and if so, whether this might influence its actions.

#### **d) Variable returns held through other interests**

When an operator holds other interests in a joint arrangement over and above the remuneration it receives for being the operator, this may indicate it is not an agent. It is common in the mining and metals sector for operators to also have a direct financial interest in the joint arrangement. By virtue of holding this other interest, the standard indicates that decisions made by the operator may differ from those it would have made if it did not hold the other interest.

In evaluating its exposure to variability of returns from other interests, IFRS 10 requires an operator to consider the following:

- (a) The greater the magnitude of, and variability associated with, its economic interests, considering its remuneration (as discussed above) and other interests, in aggregate, the more likely the operator is a principal
- (b) The more that the operator's exposure to variability of returns differs from that of the other investors, the more likely that this might influence its actions, and the more likely that the operator is a principal

While this evaluation is made primarily on the basis of returns expected from the activities of the joint arrangement, the operator must also consider its maximum exposure to variability of returns, taking into account remuneration and other interests that it holds.



### 3.1.1 So what happens if you have control?

The impact of controlling an arrangement depends on a number of factors.

The most important of these will be identifying and assessing the rights and obligations the contractual arrangement provides the parties, as well as assessing whether the arrangement is a business.

#### a) Identifying and assessing rights and obligations

- ▶ *Rights to the underlying assets and obligations for the underlying liabilities of the arrangement:* While the principal/agent assessment may lead to a conclusion that an operator has control, the fact that each party has specific rights to, and obligations for, the underlying assets and liabilities, means the operator does not control anything over and above its own direct interest in those assets and liabilities. Therefore, it still only recognises its interest in those assets and liabilities. This accounting applies regardless of whether the arrangement is in a separate vehicle<sup>1</sup> or not, as the contractual terms are the primary determinant of the accounting.
- ▶ *Rights to the net assets of the arrangement:* This only occurs where, at a minimum, the arrangement is structured through a separate vehicle. In this instance, the operator consolidates the entity and recognises any non-controlling interest.

#### b) Is the arrangement a business?

The other relevant factor is whether the arrangement is a business, as this determines whether, upon obtaining control, the requirements of IFRS 3 *Business Combinations* apply. All of the requirements of IFRS 3 apply if the entity controls the arrangement where it has rights to the net assets, and that arrangement is a business. However, if that controlled arrangement is not a business, the entity identifies and recognises the individual assets acquired and liabilities assumed based on their relative fair value, and does **not** recognise any goodwill.

For arrangements where there are rights to the assets and obligations for the liabilities, it is not clear whether IFRS 3 applies and whether goodwill could be recognised (even if outside the scope of IFRS 3). This issue has recently been referred to the IFRS Interpretations Committee. We discuss this further in section 4.1.1 of this publication.

<sup>1</sup>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."

#### How we see it

While certain aspects of joint control are unchanged from IAS 31, care is required in determining whether the arrangement is still considered to be under joint control under IFRS 11. This is because the reference to 'control' in the new definition of 'joint control' is based on the new definition of control in IFRS 10.

Under IAS 31, many consider an operator to be acting as an agent, a view which is based on the way these roles are generally perceived, and referred to, in the sector. However, entities will need to carefully assess the nature of their arrangements and determine whether this conclusion remains true, based on how guidance in IFRS 10 helps to delineate principal versus agent.

### 3.2 What are relevant activities?

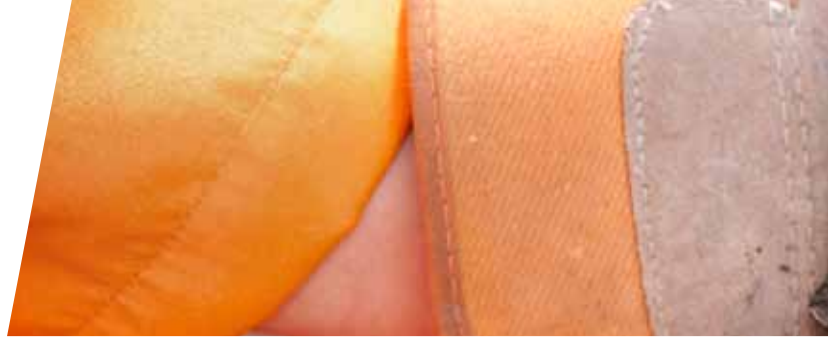
Relevant activities are those activities of the arrangement which significantly affect the returns of the arrangement. Determining what these are for each arrangement will require significant judgement.

Examples of decisions about relevant activities include, but are not limited to:

- ▶ Establishing operating and capital decisions of the arrangement including budgets – for example, for a mining and metals arrangement, approving the capital expenditure programme for the next year

And

- ▶ Appointing and remunerating a joint arrangement's key management personnel or service providers and terminating their services or employment – for example, appointing a contract miner to undertake mining operations.



### 3.3 'Unanimous consent' – what does this mean?

While the requirement for unanimous consent is not new, IFRS 11 does provide additional guidance that clarifies when unanimous consent exists, and over which activities it is required. Unanimous consent means that any party with joint control can prevent any of the other parties, or a group of parties, from making unilateral decisions about relevant activities.

Sometimes the decision-making process agreed between the parties in the JOA implicitly leads to joint control. For example, in a 50% / 50% joint arrangement, the JOA specifies that at least 51% of the voting rights are required to make a decision about relevant activities. Therefore, the parties have implicitly agreed that they have joint control because decisions about relevant activities cannot be made without both parties agreeing.

However, in other instances, the JOA may require a minimum proportion of the voting rights to make decisions. Unless it is obvious how this minimum must be achieved, or the JOA specifies which parties are required to unanimously agree, then there would not be joint control.

IFRS 11 provides some examples to illustrate this point:

	Example A	Example B	Example C
Requirement	75% vote to direct relevant activities	75% vote to direct relevant activities	Majority vote to direct relevant activities
Party A	50%	50%	35%
Party B	30%	25%	35%
Party C	20%	25%	n/a
Other	n/a	n/a	Widely dispersed
Conclusion	Even though A can block any decision, A does not control the arrangement, because A needs B to agree – therefore <b>joint control</b> between A and B.	<b>No control (or joint control)</b> because multiple combinations could be used to reach agreement	<b>No control (or joint control)</b> because multiple combinations could be used to reach agreement

#### 3.3.1 Unanimous consent over which decisions?

To have joint control, unanimous consent is required for decisions about the **relevant activities**. If unanimous consent relates only to decisions that give a party protective rights<sup>2</sup>, or over administrative matters only, and not to decisions about the relevant activities, that party does not have joint control. For example, a veto right that prevents a joint arrangement from ceasing business would likely be a protective right, and not a right that creates joint control. However, if the veto rights relate to relevant activities such as approving the capital expenditure budget, then those rights may create joint control.

For some mining and metals operations, decision-making may vary over the life of the project e.g., during the exploration and evaluation phase, the development phase and/or the production phase. For example, during the exploration and evaluation phase, one party to the arrangement may be able to make all of the decisions, whereas once the project enters the development phase, decisions may then require unanimous consent. To determine whether the arrangement is jointly controlled, it will be necessary to decide which of these activities e.g., exploration and evaluation and/or development, most significantly affect the returns of the arrangement. This is because the arrangement will only be considered to be a joint arrangement if those activities which require unanimous consent are the ones that most significantly affect the returns. This will be a highly judgemental assessment.

#### How we see it

The new (and clarified) requirements for assessing whether unanimous consent is required over relevant activities may mean some arrangements that have previously been assessed as having joint control now no longer satisfy the requirements, and hence, will not be considered joint arrangements.

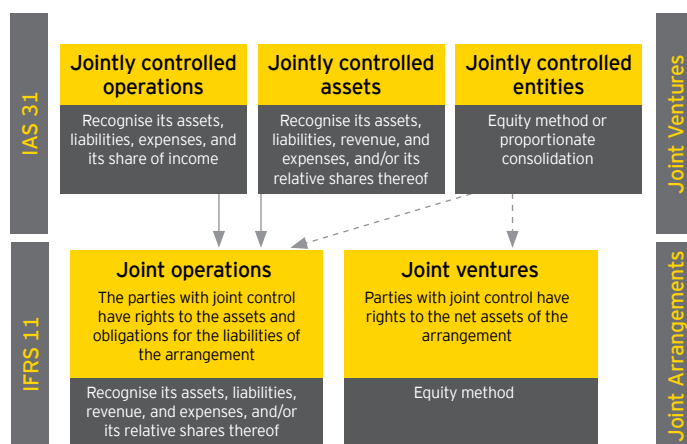
<sup>2</sup>IFRS 10 defines protective rights as those designed to protect the interests of the party holding those rights without giving that party power over the entity to which those rights relate and that relate to fundamental changes to the activities of an investee or apply in exceptional circumstances.

It is important to note that not all current JCEs will automatically be considered joint ventures under IFRS 11 – detailed analysis will be required.

## 4. Differences between joint ventures and joint operations

Once it has been established there is joint control, joint arrangements are then classified as either: joint operations or joint ventures.

Diagram 2



### 4.1 Joint operations

**JCAs and JCOs:** These are now called 'joint operations' under IFRS 11. The accounting for these arrangements will generally be the same as under IAS 31. That is, the joint operator (now defined as a party that has joint control of a joint operation and not to be confused with the operator of the joint arrangement) continues to recognise its assets, liabilities, revenues and expenses, and/or its relative shares thereof, if any. As mentioned previously, people often incorrectly refer to this accounting as proportionate consolidation, when in fact it is not. We consider this issue later in this publication.

**JCEs – rights to assets and obligations for liabilities:** It is also possible that current JCEs may be classified as joint operations under IFRS 11. Regardless of legal structure, where the party has rights to the assets and obligations for the liabilities of the underlying joint arrangement, it will be classified and accounted for as a joint operation, and accounted for as above.

#### 4.1.1 Does IFRS 3 apply to joint operations?

One area where there is currently a lack of clarity when accounting for acquisitions of interests in JCAs and JCOs, and unless resolved, will present similar issues for joint operations, is whether the principles of IFRS 3 apply.

- ▶ One view is that IFRS 3 does not apply. This is on the basis that even though the activity of the JCA/JCO or joint operation may constitute a business, the venturer/joint operator does not control that business – they only have joint control.
- ▶ The other view is that IFRS 3 is applicable. This is on the basis that the unit of account for assessing control is the venturer's/joint operator's own interest in the business of the JCA/JCO or joint operation, and the entity controls this.

This lack of clarity has led to diversity in practice. This issue was recently referred to the IFRS Interpretations Committee (the Committee) and considered at their July 2011 meeting (agenda paper 9). At the date of this publication, this issue was still being considered by the Committee.

#### How we see it

Our experience shows that practice in this area is indeed diverse and there are varying views as to whether IFRS 3 should or should not apply. It will not be a simple exercise to resolve and significant research and outreach will be required.

### 4.2 Joint ventures

**JCEs – rights to net assets:** In this instance, the arrangement will be classified and accounted for as a joint venture. The joint venturer (now defined as a party who has joint control of a joint venture) will then be required to apply equity accounting to account for this investment. This is because proportionate consolidation is no longer permitted for joint ventures.

## The removal of proportionate consolidation will not affect the accounting currently applied to JCAs/JCOs.



### 4.3 Clarifying the accounting ... what is proportionate consolidation?

As mentioned earlier, there is some misunderstanding as to what proportionate consolidation is under IFRS, and how this compares to JCA/JCO accounting under IAS 31, and the accounting for joint operations under IFRS 11. This confusion is partly due to the two approaches being technically different, from an accounting perspective, and also partly due to the way the term 'proportionate consolidation' is used under US GAAP. Under US GAAP, proportionate consolidation is used to describe a method of accounting that would be the equivalent of IFRS's JCA/JCO (and now joint operation) accounting.

As a consequence, there is some unwarranted concern that all interests in joint arrangements will require equity accounting – which is not the case. And for JCEs that are classified as joint operations under IFRS 11, it may not be clear whether the adoption of IFRS 11 will impact the financial statements.

To illustrate this:

- ▶ Where a joint operator has rights to a specified percentage of all assets (e.g. 50%) and obligations for the same specified percentage (50%) of all liabilities, there would likely be no difference between the accounting for a joint operation and proportionate consolidation.
- ▶ However, where the joint operator has rights to a specified percentage of certain assets and differing rights (and percentages) to other assets, and/or different obligations for various liabilities, the financial statements would look different when accounting for those individual rights and obligations, as compared with proportionately consolidating the same percentage of all assets and liabilities.

#### Example 1: 50% / 50% joint arrangement

Item	100% amount	Proportionate consolidation		IAS 31 – JCA/JCO accounting   IFRS 11 – JO accounting	
		Party A	Party B	Party A	Party B
Truck*	200	100	100	200	-
EE&D	1,000	500	500	500	500
Debt**	(100)	(50)	(50)	-	(100)
Other liabilities	(80)	(40)	(40)	(40)	(40)

\* Party A has rights to 100% of the truck

\*\* Party B has obligations for 100% of the debt

### 4.4 The impact of a change in classification upon transition

**JCE (proportionate consolidation) to joint venture:** Where proportionate consolidation was previously used for JCEs under IAS 31, and such arrangements are now classified as joint ventures, the transition to equity accounting under IFRS 11 will result in substantial changes to the financial statements of the joint venturer.

**JCE (proportionate consolidation) to joint operation:** As explained above (and illustrated in example 1), it is also possible that for proportionately consolidated JCEs which are now classified as joint operations, the accounting may not be identical – particularly where an entity does not have a uniform percentage interest in all assets and liabilities.

#### 4.4.1 Presentation impacts

These changes will impact the presentation of the financial statements of affected entities. For example, going from proportionate consolidation to equity accounting will cause the investment in the joint arrangement to go from being presented as multiple line items throughout the Statements of Financial Position and Performance, to single equity accounted line items. There will also be impacts on key metrics such as EBITDA. This is because, under proportionate consolidation, a joint venturer's share of any interest or tax of the joint arrangement would have been presented outside of EBITDA, whereas under equity accounting, such amounts will now be included in the single line item which forms part of EBITDA.



#### 4.4.2 Measurement impacts

In some cases, there may also be measurement differences which will affect profit or loss and/or net assets. For example, under proportionate consolidation, any losses from a joint arrangement would have been recognised as incurred. However under equity accounting, the concept of 'water line accounting' would only see such losses continue to be recognised up until the point at which the investment in the joint arrangement is reduced to nil.

For more information on the practical implications of these changes for your business e.g., on accounting systems and processes, management information and key performance indicators, etc., refer to our *IFRS Practical matters* paper referenced at the start of this publication.

#### How we see it

Where investments in JCEs that were proportionately consolidated are material, and such arrangements are now classified as joint ventures, there will be a significant impact on the presentation of the financial statements of affected entities. In some cases, there may also be measurement differences which will affect profit or loss and/or net assets. Significant changes will also occur where an equity accounted JCE is now considered to be a joint operation as the joint operator would now recognise its assets, liabilities, revenues and expenses, and/or its relative shares of those items, if any.

As a result of the changes introduced by IFRS 11 to classify a joint arrangement, we would caution entities against voluntarily changing from proportionate consolidation to the equity method, while still under IAS 31, until they have fully analysed the classification under the new standard.

## 5. Gross versus net – what should I recognise?

It is clear that a participant in a joint operation is required to recognise its rights to the assets, and its obligations for the liabilities (or share thereof) if any, of the joint arrangement. Therefore it is important that an entity fully understands what these rights and obligations are and how these may differ between the parties.

### 5.1 Operators of joint arrangements

Operators of joint arrangements may have a direct legal liability in respect of the entire balance of certain obligations arising from transactions related to the joint arrangement. These may include, but are not limited to, third party creditors, leases, employee liabilities, etc. They may also have a right of reimbursement (by virtue of the JOA) from the non-operator parties. The operator would be required to recognise 100% of such liabilities and would recognise a receivable from the non-operator parties for their share of such liabilities. IFRS prohibits the offsetting of these liabilities against these receivables in the Statement of Financial Position. In the profit or loss, however, where these costs are being incurred on behalf of the non-operator parties, i.e., the operator is acting as agent, and such costs are directly recharged, this is considered a reimbursement. Therefore, there is no effect on profit or loss as the recharge is offset against the related expense.

While, in most circumstances, the ability of the non-operator parties to pay their share of the costs incurred by the operator will not be in doubt, particularly where cash calls are paid in advance, there may be instances where they are unable to pay. Here the operator might not be able to recognise a corresponding receivable and reimbursement, and consequently, this would negatively impact its financial statements.

### 5.2 Non-operators

Non-operators would recognise a payable to the operator, which would be accounted for as a financial instrument under IAS 32 *Financial Instruments: Presentation*/IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments* and not under the standard which relates to the type of cost being reimbursed. This would mean different measurement and/or disclosure requirements would apply. For example, the non-operator's share of employee entitlements relating to the operator's employees who work on the joint project would not be accounted for under IAS 19 *Employee Benefits*.



### 5.3 Joint and several liability

It is also possible that there may be liabilities in the arrangement where the obligation is joint and several. That is, an entity is not only responsible for its proportionate share, but it is also liable for the other party's share should they be unable to pay. A common example of this in the mining and metals sector is rehabilitation obligations.

In these instances, each party not only takes up its proportionate share of the rehabilitation obligation, it is also required to assess the likelihood that the other party will not be able to meet their share. Where it is only possible (or remote) that the other party will not be able to pay, the entity is not required to do anything in addition. Where there is a possible obligation that the entity will have to cover the obligations of the other party, or there is some indication that they may not be able to pay, but it is not probable (i.e., more likely than not) that they cannot pay, then the entity would have to disclose this possible obligation as a contingent liability. However, where it is probable that the other party cannot meet some of, or the entire, obligation, the entity would need to assess what additional amount they would have to recognise.

#### How we see it

It will be critical for parties to joint arrangements to undertake a detailed review of their JOAs, including any subsequent amendments or addendums, to ensure they fully understand the rights and obligations therein, and how these are shared amongst the parties.

In many instances, the requirement for the operator to recognise 100% of certain liabilities, and then a separate receivable from the non-operator parties, and similarly the accounting for joint and several liabilities, will not negatively impact the operator's (or entity's) net asset position or net profit or loss. However, recent events illustrate that non-operator/other parties may not always be able to meet their share of obligations of the joint arrangement.

## 6. So what if I don't have joint control or control?

The accounting impact of determining that an interest in an arrangement does not provide the party with joint control or control depends on a number of factors. Again, the most important of these factors will be the rights and obligations the contractual arrangement provides the parties.

### 6.1 Identifying and assessing the rights and obligations

- ▶ *Rights to the underlying assets and obligations for the underlying liabilities of the arrangement:* Despite not having joint control (or control) the party still has rights to, and obligations for, the underlying assets and obligations. Therefore, it would continue to recognise its interest in those assets and liabilities. This accounting would apply regardless of whether the arrangement is in a separate vehicle or not, as the contractual terms are the primary determinant of the accounting.
- ▶ *Rights to the net assets of the arrangement:* This only occurs where, at a minimum, the arrangement is structured through a separate vehicle. In this instance, if the party is considered to have significant influence over the arrangement, it accounts for its interest in accordance with IAS 28 *Investments in Associates and Joint Ventures* (as amended in 2011) – equity accounting; otherwise it accounts for its interest under IAS 32/IAS 39/IFRS 9 – fair value through profit or loss or other comprehensive income (unless the investment was held for trading).

#### How we see it

Given that the accounting for these contractual arrangements depends on the rights and obligations provided to the parties, it is essential for an entity to obtain a thorough understanding and complete a detailed analysis of their rights and obligations.



## 7. New disclosures ... more information; impact on processes and systems

IFRS 12 introduces a range of new and expanded disclosures. These will require the disclosure of significant judgements and assumptions made by management in determining whether: there is joint control; and an arrangement structured through a separate vehicle is a joint venture or a joint operation. For joint ventures, it will also require the compilation and disclosure of additional information, either individually for material joint ventures, or in aggregate for the immaterial joint ventures – which will impact an entity's processes and systems.

For more information on the practical implications of these changes on your business e.g., on accounting systems and processes, data accumulation, etc., refer to our *IFRS Practical matters* paper referenced at the start of this publication.

## 8. Final thoughts

The rights and obligations provided to a party under these contractual arrangements will drive the accounting. Therefore, an entity will have to ensure it has a detailed understanding of the specific rights and obligations of its arrangements to be able to determine the impact of these new standards.

Given the unique nature of the various arrangements that currently exist, and are emerging, an entity will need to individually analyse each contract to be able to complete this assessment. The difficulty of this task will be impacted by the number and complexity of the arrangements an entity has. Robust systems and processes will need to be developed, not only to complete the initial assessment, but also to enable the ongoing assessment of current arrangements (should facts and circumstances change) and the assessment of new arrangements.

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## Ernst & Young's Global Mining & Metals Center

With a strong outlook in the sector, the global mining and metals industry is focused on future growth through expanded production, without losing sight of operational efficiency and cost optimization. The sector is also faced with the increased challenge of changing expectations in the maintenance of its social license to operate and meeting government revenue expectations.

Ernst & Young's Global Mining & Metals Center brings together a worldwide team of professionals to help you achieve your potential – a team with deep technical experience in providing assurance, tax, transactions and advisory services to the mining and metals sector.

The Center is where people and ideas come together to help mining and metals companies meet the issues of today and anticipate those of tomorrow. Ultimately it enables us to help you meet your goals and compete more effectively. It's how Ernst & Young makes a difference.

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