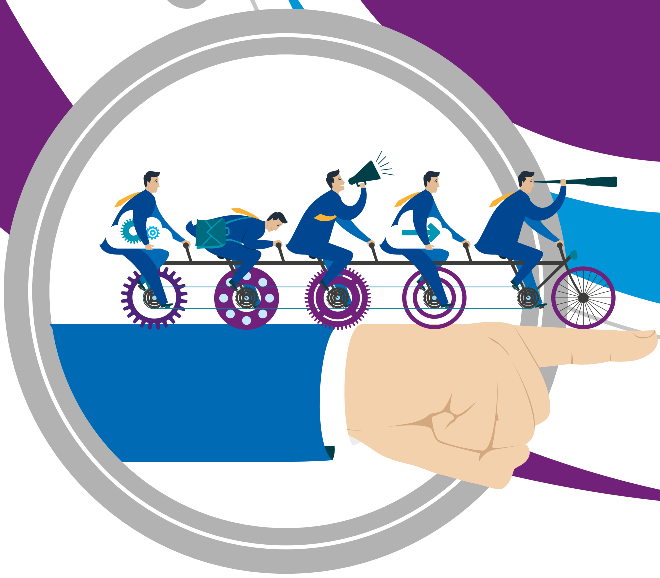
Accounting for joint operations



This article aims to:

- Summarise the accounting requirements with respect to joint operations.

Increasing competitiveness in business, has necessitated collaboration and synergy amongst various business houses. Accordingly, several entities enter into joint arrangements having different (and sometimes complicated) legal structures and forms. A challenge thus arises on the accounting for such arrangements.

Under the Indian Generally Accepted Accounting Principles (IGAAP), AS 27, *Financial Reporting of Interests in Joint Ventures,* the accounting requirements are driven only by whether the arrangements are structured through an entity. For example, jointly controlled operations and jointly controlled assets are in the nature of joint arrangements in AS 27 that do not require existence of an entity. Parties to these arrangements are simply required to recognise assets, liabilities, revenues and expenses arising from them. However, when the same arrangements are structured through an entity, AS 27 classifies them as jointly controlled entities and parties have to account for them using the proportionate consolidation method.

Under Ind AS 111, *Joint Arrangements* the accounting is driven by a principle, namely that parties to the arrangements should recognise their rights and obligations arising from the arrangements. This would generally result either in the recognition of assets and liabilities and corresponding revenues and expenses or in the recognition of an investment.

Classification of joint arrangements

Under Ind AS 111, joint arrangements are classified either as:

- A joint operation whereby the jointly controlling parties, known as joint operators have rights to the assets and obligations for the liabilities relating to the arrangement
- A joint venture whereby the jointly controling parties, known as the joint venturers, have rights to the net assets of the arrangement.

The rights and the obligations of the parties arising from the arrangements in the normal course of business are key to determining the type of arrangement, and therefore, its subsequent accounting treatment.

Factors for assessing joint operations

The guidance in Ind AS 111 provides certain indicators that entities can use to assess their rights and obligations to an arrangement. Entities should consider the following indicators:

- The structure and legal form of the arrangement

  This requires analysis of whether the joint arrangement is structured through a separate vehicle, which has a legal form that confers separation between the parties and the vehicle. If so, the arrangement may be considered a joint venture.

  Arrangements that are not structured through a separate vehicle, i.e. structured on the basis of a contractual arrangement only are generally considered to be joint operations. However, certain arrangements may be considered as joint operations even when structured through a separate vehicle. For instance, if the legal form of the separate vehicle does not cause the vehicle to be considered as an entity in its own right (i.e. it does not confer legal separation and the assets and liabilities of the separate vehicle are the assets and liabilities of the parties to the arrangement).

- The terms agreed by the parties in the contractual arrangement

  If the contractual terms specify that the parties have rights to the assets and obligations for the liabilities of the arrangement, then the arrangement could be considered a joint operation, irrespective of its separate structure and legal form.

- Assessment of the relevant 'other facts and circumstances'

  These include consideration of whether the parties designed the arrangement in a manner that gives them the right to substantially all the economic benefits relating to the arrangement. For example, when the activities are designed to provide an output to the controlling parties and the arrangement is limited from selling to third parties. Further, whether the design of such an arrangement also results in its dependence on the parties on the continuous basis for settling its liabilities. This may also occur in the example above where the parties are substantially the only contributors of cash flows to the operations of the arrangement. Such an arrangement could be considered a joint operation despite its structure and legal form.

Accounting in consolidated and separate financial statements of joint operators

The joint operation is considered to be a part of the joint operator's business, hence the joint operator recognises its assets, liabilities and transactions, including its share of those incurred jointly, in both its consolidated and its separate financial statements (following line-by-line consolidation procedure). These assets, liabilities and transactions are accounted for in accordance with the relevant standards. The joint operator does not additionally account in its consolidated or separate financial statements for its shareholding in the separate vehicle.

There could be certain practical challenges while accounting for joint operations. They are as follows:

- *Recognition of revenue by a joint operator:* If a joint operation is structured through a separate vehicle and the assessment of other facts and circumstances results in the joint arrangement being classified as a joint operation, then a question may arise on the accounting for revenue related to the output purchased from the joint operation by the jointly controlling parties.

  Ind AS 111 requires a joint operator to recognise its share of the revenue from sale of the output by the joint operation. In this regard, the IFRS interpretations committee clarified that revenue would be recognised by a joint operator only when the joint operation sells its output to third parties. For this purpose, third parties do not include other parties who have rights to the assets and obligations for liabilities relating to the joint operation.

- *Assessment of other facts and circumstances:* The IFRS interpretations committee clarified that in order to classify the joint arrangement as a joint operation as a result of assessing other facts and circumstances, it is necessary to demonstrate that: (a) each party to the joint arrangement has rights and obligations relating to economic benefits of the assets of the arrangement; and (b) each party is obliged to provide cash to the arrangement through enforceable obligations, which is used to settle the liabilities of the joint arrangement on a continuous basis.
- *Joint operator purchases output that differs from its share of ownership in the joint operation:* When a joint operator's share of output purchased differs from its share of ownership interest in the joint operation, then the IFRS interpretation committee noted that it is important to understand the reason for this occurrence. Judgement would therefore, have to be exercised to determine the appropriate accounting.

Consider this

- Each joint arrangement is required to be assessed individually to determine its classification either as a joint operation or a joint venture. In some cases, parties may be bound by a framework agreement that sets up contractual terms for undertaking one or more activities and establishes different joint arrangements for specific activities. Even in this case, each arrangement governed by that framework agreement needs to be assessed separately.
- The joint operators account for their interest in the joint operation in their separate financial statements itself. Hence, no further adjustment is required to be made by the joint operator with respect to its interest in the joint operation, while preparing its consolidated financial statements.