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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

# CL-25-1 | Corporate Financial Reporting

## Corporate Level (2025 – Curriculum)

- Consolidated Financial Statements – Part 5


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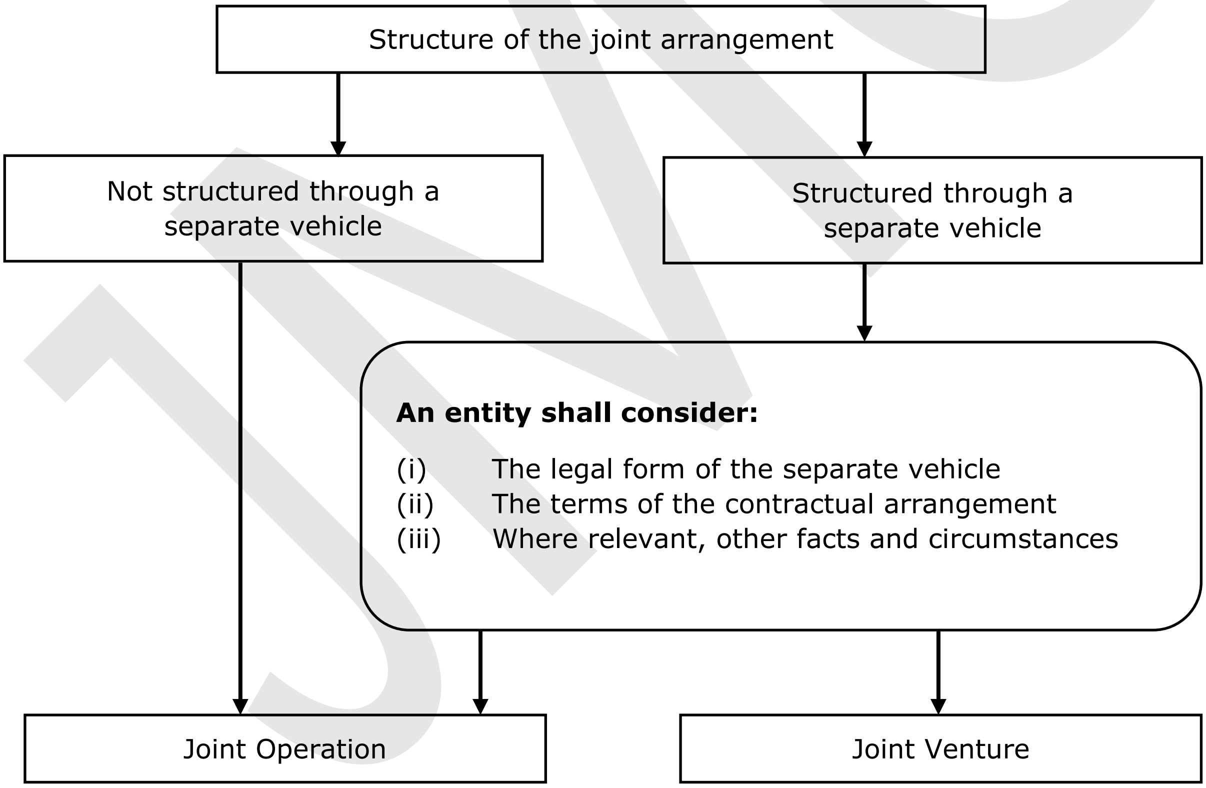
# JOINT ARRANGEMENTS (SLFRS 11)

Joint arrangements are classified as either joint operations or joint ventures depending on the rights and obligations of the parties to the arrangement. SLFRS 11 Joint Arrangements provides the accounting treatment applicable to entities over which an **investor has joint control**.

### Definitions

| | |
|---|---|
| Joint arrangement | An arrangement of which two or more parties have joint control. |
| Joint control | The contractually agreed sharing of control of an arrangement, Which exists only when decisions about the relevant activities require the **unanimous consent of the parties sharing control**. |
| Joint operation | A joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. |
| Joint venture | A joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. |

### JOINT ARRANGEMENT TYPES




### Characteristics of a Joint Arrangement

1) The parties are bound by a **contractual arrangement.**
2) The contractual arrangement gives two or more of those parties **joint control** of the arrangement.

There are **two key characteristics** of joint control:

a) there exists a contractually agreed sharing of control (It does not need to be explicit, it can be implied from the contractual terms)

b) decisions about relevant activities require unanimous consent (That is, no party can make a unilateral decision about relevant activities)

## CONTRACTUAL ARRANGEMENT

The existence of a contractual agreement distinguishes a joint arrangement from an investment in an associate. **If there is no contractual arrangement, then a joint arrangement does not exist.**

The existence of a contractual arrangement could be in one of several forms as follows.

- Contract between the parties
- Minutes of discussion between the parties
- Incorporation in the articles or by-laws of the joint venture

The contract will generally be in writing and deal with issues like:

- the purpose, activity, and duration of the joint arrangement
- how board members are appointed
- how decisions are made
- the capital or other contributions required of the parties
- how the parties share assets, liabilities, revenues, expenses or profit or loss relating to the joint arrangement

It is the contractual arrangement that establishes joint control over the joint venture, so that no single party can control the activity of the joint venture on its own.

The terms of the contractual arrangement are key to deciding whether the arrangement is a joint venture or joint operation. SLFRS 11 includes a table of issues to consider and explains the influence of a range of points that could be included in the contract. The table is summarized below.

| | Joint Operation | Joint Venture |
|---|---|---|
| **The terms of the contractual arrangement** | The parties to the joint arrangement **have rights to the assets, and obligations for the liabilities**, relating to the arrangement. | The parties to the joint arrangement **have rights to the net assets of the arrangement** (ie it is the separate vehicle, not the parties, that has rights to the assets, and obligations for the liabilities). |
| **Rights to assets** | The parties to the joint arrangement **share all interests** (eg rights, title or ownership) **in the assets relating to the arrangement in a specified proportion** (eg in | The assets brought into the arrangement or subsequently acquired by the joint arrangement **are the arrangement's assets**. The |

| | | |
|---|---|---|
| | proportion to the parties' ownership interest in the arrangement or in proportion to the activity carried out through the arrangement that is directly attributed to them). | parties have no interests (ie no rights, title or ownership) in the assets of the arrangement. |
| **Obligations for liabilities** | The parties **share all liabilities, obligations, costs and expenses in a specified proportion** (eg in proportion to their ownership interest in the arrangement or in proportion to the activity carried out through the arrangement that is directly attributed to them). | The **joint arrangement is liable** for the debts and obligations of the arrangement.<br><br>The parties are liable to the arrangement only to the extent of their respective:<br>• Investments in the arrangement<br>• Obligations to contribute any unpaid or additional capital to the arrangement, or<br>• Both |
| **Revenues, expenses, profit or loss** | The **contractual arrangement establishes the allocation of revenues and expenses on the basis of the relative performance of each party to the joint arrangement**. For example, the contractual arrangement might establish that revenues and expenses are allocated on the basis of the capacity that each party uses in a plant operated jointly. | The **contractual arrangement establishes each party's share in the profit or loss relating to the activities** of the arrangement. |
| **Guarantees** | The **provision of guarantees to third parties, or the commitment by the parties to provide them, does not, by itself, determine** that the joint arrangement is a joint operation. | |

**Joint Operations**

A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Those parties are called joint operators. Normally, **there will not be a separate entity established to conduct joint operations**.

**Example of a joint operation**

A and B decide to enter into a joint operation to produce a new product. Within this arrangement, A is responsible for undertaking one manufacturing process and B is responsible for undertaking the other. A and B have agreed that decisions regarding the joint operation will be made unanimously and that each will bear their own expenses and take an agreed share of the sales revenue from the product.

### Joint Ventures

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Those parties are called joint ventures. This will normally be established in the form of a separate entity to conduct the joint venture activities.

**Example of a joint venture**

A and B decide to set up a separate entity, C, to enter into a joint venture. A will own 55% of the equity capital of C, with B owning the remaining 45%. A and B have agreed that decision- making regarding the joint venture will be unanimous. Neither party will have a direct right to the assets or direct obligation for the liabilities of the joint venture. Instead, they will have an interest in the net assets of entity C set up for the joint venture.

## ACCOUNTING FOR JOINT ARRANGEMENTS

### Accounting for Joint Operations

If the joint operation meets the definition of a 'business' then the principles in SLFRS 3 Business Combinations apply when an interest in a joint operation is acquired:

- Acquisition costs are expensed to profit or loss as incurred.
- The identifiable assets and liabilities of the joint operation are measured at fair value.
- The excess of the consideration transferred over the fair value of the net assets acquired is recognized as goodwill.

At the reporting date, the individual financial statements of each joint operator will recognize:

- its share of assets held jointly
- its share of liabilities incurred jointly
- its share of the revenue from the joint operation
- its share of expenses from the joint operation.

The joint operator's share of the income, expenses, assets, and liabilities of the joint operation are included in its individual financial statements and so they will automatically flow through to the consolidated financial statements.

### Accounting for Joint Venture

The rules for equity accounting are included in LKAS 28 Associates and Joint Ventures and as you learnt previously, the same principles of equity accounting applies as same as for an associate.

In the individual financial statements, an investment in a Joint Venture can be accounted for:

- at cost
- in accordance with SLFRS 9 Financial Instruments, or
- using the equity method.

In the consolidated financial statements, the interest in the joint venture entity will be accounted for using the equity method. The treatment of a joint venture in the consolidated financial statements is therefore identical to the treatment of an associate.

**Test Your Understanding 28**

A, B and C establish a new entity, which is called D. A has 50% of the voting rights in the new entity, B has 30% and C has 20%. The contractual arrangement between A, B and C specifies that at least 75 of the voting rights are required to make decisions about the activities of entity D.

**You are required to:**

Explain how A should account for its investment in D in its consolidated financial statements?

**Test Your Understanding 29**

Two real estate companies (the parties) set up a separate vehicle (Supermall) for the purpose of acquiring and operating a shopping centre. The contractual arrangement between the parties establishes joint control of the activities that are conducted in Supermall. The main feature of Supermall's legal form is that the entity, not the parties, has rights to the assets, and obligations for the liabilities, relating to the arrangement.

These activities include the rental of the retail units, managing the car park, maintaining the centre and its equipment, such as lifts, and building the reputation and customer base for the centre as a whole.

The terms of the contractual arrangement are such that:

(a) Supermall owns the shopping centre. The contractual arrangement does not specify that the parties have rights to the shopping centre.
(b) The parties are not liable in respect of the debts, liabilities or obligations of Supermall. If Supermall is unable to pay any of its debts or other liabilities or to discharge its obligations to third parties, the liability of each party to any third party will be limited to the unpaid amount of that party's capital contribution.
(c) The parties have the right to sell or pledge their interests in Supermall.
(d) Each party receives a share of the income from operating the shopping centre (which is the rental income net of the operating costs) in accordance with its interest in Supermall.

**You are required to:** Explain how Supermall should be classified in accordance with SLFRS 11 Joint arrangements.

## Test Your Understanding 30

Harry has a 30% share in a joint operation. The assets, liabilities, revenues, and costs of the joint operation are apportioned on the basis of shareholdings. The following information relates to the joint arrangement activity for the year ended 31 December 2023:

• The manufacturing facility cost Rs. 30m to construct and was completed on 1 January 2023 and is to be dismantled at the end of its estimated useful life of 10 years. The present value of this dismantling cost to the joint arrangement at 1 January 2023, using a discount rate of 8%, was Rs.3m.

•During the year ended 31 December 2023, the joint operation entered into the following transactions:

- Goods with a production cost of Rs. 36m were sold for Rs.50m
- Other operating costs incurred amounted to Rs. 1m
- Administration expenses incurred amounted to Rs. 2m.

Harry has only accounted for its share of the cost of the manufacturing facility, amounting to Rs. 9m. The revenue and costs are receivable and payable by the two other joint operation partners who will settle amounts outstanding with Harry after each reporting date.

**You are required to:**

Show how Harry will account for the joint operation within its financial statements for the year ended 31 December 2023.