

ASSURANCE AND ACCOUNTING

CANADIAN GAAP – IFRS COMPARISON SERIES

Issue 19: Joint Arrangements and Associates

Both IFRS and Canadian GAAP are principle based frameworks, and from a conceptual standpoint many of the general principles are the same. However, the application of those general principles in IFRS can be significantly different from Canadian GAAP. Therefore, to understand the magnitude of the differences between the two, it is essential to look beyond the general principles and examine the detailed guidance provided in the standards. This is our eighteenth issue in a series of publications which will provide detailed information on the key differences between IFRS and Canadian GAAP with respect to joint arrangements and associates.

In this issue the focus will be on the recognition and measurement of joint arrangements and associates including:

- Significantly Influenced Investments;
- Equity Method;
- Other Issues for Significant Influence Investments;
- Joint Ventures;
- First time adoption of IFRS issues; and
- Future of Joint Arrangements guidance

Be advised that this publication is a guide to the differences between Canadian GAAP and IFRS and is not meant to be a comprehensive manual. Please contact a BDO representative for specific details and information.

References

IFRS:

IAS 28 – Investments in Associates;
IAS 31 – Interests in Joint Ventures;
SIC 13 – Jointly Controlled Entities – Non-monetary Contributions by Venturers; and
IASB ED 9 (September 2007) – Joint Arrangements

Canadian GAAP:

CICA 3051 – Investments;
CICA 3055 – Interests in Joint Ventures;
AcG-18 – Investment companies;
EIC-8 – Recognition of an equity accounted investee's losses in excess of the investment;
EIC-38 – Accounting by newly formed joint ventures; and
EIC-165 – Accounting by an investor upon a loss of significant influence



Significantly Influenced Investments

The scope of IAS 28 and Section 3051 are similar. The key difference that will be applicable to most of our clients is that there is a separate accounting guideline for investment companies – AcG 18, that doesn't have parallel guidance under IFRS.

CANADIAN GAAP	IFRS
The term <i>investments subject to significant influence</i> is used to describe a relationship when an entity is able to exercise significant influence over the strategic operating, investing and financing policies of an investee without control or joint control.	The term <i>associate</i> is used to describe a relationship when one entity has the power to participate in the financial and operating policy decisions of an investee but does not have control or joint control over those policies.
Section 3051 presumes that an investor has significant influence when it holds 20-50% of the investee's voting power.	Like Canadian GAAP, IAS 28 uses the 20-50% as guidelines to determine significant influence.
While these percentages provide guidelines under the standard, an investor that holds less than 20% is presumed not to have the ability to exercise significant influence, unless such influence is clearly demonstrated.	Similarly, if there is less than 20% ownership then other factors must be considered to determine significant influence.
However, the holding of 20% or more of the voting interest in the investee does not in itself confirm the ability to exercise significant influence; other factors need to also be considered.	Unlike Canadian GAAP, under IAS 28, 20% or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case.
The qualitative factors that need to be considered for significant influence under Canadian GAAP are: <ul style="list-style-type: none"> • Representation on the board of directors; • Participation in policy-making processes; • Material intercompany transactions; • Interchange of managerial personnel; or – • Provision of technical information 	The same qualitative factors are considered under IAS 28.
Unlike IFRS, when considering the ownership percentages, potential voting rights that are exercisable or convertible in the future are not considered.	Under IFRS, any potential voting rights that are currently exercisable or convertible, including potential voting rights held by other entities and any contractual obligations are considered in assessing significant influence. Management's intention and the financial ability to convert or exercise are not considered.
Like IFRS, control of an investee by one entity doesn't preclude significant influence of the same investee by a different entity.	Under IFRS, one entity can be an associate of an entity and be controlled by a different entity.

Equity Method

CANADIAN GAAP	IFRS
Like IFRS, an investment subject to significant influence is accounted for using the equity method. The equity method reflects the investor's share of net income and loss, distributions, and changes in the investee's other comprehensive income in the investment account.	Under IAS 28, associates are to be accounted for using the equity method. The equity method under IFRS and Canadian GAAP is similar. However, there may be changes in the investee's other comprehensive income account such as a revaluation of property, plant and equipment that would not be included under Canadian GAAP.
Unlike IFRS, there is no exemption under Canadian GAAP for investments subject to significant influence that are acquired for the purpose of sale from using the equity method.	Under IAS 28, an investment in an associate that is classified as held for sale in accordance with IFRS 5 – Non Current Assets Held for Sale in Discontinued Operations, is exempt from using the equity method.
Under Canadian GAAP upstream transactions between entities subject to significant influence are eliminated to the extent of the investor's interest. However, unlike IFRS, Canadian GAAP requires the elimination of all unrealized profits and losses for downstream transactions and are not limited to the investor's interest in the investee.	Under IFRS unrealized profits and losses on both upstream transactions (sales from the investee to the investor) and downstream transactions (sales from the investor to the investee) are eliminated only to the extent of the investor's interest in the investee.

CANADIAN GAAP	IFRS
<p>Like IFRS, the carrying amount of an investor's account is not reduced below zero for losses incurred by the investee. The limited exceptions to this are found in EIC 8:</p> <ul style="list-style-type: none"> • The investor has guaranteed obligations of the investee; • The investor is otherwise committed to provide further financial support for the investee; or • The investee seems assured of imminently returning to profitability 	<p>Under IFRS, unless the investor has an obligation to fund the losses of the associate, it would not recognize a loss below zero.</p>
<p>Like IFRS, when an entity loses its significant influence over another entity, it accounts for the investment going forward as a financial instrument in accordance with Section 3855 – Financial Instruments: Recognition and Measurement requirements.</p> <p>Unlike IFRS, the deemed cost for the measurement of any retained interest going forward is the cost of the investment at the time of the loss of significant influence.</p>	<p>When an entity no longer exercises significant influence for an investment in an associate, it stops using the equity method accounting and the investment is recorded in accordance with IAS 39 – Financial Instruments Recognition and Measurement.</p> <p>For any retained interest in the associate, the deemed cost used for the measurement going forward is based on the fair value at the time of the loss of significant influence.</p>

Other Issues for Significant Influence Investments

Other areas of Canadian GAAP and IFRS differences are around impairment, accounting policies, and reporting dates.

CANADIAN GAAP	IFRS
<p>Similar to IFRS, impairment testing for an investment subject to significant influence is performed in accordance with Section 3855: Financial Instruments – Recognition and Measurement.</p> <p>The key differences are:</p> <ul style="list-style-type: none"> • Impairment under Canadian GAAP is based on a decline in value that is considered to be other than temporary; • The calculation for impairment; and • Reversals of impairments are not permitted 	<p>Impairment testing on investments in associates is done in accordance with IAS 39 – Financial Instruments: Recognition and Measurement.</p> <p>See Canadian GAAP- IFRS Comparison Series Issue #2 and #4 for discussion on impairment of financial instruments.</p> <p>http://www.bdo.ca/library/publications/ifrs/documents/CDNGAAP-IFRSComparisonSeries-Issue4.pdf</p> <p>http://www.bdo.ca/library/publications/ifrs/documents/CDNGAAP-IFRSComparisonSeries-Issue2.pdf</p> <p>There is no concept of other than temporary decline in value under IFRS and reversals of impairment are permitted.</p>
<p>Canadian GAAP does not require uniformity of accounting policies between the investor and the investment subject to significant influence. There is also no specific guidance on the consistency of reporting periods other than that when the fiscal periods are not coterminous, events relating to, or transactions of, the investee that have occurred during the intervening period and significantly affect the investor's financial position or results of operations should be recorded or disclosed, as appropriate.</p>	<p>IAS 28 specifically requires an associate's accounting policies to be consistent with those of the investor. The reporting dates for the investor and the associate cannot differ more than 3 months. This also applies to jointly controlled entities.</p>

Disclosures for Investments in Associates

CANADIAN GAAP	IFRS
<p>Both Canadian GAAP and IFRS require the following to be disclosed separately:</p> <ul style="list-style-type: none"> • The investor's share of the profit or loss of associates accounted for using the equity method; • The carrying amount of those investments; • The investor's share of any discontinued operations of such associates; and <p>Summarized financial information of associates, including the aggregated amounts of assets, liabilities, revenues and profit or loss (required under CICA 3051 when the financial position and results of operations of companies subject to significant influence are important factors in evaluating the investor's financial position and results of operations)</p> <p>Like IFRS, the investor has to recognize its share of the other comprehensive income of associates and disclose this information in the statement of changes in equity.</p>	<p>IFRS require the following disclosures (which are not required under Canadian GAAP):</p> <ul style="list-style-type: none"> • The fair value of investments in associates for which there are published price quotations (only "useful" information under CICA 3051); • The reasons why the presumption that an investor does not have significant influence is overcome if the investor holds, directly or indirectly through subsidiaries, less than 20% of the voting or potential voting power of the investee but concludes that it has significant influence; • Reasons why the presumption that an investor has significant influence is overcome if the investor holds, directly or indirectly through subsidiaries, 20% or more of the voting or potential voting power of the investee but concludes that it does not have significant influence; • The reporting date of the financial statements of an associate, when those financial statements are used in applying the equity method and are as of a reporting date or for a period that is different from that of the investor, and the reason for using a different reporting date or different period; • The nature and extent of any significant restrictions (e.g. resulting from borrowing arrangements or regulatory requirements) on the ability of associates to transfer funds to the investor in the form of cash dividends, or repayment of loans or advances; • The unrecognized share of an associate's losses, both for the period and cumulatively, if an investor has discontinued recognition of its share of the associate's losses; • The fact that an associate is not accounted for using the equity method in accordance with IAS 28; and • Summarized financial information of associates, either individually or in groups that are not accounted for using the equity method, including the amounts of total assets, total liabilities, revenues and profit or loss <p>Where an entity avails itself of the option to account for its investments in associates at fair value through profit or loss, the only IAS 28 disclosure requirement under such circumstances is for the entity to specify the nature and extent of any significant restrictions on the ability of the associate to transfer funds to the entity in the form of cash, or repayment of loans or advances.</p>

Joint Ventures

IAS 31 and CICA 3055 identify three types of joint ventures: jointly controlled operations, jointly controlled assets and jointly controlled entities. Under both Canadian GAAP and IFRS, a joint venture relationship is when two or more parties undertake an economic activity that is subject to joint control.

CANADIAN GAAP	IFRS
<p>Canadian GAAP requires the use of the proportionate consolidation method for all joint venture arrangements excluding variable interest entities which are accounted for in accordance with AcG 15.</p>	<p>Under the current IAS 31, jointly controlled entities can be accounted for using the equity method or the proportionate consolidation method. However, the exposure draft on Joint Arrangements proposes to remove the option to use the proportionate consolidation method for jointly controlled entities. If this proposal is accepted, this would be a significant change for Canadian entities who would then have to use the equity method.</p> <p>The treatment of jointly controlled operations and jointly controlled assets is consistent with Canadian GAAP.</p>
<p>Under Canadian GAAP, there is specific guidance in EIC 38 - Accounting by newly formed joint ventures on the financial statements of the Joint Venture itself. The consensus of the EIC says that a newly formed joint venture can use any of the following bases of valuation:</p> <ul style="list-style-type: none"> • Valuation of the net assets at their fair value (fair value may differ from the values agreed upon in the joint venture agreement); • Valuation of the net assets at the carrying value of the net assets to the joint venturers; or • Valuation of the net assets at the carrying value of the joint venturer's investment in the joint venture. This would include any gain recorded by a joint venturer on the portion of the assets considered to be sold <p>Note that CICA Section 3055 addresses accounting for an investment in a joint venture by the joint venturer; however, it does not extend to accounting by the joint venture itself which is discussed in EIC 38.</p>	<p>Unlike Canadian GAAP, there is no guidance under IFRS on how a newly formed joint venture should account for its contributed assets.</p>
<p>From the perspective of the joint venturers, contributions of assets to the joint venture are dealt with in Section 3055. Canadian GAAP, like IFRS, looks to the substance of the transaction to determine whether risks and rewards have passed to support recognition of any gain to the extent of the interests of the other non-related venturers.</p> <p>However, paragraphs 28 and 29 in Section 3055 also provide explicit guidance when the contributing venturer receives cash or other assets that do not represent a claim on the assets of the joint venture. Only the portion of the gain that relates to the amount of cash received or the fair value of the other assets received should be taken to income at the time of the transfer. Any remaining portion of the gain should be deferred and amortized to income over the life of the contributed assets.</p> <p>Like IFRS, any unrealized profits or losses on transaction with jointly controlled entities are eliminated to the extent of the investor's interest in the investee.</p>	<p>For contributions to a joint venture by the joint venturer, recognition of any portion of a gain or loss from the transaction shall reflect the substance of the transaction. While the assets are retained by the joint venture, and provided the venturer has transferred the significant risks and rewards of ownership, the venturer shall recognize only that portion of the gain or loss that is attributable to the interests of the other venturers. The venturer shall recognize 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.</p> <p>Any unrealized gains or losses on non-monetary assets contributed to jointly controlled entities should be eliminated from the underlying assets. Such unrealized gains or losses should not be presented as deferred gains or losses on the venturer's consolidated balance sheet.</p> <p>Other than the additional guidance provided in paragraphs 28 and 29 of Section 3055 for cash or assets received that do not represent a claim on the assets of the joint venture, the guidance for the recognition of gains and losses by the joint venture under Canadian GAAP and IFRS is consistent.</p>

CANADIAN GAAP	IFRS
<p>Under Canadian GAAP, an investment in a jointly controlled enterprise using the proportionate consolidation method results in the venturer recognizing:</p> <ul style="list-style-type: none"> • In its balance sheet, its share of the assets and its share of the liabilities of the jointly controlled enterprise; and • In its income statement, its share of the revenue and its share of the expenses of the jointly controlled enterprise 	<p>IFRS allows two approaches for proportionate consolidation of a jointly controlled entity:</p> <ul style="list-style-type: none"> • The venturer may combine its share of each of the assets, liabilities, income and expenses of the jointly controlled entity with the similar items, line by line, in its financial statements; or • The venturer may include separate line items for its share of the assets, liabilities, income and expenses of the jointly controlled entity in its financial statements
<p>Under Canadian GAAP, there is a specific standard, AcG 18 – Investment Companies, that deals with investment companies. If an investment company meets certain criteria in AcG 18.10, then it must account for the investment at fair value with changes recognized in the income statement.</p>	<p>Since there is no parallel guidance for investment companies in IFRS, there is no requirement for such companies to recognize their investment at fair value. However, venture capital organizations and mutual funds, unit trusts and similar entities including investment-linked insurance funds are scoped out of IAS 31 and can be designated as at fair value through profit or loss or are classified as held for trading and accounted for in accordance with IAS 39 Financial Instruments: Recognition and Measurement. Such investments shall be measured at fair value in accordance with IAS 39, with changes in fair value recognized in profit or loss in the period of the change.</p>

Disclosures for Joint Ventures

CANADIAN GAAP	IFRS
<p>CICA 3055 requires disclosure of the total amounts and the major components of each of the following joint venture items:</p> <ul style="list-style-type: none"> • Current assets and long-term assets; • Current liabilities and long-term liabilities; • Revenues and expenses; • Net income; and • Cash flows resulting from operating activities, from financing activities and from investing activities 	<p>IAS 31 does not require the same disclosures. It requires disclosure of the first three items only for an interest in a jointly controlled entity not accounted for by the separate line item form under proportionate consolidation:</p> <ul style="list-style-type: none"> • Current assets and long-term assets; • Current liabilities and long-term liabilities; and • Revenues and expenses <p>Unlike Canadian GAAP, IAS 31 requires that a venturer disclose a listing and description of interests in significant joint ventures and the proportion of ownership interest held in jointly controlled entities. This information is only desirable under CICA 3055.</p>

First Time Adoption Issues

Under IFRS 1 there is an optional exemption relating to Assets and Liabilities of Subsidiaries, Associates and Joint Ventures. This is an important exemption for many Canadian entities with foreign investors that have either already adopted IFRSs or will not be adopting IFRSs at the same date as the Canadian entity. For example, when a Canadian associate adopts IFRS in Canada it may have a different date of transition to that of the investor entity. For example, if the investor entity is a European company, that entity's date of transition may have been January 1, 2004, while the Canadian associate's date of transition may be January 1, 2010. Therefore, potential differences between the investor entity and associate's accounting records could exist, especially where the measurement is dependent on the date of transition to IFRSs, or in relation to IFRS 1 elections.

Therefore, IFRS 1 provides an optional exemption for an Associate or Joint Venture that becomes a first time adopter later than an entity that has significant influence or joint control over it. This IFRS 1 also provides guidance in situations where:

- An investor entity is a first-time adopter later than its subsidiary; or
- An investor entity becomes a first-time adopter for its separate financial statements earlier or later than for its financial statements

There is also an exemption for first time adopters related to business combinations that apply to past acquisitions of investments in Associates and interests in Joint Ventures. Under this exemption a first time adopter may use its previous GAAP to account for its investments in Associates and Joint Ventures at the transition. It does not need to restate its investments in Associates and Joint Ventures using IAS 28 and IAS 31.

For further details on first time adoption issues and exemptions, please refer to the publication IFRS 1 – In a Canadian Context: http://www.bdo.ca/library/publications/ifrs/documents/IFRS1inaCanadianContext_000.pdf

The Future of Joint Arrangements under IFRS

The International Accounting Standards Board (IASB) currently has an Exposure Draft issued ED 9 Joint Arrangements published September 2007. The Board plans to introduce a new standard in 2010; however, this new standard will not be mandatorily effective for first time adopters in 2011.

The proposals in the Exposure Draft are concerned principally with remedying two aspects of IAS 31 that the Board considers to be an impediment to high quality reporting of joint arrangements - namely, that the form of the arrangement is the primary determinant of the accounting and that an entity has a choice of accounting treatment for interests in jointly controlled entities.

Under the proposed standard a joint arrangement should be classified as either:

- Joint Operation: direct interests whereby parties have contractual rights to individual assets or contractual responsibility for individual liabilities [now referred to as interests in joint operations or joint assets]; or
- Joint Venture: indirect assets whereby parties have rights to a share of the 'net' common outcome expected to be generated from a group of underlying assets and liabilities under the joint control of all of the venturers [now referred to as interests in joint ventures]

The substance of the transaction and the contractual rights and obligations agreed by the parties rather than the legal form should drive the classification of the joint arrangement.

Interests in joint ventures will be accounted for using the equity method of accounting. The option to use proportionate consolidation will be removed. If an entity has interests in jointly controlled operations it shall account for interest by recognizing its share of the joint assets, any liabilities it incurs, its share of any liabilities incurred jointly with the other parties relating to the joint arrangement, any revenue from the sale or use of its share of the output of the joint operations, and any expenses it incurs in respect of its interest in the joint arrangement.

Conclusion

In general, the principles relating to accounting for joint arrangements under Canadian GAAP and IFRS have a lot of similarities. However, when looking at the details of each standard there are also some significant differences which an entity needs to be aware of and needs to determine whether these differences will have an impact on the way joint arrangements are accounted for upon moving to IFRS.

If you require further guidance on joint arrangements under IFRS or any other IFRS information or reference sources, please contact your local BDO Canada LLP office or visit www.bdo.ca/ifrs.

The information in this publication is current as of May 10th, 2010.

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