IFRS 11 AND MINING JOINT ARRANGEMENTS

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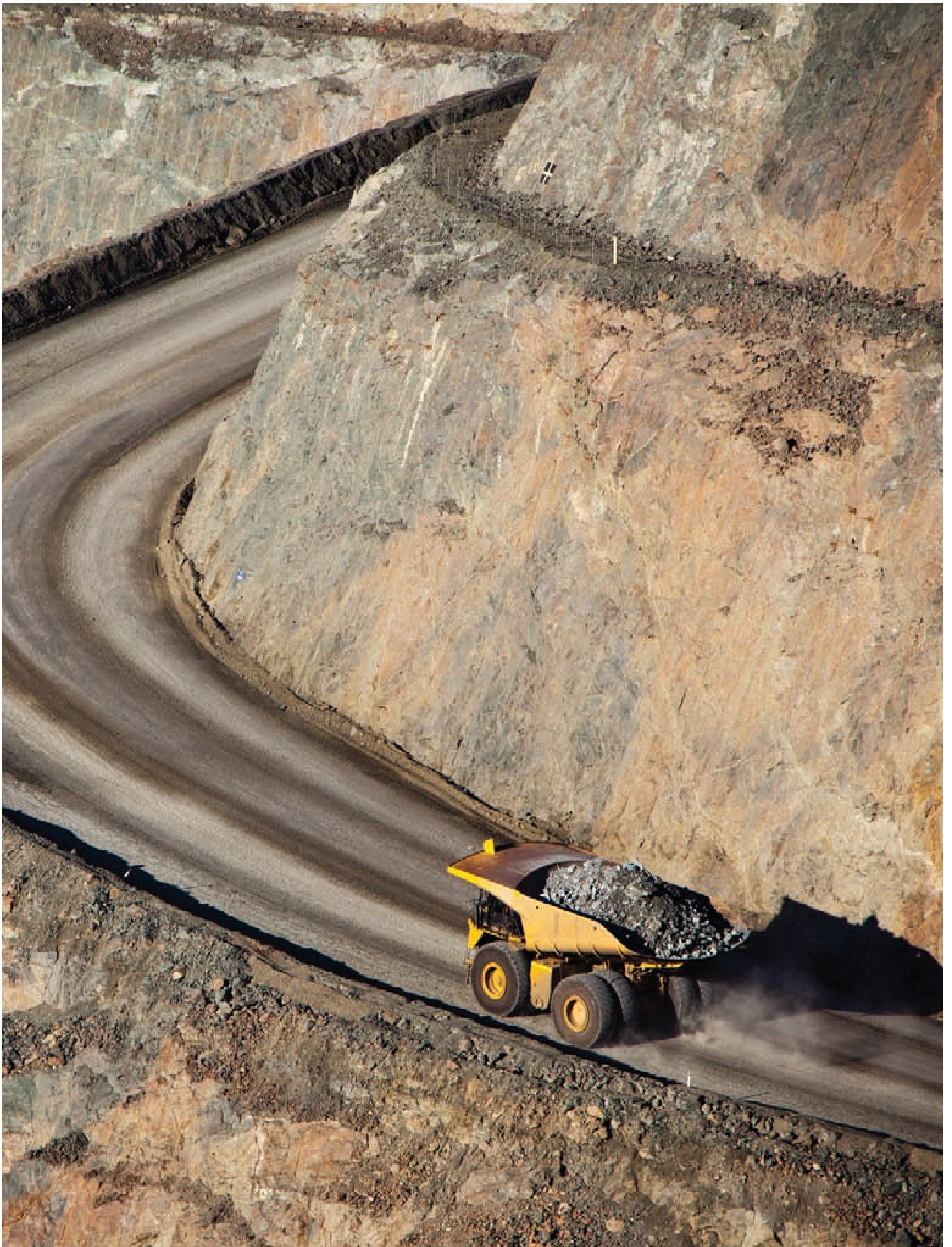


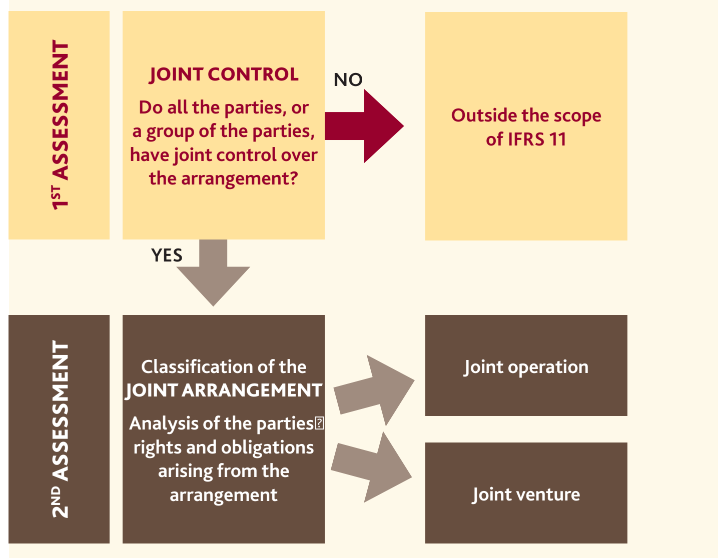
In May 2011, the International Accounting Standard Board (IASB) issued IFRS 11 Joint Arrangements[1], which supersedes IAS 31 Interests in Joint Ventures and SIC 13 Jointly Controlled Entities — Non-Monetary Contributions by Venturers. The standard is effective for years beginning on or after January 1, 2013.

Since it is very common in the mining industry for companies to enter into joint arrangements, IFRS 11 could have a significant impact on all entities in this industry, from early stage exploration companies to large integrated mining companies.

The impact of IFRS 11 on mining companies could be significant, as it could change the accounting for the joint arrangements these entities enter into:

- For companies **who have existing** joint arrangements, they should review their legal agreements to determine in the context of IFRS 11 if any changes need to be made to legal agreements or accounting for the joint arrangement.
- For companies **who are considering** entering into joint arrangements, it is important to understand how some of the key requirements of IFRS 11 will impact how you structure your agreements to ensure it is accounted for properly under the new standard.

Overall approach



The Terminology

The first change to be aware of is the introduction of the term joint arrangement. A joint arrangement is an arrangement under which two or more parties have joint control. A joint arrangement has the following characteristics:

- the parties are bound by a contractual arrangement
- the contractual arrangement gives two or more of those parties joint control of the arrangement

IFRS 11 classifies joint arrangements into two types:

- **Joint operation:** A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement (i.e. joint operators) have rights to the assets, and obligations for the liabilities, relating to the arrangement
- **Joint venture:** A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement (i.e. joint venturers) have rights to the net assets of the arrangement. Under IAS 31 the term joint venture was used to describe all joint arrangements, now it is used to describe a type of joint arrangement

In many cases this terminology will often differ from the contractual terms. It will not be uncommon for two mining companies to enter into "joint venture agreement" to explore a property, which from an IFRS 11 standpoint will be considered a joint operation.

1. The IFRS was published concurrently with four other standards: IFRS 10 Consolidated Financial Statements, IFRS 12 Disclosure of Interests in Other Entities, IAS 28 (as amended in 2011) Investments in Associates and Joint Ventures and IAS 27 (as amended in 2011) Separate Financial Statements.

Joint control

Joint control is the contractually agreed sharing of control of an arrangement. It exists only when decisions about the relevant activities of the arrangement require the unanimous consent of the parties sharing the control of the arrangement. For this purposes, 'relevant activities' are as defined in IFRS 10 being activities of the arrangement that significantly affect its returns.

An arrangement can be a joint arrangement even when not all of its parties have joint control of the arrangement. IFRS 11 distinguishes between parties that have joint control of a joint arrangement (joint operators and joint venturers) and parties that participate in, but do not have joint control of, a joint arrangement (those parties hold a simple investment).

Sometimes the decision-making process that is agreed upon by the parties in their contractual arrangement implicitly leads to joint control. For example:

- Assume two parties establish an arrangement in which each has 50% of the voting rights
- The contractual arrangement between them specifies that at least 51% of the voting rights are required to make decisions about the relevant activities.

In this case, the parties have implicitly agreed that they have joint control of the arrangement because decisions about the relevant activities cannot be made without both parties agreeing.

In other circumstances, the contractual arrangement might require a minimum proportion of the voting rights to make decisions. When that minimum required proportion of the voting rights can be achieved by more than one combination of the parties agreeing together, that arrangement is not a joint arrangement unless the contractual arrangement specifies which parties (or combination of parties) are required to agree unanimously to decisions about the relevant activities of the arrangement. Example #1 illustrates this.

Illustration 1 - Voting Rights

Three parties establish an arrangement in which entities A, B and C have 50, 30 and 20 per cent of the voting rights in the arrangement, respectively. The contractual arrangement specifies that at least 75 per cent of the voting rights are required to make decisions about the relevant activities. Therefore, even though A can block any decision, it does not control the arrangement because it needs the agreement of B. The contractual terms mean that A and B have implicit joint control of the arrangement because decisions about the relevant activities of the arrangement cannot be made without both A and B agreeing. However if the ownership percentages were 50, 25 and 25 joint control does not exist unless the contractual arrangement among the parties specified which combination of them is required to agree about decisions in respect of the relevant activities.

	Scenario 1	Scenario 2
Ownership	Entity A – 50% Entity B – 30% Entity C – 20%	Entity A – 50% Entity B – 25% Entity C – 25%
Decisions about relevant activities	At least 75% of the voting rights are required	At least 75% of the voting rights are required
Is there joint control?	**YES**- implicit joint control	**NO**- unless contractually agreed

Classification of Joint Arrangements as Joint Operations or Joint Ventures

The classification of a joint arrangement as a joint operation or a joint venture depends upon the rights and obligations of the parties to the arrangement.

When assessing the parties' rights and obligations arising from the arrangement, consider the following:

- the structure of the joint arrangement.
- when the joint arrangement is structured through a separate vehicle:
  - the legal form of the separate vehicle;
  - the terms of the contractual arrangement; and when relevant, other facts and circumstances.

Structure of the Joint Arrangement

A joint arrangement that is not structured through a separate vehicle is a joint operation. In such cases, the contractual arrangement establishes the parties' rights to the assets, and obligations for the liabilities, relating to the arrangement, and the parties' rights to the corresponding revenues and obligations for the corresponding expenses.

The contractual arrangement often describes the nature of the activities that are the subject of the arrangement and how the parties intend to undertake those activities together. For example, the parties to a joint arrangement could agree to develop a property, with each party being responsible for specific tasks and each using its own assets and incurring its own liabilities. In such a case, each joint operator recognizes in its financial statements the assets and liabilities used for the specific task, and recognizes its share of the revenues and expenses in accordance with the contractual arrangement.

In other cases, the parties to a joint arrangement might agree to share and operate a mine. In such a case, the contractual arrangement establishes the parties' rights to the well that is operated jointly, and how output or revenue from the asset and operating costs are shared among the parties. Each of the parties accounts for its share of the joint asset and its agreed share of any liabilities, and recognizes its share of the output, revenues and expenses in accordance with the contractual arrangement.

Joint Arrangement Structured Through a Separate Vehicle

A joint arrangement in which the assets and liabilities relating to the arrangement are held in a separate vehicle can be either a joint venture or a joint operation.

The legal form of the separate vehicle can be relevant when assessing the type of joint arrangement. For example, the parties might conduct the joint arrangement through a separate vehicle, whose legal form causes the separate vehicle to be considered in its own right (i.e. the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of each of the parties to the joint arrangement). In such a case, the assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle indicates that the arrangement is a joint venture. However, the terms agreed by the parties in their contractual arrangement and, when relevant, other facts and circumstances can override the assessment by the legal form of the separate vehicle and result in it being accounted for as a joint operation.

The following is an example of how other factors could influence the classification of joint arrangement structured through a separate vehicle:

Illustration 2 - Joint Arrangement Structured Through a Separate Vehicle

Assume that two parties structure a joint arrangement in an incorporated entity in which each party has a 50 per cent ownership interest. The purpose of the arrangement is to mine and produce gold concentrate, that each would further refine at their own processing facilities.

The entity's legal form initially indicates that the assets and liabilities held in the entity are the assets and liabilities of the entity. The contractual arrangement between the parties does not specify that the parties have rights to the assets or obligations for the liabilities. Accordingly, it appears that the arrangement is a joint venture. However, the parties also consider the following aspects of the arrangement:

- Under the terms of the arrangement, the parties have agreed to purchase all the concentrate produced by the entity in a ratio of 50:50. The entity cannot sell any of the output to third parties, unless this is approved by the two parties to the arrangement.
- the price of the output sold to the parties is set by both parties at a level that is designed to cover the costs of production and administrative expenses incurred by the entity. On the basis of this operating model, the arrangement is intended to operate at a break-even level.

From the fact pattern above, it can be concluded that:

- the obligation of the parties to purchase all the output produced by the entity reflects the exclusive dependence of the entity upon the parties for the generation of cash flows and, thus, the parties have an obligation to fund the settlement of the liabilities of the entity.
- the fact that the parties have rights to all the output produced by the entity means that the parties have rights to all the economic benefits of the assets of the entity.

These facts and circumstances indicate that the arrangement is a joint operation.

Structure of the joint arrangement

Structured through a separate vehicle

Legal Form

Does the legal form of the separate vehicle give the parties rights to the assets and obligations for the liabilities relating to the arrangement?

NO ↓ | YES → Joint operation

Terms of contractual arrangement

Do the terms of the contractual arrangement specify that the parties have rights to the assets and obligations for the liabilities relating to the arrangement?

NO ↓ | YES → Joint operation

Other facts and circumstances

Have the parties designed the arrangement so that:

- its activities primarily aim to provide the parties with an output, and
- it depends on the parties on a continuous basis for settling the liabilities relating to the activity conducted through it?

NO ↓ | YES → Joint operation

JOINT VENTURE

Not structured through a separate vehicle → **JOINT OPERATION**

Accounting for Joint Arrangements

The classification of your joint arrangement will ultimately impact the accounting. Joint ventures are required to be accounted for using the equity method. For many entities in the mining industry this will be a change, as use of proportionate consolidation is the predominant industry practice under IAS 31.

Joint operations shall recognize in relation to its interest in a joint operation its assets, including its share of any assets held jointly; its liabilities, including its share of any liabilities incurred jointly; its revenue from the sale of its share of the output arising from the joint operation; its share of the revenue from the sale of the output by the joint operation; and its expenses, including its share of any expenses incurred jointly. For many entities the accounting for joint operations will resemble proportionate consolidation accounting under IAS 31.

The Transition

Joint ventures — transition from proportionate consolidation to the equity method

When changing from proportionate consolidation to the equity method, an entity recognizes its investment in the joint venture as at the beginning of the earliest period presented. That initial investment is measured at the aggregate of the carrying amounts of the assets and liabilities that the entity had previously proportionately consolidated, including any goodwill arising from acquisition. If the goodwill previously belonged to a larger cash-generating unit, or to a group of cash-generating units, the goodwill is allocated to the joint venture on the basis of the relative carrying amounts of the joint venture and the cash-generating unit or group of cash-generating units to which it belonged. The opening aggregated balance of the above investment is regarded as its deemed cost at initial recognition.

If aggregating all previously proportionately consolidated assets and liabilities results in a net liability position, an entity assesses whether it has legal or constructive obligations in relation to the net liabilities and, if so, recognizes the corresponding liability. If it is concluded that there are no legal or constructive obligations in relation to the net liabilities the corresponding liability is not recognised, with an adjustment being made to retained earnings at the beginning of the earliest period presented. In such cases, disclosure is required that this approach has been followed, along with a note of the cumulative unrecognised share of losses of joint ventures as at the beginning of the earliest period presented and at the date at which IFRS 11 is first applied.

Joint operations — transition from the equity method to accounting for assets and liabilities

When changing from the equity method to accounting for assets and liabilities in respect of its interest in a joint operation, an entity is required, at the beginning of the earliest period presented, to derecognise the investment that was previously accounted for using the equity method, and any other items that formed part of the entity's net investment in the arrangement and recognise its share of each of the assets and the liabilities in respect of its interest in the joint operation, including any goodwill that might have formed part of the carrying amount of the investment.

An entity's interest in the assets and liabilities relating to the joint operation is determined on the basis of its rights and obligations in a specified proportion in accordance with the contractual arrangement. The initial carrying amounts of the assets and liabilities are measured by disaggregating them from the carrying amount of the investment at the beginning of the earliest period presented.

Any difference arising from the investment previously accounted for using the equity method together with any other items that formed part of the entity's net investment in the arrangement and the net amount of the assets and liabilities, including any goodwill, recognized is accounted for as follows:

- offset against any goodwill relating to the investment with any remaining difference adjusted against retained earnings at the beginning of the earliest period presented, if the net amount of the assets and liabilities, including any goodwill, recognised is higher than the investment (and any other items that formed part of the entity's net investment) derecognized.
- adjusted against retained earnings at the beginning of the earliest period presented, if the net amount of the assets and liabilities, including any goodwill, recognized is lower than the investment (and any other items that formed part of the entity's net investment) derecognized.

Plan for the impact of IFRS 11

The impact of IFRS 11 on mining companies could be significant, as it could change the accounting for the joint arrangements these entities enter into.

Although the standard is not effective until 2013, the transitional provisions require restatement of the comparative periods, which for entities with calendar year ends means considering all arrangements as of January 1, 2012. We highly recommend beginning the process by reviewing the original agreements of your joint arrangements as soon as possible.

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