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Dear Sirs

Exposure Draft 9 – Joint Arrangements

I am writing to give the views of the UK ASB on EFRAG's draft comment letter to exposure draft (ED) 9. The ASB is submitting its response to the IASB in parallel to this letter and I attach a copy for your information.

In the appendix to its draft letter EFRAG notes the following principal reasons for not supporting the proposals set out in ED 9:

(i) the proposals do not improve the information quality of financial reporting;
(ii) the case that proportional (proportionate) consolidation is inconsistent with the Framework is not convincing;
(iii) the ED represents a short-term position; and
(iv) the proposals do not achieve convergence with US GAAP.

In relation to (i) above the draft response focuses on whether the alternative to proportionate consolidation has been sufficiently reviewed. The ASB notes that whilst the basis for conclusions to ED 9 does not provide a detailed analysis of the merits for proportionate consolidation and equity accounting, both these methods of accounting have been in use for a considerable period of time and the arguments for and against the alternatives are well known. In this regard the IASB has articulated in paragraph BC 8 of the basis for conclusions to the exposure draft its reason for not supporting proportionate consolidation:

> "The accounting requirements of IAS 31 can lead to the recognition of assets that are not controlled and liabilities that are not obligations."

It would seem that whilst the equity method has not been reconsidered as part of this project, the IASB has clearly set out its reasons for proposing to eliminate proportionate consolidation.

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The appendix to the draft EFRAG response also notes that disclosure cannot compensate for accounting methods which do not reflect the substance of the entity's performance and financial position. The ASB agrees with this statement but notes that IAS 1 'Presentation of Financial Statements' provides minimum requirements for presentation of the income statement and statement of financial position. An entity may, if it chooses, present as a sub-heading revenues that arise from joint venture income providing this is eliminated thereafter. The ASB was also informed by members of its user community that the enhanced disclosure requirements proposed in the draft IFRS are useful and should provide better quality information than that provided by the use of proportionate consolidation.

The draft EFRAG response addresses whether proportionate consolidation is inconsistent with the Framework. The ASB considers that it is inconsistent. UK, Financial Reporting Standard (FRS) 9 does not permit the application of proportionate consolidation. The ASB issued FRS 9 in November 1997 and noted, in the development of the FRS, that:

> "The Board rejects proportional consolidation for joint ventures because it believes that it can be misleading to represent each venturer's joint control of a joint venture – which allows it to direct the operating and financial policies of the joint venture only with the consent of the other venturers – as being in substance equivalent to its having sole control of its share of each of that entity's assets, liabilities and cash flows."

The ASB considers its reasons for not permitting the use of proportionate consolidation when it issued FRS 9 are very similar to those set out by the IASB in paragraph 9 of the basis for conclusions. Paragraph 9 notes that the IASB considers recognising a proportionate share of each asset and liability of an entity is not consistent with the Framework.

As to whether the proposals represent a short term position, due to the possible changes in underlying concepts or principles, the ASB does not consider that the proposals in the exposure draft represent such significant changes that they fall within the category of changes that might need to wait until the Conceptual Framework project is further advanced. In the ASB's view the exposure draft does not propose fundamentally new accounting methods, but merely eliminates an option. Consequentially, the ASB does not consider it is necessary to wait for a global discussion of the key concepts and principles that underlie proportionate consolidation to be further advanced before the proposals set out in the exposure draft proceed to an International Financial Reporting Standard.

In view of the above the ASB does not support the principal concerns set out by EFRAG in the draft response.

Whilst the ASB is not in agreement with the principal concerns of EFRAG, it does support a number of the other matters which are set out in the draft response to the IASB – particularly those in relation to the wording of the draft IFRS. These are noted in appendix to this letter.

Should you wish to discuss any of the matters raised in this letter please do not hesitate to contact either Michelle Crisp or myself.

Yours sincerely

Ian Mackintosh
Chairman, Accounting Standards Board
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Appendix: Review of EFRAG draft comment letter

Question 1 – Definitions and terminology

Do you agree with the proposals to change the way joint arrangements are described? If not, why?

1. In response to EFRAG's question to constituents regarding whether the existing descriptions of joint arrangements have caused problems, the question notes that an important objective for the IASB is to clarify the existing descriptions, which it believes to be causing problems in practice. The ASB is not of the view that this is the objective of the exposure draft. In BC 5 it is noted that the two main concerns the IASB are addressing in the exposure draft are the treatment of the form of the arrangement as the most significant factor in determining the accounting and the choice of accounting that IAS 31 offers. The ASB does not consider that this is the same, as is suggested in the question posed to constituents, as wishing to clarify existing descriptions.

2. The ASB is in agreement with the drafting matters which are raised in paragraph 1.2 to 1.4. The ASB agrees that the section of the draft IFRS titled 'types of arrangements' could benefit from being redrafted. In its response to the IASB the ASB has suggested that it is the relationship in practice that should determine the accounting treatment for a joint arrangement rather than the contractual arrangements – which may alter over time.

3. The ASB also notes in its response to the IASB that the definition of a joint arrangement when combined with the core principle could inhibit the recognition of assets and liabilities. That is it might restrict the recognition of assets and liabilities to only those assets and liabilities that arise from contractual arrangements which is inconsistent with the principals in a number of other IFRS's.

Question 2 and 3 – Accounting for joint arrangements

Do you agree that a party to a joint arrangement should recognise its contractual rights and obligations relating to the arrangement? If so, do you think that the proposals in the exposure draft are consistent with and meet this objective? If not, why? What would be more appropriate?

4. The ASB is in agreement with the matters raised by EFRAG in its response to question 2. The ASB agrees that the core principle does raise questions regarding contractual rights. The ASB recommends that EFRAG should ask the IASB (in paragraph 2.1(b)) if they intended to restrict the notion of control over

an asset to control that exists only through contractual rights rather than presume it is an evolution of the definition of an asset.

5. The ASB also agrees that including only a core principle in the draft IFRS is optimistic. In its response to the exposure draft the ASB is proposing the revised IFRS should include both an objective and a core principle. The core principle would then set out how the objective of the IFRS should be achieved.

Do you agree that proportionate consolidation should be eliminated, bearing in mind that a party would recognise assets, liabilities, income and expenses if it has contractual rights and obligations relating to individual assets and liabilities of a joint arrangement? If not, why?

6. As noted above the ASB is generally in agreement with the elimination of proportionate consolidation and therefore does not support all of the matters raised in response to question 3.

7. The ASB is however supportive of paragraph 3.12 of the draft response to the IASB which states that equity accounting for associates and joint ventures leads to a lack of distinction between the two forms of investment. It is for this reason that the ASB qualifies its acceptance of the proposals in the ED such that they must be combined with improved disclosure requirements for joint arrangements.

8. In relation to the question for constituents, in which EFRAG asks if entities will seek different forms for their joint arrangement to avoid them having to use the equity method, the ASB notes that when financial reporting standards change then a disconnect between internal and external reporting may arise. This however is not justification for prohibiting the development of high quality accounting standards. The internal reporting and key performance measures, often a basis for management remuneration, are often not a basis for developing international financial reporting standards. The proposals in ED 9 seek to align the accounting with the economic substance of the arrangement; as such, mere changes to the legal form should not result in improper financial reporting.

Question 4

Do you agree with the disclosures proposed for this draft IFRS? If not, why? Are there any additional disclosures relating to joint arrangements that would be useful for users of financial statements?

9. In its response to this question EFRAG proposes that the income statement and balance sheet should be adapted to provide users with an indication of the financial elements included in joint ventures. The ASB notes, however, that

IAS 1 provides minimum presentation requirements – an entity can voluntarily disclose information on the face of the primary financial statements.

10. The ASB is also, generally, content with the revised disclosure in the draft IFRS and therefore does not support paragraph 4.4 which proposes that a further breakdown of the balance sheet and income statement should be required to that proposed in the draft IFRS.

Question 5

Do you agree with the proposal to restore to IAS 27 and IAS 28 the requirements to disclose a list and description to significant subsidiaries and associates? If not, why?

11. The ASB is in agreement with the response to question 5.

Question 6

Do you agree that it is more useful to users if an entity discloses current and non-current assets and liabilities of associates than it is if the entity discloses total assets and liabilities? If not, why?

12. The ASB agree that it is more useful to users of financial statements if an entity discloses current and non-current assets rather than total assets and liabilities.