BELGIAN BANKERS' AND STOCKBROKING FIRMS' ASSOCIATION

The ABB-BVB is Member
of the Belgian Financial
Sector Federation

Febelfin

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Brussels, 10 January 2008

Dear Sir, Madam,

Exposure Draft 9: Joint Arrangements

The Belgian Bankers' and Stockbroking Firms' Association welcomes the opportunity to express its views on the Exposure Draft mentioned above. The following remarks are communicated with reservation as for the decision to be taken in this matter by our Board on 25th January 2008.

Our remarks focus on the cancellation of the proportionate consolidation for joint arrangements (question 3), which we oppose for several reasons.

We are of the opinion that the "Basis for Conclusions" does not provide sufficient grounds for the abolishment of the proportionate consolidation method. Apparently, the "Basis for Conclusions" anticipates the results of the Consolidation project without asking the question if the proportionate consolidation method can still be used. At least, we expect a comparative analysis of the advantages and disadvantages of all methods, before any decision is taken about cancelling one of the commonly used consolidation methods.

According to the Board, the proportionate consolidation method is incompatible with the Framework, but this justification causes us great concern. Only a few years ago (in 2003), the proportionate consolidation method was endorsed as a benchmark consolidation method, because it better reflects the substance and the economic reality. In our opinion, such a quick change of mind casts serious doubts on the matter of due process, even if this happens within the Convergence project with USGAAP.

As a global standard setter, the Board takes on a huge responsibility in defining accounting standards. This implies, among others things, consistency in the approach taken. First, one should keep in mind that all of the changes will have to be implemented by all companies following IFRS-standards: however, one should avoid inflicting unduly costs upon companies as a consequence of changes which have not been justified in depth.

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Secondly, there is the problem of consistency in the information given in the financial statements. Readers of financial information will be confused by an inconsistent development of accounting standards.

It is still our conviction that in several cases, the proportionate consolidation method better reflects the economic substance of investments in joint ventures as compared to the equity method. The first method indeed allows for including a proportionate share of the joint venture's assets, liabilities and results into the consolidated balance sheet/profit and loss account. In our opinion, this better reflects the economic reality.

One must also bear in mind that the proportionate consolidation method is used for the internal reporting for management purposes. Abolishing this method would result in a disconnection between internal and external reporting information. In our view, this is not the right way forward.

Our detailed comment can be found in the enclosure to this letter. We hope it will be taken into account for a reconsideration of the abolishment of the proportionate consolidation method for joint arrangements.

Thank you very much in advance.

Yours sincerely,

Michel Vermaerke
Chief Executive Officer

Daniel Mareels
Head of the Taxation, Accounting Standards and Prudential Regulations Department

Encl.

cc.

IASB – ED 9 Comment Letters

ED 9 Joint Arrangements, comments of the Belgian Bankers' and Stockbroking Firms' Association

1.1. Need for a clear reflection on the special characteristics of joint arrangements

In the 'Basis for Conclusions' of ED 9, there is no in-depth reflection on the need for cancelling the technique of proportionate consolidation. The basic definitions, i.e. the actual significance of 'joint control' and 'significant influence', have not been dealt with.

ED 9 proposes a change in the terminology and definitions of the different types of joint arrangements without there being any specific justification for doing so in the 'Basis for Conclusions'. This affects the significance of what is meant by 'joint control' under the current version of IAS 31, i.e. 'it is the contractually agreed sharing of control over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control

Neither does the 'Basis for Conclusions' contain a comparative analysis of the advantages and disadvantages of the methods IAS 31 allows for. In our opinion, such an analysis is an essential part of the decision about cancelling one of the methods allowed. Only the compliance between the method of proportionate consolidation and the Framework has been looked into. In BC 4 and BC 14, IASB itself admits that no analysis has been made of the sole efficient technique, which is the equity method (so, neither has there been an analysis of the compliance between the equity method and the Framework).

We know from experience that short-term convergence projects suffer from a lack of fundamental reflection. The fact that US Gaap is not familiar with the method of proportionate consolidation in itself is no sufficient reason for just getting rid of this technique, which is commonly used in Europe. We expect at least a thorough justification.

1.2. Contradictions with the positions defended in the revised IAS 31 version of December 2003

IAS 31 was the subject of a general overhaul in 2003. At that time, a clear choice was made in favour of the method of proportionate consolidation as a benchmark method, because the proportionate method better reflects the substance and the economic reality.

We would like to remind IASB of what is said in paragraph 40 of the current IAS 31 version :

" Some venturers recognise their interests in jointly controlled entities using the equity method, as described in IAS 28. The use of the equity method is supported by those who argue that it is inappropriate to combine controlled items with jointly controlled items and by those who believe that venturers have significant influence, rather than joint control, in

a jointly controlled entity. This Standard does not recommend the use of the equity method because proportionate consolidation better reflects the substance and economic reality of a venturer's interest in a jointly controlled entity, that is to say, control over the venture's share of the economic benefits. Nevertheless, this Standard permits the use of the equity method, as an alternative treatment, when recognising interest in jointly controlled entities"

After four years, IASB now advocates the opposite point of view. At least, we expect to find a justification for this change in the 'Basis for Conclusions'. In our opinion, a mere reference to the Framework (see BC 12) cannot be considered to be an adequate justification.

1.3. <u>Nevertheless, the proportionate method continues to be allowed under USGaap</u>

According to interpretation US EITF 00-1, oil-and-gas producing entities as well as the construction industry are allowed to use a proportionate method ('equity method on a proportionate gross basis'). This interpretation would **not** be cancelled within the framework of the short-term convergence project. A partial convergence should be excluded in our opinion.

1.4. <u>The illustrative examples give no concrete cases of joint ventures</u>

We think there are no concrete examples of real joint ventures. We would like to see a reference, within the illustrative examples, to the joint venture structure commonly used by the sector of finance : two credit institutions decide to work together and to integrate their own – identical – activity/segment, such as asset management, private banking, funds management, back-office, ICT,... , together with their staff, resources, management and capital into a Newco under joint management.

We think it would be appropriate for the IASB to make an analysis of such an example taken from practice (see also 2.4).

2. <u>Practical objections</u>

2.1. <u>Frequent use of the method of proportionate consolidation by European groups</u>

Almost half of the EUROSTOXX 50 groups use the technique of proportionate consolidation. Most of the companies in the real estate business also rely on this method. This technique is also very widespread within the sector of finance.

2.2. <u>The method of proportionate consolidation better reflects the economic substance of an investment in a joint venture</u>

Belgian banks have opted for the method of proportionate consolidation, because they are convinced that this method better reflects the economic substance of their investments in joint ventures in their Financial Statements, as compared to the equity method in those cases when the investment represents a strategic activity or a core business of Belgian banks (e.g. common funding projects together with other banks, agreements for cooperating with other banks in order to jointly develop a banking activity,...).

Under the method of proportionate consolidation, their part of the assets, liabilities (including the social liabilities and the capital) together with the joint venture's results are included, line after line, into the consolidation package (software) and into the consolidated balance sheet, and, in our opinion, this corresponds with the economic reality, since the companies involved actually, albeit jointly, take care of the operational execution and control of this activity.

We would like to add that the Belgian banks also use the proportionate method for internal reporting, since the activities concerned are part of their core business. Excluding the use of the method of proportionate consolidation for external reporting would result in a disconnection between internal (management and segment operations reporting, profitability and solvency ratios...) and external reporting (Financial Statements).

2.3. <u>No application of the method of proportionate consolidation for the sole purpose of disclosures</u>

We cannot agree with IASB's vision on where to make obligatory use of the equity method in the balance sheet, **however in combination** with strict requirements for disclosure which boil down to additional comments that can be provided only through the application of the technique of proportionate consolidation.

We are convinced that the additional information in paragraph 39 b) must be mentioned in front of the balance sheet rather than in disclosures and that this information will be gathered automatically via the company's own consolidation programme by means of the method of proportionate consolidation.

The concrete application of paragraph 25 (balance sheet) and paragraph 39 (disclosure) boils down to the continued application (= maintaining a status quo) of the method of proportionate consolidation, however in combination with an 'equity method adjustment' for the presentation of the balance sheet. We cannot see the added value of this.

2.4. <u>Classification of a number of joint venture structures in joint operations</u>

We are wondering whether some of the joint venture structures under ED 9 should not be qualified as joint operations. ED 9 indeed stipulates that what must be taken into account, are the contractual rights and duties of a joint arrangement and no longer the legal structure (= substance over form).

If this principle is applied to the example given in 1.4., we may reach the conclusion that this kind of joint ventures must be booked as 'joint operations'. We would appreciate if the Board could give some guidance in this respect.