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ED 9 Comment letters
International Accounting Standards Board
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Dear Sirs

Exposure Draft 9 *Joint Arrangements*

On behalf of The Institute of State Authorized Public Accountants in Denmark (FSR), the Danish Accounting Standards Committee (Committee) is pleased to comment on the International Accounting Standards Board's (IASB) exposure draft to IFRS 9 *Joint Arrangements* (referred to as ED9).

The Committee continues to support the convergence efforts of the world's national accounting standard-setters and the IASB with the objective of developing a single set of high-quality global principle based accounting standards.

In respect of ED 9 the Committee finds that the IASB has not met this objection nor does that it, in fact, converge the accounting for joint ventures with US GAAP. The Committee does therefore not support ED 9.

Although the Committee supports the changes to the definitions and terminology on joint arrangements and also supports that that identification of joint ventures should be based on the substance rather than the legal form, we do have significant concerns about ED 9. The Committee's overall concerns and observations are described below and a more detailed response on the raised questions is included in the appendix to this letter.

- The Committee acknowledge that ED 9 in general will create convergence with US GAAP, but full convergence with US GAAP will not be achieved. US GAAP generally requires a venture to account for its interest in joint ventures using the equity method. However, ventures within the extractive and construction industries are able to apply proportionate consolidation. Consequently, unless the FASB intends to follow the IASB in eliminating proportionate consolidation entirely convergence will not be achieved in two important industrial sectors where joint ventures are very common.
- The Committee does not feel convinced by the arguments made by the IASB for it decision that the proportionate consolidation method is so fundamentally inconsistent with the Framework that it should now be prohibited. We also believe that any debate on whether proportionate consolidation is consistent with the definitions of assets and liabilities needs to be based on the reporting entity concept and what the asset definition in particular means. However, the current Framework is particularly weak on these issues, in particular, as the Framework does not discuss the reporting entity notion or consolidation at all. In our view, it therefore seems difficult to argue that some or all of a joint venture is not part of the reporting entity.
- The Committee acknowledges that the standard setting activity cannot come to a hold due to the Conceptual Framework project. However, when assessing ED 9 based on the developments within the Conceptual Framework, the Committee also finds that ED 9 is premature.

- The Committee notes that multiple studies published by for example ICAEW, EY, and KPMG on application of IFRSs show that at least 50 per cent of all entities with joint ventures apply proportionate consolidation. Consequently, the implementation of ED 9 would have an impact on current practice. We acknowledge that a significant impact on practice should not hinder implementation of a standard, if it leads to improvements in the financial reporting whereby the benefits outweigh the costs. However, we believe the benefits of an amended standard should outweigh the costs not only in the near term, but also in the medium and the longer term and that amendments should not made mostly in order to converge with US GAAP. Based on the argumentation made by the IASB in the basic for conclusion we do find that it has been demonstrated that whether the financial statements prepared under ED 9 is of a higher quality than under IAS 39 and hence, whether the benefits outweigh the costs.

Closing

For the reasons described in this comment letter we do not support ED 9. If the IASB chooses to proceeds with issued ED 9 as a standard, we strongly recommend that an impact assessment is performed in order for the IASB to have a complete basis for assessing whether the limited benefits of ED 9 outweighs the costs for users and preparers.

Should you have any questions or if you wish to discuss any of the issues raised in this letter, please contact us.

Yours sincerely

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Chairman of the Accounting
Standards Committee

Ole Steen Jørgensen
Head of Department, FSR
Secretary to the Accounting
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Appendix

Question 1

The Committee agrees that the proposed definitions and terminology, as they are more consistent with the use of the terms in general. In addition, the definitions and terminology better reflect the substance of joint arrangements and the assessment which must be made in order to determine the accounting treatment of such arrangements.

Question 2 and 3

As the Committee finds it difficult to separate the recognition of a ventures rights and obligations in a joint arrangement and the discussion of proportionate consolidation, it has decided to respond to question 2 and 3 together. The response question 2 and 3 will be provided separately for joint ventures and joint operations and joint assets.

Joint ventures

Basic for conclusion paragraph 2 and 3 of ED 9 states that the objective of ED 9 is to:

- Converge with US GAAP as part of the memorandum of understanding.
- Improve financial reporting for those activities within the scope of IAS 31 *Interests in Joint Ventures*

When evaluating whether these two objectives have been met, the Committee has concluded that this is not the case.

Although ED 9 does somewhat converge with US GAAP, significant differences between the two sets of accounting standards continues to exist. In addition, the Committee finds that the convergence which is achieved causes a less high quality accounting standard.

Below the Committee has elaborated on the reasons for this conclusion.

Is convergence achieved?

The Committee notes that US GAAP generally requires a venture to account for its interest in joint ventures, including arrangements which would classified as joint assets and joint operations under ED 9, using the equity method. However, EITF 00-01 recognises the longstanding practice in the extractive and construction industries of displaying equity-method investments in separate legal entities on a proportional basis in the financial statements of the investor. (EITF 00-1.2)

The Committee acknowledge that ED 9 in general will create convergence with US GAAP, but full convergence with US GAAP will not be achieved, unless FASB decides to change their standards according to ED 9.

Is ED 9 of a higher quality than IAS 31?

The Committee believes that the overarching objective of all standard-setting activities is to improve the quality of financial statements or at least to maintain its current quality whilst reducing the cost of using financial statements and / or of preparing financial statements. In our view, a proposal should normally only be accepted if this overarching objective is met irrespective of whether the project is a convergence project, a project designed to eliminate options in existing standards or a project on a new subject.

It seems that the IASB believes that if a standard allows an accounting policy choice then such a standard is not of a high quality, as this was the argumentation used for the amendment of IAS 23 *Borrowing Costs* and it is also used in basic for conclusion paragraph 7 of ED 9. Although the Committee acknowledges that accounting policy choices may lead to less consistency between all entities, it believes that merits for accounting policy choices do exist. The reason for this is when an accounting standard allows an accounting policy choice; it also allows an entity to apply the accounting policy which is most appropriate for its specific business activity. Such standards therefore acknowledges that a one fits all model does not always provide the better outcome.

While the Committee recognises that reducing the choice of accounting options can lead to a reduction in the costs of users, the assessment of such proposals should still include the implications for the quality of the financial statements.

In the Committee's view, the information provided in financial statements when proportionate consolidation of joint ventures is performed does provide the users with decision usefulness information.

The Committee notes that the IASB has not considered the impact of the removing the proportionate consolidation and hence, it has not assessed the impact on current practice. We would therefore like to draw the IASB's attention to that surveys suggest that the proportionate consolidate is used by a majority of entities when preparing their financial statements. (EY, ICAEW, KPMG) Consequently, the proposal to remove the proportionate consolation method will lead to significant cost for prepares and users without achieving the benefits of neither full convergence or a standard of a higher quality.

The Committee is unsure whether the proportionate consolidation method is consistent or not consistent with framework. However, as noted above a significant number of entities do believe that this method of consolidation provides more useful information than the equity method.

Significant influence is frequently exercised over an associate by the investing entity's having a representative on the associate's board. Conversely, joint control is generally exercised by the venture exercising its control by significant involvement in the management of the joint venture, both at board level and often at the operational level. We believe that the different degree of control should be reflected by a graduation of different accounting methods.

Consequently, the Committee had expected that the IASB would have provided compelling arguments for it decision that the proportionate consolidation method is so fundamentally inconsistent with the Framework that it should now be prohibited. In our view, the IASB has not provided such arguments in the Basis for Conclusions of ED 9. For example:

- Firstly, we note that the Framework has not been changed since IAS 31 was issued. It still seems to imply that reflecting substance and economic reality is central to good financial reporting.
- Secondly, we believe that any debate on whether proportionate consolidation is consistent with the definitions of assets and liabilities needs to be based on the reporting entity concept and what the asset definition in particular means. Methods of consolidation therefore also need to be understood. However, these are issues on which the Framework is particularly weak, in particular, as the Framework does not discuss the reporting entity notion or consolidation at all. In our view, it therefore seems difficult to argue that some or all of a joint venture is not part of the reporting entity. It is also unclear for us whether ED 9 has been aligned with the conceptual framework project and the developments within the definition of an asset and a liability?

It seems that the IASB has based its concerns about the proportionate consolidation on the fact that the ventures do not control the underlying assets in the joint venture. (ED 9.BC 8) While the Committee acknowledge that a venture does not unilaterally control the underlying assets in a joint venture, it also notes that the IASB in phase B *Definition of Elements* of its conceptual framework project has tentatively decided that control should not be a dominant factor in the definition of an asset.

In addition, the Committee is unsure on how phase D *Reporting Entity* of the Conceptual Framework will impact the accounting treatment of Joint Ventures and similar arrangements.

Based on the tentative decisions made by the IASB so far it seems that ED 9 may be inconsistent with the phase B of the conceptual framework project. The Committee recognises that phase B is not yet completed and that the IASB neither finally agreed on a working definition of an asset nor has it made any tentatively decisions on the criteria for recognition of an asset. (IASB Update October)

Although the Committee acknowledges that the standard setting activity cannot come to a hold due to the Conceptual Framework project, it believes that projects should not be completed mostly in order to converge with US GAAP. In addition, the Committee believes the benefits of an amended standard should outweigh the costs not only in the near term, but also in the medium and the longer term.

As noted above, the Committee does have a number of significant concerns relating to ED 9 based on the current Framework. When assessing ED 9 based on the developments within the Conceptual Framework, the Committee also finds that ED 9 is premature before the finalisation of the Conceptual Framework project.

Overall assessment

If convergence is truly to be achieved and the accounting treatment of joint ventures to be enhance, the Committee finds that further work is needed.

For these reasons we do not support the elimination of the proportionate consolidation.

Joint operations and joint assets

The Committee agrees that the purpose of the accounting treatment of joint arrangements is to reflect the rights and obligations in the consolidated or individual financial statements of the ventures. Generally, we believe that the proposed accounting treatment of joint operations and joint assets meets this objective.

We also note that the ED 9 does not seem to significantly change the current practice for the accounting of joint operations and joint assets.

Question 4

As explained in our response to question 2 and 3, we do not believe that the elimination of proportionate consolidation method is appropriate. For the purpose of preparing our response to question 4 we have assumed that proportionate consolidation will nonetheless be removed.

We believe that the information in paragraph 39 of ED 9 should not be provided per significant joint venture. Rather, we believe that the information should be provided on summary basis for all joint ventures with a listing of all significant joint ventures.

Question 5 and 6

We agree with the proposal made by the IASB.

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