XXX January, 2008

IASB
30 Cannon Street
London EC4M 6XH
UK

Draft comment letter for comments by 7 January 2008
to Commentletter@efrag.org

Re: Exposure Draft ED 9 Joint Arrangements

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the Exposure Draft ED 9 *Joint Arrangements*. This letter is submitted in EFRAG's capacity as a contributor to IASB's and IFRIC's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive IFRS on the issue.

We have structured our response as follows. We outline below the main issues we see with the proposals. In appendix 1 we discuss these issues in more detail. In appendix 2 we provide responses to the questions posed in the exposure draft. Finally, in appendix 3 we provide some suggestions of different presentations of the income statement and profit and loss account which could provide useful information to the user of financial statements if proportionate consolidation is eliminated.

Our main concern relates to the proposed elimination of proportionate consolidation.

The case for eliminating proportionate consolidation is not sufficiently compelling

Although we in general support the elimination of accounting options, we believe nevertheless that it is essential that decisions as to which options are eliminated are made only after a full consideration of all of the options against the same relevant criteria. It appears in this case that only the proportionate consolidation option has been subject to this type of review. In our view, were the other option (the equity method) to be subjected to a proper evaluation, it would also be found wanting.

- The usefulness of the information provided. The stated objective of the project is to improve financial reporting, yet we are not convinced that prohibiting the use of proportionate consolidation would achieve that objective.

- Inconsistencies with the Framework. Although the ED argues that proportionate consolidation is inconsistent with the Framework, we are not convinced. (We note in particular that the current IAS 31 *Interests in Joint Ventures* states that proportionate consolidation reflects the substance and economic reality of joint venture arrangements.) We agree with this statement. Nor are we convinced that it is any less consistent with the Framework than equity accounting.

- A possible need for further changes. Many of the concepts and principles underlying the treatment of joint ventures—for example, the notion of the reporting entity, consolidation methods, and the definitions of assets and liabilities—are currently under review. If those concepts and principles are revised in any way as a result of that review, further changes might be needed to joint venture accounting. Making changes now when there is a risk of further changes (and perhaps even of changes being reversed) is very disruptive.

- Convergence with US GAAP. Although the ED argues that its proposals achieve convergence in principle with US GAAP, US GAAP permits the use of proportional consolidation in two major industrial sectors in which joint ventures are common.

There are many entities in Europe that currently apply proportionate consolidation to their jointly-controlled entities. It is also clear that many entities and users find the informational content of proportionate consolidation to be high. The disruption that these proposals seem likely to cause those entities and users can be justified only if the proposals will result in better financial reporting. However, the ED has not made a compelling case for change at this current time. We have therefore concluded that it is premature to amend IAS 31 in the way proposed at this stage.

A suggestion

For the above reasons, we believe that IFRS should continue to permit the two existing options of proportionate consolidation and the equity method to be used to account for joint ventures. However, currently entities have a free choice between these options and we think it would be helpful to users if IAS 31 were amended to limit that choice. In particular, there could be a requirement for the management of the entity to choose whichever of the two accounting methods is the most appropriate for all its jointly-controlled entities, taking into account the circumstances of the reporting entity. The entity could further be required to disclose the reasons why it believes that the accounting method it has chosen is the more appropriate for its circumstances. Finally, the revised standard could provide criteria that would direct the management of the reporting entity in its choice of the most appropriate method.

A final comment

We believe that, whichever accounting method is chosen, it is important that sufficient disclosure is provided to allow the user to understand the nature and extent of the reporting entity's activities that are carried out in jointly-controlled entities. The equity method may fail to give the user a good appreciation of the scale of the activities because of the netting-off of elements in the primary financial statements. Equally, proportionate consolidation, as it is generally applied under one of the approaches permitted by current IAS 31, aggregates controlled and jointly-controlled items in the same lines of the primary statements, thereby making it unclear to the user what proportion of the assets and liabilities are subject to joint control or sole control. We believe that the disclosure requirements of IAS 31 and ED9 are not sufficient in that respect.

If you would like further clarification of the points raised in this letter, either Gregory Hodgkiss or I would be happy to discuss these further with you.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

APPENDIX 1
Main issues raised by ED9 *Joint Arrangements*

Do the proposals improve the informational quality of financial reporting?

1 This project is stated objective is to improve financial reporting for those activities within the scope of IAS 31 *Interests in Joint Ventures* (ED 9 BC1). We strongly support this objective. In our view, the objective of all standard-setting activity should be to enhance the quality of the information provided to users or at least to maintain its quality whilst reducing the cost of using it and/or of preparing it. In the end, this is the benchmark against which all proposals need to be measured. That is the case regardless of whether the project is a convergence project, a project designed to eliminate options in existing standards or a project on a new subject. So for example, although we recognise that reducing the choice of accounting options can lead to a reduction in the costs of users, in evaluating proposals for such reductions we need still to consider the implications for the quality of information provided. Similarly, although we support the objectives of the IFRS/US GAAP convergence project (because the project has the potential to reduce costs for both preparers and users), it is still important to consider the implications of any convergence proposal for the quality of the information provided.

2 We recognise that allowing a choice of accounting options can lead to additional costs for users, and also sometimes confusion amongst users. This can be a particular problem if different parties to a particular individually significant joint venture choose to account for it differently, thereby obliging users who wish to compare the different venturers' financial statements to restate them onto a comparable basis. We accept therefore that the elimination of options is a legitimate aim of the periodic review of standards carried out by the IASB. However, if the stated objective of this project is to be met, it is important, before deciding to eliminate an option in an IFRS, to evaluate all the options to identify which options are the most useful and which the least useful.

3 It is our understanding that the use of proportionate consolidation option to account for joint ventures is widely thought to produce useful, albeit not perfect, information. Therefore, in our opinion the IASB should have, before proposing the elimination of that option, considered whether the remaining option provided information that was as useful. As far as we can tell from the ED's Basis for Conclusions, this was not done. We believe it follows that there is insufficient basis for the proposal to eliminate proportionate consolidation as an option.

4 We note that to a large extent what the proposals will in effect do is take information that is currently disclosed via the balance sheet and instead disclose it in the notes. This seems unfortunate because it is the primary financial statements that receive the most attention from users (as they provide the most concise overall view of the entity's performance) and which therefore should wherever possible contain the most useful information.

5 (In any event, when proportionate consolidation is used, all the detailed disclosures required for consolidated entities are also required for those proportionately consolidated entities, whereas the disclosures required in respect of entities incorporated by the equity method are very summary. The insights provided by the two different disclosure regimes are very different.)

6 It is generally accepted that it is essential that the financial statements reflect the substance and economic reality of an entity's financial position and financial

performance. As IAS 31 itself makes clear, this is achieved in the case of joint ventures through the use of proportionate consolidation. Although the ED is proposing that the disclosures provided about joint ventures should be enhanced significantly, it also proposes a prohibition on proportionate consolidation; it is widely accepted that note disclosure cannot compensate for accounting methods which do not reflect the substance of the entity's performance and financial position.

7 For all of the above reasons, EFRAG is not convinced that the proposals improve the usefulness of the financial statements.

Is proportionate consolidation inconsistent with the Framework?

8 IAS 31 maintains that proportionate consolidation is the better method of accounting for joint venture entities because it gives the better representation of the substance of the arrangement. For example, IAS 31.32 states that "when recognising an interest in a jointly controlled entity, it is essential that a venturer reflects the substance and economic reality of the arrangement, rather than the joint venture's particular structure or form. In a jointly controlled entity, a venturer has control over its share of future economic benefits through its share of the assets and liabilities of the venture. This *substance and economic reality* are reflected in the consolidated financial statements of the venturer when the venturer recognises its interests in the assets, liabilities, income and expenses of the jointly controlled entity *using* one of the two reporting formats for *proportionate consolidation*…" (Emphasis added). This wording seems to have been chosen to make it clear that proportionate consolidation is consistent with the Framework, particularly its reliability notion and its definitions of assets and liabilities[1].

9 Presumably the IASB does not share that view. However, bearing in mind what IAS 31 says, we would have expected the IASB to provide compelling arguments to support the assertions that proportionate consolidation is fundamentally inconsistent with the Framework. We believe that the Basis for Conclusions of ED 9 does not do this. For example:

(a) The Framework has not been changed since IAS 31 was issued and it still seems to imply that reflecting substance and economic reality is central to good financial reporting. Does the IASB believe that is no longer the case or does it believe that the meaning of 'substance' and 'economic reality' and of the definitions has evolved? Commentators need to understand this if they are to engage the IASB in informed debate.

(b) It seems to us that any debate about whether proportionate consolidation is consistent with the definitions of assets and liabilities needs to consider both the reporting entity concept and what the asset definition in particular means. Methods of consolidation also need to be understood. Yet these are issues on which the Framework is particularly weak. Indeed, the Framework does not discuss the reporting entity notion or consolidation at all, which makes it difficult in our view to argue that some or all of a joint venture is not part of the reporting entity.

[1] An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. [IASB Framework, paragraph 49]

Similarly, the work the IASB has carried out over the last year on its asset definition has highlighted a number of concerns that the IASB has about the definition. For example, we wonder whether what is meant by control of an asset is really so clear in the Framework that ED 9 should be drawing such a fundamental distinction between the quality of control that an entity enjoys over a joint asset and that which it enjoys over an asset owned by a joint venture which the entity jointly controls. Bearing all that in mind we question whether the position is sufficiently clear to conclude that proportionate consolidation involves recognising things as assets that are not assets. We also wonder whether it is as clear as the ED implies that the whole of the 'thing' recognised as an asset when equity accounting is applied is actually an asset as defined.

(c) We note that, with a few exceptions (such as, for example, the accounting for losses and impairments), the measurement methods and recognition criteria used for proportionate consolidation and the equity method are identical. The net profit and net assets shown in the venturer's income statement and balance sheet will in many cases be the same. In practice, the difference between the two methods is really that of the degree of aggregation and offsetting of the underlying elements. Again this is not something that the Framework is very clear about.

10 For all of the above reasons, EFRAG is not convinced that proportionate consolidation is necessarily inconsistent with the Framework, nor any less consistent than equity accounting.

Do the proposals of ED 9 represent a short-term position?

11 The IASB and the FASB are currently undertaking a number of projects that seem likely to introduce the notion of a reporting entity and change the definition of assets and liabilities, the principles of asset and liability recognition, the principles of control and the consolidation of entities. While we understand that the IASB cannot cease its standard-setting activities until it finalises this work, we think it is important that changes to existing standards should not be undertaken if it is possible that those changes might need to be reversed (or if further changes might be necessary) because of changes to the underlying concepts and principles. That would be very disruptive.

12 In our view, the fact that US GAAP has (as explained in the next section) had to allow exceptions to its general principle that proportionate consolidation should not be applied, and the fact that an approach that the IASB believes is more consistent with the Framework seems to result in less useful information (and therefore requires additional disclosure) are both signs that the Framework's concepts and guidelines in these areas might not yet be quite right. Bearing that in mind, we think that it would not be unreasonable to wait until the global discussion of the key concepts and principles underlying the proportionate consolidation debate is further advanced before proceeding with these proposals.

Do the proposals of ED 9 achieve convergence?

13 We understand (from BC 24 of ED 9) that one of the perceived benefits of the proposed amendments to IAS 31 is to achieve convergence "in principle" with US GAAP. However, US interpretation EITF 00-1 permits US oil- and gas-producing entities and entities in the construction industry to use proportionate consolidation ("equity method on a proportionate gross basis"), on the grounds that this is established practice in those industries. It is not clear to us whether the FASB

intends to follow the IASB in eliminating proportionate consolidation entirely but, unless it does—and does so soon—convergence will not be achieved in two important industrial sectors where joint ventures are very common. Some would argue that is not convergence in principle.

14 We also note that the IASB has said before that the objective of the IASB/FASB convergence project is to converge to the better of the two GAAPs, with the proviso that if that better of the two is not good enough a third way has to be found. As ED 9 is not proposing to converge fully on US GAAP, it could be argued that it represents a 'third way'; although there appears to have been insufficient work done to think of the proposals in that way. On the other hand, there also appears to have been insufficient work done to conclude that convergence is taking place around the better of the two GAAPs.

A possible way forward

15 For all of the above reasons we think it would be premature and perhaps even inappropriate to eliminate the option of proportionate consolidation from IAS 31 at the current time. On the other hand, we think an amendment that the IASB could make that might be helpful to users of financial statements would be to insert in IAS 31 a requirement for management to select the accounting method for jointly-controlled entities that best reflects the entity's circumstances and sector of activity and will result in the most appropriate information (in other words, will be the most useful to users). The standard could perhaps include criteria to direct management towards the most useful accounting method, and could require management to justify its choice of method in its disclosures.

APPENDIX 2
EFRAG's responses to the questions asked in ED 9

NB The text of the invitation to comment is reproduced in bold italics below.

General Comment

As stated in the covering letter, EFRAG's view is that IAS 31 should not be amended at this time. The comments below are intended to assist the IASB in its deliberations on the development of a final standard. Those of our comments which are based on the assumption of a change in the accounting standard for joint arrangements do not imply our agreement to making a change at present.

Question 1 – Definitions and terminology

The exposure draft proposes that the IFRS should be applied to arrangements in which decisions are shared by the parties to the arrangement. The exposure draft identifies three types of joint arrangement—joint operations, joint assets and joint ventures. A party to an arrangement may have an interest in a joint operation or joint asset, as well as an interest in a joint venture. Joint ventures are subject to joint control (see paragraphs 3–6 and 8–20 and Appendix A of the draft IFRS and paragraphs BC16–BC18 of the Basis for Conclusions). Question 1: Do you agree with the proposal to change the way joint arrangements are described? If not, why?

1.1 Some commentators question whether a change in the descriptions of the various types of joint arrangement is necessary. It appears from discussions with our constituents that the descriptions of current IAS 31 *Joint Ventures* (IAS 31) do not appear to have caused difficulty in practice.

Question for Constituents
An important objective for the IASB in this project was to clarify the existing descriptions, which it believed to be causing problems in practice. Have they caused you problems in practice and are the revised descriptions better?

1.2 In our view, the section of ED 9 entitled "Types of joint arrangement" requires an introduction to explain what the essence of a joint arrangement is, before introducing the three types of joint arrangement. In the proposals, the notion of shared decision making is not introduced until paragraph 7, even though it is fundamental to a joint arrangement. The definitions relevant to joint arrangements are located in appendices to the standard, as in recent IFRSs, but it would be probably be more helpful here to discuss the characteristics of joint arrangements, such as shared decision making and joint control, additionally at the beginning of this section in order to facilitate the understanding of the different types of arrangement and the consequent accounting for them.

1.3 It is not clear what point paragraph 4 of ED 9 is making. We think it is saying that in respect of any one joint arrangement the three types of joint arrangement are not mutually exclusive. If this is correct then the wording could be amended to something like the following: "In respect of any one individual joint arrangement, a party to the arrangement may have interests in one or more of the different types of joint arrangement at the same time. Each of these has to be accounted for appropriately in accordance with this IFRS."

1.4 We find the description of the joint venture, as laid out in paragraphs 15 to 20 of ED 9, to be confusing. In particular, paragraph 18 does not seem to follow on logically from the preceding paragraphs, but to exist in parallel. In our reading, the description (and the definition) of a business[2] is very similar to the description of a joint venture. In addition, IFRS 3 Business Combinations currently contains a definition of a business[3] which is very similar to that used in the definitions section of ED 9. ED 9.15 states that the venturer's interest is in its share of the outcome of the activities of the joint venture and ED 9.17 states that a joint venture controls assets, incurs liabilities and expenses and earns revenue. These descriptions of a joint venture appear to us to be so similar to the definitions of a business that it may be clearer to combine these and describe an interest in a joint venture as an interest in a business (as defined in Appendix A to IFRS 3 and Appendix A to ED 9) over which the venturer enjoys joint control (as defined in Appendix A to ED 9).

1.5 We see a further potential point of confusion in the description of a joint venture. Paragraphs 15 to 20 define a joint venture as a set of activities in which the venturer's interest is limited to an interest in the net outcome. However, in addition to this description, the flowchart in Appendix B seems to imply that a joint venture can also be a residual, i.e., when all the individual assets and obligations have been recognised by the party to the arrangement "any remaining assets and liabilities" represent an interest in a joint venture to be accounted for using the equity method. We are concerned about defining a joint venture by default in this way, as we think it is always clearer to identify an arrangement positively. Furthermore, we find it hard to understand how the disclosures required for joint ventures could be useful in respect of such a residual.

1.6 The flowchart illustration of Appendix B to ED 9 would be more helpful if the various "decision points" were linked the relevant paragraphs of the standard by cross-reference, as in IAS 39 paragraph AG 36 or IAS 37 Appendix B. This would allow preparers to understand what the principles or analysis involved at each stage are.

1.7 Although one of the objectives of ED 9 is to move away from the current situation of treating the form of the arrangement as the most important factor in determining the accounting we are not sure that this has been achieved. In illustrative example 4, for example, the accounting for the arrangement is determined by the fact that an entity has been set up to own and operate the shopping centre. The accounting would be different if each venturer continued to own 50% of the shopping centre and had set up an operating entity, and different again if the centre was operated by one of the venturers and revenues and expenses billed between the venturers. The substance of the arrangement is really the same in all cases.

Possible need for further guidance

1.8 The requirements of SIC 13 *Jointly Controlled Entities- Non-Monetary Contributions by Venturers* (SIC13) and IAS 31 paragraphs 48 – 50 in respect of transactions between a venturer and a joint venture have been replaced by a reference in paragraph 27 of ED 9 to paragraph 22 of IAS 28. We wonder whether this will be

[2] An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants. [ED 9 Appendix A]

[3] An integrated set of activities and assets conducted and managed for the purpose of providing:
(a) a return to investors; or
(b) lower costs or other economic benefits directly and proportionately to policyholders or participants.
A business generally consists of inputs, processes applied to those inputs, and resulting outputs that are, or will be, used to generate revenues. If goodwill is present in a transferred set of activities and assets, the transferred set shall be presumed to be a business.

sufficient guidance once SIC 13 and current IAS 31 have been withdrawn, or whether the guidance of the consensus of SIC 13 should also be incorporated into IAS 28.

1.9 According to paragraph BC20 of ED 9 the Board proposes to incorporate into the IFRS the consensus of SIC13. However, while SIC-13 prohibits recognition of a gain or loss when a contribution to a joint venture lacks commercial substance, there is no corresponding requirement in paragraph 22 of IAS 28. If this change is intentional then it would be helpful to understand why the change improves the quality of financial reporting.

1.10 Paragraphs 52 and 53 of IAS 31 in respect of the joint venture operator's fees have been removed from ED 9, presumably on the grounds that the accounting for these is obvious. We believe it may still be useful to specify that such fees should be accounted for as an expense of the joint venture and as revenue in accordance with IAS 18 for the operator. This would prevent diversity in accounting from arising in practice, such as in the case of the operator being remunerated by special dividends or a disproportionate share of the net income. In the absence of guidance these could be accounted for as dividends.

1.11 We reviewed ED 9's illustrative examples with members of the EFRAG Joint Venture Working Group. The general conclusion of the members was that the examples were not sufficiently detailed nor were they explained clearly enough to allow preparers to understand the principles that had been applied and what the accounting was in concrete terms. For example, Example 2 states that the rights to access to an asset and its residual value would be recognised "in accordance with applicable IFRSs". The variant to this example states that it should have "little effect" on the accounting by the venturers, even though the latter have provided financing to the joint venture, which could be shown as an investment in the joint venture in accordance with paragraph 20 of ED 9, instead of as an item of property, plant and equipment as in the first part of the example. As another illustration of this, example 4 surprised many members, who saw this as a case where the substance was that of a joint asset but the ED seemed to privilege its form as a jointly-controlled entity to determine the accounting. We believe that the illustrative examples would be much more understandable and helpful if the "applicable IFRSs" were specified and the accounting described.

1.12 Certain disclosures have to be made in respect of joint ventures which are scoped out of ED 9 by paragraph 2. We feel there is a risk that these disclosure requirements might be overlooked because of their location in this section and believe that it would be clearer to include the disclosure requirements in a separate paragraph within the Scope section.

1.13 Paragraph 23 states that "A venturer shall recognise its interest in a joint venture using the *equity method*…" We think that the equity method is also a measurement method and that it may be useful to state this here, i.e. "…recognise and measure its interest…" We note that in paragraph 23(b) no direction is given as to how the interest in a joint venture should be treated by a parent which is allowed not to present consolidated financial statements. We think it could be helpful to understand why it is not necessary to provide such guidance.

1.14 As a final minor point on this section, we do not think that the inclusion of the reference to "a foreign country" adds anything useful to the example of a joint venture in paragraph 19.

Questions 2 and 3 – Accounting for joint arrangements

The exposure draft proposes:

- ***that the form of the arrangement should not be treated as the most significant factor in determining the accounting.***

- ***that a party to a joint arrangement should recognise its contractual rights and obligations (and the related income and expenses) in accordance with applicable IFRSs.***

- ***that a party should recognise an interest in a joint venture (ie an interest in a share of the outcome generated by the activities of a group of assets and liabilities subject to joint control) using the equity method. Proportionate consolidation would not be permitted.***

(See paragraphs 3–7 and 21–23 of the draft IFRS and paragraphs BC5–BC15 of the Basis for Conclusions.)

Question 2: 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?

2.1 The Core principle of ED 9 is that "parties to a joint arrangement recognise their contractual rights and obligations arising from the arrangement". Although at first sight it would appear to be difficult to disagree with this as a principle, the wording of this actually raises a number of questions about whether the definitions of assets and liabilities have been modified by this.

(a) It is not clear in the core principle cited in the question above whether the word "contractual" relates only to rights or also to obligations. If "contractual" relates to obligations, then this should be made clear. It should also be clarified whether this is intended to mean the same as both "legal" and "constructive" as used in respect of obligations in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, and if it is intended to mean something different from legal and constructive obligations, then the Basis for Conclusions should explain why and how the terms differ.

(b) Similarly, the use of the words "contractual rights" instead of "asset" might be intended to represent a change in the definition of an asset. We note that IAS 38 *Intangible assets* paragraph 12 states that "An asset meets the identifiability criterion in the definition of an intangible asset when it: […] (b) arises from contractual or other legal rights, […]". IAS 38.13 goes on to state that "An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control […] normally stems from legal rights that are enforceable in a court of law. […] However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way." Thus ED 9 appears to be restricting the notion of control over an asset to control that comes about as a result of a contract, whereas IAS 38 states that one can have legal rights to an asset without a contract, and that control can even exist in the absence of legal rights. This restriction represents, in our view, an evolution in the definition of an asset and is important that the IASB clarifies its intentions in this area and explains why any change is appropriate.

2.2 It would, of course, be very convenient if the "core principle" behind a particular accounting standard could always be summed up in a short phrase or single paragraph, but we doubt whether this is achievable in most cases. Notwithstanding the need for clarification discussed above, the core principle of ED 9 could equally be applied to accounting for leases or indeed most aspects of the recognition of assets and liabilities in financial statements, and we therefore find it too generic to be of real value in this (draft) IFRS. We believe, therefore, it should be removed from any final standard that may be developed. An overarching principle like this might best be stated in a conceptual statement such as the Framework.

2.3 Given the questions we have about whether the core principle represents a change in the definitions of assets and liabilities, we cannot conclude on whether the proposals in the ED are consistent with this objective. We urge the IASB to clarify its intentions here.

Possible need for further guidance

2.4 What might be useful, we think, is for the proposed standard to state that it requires a careful analysis of the elements of the arrangements to be made in order to identify those assets, liabilities, revenue and expenses which are in substance those of the entity which is a party to the arrangement, and those in which the entity cannot be deemed to have a direct interest. It might also be more helpful than the current IAS 31 if the proposals explained the difference in concept between an entity recognising its own assets/liabilities/revenue/expense etc. and the entity's proportionate consolidation of another entity's assets/liabilities etc., even though the resulting presentation might seem to be the same.

Question 3: 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?

3.1 As discussed in the comment letter and Appendix 1 above, in our view the ultimate test for this proposal is would it improve the quality of the information provided? We think the proposals fail that test.

Eliminating options

3.2 We accept that the elimination of options is a legitimate aim of the periodic review of standards carried out by the IASB. However, we believe that, in order to eliminate options, the IASB should first evaluate the alternative treatments to identify which alternative results in the higher quality financial reporting. As the IASB has not undertaken such an exercise in this case, we believe there is insufficient basis for the elimination of proportionate consolidation as an alternative treatment.

Substance over form

3.3 The existing IAS 31 maintains that proportionate consolidation is the better method of accounting for joint venture entities on the grounds that this method gives the better representation of the substance of the arrangement. Some believe that this still holds true; in other words, that proportionate consolidation provides the best representation of the economic substance of the joint venture for the following reasons:

(a) Management decision making is based on detailed understanding of the underlying operations, assets, liabilities, cash flows etc., not on the share of net outcomes. Incorporation of the venturer's share of these assets, liabilities etc. in group financial statements is believed to give users a fuller view of the scale of the operations managed, and the risks etc. borne by, the group, and in the right circumstances is a better indicator of future cash flows than equity accounting.

(b) Either as the result of their choice of business model or because joint ventures are the only way to gain access to some countries, many consolidated groups carry out large parts of their activity through joint ventures. As an example, joint arrangements can represent as much as 70% of the activity of some major French groups. Management of the group's interest in these joint ventures is just as important, and may require as much resource, as those of exclusively owned activities. Proportionate consolidation more closely reflects the management effort and activity and management's involvement in the decision making of the joint venture.

3.4 We understand that many EU preparers, particularly in those countries where proportionate consolidation was established practice under the national GAAP, use proportionate consolidation for their internal reporting. Elimination of proportionate consolidation would lead to a disconnection between the way the group is reported internally and externally. If proportionate consolidation is eliminated, we believe that some preparers will nonetheless continue to use it for their internal reporting and for their operating segment presentation, as allowed by IFRS 8.

Question for Constituents
It has been suggested to us that some entities are already looking at different legal forms of joint arrangement which would allow them to recognise the arrangements as joint operations or assets in order not to lose their key performance measures as a result of ED 9's requirements. Do you believe that your company or other companies will seek different legal forms for their joint arrangements which will allow them to avoid having to use the equity method?

Consistency with the Framework

3.5 In paragraph BC8 of ED 9 the IASB argues that proportionate consolidation is not appropriate because it results in an entity's recognising as assets and liabilities a proportion of items that it does not control or for which it has no obligation. Paragraph BC9 also states that this accounting is "not consistent with the Framework, which defines assets in terms of exclusive control and liabilities in terms of present obligations." We do not find these arguments compelling for a number of reasons.

3.6 We believe that method of accounting for jointly-controlled entities is primarily a question of the scope of the reporting entity and consolidation.

(a) The assets and liabilities that are recognised in the balance sheet are those of the reporting entity. It is therefore necessary first to identify the reporting entity, addressing the specific issue in the context of ED 9 as to whether joint control is sufficient to bring the jointly-controlled entity into the scope of consolidation. If it is determined that the jointly-controlled entity is part of the reporting entity then a suitable consolidation method must be found. It is only at this point, in our view, that paragraph 49(a) of the *Framework* becomes relevant to the question of what assets and liabilities are recognised in the reporting entity's financial statements.

(b) SIC 12 *Consolidation-Special Purpose Entities* requires an SPE to be consolidated when the substance of the relationship is that an entity controls the SPE. Paragraph 10 of the Interpretation sets out examples of circumstances which indicate that an SPE is controlled by an entity. These examples are largely based on whether the entity obtains benefits (or the majority of the benefits) from the SPE and is exposed to the risks of ownership or incident to the activity of the SPE, rather than whether it has control over the individual assets and liabilities of the SPE. The circumstances used here to indicate control of an SPE could also be applied to the venturer's interest in a jointly controlled entity. We believe it should be made clear why an SPE which is not apparently controlled should be consolidated whereas a jointly-controlled entity should not be proportionately consolidated.

3.7 We note that the question of what "control" means in the context of an asset is a difficult one in several areas of accounting, and has caused problems in connection with, for example, IFRS 4 *Insurance Contracts* and IFRIC 12 *Service Concession Arrangements*. Paragraph BC8 of ED 9 makes no distinction between 'control' over an asset and 'control' over an entity. Although there are definitions of "control" in several IFRSs, these are all used in the context of control over an entity. The definition of an asset in paragraph 49(a) of the Framework[4] does not include the word "exclusive" in its definition, and this notion is not used in this context anywhere else in the Framework, as far as we can see. We think that the Board may be pre-judging the outcome of the work it is carrying out on the asset definition as part of its Framework project on the definition of in concluding that "control" in the Framework can only mean "exclusive control" and never "joint control". Moreover, we note that the latest working definition of an asset included in the papers for the 16 October 2007 IASB/FASB meeting also does not seem to require exclusive control[5].

[4] Existing IASB and FASB Definitions of an Asset

An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity. [IASB Framework, paragraph 49]

Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. [CON 6, paragraph 25; Footnote reference omitted.]

[5] Proposed Working Definition of an Asset

An asset is a present economic resource to which the entity has a present right or other privileged access.

a. *Present* means that both the economic resource and the right or other privileged access to it exist on the date of the financial statements.

b. An *economic resource* is something that has positive economic value. It is scarce and capable of being used to carry out economic activities such as production and exchange. It can contribute to producing cash inflows or reducing cash outflows, directly or indirectly, alone or together with other economic resources. Economic resources include unconditional contractual promises that others make to the entity, such as promises to pay cash, deliver goods, or render services. Rendering services includes standing ready to perform or refraining from engaging in activities that the entity could otherwise undertake.

c. A *right or other privileged access* enables the entity to use the present economic resource directly or indirectly and precludes or limits its use by others. Rights are legally enforceable or enforceable by equivalent means (such as by a professional association). Other privileged access is not enforceable, but is otherwise protected by secrecy or other barriers to access.

3.8 The Framework has not yet been modified from that which was in place when the 2003 revision of IAS 31 was published. The judgement of the Board at the time appears to have been that the qualitative characteristic of reliability, and in particular the need to privilege substance over form in faithfully representing the economic reality of the arrangement (as suggested by paragraph 35 of the Framework) was the determining factor in its decision on the most appropriate accounting method. We believe that the Board should explain clearly why it now appears to believe that form is more important than substance in this instance.

3.9 We are not sure whether proportionate consolidation is consistent with the Framework, but the entities which currently use proportionate consolidation seem to believe that it may be more relevant and reliable (ie it reflects the substance) than the equity method, and that it provides more useful information. We are equally not sure whether the equity method is consistent with the Framework. Although ED 9 paragraph BC14 states that "the consideration of the equity method, and any alternative to it, is outside the scope of this short-term project", we believe that the appropriateness of the equity method and its consistency with the Framework must be clearly justified before proportionate consolidation is eliminated from IAS 31. The Basis for Conclusions must provide an analysis of both the proportionate consolidation and equity methods, and a conclusion as to why the latter is superior, if that is the case.

3.10 Furthermore, the equity method must be shown to be sound under the future conceptual framework that is currently being developed. We believe that it would be very unfortunate and disruptive to force all reporting entities to apply the equity method if that too is to be eliminated in the near future.

3.11 As discussed in our comment letter, the difference between the equity method and proportionate consolidation is really one of presentation as the measurement and recognition criteria of the two methods are quite similar. We wonder therefore whether the equity method really is more correct than proportionate consolidation.

Other considerations

3.12 Elimination of proportionate consolidation means that there is a lack of differentiation between accounting for JVs and associates, whereas the degree of control is very different (joint control for the former and significant influence for the latter). Significant influence is frequently exercised over an associate by the investing entity's having a representative on the associate's board. Joint control is generally exercised in a way which requires much more involvement by the investor in the management of the joint venture, both at board level and often at the operational level. Some believe that these differing degrees of control should be reflected by a graduation of different accounting methods. We find the argument of BC 24 (that the equity method has been used to account for joint ventures in many parts of the world and that the equity method is outside the scope of the project) insufficient justification for taking the fundamental step of eliminating the proportionate consolidation option.

3.13 We understand from BC 24 of ED 9 that two of the elements of the motivation behind the proposed amendments to IAS 31 are to achieve comparability and to achieve convergence "in principle" with US GAAP. Our understanding of the US interpretation EITF 00-1 is that the US oil- and gas-producing entities and entities in the construction industry may continue to use proportionate consolidation ("equity method on a proportionate gross basis") as this is an established practice in those industries. If this is the case, convergence will not be achieved. FASB has not yet determined whether it will adopt IAS 31 or its equivalent without any exceptions, such as those cited in EITF 00-1. In our view, the disruption caused by convergence "in principle" can only be justified if it achieves actual full convergence.

3.14 In summary, we find the arguments of the Basis for Conclusions insufficient to justify a change which will not lead to full convergence. In addition, we believe that it is premature for the IASB to eliminate proportionate consolidation on the grounds of inconsistency with the current Framework when the conceptual framework project is far from completion and may fundamentally change the principles of asset and liability recognition, the principles of control and the consolidation of entities and the definition of the reporting entity.

Questions 4–6 – Disclosure

The exposure draft proposes:

- ***to require an entity to describe the nature of operations it conducts through joint arrangements (see paragraph 36 of the draft IFRS and paragraph BC22 of the Basis for Conclusions).***
- ***to align the disclosures required for joint ventures with those required for associates in IAS 28 Investments in Associates (see paragraphs 39–41 of the draft IFRS and paragraph BC23 of the Basis for Conclusions).***
- ***to require the disclosure of summarised financial information for each individually material joint venture and in total for all other joint ventures (see paragraph 39(b) of the draft IFRS and paragraph BC13 of the Basis for Conclusions).***
- ***as consequential amendments to IAS 27 Consolidated and Separate Financial Statements and IAS 28, to require disclosure of a list and description of significant subsidiaries and associates. Those disclosure requirements were deleted in 2003 as part of the Improvements project. However, the Board understands from users that such disclosures are useful.***
- ***as a consequential amendment to IAS 28, to require disclosure of current and non-current assets and current and non-current liabilities of an entity's associates. The proposed IFRS would require disclosure of current and non-current amounts, whereas IAS 28 currently requires disclosure of total assets and total liabilities.***

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?

4.1 As we have already explained, we do not believe it is appropriate at the current time to eliminate proportionate consolidation. However, in order to be as helpful as possible we have, for the purpose of responding to question 4, assumed that proportionate consolidation will nevertheless be eliminated.

4.2 As discussed in our response to question 3 above, we do see a difference between the degree of involvement an entity has in the operation of a jointly-controlled entity and that which it has in an associate. We believe that the summarised disclosures proposed in ED 9 are appropriate for associates. However, the deeper involvement of reporting entities in the operations of their jointly-controlled entities requires, in our view, more detailed disclosures in order to help the user of the financial statements to understand the importance of these entities to the group.

4.3 If ED 9 were to become a final standard, we believe that the best way to compensate for the loss of aggregated information in the primary statements would be to adapt the presentation of the income statement and balance sheet to provide users with an indication of the financial elements included in the joint ventures. In Appendix 3 we provide a series of possible formats for such presentation which we commend to the IASB's attention. There are certainly other possible presentations, but in any event we would recommend that such presentation formats be permitted but not be mandatory, thus leaving management to decide upon what it believes to be the most useful and relevant formats for the entity's circumstances.

4.4 In the absence of modified primary statement formats, as discussed in paragraph 4.3, we think the proposed disclosures in respect of the joint ventures may not go far enough to compensate for the loss of proportionate consolidation as far as detail is concerned. Further breakdown of the balance sheet and income statement along the lines of the main financial statements would help users gain a fuller understanding of the scale, degree of control and risks of the reporting entity:

(a) Balance sheet: split of non-current assets between intangibles and property, plant and equipment; current assets split between inventories, receivables and other; other liabilities sub-divided to show provisions, finance debt and other.

(b) Income statement to show major lines: revenue; operating expenses; operating profit/loss; exceptional items (gain/loss on disposals); interest expense; tax.

4.5 However, we question whether details of the balance sheet and income statement of individually material joint ventures, as required by paragraph 39 (b), are necessary. We are aware that there are entities which create large joint ventures for individual contracts. This disclosure requirement would mean that the client for the contract would be able to identify the margin the venturer is making on the contract. We recognise that this requirement is similar to the IFRS 8 requirement to disclose the existence of the major customers upon which the entity might depend, but we would point out that IFRS 8 does not require identification of the customers. We suggest that a requirement only to identify the major joint venture without details of its financial statements might satisfy the purpose of the disclosure whilst avoiding disclosing commercially sensitive information. In addition, it may be useful for the future standard to provide more guidance on how large an "individually material joint venture" should be to warrant separate disclosure.

4.6 Paragraph 38 specifically mentions that contingent liabilities are to be disclosed in accordance with IAS 37. We understand that it is necessary to lay out the requirements of paragraphs 38(a) and (b) because they are more detailed than the more general disclosure requirements of IAS 37, but we wonder why the reference to IAS 37 is needed.

Question 5: Do you agree with the proposal to restore to IAS 27 and IAS 28 the requirements to disclose a list and description of significant subsidiaries and associates? If not, why?

5.1 Yes, we see this information as useful.

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?

6.1 Yes, these disclosures are useful, but we believe that it would be more useful to provide more information than currently proposed, as discussed in our response to Question 4. However, financial details of individually material joint ventures which could be commercially sensitive should not be required.

APPENDIX 3
Examples of Possible Presentation of Joint Ventures in Income Statement and Balance Sheet under Equity Method

EXAMPLE 1 (UK FRS 9) — **CONSOLIDATED PROFIT AND LOSS ACCOUNT**

	2006			**2005**		
	Group CUmillions	**Share of Joint ventures** CUmillions	**Total** CUmillions	**Group** CUmillions	**Share of Joint ventures** CUmillions	**Total** CUmillions
Turnover:	200	120	320	200	120	320
Cost of sales	-120	-80	-200	-120	-80	-200
Gross profit	80	40	120	80	40	120
Administrative expenses	-40	-10	-50	-40	-10	-50
Operating profit	40	30	70	40	30	70
Gain/(loss) on disposals of fixed assets	0	0	0	0	0	0
Group share of net profit after tax in						
Joint ventures	15	-15	0	15	-15	0
Associates	10		10	10		10
	65	15	80	65	15	80
Interest receivable	6	0	6	6	0	6
Interest payable	-26	-10	-36	-26	-10	-36
Profit before tax	45	5	50	45	5	50
Tax	-5	-5	-10	-5	-5	-10
Net profit after tax	40	0	40	40	0	40

EXAMPLE 1 (UK FRS 9) — **CONSOLIDATED BALANCE SHEET**

	2006			**2005**		
	Group CUmillions	**Share of Joint ventures** CUmillions	**Total** CUmillions	**Group** CUmillions	**Share of Joint ventures** CUmillions	**Total** CUmillions
Non-current assets						
Intangible assets	80	20	100	80	20	100
Property, plant and equipment	400	80	480	400	80	480
Investments accounted for by the equity method						
Investments in joint ventures	50	-50	0	50	-50	0
Investments in associates	20		20	20		20
	550	50	600	550	50	600
Current assets						
Inventory	15	5	20	15	5	20
Trade and other receivables	75	23	98	75	23	98
Cash and cash equivalents	10	2	12	10	2	12
	100	30	130	100	30	130
Total assets	650	80	730	650	80	730
Current liabilities						
Trade and other payables	-40	-8	-48	-40	-8	-48
Current tax payable	-5	-2	-7	-5	-2	-7
Finance debt	-5		-5	-5		-5
	-50	-10	-60	-50	-10	-60
Non-current liabilities						
Provisions	-10	0	-10	-10	0	-10
Deferred tax	-50	-5	-55	-50	-5	-55
Finance debt	-200	-65	-265	-200	-65	-265
	-260	-70	-330	-260	-70	-330
Total liabilities	-310	-80	-390	-310	-80	-390
Net assets	340	0	340	340	0	340
Capital and reserves						
Equity holders of the parent	300			300		
Minority interest	40			40		
Shareholders' equity	340			340		

EXAMPLE 2

CONSOLIDATED PROFIT AND LOSS ACCOUNT

	2006		**2004**	
	CUmillions	CUmillions	CUmillions	CUmillions
Turnover:				
Group and share of joint ventures	320		320	
Less: Joint ventures	-120		-120	
Group turnover		200		200
Cost of sales				
Group and share of joint ventures	-200		-200	
Less: Joint ventures	80		80	
Group cost of sales		-120		-120
Gross profit		80		80
Administrative expenses				
Group and share of joint ventures	-50		-50	
Less: Joint ventures	10		10	
Group administrative expenses		-40		-40
Group operating profit		40		40
Gain/(loss) on disposals of fixed assets				
Group and share of joint ventures	0		0	
Less: Joint ventures	0		0	
Group Gain/(loss) on disposals		0		0
Group share of net profit after tax in				
Joint ventures		15		15
Associates		10		10
Interest receivable				
Group and share of joint ventures	6		6	
Less: Joint ventures	0		0	
Group interest receivable		6		6
Interest payable				
Group and share of joint ventures	-36		-36	
Less: Joint ventures	10		10	
Group interest payable		-26		-26
Profit before tax		45		45
Tax				
Group and share of joint ventures	-10		-10	
Less: Joint ventures	5		5	
Group tax on profit		-5		-5
Net profit after tax		40		40

EXAMPLE 2

CONSOLIDATED BALANCE SHEET

	2006		**2005**	
	CUmillions	CUmillions	CUmillions	CUmillions
Non-current assets				
Intangible assets				
Group and share of joint ventures	100		100	
Less: Joint ventures	-20		-20	
Group intangible assets		80		80
Property, plant and equipment				
Group and share of joint ventures	480		480	
Less: Joint ventures	-80		-80	
Group property, plant and equipment		400		400
Investments accounted for by the equity method				
Investments in joint ventures		50		50
Investments in associates		20		20
		550		550
Current assets				
Inventory				
Group and share of joint ventures	20		20	
Less: Joint ventures	-5		-5	
Group inventory		15		15
Trade and other receivables				
Group and share of joint ventures	98		98	
Less: Joint ventures	-23		-23	
Group trade and other receivables		75		75
Cash and cash equivalents				
Group and share of joint ventures	12		12	
Less: Joint ventures	-2		-2	
cash and cash equivalents		10		10
		100		100
Total assets		650		650
Current liabilities				
Trade and other payables				
Group and share of joint ventures	-48		-48	
Less: Joint ventures	8		8	
Group trade and other payables		-40		-40
Current tax payable				
Group and share of joint ventures	-7		-7	
Less: Joint ventures	2		2	
Group current tax payable		-5		-5
Finance debt				
Group and share of joint ventures	-5		-5	
Less: Joint ventures	0		0	
Group finance debt		-5		-5
		-50		-50
Non-current liabilities				
Provisions				
Group and share of joint ventures	-10		-10	
Less: Joint ventures	0		0	
Group provisions		-10		-10
Deferred tax				
Group and share of joint ventures	-55		-55	
Less: Joint ventures	5		5	
Group deferred tax		-50		-50
Finance debt				
Group and share of joint ventures	-265		-265	
Less: Joint ventures	65		65	
Group finance debt		-200		-200
		-260		-260
Total liabilities		-310		-310
Net assets		340		340

EXAMPLE 2(a) Alternative presentation — **CONSOLIDATED BALANCE SHEET**

	2006		**2005**	
	CUmillions	CUmillions	CUmillions	CUmillions
Non-current assets				
Group intangible assets		80		80
Group property, plant and equipment		400		400
Investments accounted for by the equity method				
Net assets of joint ventures				
Intangible assets	20		20	
Property, plant and equipment	80		80	
Non-current assets	100		100	
Current assets	30		30	
Current liabilities	-10		-10	
Deferred tax	-5		-5	
Finance debt	-65		-65	
Non-current liabilities	-70		-70	
Investments in joint ventures		50		50
Investments in associates		20		20
		550		550
Current assets				
Group inventory		15		15
Group trade and other receivables		75		75
cash and cash equivalents		10		10
		100		100
Total assets		650		650
Current liabilities				
Group trade and other payables		-40		-40
Group current tax payable		-5		-5
Group finance debt		-5		-5
		-50		-50
Non-current liabilities				
Group provisions		-10		-10
Group deferred tax		-50		-50
Group finance debt		-200		-200
		-260		-260
Total liabilities		-310		-310
Net assets		340		340
Capital and reserves				
Equity holders of the parent		300		300
Minority interest		40		40
Shareholders' equity		340		340

EXAMPLE 3

CONSOLIDATED PROFIT AND LOSS ACCOUNT

	2006		2005	
	Equity method	**Proportionate consolidation**	**Equity method**	**Proportionate consolidation**
	CUmillions	CUmillions	CUmillions	CUmillions
Turnover:	200	320	200	320
Cost of sales	-120	-200	-120	-200
Gross profit	80	120	80	120
Administrative expenses	-40	-50	-40	-50
Operating profit	40	70	40	70
Gain/(loss) on disposals of fixed assets	0	0	0	0
Group share of net profit after tax in				
Joint ventures	15		15	
Associates	10	10	10	10
	65	80	65	80
Interest receivable	6	6	6	6
Interest payable	-26	-36	-26	-36
Profit before tax	45	50	45	50
Tax	-5	-10	-5	-10
Net profit after tax	40	40	40	40

EXAMPLE 3

CONSOLIDATED BALANCE SHEET

	2006		2005	
	Equity method	Proportionate consolidation	Equity method	Proportionate consolidation
	CUmillions	CUmillions	CUmillions	CUmillions
Non-current assets				
Intangible assets	80	100	80	100
Property, plant and equipment	400	480	400	480
Investments accounted for by the equity method				
Investments in joint ventures	50		50	
Investments in associates	20	20	20	20
	550	600	550	600
Current assets				
Inventory	15	20	15	20
Trade and other receivables	75	98	75	98
Cash and cash equivalents	10	12	10	12
	100	130	100	130
Total assets	650	730	650	730
Current liabilities				
Trade and other payables	-40	-48	-40	-48
Current tax payable	-5	-7	-5	-7
Finance debt	-5	-5	-5	-5
	-50	-60	-50	-60
Non-current liabilities				
Provisions	-10	-10	-10	-10
Deferred tax	-50	-55	-50	-55
Finance debt	-200	-265	-200	-265
	-260	-330	-260	-330
Total liabilities	-310	-390	-310	-390
Net assets	340	340	340	340
Capital and reserves				
Equity holders of the parent	300		300	
Minority interest	40		40	
Shareholders' equity	340		340	