



<b>To:</b>	<b>AASB Members</b>	<b>Date:</b>	12 April 2010
<b>From:</b>	<b>Siva Sivanantham and Maybelle Chia</b>	<b>Agenda Item:</b>	4.1
<b>Subject:</b>	<b>Joint Arrangements</b>	<b>File:</b>	–

## ACTION

- 1 Receive an update on the IASB's tentative decisions to-date on the Joint Ventures project as a background to considering the forthcoming replacement Standard for IAS 31 *Interests in Joint Ventures* and consider specific matters that the Board might wish to raise with the IASB.

## BACKGROUND

- 2 The review of IAS 31 *Interests in Joint Ventures* forms part of the IASB/FASB's short-term project to reduce differences between IFRS and US GAAP. The project is being conducted by the IASB only. The IASB has not reconsidered all of the requirements in IAS 31 – only major differences with US GAAP are addressed.
- 3 In September 2007, the IASB issued for public comment Exposure Draft ED 9 *Joint Arrangements* proposing a replacement Standard for IAS 31. The AASB issued its domestic ED 157 *Joint Arrangements* (incorporating the IASB ED) in October 2007 with comments due by 11 January 2008.
- 4 The main changes proposed in ED 9 were terminology changes, removal of the proportionate consolidation option and changes to the disclosure requirements.
- 5 The terminologies for the three types of identified joint arrangements were proposed to change from IAS 31 as follows:
  - Jointly controlled operation becomes joint operation;
  - Jointly controlled asset becomes joint asset; and
  - Jointly controlled entity (JCE) becomes joint venture.

Based on these proposals, a party to a joint operation or a holder of joint assets would no longer be called a 'venturer' and would be referred to as a 'party'.
- 6 At present, IAS 31 allows parties to a JCE to apply either the proportionate consolidation or equity method of accounting. The IASB considered that having options for accounting for similar

transactions impairs comparability and therefore decided to propose to remove the proportionate consolidation alternative, which is not part of US GAAP in general for joint ventures.

## **AASB SUBMISSION TO IASB ED 9**

- 7 While agreeing that IAS 31 requires amendment, the AASB's Submission to the IASB stated that the proposals in the ED require further research, in particular the concept of joint control within the Conceptual Framework. In addition, the Submission noted that the AASB:
- does not support removing the proportionate consolidation method until substantial research into the most appropriate method for accounting for joint ventures is conducted (and the Board also noted that US GAAP allows proportionate consolidation for entities in the oil and gas industry in which joint venture arrangements are common);
  - believes the proposed terminology and definitions need to be further clarified; and
  - considers that there are practical implementation difficulties associated with the proposed changes.
- 8 A copy of the AASB's Submission is provided in Agenda Paper 4.2 for your information. If you would like to receive a copy of ED 9 (AASB ED 157), please contact Siva Sivanantham via email (ssivanantham@asb.gov.au). Copies will be available at the forthcoming Board meeting.

## **IASB REDELIBERATION OF ED 9 PROPOSALS**

- 9 At the April 2008 IASB meeting, the staff presented a summary of the comment letters received on ED 9. The IASB discussed the main issues raised and reaffirmed the principles in the ED. The IASB recognised that many respondents have a different interpretation and assessment of the implications of the model proposed from those of the IASB. It was noted that the proposed IFRS would need to be improved to address this gap. The IASB asked the staff to seek the views of additional users and to contact some of the respondents in order to gain a better understanding of their concerns.
- 10 The IASB continued its discussion of the proposals at its meetings in May, June and December 2009 and February and March 2010. The tentative decisions made at these meetings are summarised in paragraphs 12 – 45 below.
- 11 The IASB plans to continue its discussion at future meetings, with the aim of publishing an IFRS in the second quarter of 2010.

## **IASB TENTATIVE DECISIONS TO-DATE**

### **Joint Control instead of Shared decision-making**

- 12 In ED 9, the term 'shared decisions' was presented as a feature of all types of joint arrangements, while 'joint control' was only referred to a specific type (i.e., only referred to joint ventures). During the IASB's redeliberations, the IASB staff advised that the initial intention to associate 'joint control'

only to 'joint ventures' was due to the fact that the definition of 'control' in IAS 27 *Consolidated and Separate Financial Statements* referring to the 'power to govern the financial and operating policies of an entity to as to obtain benefits from its activities' was found not to translate well to an 'asset' or 'operation'.

- 13 The IASB noted that it is confusing to introduce two terms (i.e., 'shared decisions' and joint control') with similar meaning (i.e., requirement of unanimous consent for strategic decisions) depending on whether the arrangement is a 'joint operation/asset' or a 'joint venture'. It also noted that there are strategic operating and financing decisions related to arrangements that are joint assets or operations such as approving the budget, designing employment contracts and approving external borrowings. Accordingly, the IASB decided to replace the term 'shared decision-making' with 'joint control' for all types of joint arrangements.

## **Two types of joint arrangements instead of three**

- 14 ED 9 proposed 3 types of joint arrangements being 'joint operations', 'joint assets' and 'joint ventures'. During the redeliberation of ED 9 proposals, the IASB noted that it would be better if the Standard described only two types of joint arrangements (i.e., 'joint operations' and 'joint ventures'), because the sub-classification between 'joint operations' and 'joint assets' is problematic since elements from both types often occur in the one arrangement. Furthermore, the parties to both types of arrangements can have interests in assets, liabilities, revenues and expenses. Therefore, both arrangements should probably result in the same accounting outcome.
- 15 Hence, the IASB decided to consider 'joint operations' and 'joint assets' as a single type of joint arrangement called 'joint operation'.

## **Hybrids (two different types of joint arrangements within the same joint arrangement)**

- 16 Each different type of joint arrangement was defined in ED 9 (in particular, paragraphs 8 and 15) as being a joint arrangement or part of a joint arrangement. In addition, the flowchart of Appendix B of the ED stated that a joint venture is 'any remaining assets and liabilities ...'. In other words, any assets or liabilities not identifiable as joint assets or joint liabilities default to a joint venture.
- 17 During the redeliberation, the IASB noted that it was not the intention to define a joint venture as a residual. Accordingly, it decided to clarify in the new Standard that a joint arrangement could comprise both a joint operation and a joint venture, but each need to be a complete arrangement in their own right and not merely a residual.

## **Determining the type of joint arrangement: ‘open assessment’ rather than a ‘rebuttable presumption’**

- 18 Paragraph 18 of ED 9 introduced the term ‘business’ to describe ‘joint ventures’ as follows: “A *business* usually involves assets and resources working together to achieve an outcome, which requires decisions of a financial and operating nature. A business that is subject to joint control is, therefore, a joint venture, unless circumstances indicate otherwise. Such circumstances would indicate that the parties have contractual rights to the assets of the business and have contractual obligations for the expenses of the business”.
- 19 Many respondents to ED 9 stated that it was unclear why the ED included the reference to ‘business’ and how it was intended to be interpreted. The most common doubt was whether ‘business’ in paragraph 18 of the ED was providing an example of a joint venture or whether an entity would only have interest in a joint venture when that joint venture is a business. During the redeliberation, the IASB noted that a ‘business’ as defined in IFRS 3 *Business Combinations* could be found in all types of joint arrangements and that, therefore, the existence of a ‘business’ as such is not a distinctive feature of a specific type of joint arrangement. Furthermore, the IASB noted that paragraph 17 of the ED introduced another feature when it described joint ventures, as follows: ‘A joint venture often involves the establishment of a legal entity, such as a corporation’.
- 20 On redeliberation, the IASB decided that, for a joint arrangement established in a separate entity, it is necessary to consider all relevant facts and circumstances to assess whether the arrangement is a joint operation or a joint venture. There should not be a rebuttable presumption that the arrangement is a joint venture.

## **Parties to joint arrangements that do not share in ‘joint control’**

- 21 IAS 31 defines *investors in a joint venture* as parties to a joint venture with no joint control over the joint venture (note that these words were not carried into ED 9). Paragraph 51 of IAS 31 states that “an investor in a joint venture that does not have joint control shall account for that investment in accordance with IAS 39 or, if it has significant influence in the joint venture, in accordance with IAS 28”.
- 22 One of the audit firms responding to ED 9 provided the following comment:
- “There is currently a lot of uncertainty as to how parties to jointly controlled operations and jointly controlled assets (as defined in IAS 31) that do not share in ‘joint control’ should account for their interest in those joint ventures. Because the existing IAS 31 has a stronger emphasis on the ‘legal form’ of joint venture arrangements, the wording of paragraph 51 is commonly only applied to joint ventures where the joint venture is operated through an incorporated joint venture and so each investor has a legal ‘investment’ in the form of shares or other ownership interest.

Accordingly, there is effectively no guidance on how non-jointly controlling parties to a jointly controlled operation or jointly controlled asset should account for their interests in the unincorporated joint venture. From our experience, some entities account for their interest as a financial asset, others as an intangible asset and others as an 'undivided interest' in the underlying assets. The accounting outcome often depends on the exact facts and circumstances surrounding the joint venture agreement."

- 23 The IASB noted that each of the parties in a joint operation has rights and obligations to assets and liabilities independently from whether the party is a party sharing in 'joint control' in the joint operation. Consequently, the IASB decided:
- (a) to introduce a term such as 'investor in a joint arrangement' to identify parties to joint arrangements that do not have joint control in the arrangement;
  - (b) that an investor in a joint arrangement that is a joint operation should account for its assets, liabilities, revenues and expenses, including its share of any assets, liabilities, revenues and expenses arising from the joint operation; and
  - (c) that an investor in a joint arrangement that is a joint venture should account for its interest in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* or, if it has significant influence in the joint venture, in accordance with IAS 28 *Investments in Associates*.

## **Clarification of the accounting requirements for 'joint operations': nature of assets**

- 24 Many respondents to ED 9 were concerned that there was insufficient guidance in the ED around the nature of the assets and liabilities that might be recognised on application of the proposals. One of the points raised was whether a party to a joint asset should recognise its 'rights to use' (as referred in the Illustrative Examples) or its 'right to share' (paragraph 12 of ED 9) or whether it should directly recognise 'its share of the joint asset' (paragraph 22 of ED 9). The concern raised by this uncertainty was the different accounting implications of these possible interpretations of the accounting requirements.
- 25 The IASB staff noted that ED 9 used the term 'right of use' to illustrate that an entity could report individual assets even if the assets were hosted in an incorporated entity. The words 'right of use' were borrowed from the *Framework*, because the Framework acknowledges that the right of ownership is not essential for an entity to recognise an asset. Accordingly, the IASB decided that a party with an interest in a joint operation would recognise the assets or the shares of the assets it controls, classified according to the nature of the assets.

## Transactions between a party and a joint arrangement: consequential amendments to IAS 28

- 26 The IASB noted an inconsistency between the requirements in IAS 27 and SIC-13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*. The inconsistency relates to the accounting for gains and losses resulting from contributions of non-monetary assets to JCEs. SIC-13 requires gains or losses arising from contributions of non-monetary assets to a JCE to be recognised only to the extent of the interest attributable to the other equity holders. Where the non-monetary asset consists of a subsidiary that is contributed to a JCE, IAS 27 (in particular paragraph 34) requires the assets and liabilities of the subsidiary to be derecognised and gains or losses to be recognised in full in profit or loss.
- 27 The IASB decided not to resolve the inconsistency as part of the Joint Ventures project, but to deal with it separately. It also decided to incorporate the requirements in SIC-13 and any guidance relating to the equity method for joint ventures as a consequential amendment to IAS 28.
- 28 Furthermore, the IASB discussed constituents' comments on the section of ED 9 relating to the accounting for transactions between the parties and their joint arrangements and tentatively decided:
- (a) not to incorporate the criteria from SIC-13 that a gain or loss attributable to other parties in respect of non-monetary asset contributions can only be recognised when significant risks and rewards of ownership have been transferred to the arrangement and the gains or losses can be measured reliably.
- The IASB noted that the references to risks and rewards used in SIC-13 are not consistent with the control model currently being used and that the condition relating to reliable measurement is already included in the *Framework* when discussing recognition. Thus, it is not necessary to keep these SIC-13 requirements in the final Standard.
- (b) to incorporate the requirement that the transaction should have commercial substance for the recognition of gains and losses arising from contributions of non-monetary assets.
- The IASB decided to keep this requirement as, in essence, these rules are designed to prevent the recognition of gains where an entity enters into an artificial transaction with the intention of 'manufacturing' a gain by attributing inflated values to the assets exchanged, when in fact the exchange of assets that are similar is not expected to change the configuration of the entity's cash flows.
- (c) to incorporate from IAS 31 (in particular, paragraphs 48-50) the requirement of full recognition of losses when the contribution, sale or purchase provides evidence of a reduction in the net realisable value or recoverable amounts of the assets contributed, sold or purchased.

The IASB decided to keep this requirement in the final Standard on the basis that ED 9 did not aim to change the current accounting practice for these transactions and that IAS 28 does not specifically cover this circumstance.

- (d) to clarify in the final standard that, when a joint operation is structured through an entity, transactions between the parties and the joint operations are, in essence, transactions between the parties themselves.

The IASB noted that there might be some arrangements that are JCEs according to IAS 31 that will be 'joint operations' under the new Standard. The fact that the 'joint operation' is housed in an entity should not change the accounting.

## Scope

- 29 Paragraph 2 of ED 9 states:

"This [draft] IFRS shall be applied by all entities to interests in *joint arrangements*, except interests in joint ventures held by:

- (a) venture capital organisations, or  
(b) mutual funds, unit trusts and similar entities including investment-linked insurance funds that upon initial recognition are designed as at fair value through profit and loss or are classified as held for trading and accounted for in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* [...]"

- 30 During the redeliberation, the IASB discussed whether the scope paragraph should be modified to clarify that joint arrangements held by 'all' entities are within the scope of the final Standard. The IASB noted that the assessment of whether the arrangement is or is not within the scope of the Standard, is independent of the fact that the specific arrangement is allowed to be measured using a measurement basis different from the measurement basis required in the Standard.

- 31 Hence, the IASB decided to modify the scope paragraph of ED 9 to state that the IFRS should be applied by all entities in accounting for interests in joint arrangements. The requirement for venture capital organisations or mutual funds, unit trusts and similar entities including investment-linked insurance funds that upon initial recognition are designated as at fair value through profit or loss to measure their investment at fair value in accordance with IFRS 9 *Financial Instruments* or IAS 39 will be placed in the measurement section of the new IFRS. In addition, the IASB agreed to amend the scope paragraph in IAS 28 as a consequential amendment to align IAS 28 with the decisions described above.

## Loss of Joint Control

- 32 ED 9 carried forward the requirements in IAS 31 in relation to loss of joint control, with one exception. Under ED 9, there is no need to remeasure the remaining interest in a joint venture when

the entity retains significant influence. During the redeliberation, the IASB noted that while the ED proposals were simpler and potentially less costly, they were inconsistent with the assertion that loss of joint control is a 'significant economic event' that changes the nature of an investment, as stated in IAS 27 (in particular, paragraph BC64). Characterising the change from 'joint control' to 'significant influence' as a 'significant economic event' means that the proposal in ED 9 was an exception.

- 33 Following a discussion of the current requirements in IAS 27, IAS 28 and IAS 31, the IASB agreed that the term 'significant economic event' should be redefined as an event that changes the nature of the involvement and affects the group boundaries. Therefore, it decided to remove all descriptions that associate loss of joint control and loss of significant influence in existing IFRSs with the term 'significant economic event'. This term is retained for the event of loss of control. In addition, the IASB decided to:
- (a) confirm that the requirements for the loss of joint control proposed in ED 9 would be carried into the IFRS; and
  - (b) amend IAS 21 *The Effects of Changes in Foreign Exchange Rates* to treat the loss of joint control over a joint venture that includes a foreign operation but in which the investor retains significant influence as a partial disposal instead of a disposal.

## Transitional Provisions

- 34 ED 9 proposed retrospective application of the new Standard, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. As a result, the ED did not include transitional provisions.
- 35 During the consideration of ED 9 comment letters, the IASB noted some respondents were concerned about applying the resulting IFRS retrospectively. The IASB also noted that some preparers recently contacted by the IASB staff had already implemented the proposed changes retrospectively and that these preparers did not consider the process to be a highly technically complex exercise notwithstanding that they did not have complex transactions.
- 36 In addition, the IASB noted that the changes that the new Standard will introduce will mostly affect the accounting for existing JCEs that are currently accounted for under proportionate consolidation method and that will, in accordance with the new Standard, become joint ventures accounted for under the equity method. Fewer JCEs that are currently equity accounted will be joint operations under the new Standard.

### **JCE accounted for proportionately in IAS 31 that will become a Joint Venture under the new Standard (i.e., *proportionate consolidation to equity method*)**

- 37 The IASB decided that JCEs will transition from proportionate consolidation to the equity method, by aggregating at their respective carrying values the proportionate consolidated assets and liabilities into a single line item. The investment will need to be tested for impairment in accordance to

IAS 36 *Impairment of Assets* at the date at which the standard is applied, and at the corresponding comparative periods. The IASB also agreed to require disclosure of the breakdown of the opening balance of the investment for the period in which the IFRS is first applied.

- 38 This represents a modified retrospective approach whereby the new IFRS will be applied retrospectively to all periods presented, with any catch-up adjustments (including impairments) in periods prior to those presented being recognised in the earliest period presented.

**JCE accounted for under the equity method in IAS 31 that will become a Joint Operation under the new Standard (*i.e., equity method to accounting for (shares of) assets and liabilities*)**

- 39 The IASB had a preliminary discussion relating to the transitional provisions for JCEs that will have to transition their accounting from the equity method to the accounting for shares of assets and liabilities. The IASB reached no decisions on this issue, but stated that the objective for these transitional provisions should be for an entity to account for the (shares of) assets and liabilities retrospectively.

- 40 In these circumstances, the entity would have to derecognise the investment, and recognise its share of the assets and liabilities in the arrangement. The IASB noted that the equity accounted carrying amount at the date of transition would be allocated to assets and liabilities on a reasonable basis. Although fair value might be an appropriate basis, the IFRS should not prescribe any particular basis.

**JCE accounted for proportionately in IAS 31 that is a Joint Operation under the new Standard (*i.e., proportional consolidation to accounting for (shares of) assets and liabilities*)**

- 41 The IASB agreed that no special transitional provisions are necessary in this case. The IASB staff noted that no major differences are likely to arise, except that the assets, liabilities, revenues and expenses will also be recognised in the party's separate financial statements. Consequently, the investment recognised at cost or under IFRS 9/IAS 39 in the separate financial statements will be derecognised, and the assets and liabilities will need to be recognised accordingly at their carrying value at the effective date of the Standard. Any difference should be recognised in retained earnings and should be disclosed.

**Separate financial statements**

- 42 The IASB agreed to clarify in the Standard that the accounting for interests held by an entity in joint operations will be the same in the party's separate, individual and consolidated financial statements. In addition, the term 'jointly controlled entities' in IAS 27 should be replaced with 'joint ventures', so that the requirements for the accounting for investments in joint arrangements in the separate financial statements of the parties refer exclusively to the 'joint ventures' type of arrangement.

## Disclosures

- 43 The IASB discussed the disclosure requirements for joint arrangements and associates noting that that these disclosures would form part of the comprehensive disclosure standard for a reporting entity's involvement with other entities that is not in the scope of IAS 39/IFRS 9.
- 44 The IASB tentatively decided:
- (a) to align the disclosure objectives for joint arrangements and associates;
  - (b) not to require disclosure of the basis of joint control (however, the requirements in paragraphs 37(c) and 37(d) of IAS 28 are to be carried forward to the new Standard);
  - (c) to require a list and description of investments in individually-material joint arrangements and associates;
  - (d) to require that an entity discloses commitments relating to its joint arrangements, including its share of commitments incurred jointly with other parties;
  - (e) to require an entity to disclose contingent liabilities relating to its joint arrangements and associates, including its share of contingent liabilities incurred jointly with other parties or investors;
  - (f) not to require summarised financial information for joint operations;
  - (g) that the summarised financial information to be presented for joint ventures and associates should be the same, independent of the measurement method by which the joint venture or associate is being accounted for; and
  - (h) to align the disclosure of information relating to the fact that a joint venture or associate is not accounted for using the equity method, and to provide the fair value of investments in joint ventures and associates for which there are published price quotations.
- 45 The IASB also had a preliminary discussion relating to the aggregation and level of detail of the summarised financial information required for joint ventures and associates. No decisions were reached on this issue.

## OTHER MATTERS

### Public sector and private sector not-for-profit entities

- 46 In relation to the public sector, the AASB staff consulted with relevant public sector constituents who have noted that no significant issues are likely to arise as a result of the IASB's proposed changes, since proportionate consolidation is not generally applied. There are currently some issues around the use of equity accounting and how this reconciles with GFS, but the issues would not change under the IASB's proposals.
- 47 Staff are not aware of any unique features specific to private sector not-for-profit entities, other than (possibly) 'strategic alliances' or corporate partnerships. Based on our preliminary research, it appears common for private sector not-for-profit entities such as charities to establish strategic

alliances or corporate partnerships with for-profit entities. Under these arrangements, a charity may receive support from a business, usually in kind – such as in the form of staff volunteers or business expertise. In return, the corporate entity may benefit from the recognition of being a good corporate citizen or corporate philanthropist. Staff consider that the likely changes to accounting for joint arrangements will not give rise to any new issues in this area. The issue of whether such strategic alliances would fall within the scope of joint arrangements is probably no more of an issue under the proposed replacement Standard as it is under the existing AASB 131. Staff note that the main asset a private sector not-for-profit entity is likely to bring to any joint arrangement is an unrecognised internally generated intangible asset (its 'brand').

## **Application of IAS 21 to parties to joint arrangements that do not share in joint control**

- 48 The AASB staff and IASB staff have recently been informed of an issue relating to interests in jointly controlled assets or operations (under the existing IAS 31) where the party does not participate in joint control over the joint venture. The issue relates to interests in such ventures where the manager prepares financial information in a functional currency that is different from the investor's own functional currency. From the perspective of the non-jointly controlling party, it appears clear the arrangement is not a 'joint venture' for the purposes of the definition of 'foreign operation' under IAS 21 as it stands. However, there are divergent views as to whether such an interest might be a foreign operation by virtue of being a 'branch' and if so, whether paragraph 39 of IAS 21 can be applied (either directly or by analogy) when accounting for the interest such that a foreign currency translation reserve (FCTR) arises. If such an interest is not considered a 'foreign operation' under IAS 21, the share of non-monetary assets recognised would generally be recorded at 'cost' (based on historical exchange rates) and foreign exchange gains/losses on monetary items would be recognised in the profit or loss.
- 49 Some argue an interest in a joint venture in these circumstances cannot be a 'foreign operation' and look to control, joint control or significant influence as the 'determinant' of whether FCTR accounting is permissible (believing a 'branch' requires control over a whole asset, rather than a part of an asset). Others note the venturers sharing joint control in the same joint venture would be required to recognise a foreign currency translation reserve in these circumstances (under existing standards) and it appears incongruent for other participants in the joint venture not to do the same when the joint venture operation is an 'activity'. Those holding the view a FCTR is permissible also point out that it may be impracticable to obtain the necessary information to apply the 'cost' and 'FX gain/loss' approach.
- 50 Staff note that there are varied approaches in practice under existing standards. Now that it appears the accounting treatment for all parties to a jointly controlled operation are to be treated in the same

way (recognise a share of underlying assets and liabilities), the issue may become more prevalent under the new IFRS on joint arrangements.

## Impairment

- 51 The transition to the equity method may lead to an impairment not being recognised that would otherwise have been recognised under proportionate consolidation. For example, if a share of inventory were proportionately consolidated that is assessed under IAS 2 *Inventories* as being impaired, that impairment may be offset within a cash generating unit under IAS 28, which requires that if objective evidence of impairment exists under IAS 39 the entire equity accounted investment is tested for impairment in accordance with IAS 36.

## Capitalisation of borrowing costs

- 52 Under proportionate consolidation, if the JCE itself did not incur any borrowing costs, the entity would capitalise its own relevant borrowing costs in respect of qualifying assets of the proportionately consolidated JCE. However, under the equity method, an entity with an interest in a JCE would not be able to capitalise its borrowing costs because investments accounted for under the equity method are not qualifying assets under IAS 23 *Borrowing Costs*. Accordingly, retrospective application of the new Standard would mean that an entity that was proportionately consolidating would now have to reverse the impacts of having capitalised. The IASB staff view is that this would be a feasible adjustment to make.

## Hedging

- 53 Under proportionate consolidation, an entity might be able to apply hedge accounting to assets, liabilities, revenues, etc. of the JCE. An entity applying the equity method to account for its interest in a JCE would only be able to apply hedge accounting to the equity accounted investment as a whole. Depending on how the hedge was structured and documented, it may mean that a previously effective hedge becomes ineffective. In these cases, it may be appropriate to discontinue on the date of transition and to reclassify any balances relating to cash flow hedging from other comprehensive income into retained earnings at the beginning of the comparative period.

## Intercompany balances

- 54 Under proportionate consolidation, intercompany balances (receivables and payables) and intercompany transactions (revenues and expenses) are eliminated to the extent of the venturer's percentage of participation. Under the equity method, there is no elimination of intercompany transactions for the venturer's percentage of participation. This adjustment when changing to equity method would require rebooking intercompany balances and transactions that had been eliminated. This adjustment could potentially be time consuming. Although the net impact of this adjustment is nil, it affects the gross presentation of assets, liabilities, revenues and expenses.

## Recognition of losses below zero

- 55 Under the equity method, a party ceases to recognise its share of losses in a JCE as soon as the investment has been written down to zero, unless the investment has a legal or constructive obligation to fund the losses of the JCE. Under the proportionate consolidation method, there is no such restriction. An entity changing to equity method would need to identify its share of any losses recognised under proportionate consolidation for which it does not have a legal or constructive obligation, and reverse its effect. This share of losses would need to be removed from the starting balance of the investment accounted for under the equity method at the date upon which the Standard becomes effective.

## SPECIFIC MATTERS FOR THE AASB

- 56 AASB staff seek the Board's views on the following:
- (a) Are there any issues connected with the likely transitional provisions that the Board considers should be raised with the IASB?
  - (b) Does the Board have a view on the issue relating to the application of IAS 21 to parties to joint arrangements that do not share in joint control discussed in paragraphs 48 – 50 above?
  - (c) Are there any further issues the Board wants to draw to the attention of the IASB in finalising the replacement Standard for IAS 31?

## ATTACHMENT

Agenda Paper 4.2: AASB's Submission to IASB ED 9 *Joint Arrangements*