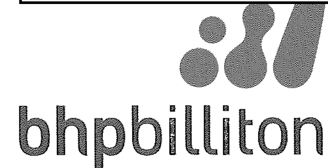
ED 151 Sub 18 - tabled

AASB 14-15 March 2007
Agenda paper 3.3



Group Accounting and Reporting

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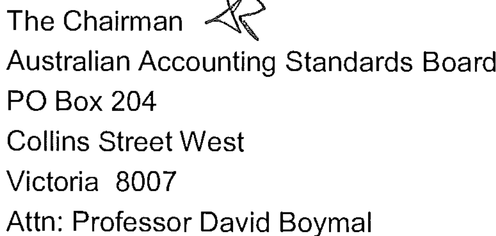
5 March 2007



The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West
Victoria 8007
Attn: Professor David Boymal

Dear David

Exposure Draft ED 151 "Australian Additions to, and Deletions from, IFRSs

We refer to Exposure Draft ED151 "Australian Additions to, and Deletions from, IFRS". The AASB has issued this ED to remove differences that exist between Australian equivalents to IFRS (AIFRS) and the corresponding IFRS. Those differences have arisen as a consequence of the AASB's previous policy, when developing AIFRS, of removing non-preferred choices existing in IFRS and preserving elements of previous A GAAP considered worthy of retention.

We agree that the provision of arbitrary choice in accounting standards is less than ideal, and that previous Australian GAAP was better drafted in some areas than the IFRS's from which AIFRS's were developed. However, as expressed in all of our comment letters to the AASB during the AIFRS harmonisation program, we believe it is far more important for AIFRS to be entirely consistent with IFRS, than it is for AIFRS to be superior to IFRS. The AASB has now acknowledged that differences between AIFRS and IFRS can create unintended outcomes which increase the cost and complexity of IFRS compliance. We applaud the AASB for modifying its policy in this regard and therefore entirely support the objectives of this exposure draft.

Proportionate consolidation for joint venture entities

The only aspect of the ED which causes us concern relates to the proportionate consolidation method of accounting for joint venture entities. The explanation on page 18 of the ED indicates that reinstatement of choice of this method of accounting is subject to progress by the IASB and FASB in removing this option from IAS31. We believe that this option must be reinstated to maintain consistency between AIFRS, IFRS and US reporting rules for foreign registrants as they exist today. At the time that the IASB, FASB and SEC choose to make changes affecting this basis of accounting, AIFRS should follow.

In the event the IASB has not issued a definitive exposure draft at the time that ED151 is due to be adopted by the AASB as a standard, we believe it is inappropriate for the AASB to seek to pre-empt what the IASB's exposure draft will contain. Therefore, the reinstatement of proportionate consolidation should occur in conjunction with all other re-alignments of AIFRS to IFRS.

In the event the IASB has issued an exposure draft at the time that ED151 is due to be adopted by the AASB as a standard, we nonetheless believe that the proportionate consolidation method should still be reinstated. We hold this view as any AIFRS accounting standard derived from the IASB ED is unlikely to become effective until 2010. For the intervening periods of 2007, 2008 and 2009, the proportionate consolidation method remains available to all IFRS reporting entities, and should remain available to all AIFRS reporting entities. Furthermore, the final IFRS standard may vary from the exposure draft, which further supports our view that the AASB should not pre-empt the IASB in removing differences between AIFRS and IFRS.

Some commentators have suggested that proportionate consolidation is rarely used as most entities chose to apply the equity accounting method. In the resources sector, this is far from the truth. As demonstrated in KPMG's analysis of financial reporting practices in the resources sector[1] (refer relevant extracts included in Appendix One), proportionate consolidation remains the predominant means of accounting for joint ventures.

A careful reading of the IASB's project papers concerning IAS31 indicate that the direction being taken by the IASB is not to simply remove proportionate consolidation from IAS31, but to replace it with the normal recognition of assets and liabilities in which a venturer has a direct interest, regardless of the legal form of the joint venture. Thus, if a venturer has a direct interest in the asset and liabilities, albeit derived through a shareholding in a joint venture entity, the method of accounting with essentially the same outcome as proportionate consolidation will be required.

Merits of proportionate consolidation

With respect to the merits of proportionate consolidation, we note the following:

- Its retention as a method of accounting was the preferred choice of the majority of respondents to ED121.
- It provides information which is far more relevant to estimating future cash flows, in assessing the nature and scope of influence of management's governance and accountabilities and provides significantly greater transparency of information.
- Proportionate consolidation provides information which is aligned with the manner in which cash flows will be generated (conveying the nature of assets over which the entity has joint control) rather than information which is confined to the legal mechanism through which that joint controlling interest is held
- While BHP Billiton is compelled to use equity accounting under AIFRS for joint venture entities, it has been equally compelled by analysts and other key users to publish corresponding IFRS data. This is necessary so that such users are able to compare the financial performance of all of our businesses on a consistent basis, some of which are conducted through unincorporated joint ventures, while others are through incorporated joint ventures. In this situation, our published AIFRS information is regarded by the market as irrelevant.

Segment reporting and US GAAP

We note that the changes in segment reporting introduced via IFRS8 will cause BHP Billiton to measure its segment revenues, expenses, assets and liabilities in the same manner as they are reported to the chief operating decision maker. Accordingly, segment information will be reported to shareholders applying proportionate consolidation for all joint ventures.

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[1] KPMG Global Mining and Reporting Survey 2006

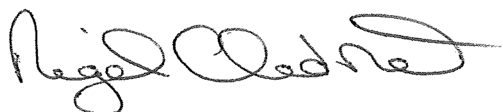
Consistency between that segment information and the Group's overall financial information will be enhanced by the reinstatement of the proportionate consolidation method.

Some commentators have also stated that US GAAP does not permit proportionate consolidation, underpinning the motivation of the IASB to remove that method of accounting from IAS31. However, as shown in KPMG's report, proportionate consolidation is used in the US as it is permitted by two different mechanisms. EITF 01-1 permits proportionate consolidation for unincorporated joint ventures operating in specific industries. Further, SEC Rules[2] allow a foreign registrant to apply proportionate consolidation in its US GAAP financial information if that basis of accounting is permitted by the registrant's home country GAAP.

Conclusion

We fully support the AASB's objectives to realign AIFRS and IFRS, and therefore fully support ED151, including specifically the reinstatement of proportional consolidation for joint venture entities. Should you have any queries concerning comments made in this response, please do not hesitate to contact Mr Nigel Chadwick on 9609 3821.

Yours sincerely,



Nigel Chadwick
Group Financial Controller

[2] Refer Form 20-F Item 17(c)(vii)

Examples of accounting disclosure in this respect were as follows:

Example 2.26: Newcrest Mining Limited

"Individual assets are grouped for impairment purposes at the lowest level for which there are separately identifiable cash flows. Generally, this results in the consolidated entity evaluating its mine properties on a geographical basis."

Source: Newcrest Mining Limited 2006 Annual Report

Example 2.27: Coeur D'Alene Mines Corporation

"In estimating future cash flows, assets are grouped at the lowest level for which there are identifiable cash flows that are largely independent of cash flows from other asset groups. Generally, in estimating future cash flows, all assets are grouped at a particular mine for which there is identifiable cash flow."

Source: Coeur D'Alene Mines Corporation 2005 Annual Report

Example 2.28: Newmont Mining Corporation

"With the exception of other mine-related exploration potential and greenfields exploration potential, all assets at a particular operation are considered together for purposes of estimating future cash flows. In the case of mineral interests associated with other mine-related exploration potential and greenfields exploration potential, cash flows and fair values are individually evaluated based primarily on recent exploration results and recent transactions involving sales of similar properties."

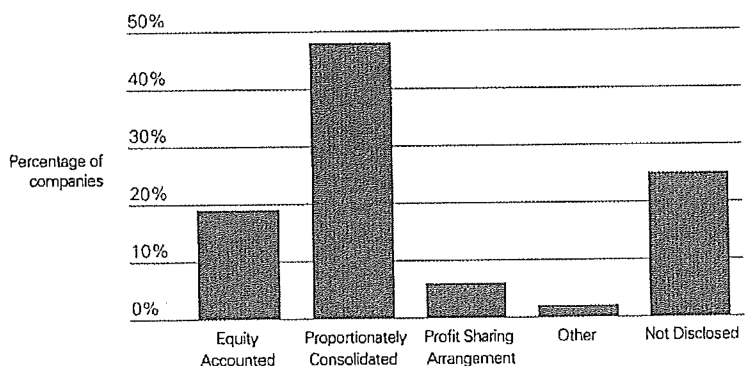
Source: Newmont Mining Corporation 2005 Annual Report

2.9 Accounting for joint venture arrangements

Joint venture arrangements are commonly used in the mining industry as a means for companies to reduce business risk, combine valuable resources and attract investors and appropriately skilled employees. The survey found that 75 percent (2003: 70 percent) of companies disclosed that they had at least one joint venture arrangement.

The chart below shows the accounting for joint venture arrangements disclosed by the 44 companies included in the survey:

Chart 2.8: Accounting treatment of joint venture arrangements



Source: KPMG International

On a country by country basis this can be broken down as follows:

Table 2.12: Accounting treatment of joint venture arrangements by country

	Australia	Canada	South Africa	United Kingdom	United States	BRICs	Total
Equity Accounted	3	1	–	2	1	2	9
Proportionately Consolidated	2	10	5	3	3		23
Profit Sharing Arrangement	–	–	1	–	2	–	3
Other	–	1	–	–	–	–	1
None or Not Disclosed	1	1	1	3	1	5	12
Total	6	13	7	8	7	7	48

Note: Four companies disclosed more than one type of joint venture arrangement in their accounts.

Source: KPMG International

The survey found a large portion of companies apply proportionate consolidation particularly in Canada and South Africa, while the United Kingdom and Australia showed a mix between equity accounting and proportionate consolidation.

For many companies, established industry practice pre-IFRS was often to recognize these joint arrangements by proportionate consolidation, such that each participant account for income from sales of their share of the product and their proportionate share of expense, assets and liabilities.

While this practice is still common for some types of arrangements, to continue to account in this manner under IFRS, it must be demonstrated that genuine joint control exists. Joint control is unanimous consent of all joint venture parties with respect to strategic financial and operating decisions. In addition Australian equivalents to IFRS (AIFRS) remove the proportionate consolidation alternative for jointly controlled entities and mandate equity accounting.

For many companies transitioning to IFRS and AIFRS this has caused a change in accounting as the unanimous consent test is not met in all circumstances, particularly when ownership interest is not '50/50'. Depending on the terms of the agreement, the changes have led to consolidation, where control rather than joint control exists; or more commonly to equity accounting for those who own less than 50 percent.

If a company's major asset is an active interest in a joint venture, then the requirement to equity account rather than proportionately consolidate will have a pervasive impact on the financial statements: all underlying assets and liabilities are replaced by one line 'investment in associates' in the balance sheet and revenue, costs and tax expense are replaced by one line in the income statement 'share of profits from associates', which is reported after tax.

As a consequence, there seems to be a growing trend for companies to disclose additional 'non-GAAP' measures to focus on the results which they previously reported on directly. This is covered in greater detail in section 2.14.

"The survey found a large portion of companies still apply proportionate consolidation"

Examples of accounting policies with respect to accounting for joint venture arrangements are as follows:

Example 2.29: Xstrata Plc

Interests in joint ventures

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. The financial statements of the joint ventures are prepared for the same reporting period as the company, using consistent accounting policies. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

Jointly controlled operations

A jointly controlled operation involves the use of assets and other resources of the group and other venturers rather than the establishment of a corporation, partnership or other entity.

The group accounts for the assets it controls and the liabilities it incurs, the expenses it incurs and the share of income that it earns from the sale of goods or services by the joint venture.

Jointly controlled assets

A jointly controlled asset involves joint control and offers joint ownership by the group and other venturers of assets contributed to or acquired for the purpose of the joint venture, without the formation of a corporation, partnership or other entity.

The group accounts for its share of the jointly controlled assets, any liabilities it has incurred, its share of any liabilities jointly incurred with other ventures, income from the sale or use of its share of the joint venture's output, together with its share of the expenses incurred by the joint venture and any expenses it incurs in relation to its interest in the joint venture.

Jointly controlled entities

A jointly controlled entity involves the establishment of a corporation, partnership or other legal entity in which the group has an interest along with other venturers.

The group recognizes its interest in jointly controlled entities using the proportionate method of consolidation whereby the group's share of each of the assets, liabilities, income and expenses of the joint venture are combined with the similar items, line by line, in its consolidated financial statements.

When the group contributes or sells assets to a joint venture, any portion of gain or loss from the transaction is recognized based on the substance of the transaction. When the group has transferred the risk and rewards of ownership to the joint venture, the group will generally only recognize the portion of the gain or loss attributable to the other ventures, unless the loss is reflective of an impairment, in which case the loss is recognized in full. When the group purchases assets from the joint venture, it does not recognize its share of the profits of the joint venture from the transaction until it resells the assets to an independent party. Losses are accounted for in a similar manner unless they represent an impairment loss, in which case they are recognized immediately.

Joint ventures are accounted for in the manner outlined above, until the date on which the group ceases to have joint control over the joint venture.

Source: Xstrata Plc 2005 Annual Report

Example 2.30: Anglo Platinum Limited

Joint ventures

The group's interest in jointly controlled entities is accounted for through proportionate consolidation. Under this method the group includes its share of the joint venture, individual income and expenses, assets and liabilities in the relevant components of its financial statements on a line-by-line basis.

Where a group company undertakes its activities under joint venture arrangement directly, the group's share of jointly controlled assets and any liabilities incurred jointly with other venturers is recognized in the financial statements of the relevant company and classified according to their nature. Liabilities and expenses incurred directly in respect of interests in jointly controlled assets are accounted for on an accrual basis. Income from the sale or use of the group's share of the output of jointly controlled assets is recognized when the revenue recognition criteria detailed in the accounting policy note 9 are met.

Source: Anglo Platinum Limited 2005 Annual Report