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Exposure Draft: ED 9 *Joint Arrangements*
International Accounting Standards Board
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ED 9 *Joint Arrangements*

The Australian Accounting Standards Board (AASB) welcomes the opportunity to comment on the IASB's Exposure Draft ED 9 *Joint Arrangements*.

The AASB sought the views of Australian constituents and has considered these responses in formulating its comments.

Although the AASB agrees that the current IAS 31 *Interests in Joint Ventures* requires amendments, it strongly believes that the proposed amendments in ED 9 require further research. The AASB considers the main area of research required concerns the concept of joint control within the Conceptual Framework. Currently the Conceptual Framework implies that an entity either has or does not have control, and the concept of joint control is not addressed. This issue is central to a joint arrangements standard. Accordingly, the AASB does not support many of the proposals as currently drafted. Specifically the AASB:

- disagrees with the elimination of the proportionate consolidation method at this stage;
- believes the proposed terminology and definitions need to be further clarified; and
- considers there are practical implementation difficulties associated with the proposed changes.

The AASB's detailed responses to the specific questions accompanying ED 9 are attached.

If you have any queries regarding any matters in this submission, please contact Joanna Spencer (jspencer@aasb.com.au) or myself.

Yours sincerely

David Boymal
Chairman

ED 9 Joint Arrangements

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?

Although the AASB understands the rationale for changing the definitions and terminology related to joint ventures, it does not support the proposed changes as they are currently drafted in ED9. Our specific reasons are as follows.

Lack of Clarity

The AASB considers that the definitions and terminology lack clarity and there is an insufficient level of detail which would enable the definitions to be effectively applied in practice. This is likely to result in inconsistent classifications of joint arrangements. The AASB is concerned that the terms ‘joint operation’, ‘joint asset’ and ‘joint venture’ are not specifically defined and are only identified by way of narrative descriptions in paragraphs 8, 11 and 15 respectively. Whilst the AASB acknowledges that this is similar to the approach taken in IAS 31 *Interests in Joint Ventures* it believes that it would be far more helpful to users to have authoritative definitions for these arrangements.

Shared decision-making

Under the ED 9 proposals, the definition of a joint arrangement appears to require **all** parties to be involved in shared decision-making. The AASB believes that this requirement is too restrictive and is likely to exclude a large number of arrangements from the scope of the proposed Standard and would result in similar interests being treated in different ways. For example, an entity may have a 20% interest in two separate arrangements that both involve four other parties. Under one arrangement all parties are involved in decisions and in the other arrangement one of the other four parties is not involved in making decisions. As currently drafted, this second type of arrangement would be excluded from being a joint arrangement even though the substance of the arrangements are the same.

Further the proposed standard does not adequately articulate how the concept of shared decision-making is intended to operate and which decisions will come under this term. Paragraph 7 provides some indication of elements to be included in a contractual document but does not refer to the actual activity of decision-making. There is also concern that shared decision-making is focussed at too low a level to be practically applied and does not reflect the commercial reality of most joint arrangements. For example, the day-to-day running of many operations is undertaken by managers and the investing parties only participate in more strategic decisions. As presently drafted, the ED may potentially preclude these operations from being joint arrangements.

Business

Paragraph 18 of ED 9 states that a business that is subject to joint control will usually result in a joint venture, unless circumstances indicate otherwise. It is unclear whether this is merely providing an example of a joint venture or whether an entity would only have an interest in a joint venture when that joint venture is a business as defined.

Output v Outcome

Paragraph 15 states that parties to a joint venture are entitled to a share of the 'outcome' of the activities of the joint venture, which implies an entity that shares the 'output' instead of the 'outcome' would be precluded from treating its investment as an interest in a joint venture. This may lead to inconsistent treatments of similar interests. For example, parties to a joint venture may agree that each party can elect to take either cash or product in relation to their share of the venture, however, as paragraph 15 as currently worded it would indicate that payment in product would preclude such an arrangement from being classified as a joint venture. For many entities an election about whether to take a share of profit or a share of output is made on an annual basis, and it is unclear whether, under the proposals as currently drafted, the basis of accounting would change when the election changes.

Current Industry Terminology

Several of our constituents expressed concern that the proposed terminology is not intuitive and is inconsistent with that currently used in the extractive industries. For example restricting the term joint venture to what was previously a jointly controlled entity may be confusing to users as this is currently used as an umbrella term for all three types of joint arrangements.

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?

Whilst the AASB agrees with the principle that parties to a joint arrangement should recognise their contractual rights and obligations relating to the arrangement, there appears to be a contradiction with the first dot point above in that too much emphasis has been placed on 'contractual' for the form of the arrangement not to be treated as the most

significant factor. The AASB also has some reservations about the practical implications of such a principle. Specific matters of concern are as follows.

No legal entity for Joint Venture

Under the ED's proposals, it appears that it would be possible for an unincorporated joint venture to be classified as a joint venture which would then require equity accounting. However, this raises a number of practical issues such as:

- how the equity method would be applied when no legal entity exists
- how to determine equity movements if there is no legal equity
- what would constitute a dividend
- how is cost of investment and share of profit/loss determined?

Use of the Equity Method

As stated above the AASB agrees with the principle of parties to a joint arrangement recognising their contractual rights and obligations, however it has reservations as to whether this will be achieved for joint ventures if they are required to use the equity method. AASB constituents are generally of the opinion that the contractual rights and obligations of an entity may not be reflected in a relevant way on the face of the financial statements when the equity method is applied instead of proportionate consolidation, as the one line equity method will result in a loss of significantly useful information. Although the ED proposes further disclosures to provide much of this information, constituents are generally of the opinion that these disclosures would not compensate for a less transparent accounting method (see our comments below re disclosures).

Applicable IFRSs

Parties to a joint operation or joint asset are required to recognise their interests in their contractual rights and obligations in accordance with 'applicable IFRSs', however the ED does not provide any further guidance, for example would a proportional share in a tangible asset result in the recognition of an intangible asset? Paragraph IE11 of Illustrative Example 2 implies that it is the intangible right (the right to use the jet aircraft) which the parties recognise on the balance sheet. However, this differs from Illustrative Example 6 paragraph IE45 which states that, in this joint asset arrangement, parties recognise as assets and liabilities their respective interests in the mineral rights, production equipment, minerals extracted, liabilities incurred, decommissioning liabilities and financing of the operations. Although these mineral rights appear to be similar to the rights in Illustrative Example 2, US GAAP EITF Issue No. 04-2 *Whether Mineral Rights are Tangible or Intangible Assets* concludes that mineral rights are tangible assets. Therefore, the AASB considers that the ED needs to provide more guidance on which IFRSs are applicable in which situation.

Unit of Account

The AASB considers that there may be difficulties in practice in applying the unit of account notion whereby parts of assets (a floor of a building) are recognised as the unit of

account as in Illustrative Example 3. This concept may be premature as it precedes the IASB's more fundamental research on the Conceptual Framework. There also appears to be a conflict with the requirement of IFRIC 4 *Determining whether an Arrangement contains a Lease*, that takes an all or nothing approach under which an asset is not recognised under a lease unless substantially all of the output flows to the entity, even when the entity has unilateral control over the output that does flow.

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?

Although the AASB does not necessarily agree with the use of the proportionate consolidation method, it does not agree that this option should be removed until there has been more detailed research into the implications of its removal and compelling reasons for its removal are given. Specific reasoning for our opinion is as follows.

Enhance faithful representation

Paragraph IN1 states that one objective of the ED is to enhance the faithful representation of joint arrangements in the financial statement of an entity. However, the AASB would contend that in some cases using the equity method for a joint venture provides little if any useful information for users which reflects the substance of the arrangement. In many cases, we consider that proportionate consolidation provides greater transparency for users.

US GAAP Convergence

The ED states that this draft Standard is part of the short-term convergence project to reduce the difference between IFRSs and US GAAP. However, this objective does not appear to be achieved when US GAAP allows proportionate consolidation for entities in the oil and gas industries in which joint venture arrangements are common.

Justification for removing proportionate consolidation

The AASB considers that no compelling argument has been presented for the removal of the proportionate consolidation method. There is insufficient explanation about why the IASB considers equity accounting to be a superior approach for accounting other than the arguments provided in paragraph BC14 which suggest that some Board members considered it inappropriate to account for an associate and a joint venture using the same method and that the equity method has been used for joint ventures for many years in various jurisdictions. The AASB does not consider these to be sufficient justifications for removal of this option and does not support removing the proportionate consolidation method until substantial research into the most appropriate method for accounting for joint ventures is conducted.

Questions 4-6 – Disclose

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?

The AASB agrees that an entity should be required to describe the nature of the operations it conducts through any joint arrangements.

Notwithstanding our disagreement with the proposal to eliminate the proportionate consolidation method until further research has been conducted, the AASB does agree that if joint ventures and associates both use equity accounting then their disclosures should be aligned.

Further to our comments on the removal of proportionate consolidation, the AASB does not consider that imposing additional disclosure of summarised information for each material joint venture is warranted and if additional information is deemed necessary in the notes then the requirements of the Standard should be re-examined. The AASB considers that the accounting method should largely reflect the information needed by users and that significant disclosures should not be 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?

The AASB agrees with the proposal that the disclosure requirements of IAS 27 *Consolidated and Separate Financial Statements* and IAS 28 *Investments in Associates* to disclose a list and description of significant subsidiaries and associates should be reinstated.

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?

The AASB agrees that disclosing current and non current assets/ liabilities is more useful for users, however, it does not feel that this would compensate for the removal of the proportionate consolidation method and the information this method provides to users in many cases.