

International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH

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Exposure Draft ED 9 Joint Arrangements

Grant Thornton International is pleased to comment on the International Accounting Standards Board's (the Board) Exposure Draft ED 9 *Joint Arrangements* (the Exposure Draft).

In summary we have reservations over this project. We explain our concerns in our answers to the specific questions raised in the Exposure Draft. We would draw your attention in particular to three main concerns.

Firstly, we do not believe that a sufficiently robust argument has been made that the equity method is superior to proportionate consolidation. Mandatory use of equity accounting will impose complex change on many preparers; the recent report *EU Implementation of IFRS and the Fair Value Directive* (prepared by the Institute of Chartered Accountants in England and Wales for the European Commission) found for instance that in a survey of 101 companies with interests in joint ventures, 60 used the proportionate consolidation method. Accordingly, we believe this method should be eliminated only if a convincing case can be made that financial reporting will be improved as a result. We recognise that this project is part of the Board's short-term US GAAP convergence project and support the Board's and the Financial Accounting Standards Board's convergence endeavours. However, we do not believe that convergence alone is sufficient justification for a change of this order.

Secondly, we consider that the replacement of the concept of a jointly controlled entity with that of a joint venture should, if enacted, be accompanied by a clearer definition, principle or set of principles to establish the boundary between a joint venture and other types of joint arrangement. We elaborate on this concern in our response to Question 1.

Our third main concern relates to the Exposure Draft's proposed new core principle of recognition of the contractual rights and obligations arising from a joint arrangement. A rights and obligations-based model is in our view a significant step. We note that IFRS does not currently require the recognition of contractual rights and obligations for most types of contract. Moreover, we are not convinced that the Exposure Draft's specific requirements (which, apart from the elimination of proportionate consolidation, are largely the same as those of IAS 31 *Joint Ventures*) are consistent with the proposed core principle. We elaborate on this concern in our response to Question 2.

For these reasons, should the Board decide to proceed with the elimination of proportionate consolidation, our preference would be that this option is simply removed from IAS 31 *Interests in Joint Ventures* (IAS 31).

Our detailed comments on the proposals are included in our responses below to the questions in the Invitation to Comment.

Question 1: Do you agree with the proposal to change the way joint arrangements are described? If not, why?

We have no objection to the revised terminology to describe types of joint assets and joint operations (although we also see no pressing need for these changes either). We do agree that the definition of joint control does not translate well to an asset or operation. We therefore understand the wish to replace the terms 'jointly controlled assets' and 'jointly controlled operations' with 'joint assets' and 'joint operations'. We do note however that those terms do not appear in the definitions section of the Exposure Draft and believe that they should be added. On this point, we note that paragraphs 8, 11 and 15 read very much like definitions; we are not sure whether they are intended to be so or not. If they are, then it would be better to include them in the definitions section of any final Standard rather than leave them where they currently are.

We do have a concern with the replacement of the concept of a 'jointly controlled entity' with a 'joint venture'. We support the Board's objective of accounting based on the economic substance of transactions rather than their legal form, and we understand that judgement is a necessary part of achieving this goal. However, the proposed elimination of proportionate consolidation will almost certainly put additional pressure on the boundary between 'joint ventures' and other types of joint arrangement. IAS 31's approach of basing this boundary on the existence of an entity is straightforward to apply. In contrast, we find the Exposure Draft's description of a joint venture (at paragraphs 15 to 20) to be a somewhat confusing mixture of different concepts.

Moreover, we do not share the Board's concern that the legal effects of an entity structure can be reversed through guarantees or indemnities (expressed at BC6). If such arrangements are in place, they are likely in practice to reverse only some aspects of the legal structure. Such arrangements might also be recognised separately from the investors' interest in the equity of the investee (if required under applicable IFRS).

It would also be helpful to understand if the Board intends that some arrangements that do not involve an entity could be joint ventures.

The draft Illustrative Examples do not add any clarity on these points. The example at IE 46 appears to meet the definition of a joint venture in that the venturers share in the overall outcome of the economic activity. However, the arrangement in question is described as one involving joint assets.

Finally, we consider that equity accounting does not work well for arrangements that do not involve an entity.

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?

Regarding the first question, a "rights and obligations" model is in our view a significant step. We note that IFRS does not require the recognition of contractual rights and obligations for most types of contract, such as leases and most executory contracts. We are not convinced that a limited scope revision of IAS 31 is the appropriate point at which to introduce such an important and undeveloped concept.

Moreover, we are concerned that the Exposure Draft does not actually apply this core principle. For example, paragraph 22, dealing with joint assets, requires that "a party shall recognise its share of the joint asset and any liabilities it incurs". This requirement does not refer to rights or obligations. It could also be argued that a right relating to an asset is an intangible asset. Paragraph 22 is likely to be interpreted as requiring recognition on the basis of the nature of the underlying joint asset.

Similarly, paragraph 16 of the Exposure Draft is phrased in terms of assets and liabilities of a joint venture rather than rights and obligations. We believe then that the changes in description will lead to confusion among preparers and divergent accounting treatments.

As well as these conceptual concerns, the inconsistencies in the Exposure Draft appear likely to lead to confusion in practice. As an example of the potential the proposals have to confuse, we would point towards Illustrative Example 2 in the Exposure Draft. This states that "the company would recognise an aircraft asset that excludes the rights of use transferred to the parties". This seems to indicate that the recognition of an intangible asset or some type of lease accounting is envisaged. Not only will this create valuation issues and expenditure for preparers of accounts, it will also create the need for significant levels of judgement when preparing the accounts. It would also appear to introduce concepts that are more akin to leasing issues, possibly pre-judging the results of that project as well as that of the Framework.

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?

We do not believe that a sufficiently robust case has been made for the elimination of the proportionate consolidation method. We acknowledge that proportionate consolidation has some conceptual drawbacks but we do not consider equity accounting to be superior conceptually or practically. The Board argues that equity accounting has been used and supported in different parts of the world for many years; this comment could be applied to proportionate consolidation as well. We do not believe that it is appropriate to eliminate this method of accounting unless a more convincing case can be offered that equity accounting provides more useful information. We also note that the proposed disclosures would involve taking much of the information that proportionate consolidation puts on the balance sheet and relegating it to the footnotes.

We also question whether elimination of the method of proportionate consolidation will really be convergent with US GAAP. While we agree equity accounting is in theory the core US GAAP method, in practice proportionate consolidation is used in many important industries such as oil, construction and transport. If the objective of the Exposure Draft is to reduce differences between IFRS and US GAAP as is noted in IN2 of the Exposure Draft, we would question whether the project will achieve this goal.

In any case convergence should be pursued only if it also results in a demonstrable improvement in financial reporting. This does not seem to be the case to us here.

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?

We are generally supportive of the proposed disclosures. We would however question two specific disclosures, which we do not believe to be necessary.

Firstly, we would query the need for an entity to disclose any capital commitments it has relating to its interests in joint ventures or its share of capital commitments incurred jointly with other parties (paragraph 37). Disclosure along these lines is not required for investments in associates. Given this, we question why the disclosure should be necessary for joint ventures.

Secondly, we disagree with the proposed disclosure of the reason for a joint venture using a different date or different reporting period to that of a venturer (paragraph 39(c)). While this disclosure makes sense in a parent-subsiary relationship, we do not believe it is appropriate in the case of a joint venture, as a venturer will frequently not be able to dictate the reporting date of a joint venture because of the conflicting needs of other venturers.

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?

We agree. Although we have a general concern over what we perceive to be an ever increasing disclosure burden under IFRS, we note that many jurisdictions require this information to be produced in any case under local law. This indicates that there is a demand for this information, and we therefore support the proposed amendment.

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?

We disagree with the proposal to include this information. Essentially these disclosures would be reproducing the information that is being removed by the elimination of proportionate consolidation. If the Board believes that it is inappropriate to allow proportionate consolidation, then we would ask why it thinks that there is a need to present disclosures breaking assets and liabilities down into current and non-current items as would be done were proportionate consolidation being used.

Other comments

Joint control

In relation to the idea of joint control, which is still referred to in discussing joint ventures (paragraph 15 of the Exposure Draft), we question the lack of reference to the concept of unanimous consent.

Unanimous consent is an integral part of the definition of joint control in IAS 31, but is not mentioned in the definition of 'joint control' as set out in Appendix A to the Exposure Draft. It would appear possible then that in a situation where two entities share power over the everyday operations of a business but where one party has a right of veto over certain aspects of the business, that business could be treated as a joint venture under the proposals. We question whether this is what the Board intended, and would note that the test of unanimous consent has proved important in practice as a means for determining whether a joint venture exists or not.

Hierarchy of types of arrangement

Paragraph 16 of the Exposure Draft states that the assets and liabilities of a joint venture comprise those residual assets and liabilities that have not been allocated to either joint assets or joint operations. We would prefer this hierarchical structure for allocating assets and liabilities to the different types of joint arrangement to be expressed at the beginning of the Standard either as part of the core principle or in the section on types of arrangement.

We suggest amending paragraph 4 of the Exposure Draft, adding the following sentence to it:

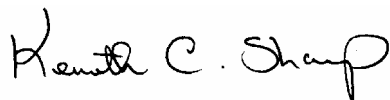
"A venturer should first identify those assets and liabilities of a joint arrangement that are joint operations or joint assets of the venturers. Any remaining assets and liabilities of the joint arrangement will then be accounted for as a joint venture".

Recognition of an interest in a joint venture

In relation to paragraph 23(c)(i) of the Exposure Draft, we note that this text is consistent with the wording used in IAS 28 *Investments in Associates*. However, we consider that this approach (of amending accounting requirements on the basis of owner consent) over emphasises the needs of owners over those of other users of the financial statements. We are also concerned that it is open to manipulation.

If you have any questions on our response, or wish us to amplify our comments, please contact our Director of International Financial Reporting, Andrew Watchman (andrew.watchman@gtuk.com or telephone + 44 207 391 9510).

Yours sincerely,



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