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Association pour la participation des entreprises françaises à l'harmonisation comptable internationale

Mouvement des Entreprises de France
MEDEF

A F E P

Association Française des Entreprises Privées

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Paris, Paris, January 10, 2008

Re: ED 9 Joint arrangements

ACTEO, AFEP & MEDEF welcome the opportunity to comment on the exposure draft ED9 "Joint arrangements".

ED9 is proposing to deeply impact corporate financial reporting for those entities which develop their core businesses via joint venture set up and monitoring. In this project even more than in any other, we believe usefulness of financial reporting should be the driving thread towards appropriate decisions. Then, we believe the appropriate reporting for joint ventures should be developed in liaison with the financial statement and consolidation projects. Therefore, ED9 in our view raises a timing issue.

Moreover, we understand that the main justification for this project is the convergence agreement reached with the FASB and that the outcome of the project had been decided a priori. We disagree with the IASB making decisions for the sake of "convergence" without any prior technical analysis at hand.

Twice in the past five years the IASB had considered the potential elimination of the proportionate consolidation. The Board had decided against it, because the equity method was not an alternative that they favoured or that they believed was superior to justify requiring the change. We agree with the IASB's former conclusions that the equity method is not an appropriate method to best reflect the underlying economics of a joint arrangement which conveys an entity an indirect interest in jointly held assets and liabilities. We believe that the change from proportionate consolidation to equity method should not be imposed on entities, without any analysis that the change would result in improved financial reporting.

As the IASB well knows (it was one of the main arguments on the basis of which the IASB has decided in the past not to go ahead with the elimination of proportionate consolidation), users find in the outcome of proportionate consolidation useful information. Indeed, the elimination of proportionate consolidation would result in:

- assets and liabilities which heavily contribute to financial positions of listed entities to be reported nowhere, except for the annual accounts of the unlisted joint ventures, which may or may not be subject to mandatory publication. This type of information is useful to users.
- a move into aggregating and netting interests in assets and liabilities which may have different economic behaviours, and which create synergies with assets and liabilities under exclusive control by the group. This type of aggregation is heavily fought against by users.

If the IASB feels constrained, because of convergence agreements, to move ahead and eliminate the existing IAS 31 accounting policy choice in the short-term, we believe, in spite of our above general statements, that ED9 proposals should be re-deliberated on the following bases:

- we believe that determining whether an entity has a direct interest in jointly held assets and liabilities brings improvement to previous requirements as it focuses on the substance of the agreement rather than on its form; we note however that entities which are testing the proposed requirements find them in some circumstances quite difficult to apply. Criteria given in "joint operations" and "joint assets" definitions should be improved in order to be able to classify the contracts according to their substance. We therefore would like to present and explain the main difficulties encountered (especially with public organisations) to the IASB staff in a meeting to be set up in the near future This discussion could take into account a holistic approach based on risks and rewards taken by the venturers in some joint arrangements. Recommendations for clarifications in the wording and/or supplementary illustrative examples are the intended constructive outcome of such a meeting.
- we urge the IASB to consider alternative presentation possibilities, in order to compensate, on the face of the financial statements, for the loss of financial information that would result from ED 9 proposed requirements. Indeed disclosures can not cope with the lack of appropriate display on the face of financial statements, as most users in the market need to rely on gross aggregates from P&L and Balance Sheet; we believe in particular that the IASB should introduce the difference between interests in joint ventures which management would qualify as operating and others which management would qualify as investing (consistently with the IASB preliminary views on the presentation of financial statements).
- we finally wish the IASB to consider the impact of its tentative decision on segment reporting. Entities who are heavily involved in joint ventures as a means of development of their core activities (often because of legal restrictions imposed to foreign investors by local jurisdictions) are likely to go on monitoring their activities using some disaggregated information of their share of assets and liabilities in joint ventures. Therefore the elimination of proportionate consolidation is likely to create a significant deviation between the entity's primary financial statements and segment information. We do not believe that the IASB should make decisions which encourage such deviations.

If you would like further clarification of the points raised in this letter, please do not hesitate to contact us.

Yours sincerely

ACTEO

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Director General

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APPENDIX 1 to ACTEO, AFEP & MEDEF letter commenting ED 9 Joint Arrangements:
Answers to the invitation to comment

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?

We believe that the way joint arrangements are described focuses on the interests an entity may have in the arrangement. As a result the descriptions are meant to facilitate the application of the requirements stated in paragraphs 21-23. We therefore agree with the proposed changes.

However we believe that joint control should be given more emphasis than is granted at present. Indeed joint control is the common feature that helps identifying either joint operations, assets and ventures. We disagree with the view expressed in BC17 that joint control would not be relevant when considering joint operations and assets.

Furthermore we are uncomfortable with the revised definition of joint control. We understand from the basis for conclusions that the intent is to mirror the definition of control included in IAS 27. We however believe that the notion of "unanimous consent of the parties" is a key notion in the definition of joint control which should not be eliminated. In practice it helps forming judgement in assessing control over an entity, an operation or an asset.

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?

We agree that a party to a joint arrangement should recognise its direct interests in assets and liabilities arising from a joint arrangement. We believe that such a principle helps focus on the economic substance of some arrangements and therefore provides a more robust basis for the accounting of joint assets and operations.

However we have some reservations on the proposals:

- we note that the wording used is not based on the present definitions of assets and liabilities and present recognition criteria; we believe that the present framework should apply until appropriate revision has eventually taken place;
- we wonder whether the proposed drafting would not lead to a potential overriding of legal form over economic substance;
- furthermore, and may be more importantly, entities already simulating the application of ED9 proposed requirements encounter difficulties in the analysis of their more complex contracts. In the service concession industry, for example, it is not uncommon for public grantors and private operators to become partners in joint ventures in order to carry out service concession arrangements. The joint venture structure should not be examined alone as it is totally dependant from the public service concession arrangement signed with the public authority, from the local specific legal framework relating to public services, from shareholders' agreements.... Connections between those documents are" strong" and therefore the analysis of such legal/contractual arrangements needs, in our view, to be carried out as a whole. The proposed drafting of ED9 proposals and illustrative examples does not enable us to reflect properly in the accounts the whole of the existing agreements. Indeed examples would lead us to apply the "joint venture model" without taking into consideration particularities of concession activities and therefore specific responsibilities granted to partners. An analysis of "risks and advantages "of the operation for each partner would enable to better understand those complex operations.

  As a result, we urge the Board to consider and include some supplementary illustrative example of such arrangements and of a holistic approach to them (we would be happy to provide the appropriate material) in order to ensure that the final standard is applied as intended by the Board.

  As a result, we would like to organise a meeting between the IASB staff in charge of the project and a delegation of ACTEO's members to discuss the difficulties identified, on the basis of real-life examples. Such a meeting could favourably influence further work on the issue and lead staff to recommend useful clarifications.

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 note that both proportionate consolidation and equity method have the same outcome on the financial position and performance of an entity. We can infer from this observation that:

- in principle, US GAAP and IFRS lead to the same accounting outcome. The relevance of this project as part of the convergence program can therefore be questioned;
- the discussion to be held could be concentrated on a question of display rather than on a question of concepts, and that the ultimate decisions should therefore be based on what display is the most useful to users.

We would tend to agree with the Board that there is quite significant a difference between exclusive control and joint control. We however would also want to emphasize that there is also a very significant difference between joint control (no financial or strategic decision can be made without being agreed by the entity) and significant influence (financial and strategic decisions may be made against the entity's views on the issue at stake). We also would want to stress that synergies between joint ventures and the other assets and liabilities held / born by the group may be created. In those circumstances, economic returns from joint ventures are not limited to financial return from an investment item. Accordingly we question whether the equity method is appropriate to reflect so different economic situations. We therefore believe that prior to any decision the IASB should analyse the merits of the equity method and demonstrate that the switch from proportionate consolidation to the equity method would result in better financial reporting, i.e. in more useful information to users.

We however doubt that such a conclusion can be reached. Indeed:

- the IASB's tentative decision to eliminate proportionate consolidation would result in assets and liabilities which heavily contribute to financial positions of listed entities to be reported nowhere, except for the annual accounts of the unlisted joint ventures, which may or may not be subject to mandatory publication. This type of information is useful to users.
- a move into aggregating and netting interests in assets and liabilities which may have different economic behaviours. This type of aggregation is heavily fought against by users.

As a result of all observations above, we wish to formulate the following conclusions:

- it seems reasonable that the IASB should make decisions in order to present assets and liabilities held under exclusive control distinctly from assets and liabilities held under joint control;
- it seems reasonable that the IASB retain some disaggregated presentation of interest in jointly controlled assets and liabilities on the face of the primary financial statements whenever joint ventures are being entered into in view of the development of core activities of the entity, joint control being the means to develop as strong synergies with other exclusively controlled activities as possible (in contrast with joint ventures primarily decided for investment purposes);
- we believe that the IASB should introduce in the primary financial statements the difference between interests in joint ventures which management would qualify as

operating and others which management would qualify as investing (consistently with the IASB preliminary views on the presentation of financial statements). Such a difference could call for more disaggregated information to be provided to users, on the face of primary financial statements, in the first set of circumstances, as illustrated in the example we provide as appendix 2.

We therefore recommend the IASB the following course of action prior to any finalisation of ED9 into a final IFRS:

- to analyse the merits of the equity method with the objective of bringing to users on the face of primary financial statements the most useful information on joint ventures which are entered into in view of the development of core activities of the entity;
- to share such an analysis with the FASB, in order to promote the possibility of the two Boards making similar decisions in order to best reflect the economics at stake;
- to freeze temporarily any decision to eliminate proportionate consolidation until the above analysis and related conclusions are available;
- to carefully consider our recommendations, even if following them would require exposure of modified proposals before a final standard can be issued. We are available to assist, if assistance can help design appropriate and acceptable solutions.

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?

No, we disagree with the proposed disclosures for the following reasons:

- we do not believe that disclosures can cope with lack of appropriate presentation in the primary financial statements;
- we do not believe that very limited information (revenue and profit or loss) detailed by entity can cope for the loss of more detailed line items aggregated as a whole;
- in addition, we do not believe that detailed information by entity is in any way helpful to users who need to rely on aggregated information, both at primary financial statement and at segment reporting levels. Furthermore, in circumstances where a joint venture is created to carry out a specific commercial agreement, identification of revenue and profit or loss at the level of the individual entity, provided it is significant, can lead to publish commercial sensitive information (although not useful to investment decisions).

We therefore believe that a different display in the primary financial statements needs to be considered. An entity's share in assets and liabilities of joint ventures could be presented in the balance sheet under a separate caption "Share of assets/ liabilities held under joint control". This separate caption could be disaggregated in more detail as necessary (current/ non current etc…). The same would apply to the income statement where distinction could be made between flows derived from changes in assets and liabilities under exclusive control and an entity's share in the income and expenses incurred in joint ventures.

We have included as appendix 2 presentation examples (on the basis of fully disaggregated information) which would, if adopted by the Board, adequately compensate for the loss of information that the elimination of proportionate consolidation would generate. We observe that such presentation would remain sustainable, were IASB's and FASB's tentative preliminary views on the presentation of financial statements were to be implemented.

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?

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?

As we have already emphasised, we believe that users' needs claim for disaggregated information of assets and liabilities and of income and expenses. We therefore answer positively to the above question, although we believe the question is not raised from an appropriate angle.

APPENDIX 2 to ACTEO, AFEP & MEDEF letter commenting ED 9 Joint Arrangements: Presentation examples

BALANCE SHEET	year 2007			year 2006		
	Group	Share of operating joint ventures	Total	Group	Share of operating joint ventures	Total
	€ m	€ m	€ m	€ m	€ m	€ m
Non current assets	**522**	**102**	**624**	**498**	**100**	**598**
Intangible assets	100	40	140	98	39	137
Property, plant and equipment	300	135	435	290	125	415
Investments in operating joint ventures	80	-80	0	71	-71	0
Investments in investing joint ventures	7		7	5		5
Investments in associates	13		13	12		12
Other financial Investments	5		5	5		5
Deffered Tax assets	5	2	7	5	2	7
Other receivables	12	5	17	12	5	17
Current Assets	**67**	**27**	**94**	**55**	**26**	**81**
Inventory	10	4	14	10	4	14
Trade and other receivables	50	20	70	40	20	60
Cash and cash equivalents	7	3	10	5	2	7
TOTAL ASSETS	**589**	**129**	**718**	**553**	**126**	**679**
Total Equity	**267**		**267**	**248**		**248**
Capital	150		150	150		150
Consolidated reserves	111		111	86		86
Net Income for the period	26		26	25		25
Minority interests	-20		-20	-13		-13
Non current liabilities	**282**	**113**	**395**	**263**	**110**	**373**
Provisions	40	16	56	39	16	55
Deffered tax liabilities	10	4	14	10	4	14
Finance Debt	202	81	283	185	78	263
Other payables	30	12	42	29	12	41
Current liabilities	**40**	**16**	**56**	**42**	**16**	**58**
Trade and other payables	30	12	42	32	12	44
Current tax payable	5	2	7	5	2	7
Finance Debt	5	2	7	5	2	7
TOTAL LIABILITIES	**589**	**129**	**718**	**553**	**126**	**679**

INCOME STATEMENT	year 2007			year 2006		
	Group	Share of operating joint ventures	Total	Group	Share of operating joint ventures	Total
	€ m	€ m	€ m	€ m		
Turnover	**200**	**120**	**320**	**195**	**120**	**315**
Cost of sales	-80	-55	-135	-78	-54	-132
Gross Profit	**120**	**65**	**185**	**117**	**66**	**183**
Selling expenses	-50	-32	-82	-49	-31	-80
General and administrative expenses	-20	-12	-32	-20	-12	-32
Depreciation and amortization	-10	-6	-16	-10	-6	-16
Operating income	**40**	**15**	**55**	**38**	**17**	**55**
Financial result	-8	-2	-10	-8	-2	-10
Share of net profit of investing JV's	2		2	4		4
Share of net profit of associates	1		1	-3		-3
Income tax	-11	-4	-15	-11	-4	-15
Net profit after tax	**24**	**9**	**33**	**20**	**11**	**31**
Minority interest	-7			-6		
Net profit after tax and minority interest	**17**	**9**	**26**	**14**	**11**	**25**

CASH FLOW STATEMENT

	year 2007			year 2006		
	Group	Share of operating joint ventures	Total	Group	Share of operating joint ventures	Total
	€ m	€ m	€ m	€ m	€ m	€ m
Profit before taxation	**35**	**13**	**48**	**31**	**15**	**46**
Adjustment for:						
Depreciation	10	6	16	10	6	16
Investment income	-3	0	-3	-1	0	-1
Interest income and expense	8	2	10	8	2	10
	50	**21**	**71**	**48**	**23**	**71**
Increase in trade and other receivables	-10	0	-10	-2	-1	-3
Decrease in inventories	0	0	0	0	0	0
Increase in trade payables	2	0	2	-2	-1	-3
Cash generated from operations	**42**	**21**	**63**	**44**	**21**	**65**
Income taxes paid	-11	-4	-15	-11	-4	-15
Net cash from operating activities	***31***	***17***	**48**	***33***	***17***	**50**
Cash flow from financing activities						
Purchase of PPE	-50	-18	-68	-53	-18	-71
Net cash from investing activities	***-50***	***-18***	**-68**	***-53***	***-18***	**-71**
Cash flow from financing activities						
Proceeds from LT borrowings	21	2	23	22	2	24
Net cash from financing activities	***21***	***2***	***23***	***22***	***2***	***24***
Net increase in cash and cash equivalents	**2**	**1**	**3**	**2**	**1**	**3**
Cash and cash equivalents at beginning of period	**5**	**2**	**7**	**3**	**1**	**4**
Cash and cash equivalents at end of period	**7**	**3**	**10**	**5**	**2**	**7**