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These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: **March 2006, London**

Project: **Joint Ventures Research Project - Paper III: Alternative Views on Papers I and II (Agenda Paper 9D)**

Abstract

This paper notes the main alternative views that various parties have expressed in relation to the proposals in Papers I and II, namely:

- To identify the nature of a participant's interest(s) in a joint arrangement, it is irrelevant whether the arrangement is an *integrated resource arrangement* or a *non-integrated resource arrangement*.
- The first question to ask in relation to a joint arrangement is whether it is jointly controlled. Joint control should not be defined as existing *only* in relation to integrated resource arrangements.
- Instead of assessing whether an integrated resource arrangement exists, joint arrangements should be classified according to whether the arrangement is a business. This is because indirect interests in the underlying resources deployed in joint arrangements could only arise if the joint arrangement is a business.

Introduction

1. The following parties have reviewed various drafts of Papers I and II and expressed disagreement with some proposals in those papers:
 - (a) IASB Board advisers;
 - (b) IASB staff working on the joint ventures component of the Short-Term Convergence Project; and
 - (c) most recently, participants in a discussion of the papers at the meeting of National Standard Setters with IASB representatives held on 13-14 March 2006, which include some of the IASB Board advisers to this research project.¹
2. The purpose of this paper is to describe their main concerns and alternative views.
3. Because the comments made at the National Standard Setters meeting are wide-ranging and reflect the outcome of a dialogue between various parties, this paper describes them first.

National Standard Setters

Integrated resource arrangements and non-integrated resource arrangements

4. Several discussants disagreed with the proposal that a joint arrangement must be an *integrated resource arrangement* to qualify as a joint venture.² Some of them observed that it would be very difficult to operationalise this criterion. For example, the requirement that an integrated resource arrangement primarily pursues its own separate strategic objectives is very subjective to apply (and unnecessary because the real issue is “To what does the decision making relate?”). They said the tipping point between qualifying as either an integrated resource arrangement or a non-integrated resource arrangement is unclear, and seems to be that an arrangement’s operations

¹ Other Board advisers made similar points to the research team.

² The other essential characteristic of a joint venture proposed in Paper II is that the arrangement is jointly controlled.

have reached a certain level of complexity. They expressed the view that the driver or principle for distinguishing integrated resource arrangements from non-integrated resource arrangements is not apparent.

5. Moreover, all of those discussants commented that to identify whether a particular interest of a participant in a joint arrangement is either:
 - (a) an investment in a joint arrangement (an indirect interest); or
 - (b) an asset used in the arrangement's activities but controlled by the participant (a direct interest),

it is irrelevant whether the arrangement is an *integrated resource arrangement* or a *non-integrated resource arrangement* as defined in Paper II.

6. Their primary reason for this view is that they disagree with treating a participant's interests in a joint arrangement necessarily as either *entirely* direct interests or *entirely* indirect interests (which they regard as the logical outcome of classifying interests according to whether an arrangement is an integrated resource arrangement). Participants can hold both types of interest in either an integrated resource arrangement or a non-integrated resource arrangement.

7. To illustrate the point in the last sentence of paragraph 6, the group discussed the following scenarios:

- (a) the olive pressing machine example in Scenario 2 of Appendix 2 to Paper II;
and
 - (b) the example described in paragraph 13.

Olive pressing machine example

8. In this example, a group of farmers purchases jointly a machine that each farmer has a right to use on specified days. No farmer has the right to unilaterally decide to sell or substantially modify the machine, or to change its maintenance plan. Paper II argues this arrangement is a non-integrated resource arrangement. In addition, for this paper,

assume that each farmer contracts to pay a share of servicing costs such as maintenance.

9. Those who expressed a view on this example agreed that it would not be representationally faithful for a participant (farmer) to report its interests in the arrangement as a single asset, such as:
 - (a) a share of an olive pressing machine (they took this view because of the assumed facts in the second sentence of paragraph 8); or
 - (b) an investment to which the equity method is applied.
10. Instead, they argued that each farmer should account separately for its unilaterally controlled asset—its right of use—and its indirect interest in the other future economic benefits (e.g., residual value) embodied in the machine.
11. The conclusions in paragraphs 9 and 10 are consistent with those expressed in Scenario 2 in Appendix 2 to Paper II. However, the discussants reached these conclusions without considering whether the joint arrangement is an integrated resource arrangement.³ Instead, they considered which rights give rise to unilateral control of resources and which rights give rise to joint control of resources (joint control is discussed in paragraphs 16-19).
12. Various discussants agreed that the additional assumption that each farmer contracts to pay a share of servicing costs results in identifying a liability of each farmer to pay its share of costs.

Example of an integrated resource arrangement

13. A jointly controlled entity holds direct rights in assets contributed by participants, carries on an economic activity that is separate from the activities of its participants, and primarily pursues its own separate strategic objectives. The details are as follows:

³ One Board adviser asked “What is the difference between an investment in a joint venture and a beneficial interest in a non-integrated activity?” Based on the conclusions in paragraphs 9 and 10, the answer would be “none”.

The entity is established primarily to produce and sell products to entities unrelated to its participants. It has unilateral control of the property, plant and equipment it uses in its operations, which was contributed by its participants. The entity incurs its own liabilities to pay for operating costs (such as wages) and to service its loans. In times of unused capacity, it processes raw materials provided by its participants into finished products for distribution to them, and recoups from them the processing costs. The entity does not control those raw materials at any stage during the production process (under the terms of the arrangement, the entity cannot sell the materials, use them as collateral for borrowing, or swap them with materials used to produce goods for sale to unrelated parties). Under the terms of the arrangement, each participant has an equity interest in the entity and an obligation to pay for any processing costs incurred by the entity in processing its raw materials.⁴

14. Discussants observed that in these circumstances, each participant unilaterally controls the raw materials being processed on its behalf, but not the other resources used by the jointly controlled entity.⁵ (However, one discussant questioned whether the raw materials really are part of the joint arrangement.) Each participant has an equity investment in the entity, and thus an indirect interest in its underlying assets and liabilities. Each participant has a separate liability for its obligation to pay for processing costs, but does not have a present obligation in respect of the *entity's* liabilities. Therefore, although the entity is an integrated resource arrangement, its participants hold both direct and indirect interests in the resources it uses, and incur a separate liability for work done by the entity on its behalf.
15. Some discussants observed that in joint arrangements, participants may hold only direct interests, or hold direct and indirect interests (in varying proportions), or hold only indirect interests.

Limiting the application of joint control to integrated resource arrangements

⁴ Discussants at the National Standard Setters meeting did not describe all of these assumed facts. This fact pattern illustrates the key features they mentioned.

⁵ Arguably, the raw materials are not really part of the joint arrangement.

16. The discussants disagreed with the proposal in Paper II (paragraph 42) that joint control be defined as existing *only* in relation to integrated resource arrangements. Paragraph 45 of Paper II argues that joint control is meaningless to non-integrated resource arrangements because participants in them have direct rights to the assets they contributed to the arrangement. The meeting discussants rejected that argument because:
- (a) In arrangements that Paper II calls non-integrated resource arrangements, participants can have *indirect* rights in at least some of the resources they contributed to the arrangement. This is illustrated in paragraphs 8-10 of this paper.
 - (b) Having direct rights in assets is not incompatible with describing the arrangements in which they are used as “jointly controlled”, despite the implication to that effect in the abovementioned argument in Paper II. Identifying an asset as “jointly controlled” is merely a way of highlighting that participants in it should not account for the asset as if they unilaterally control it. The key is to identify the rights that the participant unilaterally controls.

Proposed approach to joint control

17. Discussants said the first question to ask in relation to a joint arrangement is whether it is jointly controlled. If it is not, there are no special accounting issues to address, and general accounting principles should be applied. The second question is “To what does the joint control relate?” One discussant gave an example of a joint arrangement for the extraction and processing of minerals, in which all resources used for those processes are controlled by the arrangement, but each participant controls the process of marketing its share of the products. The marketing process is not subject to joint control.
18. The second question in paragraph 17 was rephrased by some discussants as “What does the participant control?” The writer observes that control of an asset must be unilateral. In some joint arrangements, a participant may retain control of some or all of the resources it “contributes” to the joint activity. When a participant loses control of assets it contributes to a joint arrangement, but has a contractual right to a share of

distributions of the arrangement's profit, the item it controls (unilaterally) is an investment in the arrangement.

19. Some discussants said more guidance is needed on the meaning of joint control. For example, some said it was unclear which decisions relating to a joint arrangement qualify as “strategic financial and operating decisions” (as referred to in the proposed definition of joint control in paragraph 42 of Paper II). That proposed definition effectively incorporates the reference to “strategic financial and operating policies” in the definition of control tentatively agreed by the IASB in its Consolidation project. IASB staff working on the joint ventures component of the Short-Term Convergence project think guidance on strategic decisions/policies should be considered in the Consolidation project and drawn upon in the work on joint ventures, rather than being addressed separately in the Short-Term Convergence Project.

Using the concept of a business

20. Discussants said that rather than classifying joint arrangements according to whether an integrated resource arrangement exists (as proposed in Papers I and II), joint arrangements should be classified according to whether a business exists. Discussants used *business* with its meaning in the Exposure Draft of Proposed Amendments to IFRS 3 *Business Combinations*, the definition of which is:

“A business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing either:

- (1) a return to investors; or
- (2) dividends, lower costs, or other economic benefits directly and proportionately to owners, members, or participants.”

21. They opined that indirect interests in the underlying resources deployed in joint arrangements could only arise if the joint arrangement is a business, and the primary purpose of defining a joint venture is to identify which interests of participants in joint arrangements are direct and which are indirect interests in the underlying resources. They stressed the importance of avoiding using different terms to describe the same concept in different contexts.

22. Thus, if a business were jointly controlled, it would be treated as a jointly controlled entity (using the terminology currently in IAS 31). Based on the IASB Board's decision in December 2005 to remove the option to apply proportionate consolidation to interests in jointly controlled entities, this would mean the participants would apply the equity method to their investment in the business. However, discussants did not say that all of a participant's resources used in a jointly controlled business must be treated as an investment in the business. The implication of their comments in paragraph 14 is that if a participant still controls some resources used in the business, such as raw materials processed on its behalf, it should account for those items separately from its investment in the business.
23. In expressing support for using the concept of a business to identify joint arrangements in which participants hold an investment, some discussants acknowledged that the definition of a business in the IFRS 3 Exposure Draft might change when the Board finalises a revised IFRS 3.

Comments by IASB staff working on the joint ventures component of the Short-Term Convergence Project

24. Similar views to those expressed at the National Standard Setters meeting had been expressed by IASB staff in discussions with the research team.

Other Comments by IASB Board Advisers

25. A Board adviser commented there is insufficient discussion in the Papers of the nature of the asset the participant controls, which depends on whether it has lost control of the resources it contributed to the arrangement.⁶ The Board adviser said it is crucial whether the participant can realise its interest in the arrangement by selling it without triggering sale of the assets it contributed to the arrangement's operations. For example, can a participant that contributed a building to an arrangement withdraw from the arrangement by selling its interest in the arrangement without the building being sold?

⁶ This comment was also made at the National Standard Setters meeting.