30 Cannon Street, London EC4M 6XH, England
Phone: +44 (0)20 7246 6410, Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org   Website: http://www.iasb.org

International
Accounting Standards
Board

INFORMATION FOR OBSERVERS
WORLD STANDARD SETTERS MEETING, SEPTEMBER 2007, LONDON

Round-Table Discussion:
The Reporting Entity and Consolidations
Part 1—Conceptual Framework Phase D: Reporting Entity

Introduction

1. The IASB and FASB are undertaking a joint project to develop a common and improved conceptual framework. Initially, the boards are focusing on conceptual issues in the context of business entities in the private (ie non-governmental) sector. The project is being conducted in a series of eight phases. There are four phases of the project currently underway. This paper discusses the reporting entity phase. In the other three phases currently underway, the boards are considering issues relating to the objective of financial reporting, the qualitative characteristics of financial reporting information, the definitions of elements of financial statements, the unit of account, recognition and derecognition of elements of financial statements, and initial and subsequent measurement of items in financial statements. In later phases, the boards will consider matters of financial statement presentation and disclosure and the applicability of the concepts in earlier phases to other types of entities.

2. The boards' existing conceptual frameworks do not include a reporting entity concept. The IASB's *Framework for the Preparation and Presentation of Financial Statements* defines

the reporting entity in one sentence with no further explanation.[1] The FASB's *Statements of Financial Accounting Concepts* do not contain a definition of the reporting entity or discussion of how to identify one. As a result, neither framework specifically addresses the reporting entity concept. Hence, the reporting entity phase of the conceptual framework project is intended to fill a gap in the boards' frameworks.

3. The boards have completed their initial deliberations for this phase and a Discussion Paper is being drafted. The boards plan to publish that Discussion Paper for comment in the fourth quarter of 2007, with a comment period of 120 days.

4. Sections 1 to 3 of this paper provide a summary of the main issues discussed by the boards in their initial deliberations, and their preliminary views on those issues. Section 4 provides further information on one particular issue, and sets out some questions participants to discuss at the Round-table.

Section 1: The reporting entity concept

5. As noted earlier, the objective of this phase of the project is to develop a reporting entity concept for inclusion in the boards' common conceptual framework. That concept is intended to assist the boards when developing standards for general purpose external financial reports prepared in accordance with International Financial Reporting Standards (IFRS) or US generally accepted accounting principles (US GAAP).

6. In particular, an important issue, both conceptually and when setting financial reporting standards, is the relevance of legal structure when determining what constitutes a reporting entity. More specifically, questions arise about the relevance of legal structure when determining which particular assets, liabilities and activities fall within the boundary of the entity reporting. Conceptually, this could be divided into two types of boundary issues:

   (a) dissaggregation issues, in particular, whether a component of a legal entity, such as unincorporated branch, is a suitable subject of general purpose external financial reports (discussed in paragraphs 7 and 8 below); and

   (b) aggregation issues, in particular, determining when the legal boundary between two or more legally separate entities should be disregarded, and presented as a single economic unit, often referred to as a group entity (discussed in Section 2 below).

7. In many cases, businesses are conducted using some form of legal structure, such as a corporation or partnership. However, that is not always the case. For example, a business

[1] IASB *Framework*, paragraph 8, states "A reporting entity is an entity for which there are users who rely on the financial statements as their major source of financial information about an entity."

owned and operated by an individual person (commonly referred to as a sole proprietorship) might not be operated through a separate legal entity. Yet general purpose external financial reports might be prepared for that sole proprietorship, for example, when seeking funding from a bank or when providing financial information to prospective purchasers of the business. Similarly, in some jurisdictions, an unincorporated branch of an overseas corporation might be required to (or choose to) prepare general purpose external financial reports, for example, to provide financial information to existing and potential creditors of that branch.

8. The boards' preliminary view is that a *reporting entity* should not be limited to business activities that are structured as separate legal entities. Rather, a reporting entity could be broadly described as being a circumscribed area of business activity of interest to present and potential investors and creditors. This would include, for example, a sole proprietorship, branch, corporation, trading trust, or partnership.

Section 2: Group reporting entity

Introduction

9. This section discusses issues arising in the context of a group entity. The term *group entity* (or group reporting entity) is used in this paper to refer to an entity that comprises two or more legally separate entities that are regarded as being a single economic unit for financial reporting purposes. The term *group financial statements* is used here to refer to the financial statements of a group entity. Both *consolidated* financial statements and *combined* financial statements, as prepared in practice today and discussed further in this paper, are types of group financial statements.

10. In accounting practice, it has long been common for group financial statements to be prepared, in which the results and activities of two or more legally separate organisations (such as two or more corporations) are consolidated together, and presented as a single economic unit. In general, the concept of control is used as the basis for determining which entities should be included in the group. That is to say, a group comprises a parent entity and other entities under its control (or in which the first entity has a controlling financial interest).

11. Even though there has been a long-established practice of preparing consolidated financial statements, questions continue to arise about that practice, including questions that are relevant to the conceptual framework project. In particular, one such question is whether

the control concept is the most appropriate basis for determining the composition of a group entity, or whether another approach should be adopted.

12. The boards considered the following approaches to determining the composition of a group entity:

(a) a controlling entity model

(b) a common control model

(c) a risks and rewards model.

13. The first two approaches both apply the concept of control, in the context of one entity (the parent entity) having control over one or more other entities (the subsidiary entities). Therefore, the boards discussed the meaning of control. The boards' preliminary view is that control should be defined to include both a *power* element and a *benefits* element, together with a link between the two. The boards also discussed and reached preliminary views on some other issues relating to the control concept, including:

(a) determining whether one entity has control over another involves an assessment of all the current facts and circumstances; therefore, the concept of control includes all situations in which control currently exists, even though it might be temporary;

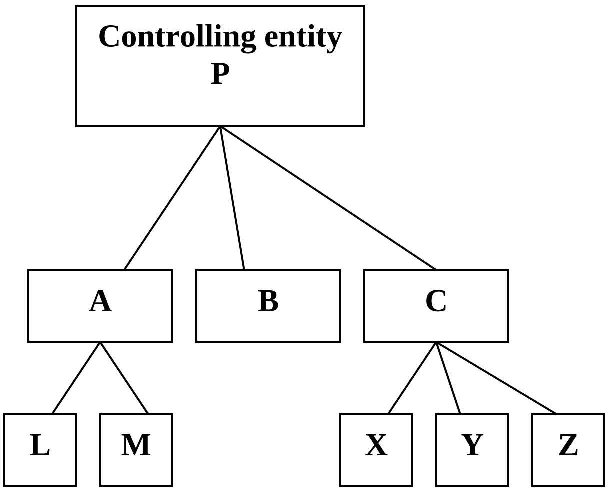
(b) the control concept should not be limited to circumstances in which the entity has sufficient voting rights or other legal rights to direct the financing and operating policies of another entity, but should be a broad concept that encompasses economically similar circumstances;

(c) control cannot be shared, that is, control involves a single entity (not multiple entities) having control over another entity.

Outline of the controlling entity model, common control model and risks and rewards model

14. Under the controlling entity model, a group reporting entity comprises the controlling entity (ie the parent) and other entities under its control (ie its subsidiaries).

15. For example, consider the following group of entities:



16. The following combinations of entities would be possible under the controlling entity model:

    (a) The group headed by the ultimate controlling entity, P, plus all the other entities (A, B, C, L, M, X, Y and Z)

    (b) A + L + M

    (c) C + X + Y + Z

17. Under the common control model, *combined* financial statements are prepared, which combine the results and activities of two or more commonly controlled entities. In contrast to *consolidated* financial statements, combined financial statements do not include the controlling party (the parent) as part of the group reporting entity. For example, referring to the group of entities described in paragraph 15 above, the combined financial statements of Entity L and Entity M would include the combined assets, liabilities and activities of the two entities, but not the assets, liabilities or activities of their parent entity (Entity A). The common control model is discussed further in Section 4 below.

18. The boards also considered a risks and rewards model. Some have suggested an approach whereby two entities would be combined into a group reporting entity when the activities of the second entity affect the wealth of the residual shareholders (or claimants) of the first entity. The boards noted that, to be workable, it would be necessary to narrow down the notion or define it more precisely. The nature of a residual interest is such that the activities of virtually every other entity with which an entity conducts business has the potential to affect that entity and the wealth of its residual shareholders. Hence, it would be necessary to identify some relevant factors. For example, the following factors could be considered:

(a) The nature of the financial interest, in particular, whether it exposes the first entity to risks and/or rewards, such as a 'residual' or 'ownership' interest.

(b) The extent of exposure to risks and rewards.

19. There is some overlap between the controlling entity model and the risks and rewards model described above, because the definition of control includes a *benefits* element. For example, whenever it is difficult to determine who has power over an entity, accounting standards often look to the benefits element instead, to help determine whether the first entity controls the second entity. That often entails considering factors relating to the first entity's entitlement to benefits and/or its exposure to the risk of the loss of those benefits. However, the risks and rewards model has the potential to be both broader and narrower than the controlling entity model, for the following reasons:

(a) It is broader, because it does not require a power element, hence could result in entities being combined or consolidated when the first entity does not have power over the second entity—not only in situations when it is difficult to determine who has power over an entity, but also when someone else clearly has that power.

(b) It could be narrower, because—depending on the conclusions reached on the issues raised in paragraph 18 above—it may require a focus on particular types of benefits and a particular level of benefits.

The boards' preliminary views

20. The boards' preliminary view is that the risks and rewards model does not seem to provide a conceptually robust basis for determining the composition of a group entity. The basic idea is so broad that, in order to place what seem like reasonable and necessary limits on which entities should be included in the group, it would be necessary to develop criteria that would involve drawing some bright lines, such as the minimum level of exposure to risks and/or rewards. Although *applying* the controlling entity model might sometimes result in bright lines being drawn at the standards level, the concept itself is much more definitive—a control relationship either exists or it does not. The fact that there can be difficulties in practice determining whether the power element of control exists does not negate this conclusion at the conceptual level. In the boards' view, this is similar to difficulties in determining whether an asset or liability exists. In contrast, the risks and rewards model seems to require bright lines to be drawn at the conceptual level, which the boards found undesirable.

21. The boards, therefore, focused on the controlling entity model and common control model. The boards' preliminary view is that, overall, the controlling entity model is *more* consistent with the objective of financial reporting, compared with the common control model. They noted that, when one entity has control over another, it has the ability to direct the other entity's financing and operating policies, so as to access benefits flowing from that entity (or to reduce the incidence of losses), and to increase, maintain or protect the amount of those benefits. The benefits that the parent entity derives from the subsidiary entity, and that ultimately flow to the parent entity's investors and creditors, depend significantly on the subsidiary's activities and the parent's actions in directing those activities. Thus, setting aside the legal boundary between the parent entity and subsidiary entity, and presenting information about them as a single economic unit—a circumscribed area of business activity—provides useful information to present and potential investors and creditors.

22. However, in the boards' preliminary view, there are also *occasions* when combined financial statements of commonly controlled entities would provide useful information to investors and creditors (discussed further in Section 4 below). Hence, the boards' preliminary view is that the common control model should not be ruled out at the conceptual level. Rather, the conceptual framework should explain that the common control model is an approach to determining the composition of a group entity that may be used in some circumstances. It would be determined at the standards level when the common control model should or may be applied. In contrast, the controlling entity model is the primary basis to be used to determine the composition of a group entity.

Section 3: The general purpose external financial reports of a parent entity

23. The boards considered two issues relating to the financial reports of a parent entity:

    (a) parent-only (or separate) financial statements[2] and consolidated financial statements—determining which set of financial statements (or both) meets the objective of general purpose external financial reporting.

    (b) the parent company approach to the preparation of consolidated financial statements.

24. The boards' preliminary view is that consolidated financial statements meet the objective of general purpose external financial reporting, by providing useful information to present and potential investors and creditors. The boards did not reach a common preliminary

[2] In parent-only (or separate) financial statements, information is presented about the parent's investment in its subsidiaries, and returns on that investment, rather than the underlying assets, liabilities and activities of those subsidiaries.

view on whether parent-only financial statements should also be provided in the general purpose external financial report of a parent entity. The Discussion Paper sets out three views on this issue.

25. On the matter of the parent company approach to the preparation of consolidated financial statements, the boards' preliminary view is that this approach relates to the presentation of information in those financial statements, including goodwill and minority interest accounting, and accounting for and disclosure of related party transactions. Hence, the approach is not pertinent to the higher-level conceptual issue to be addressed in this phase of the project, namely selecting the appropriate basis for determining the composition of a group entity. However, the boards noted that the parent company approach may provide some insights into issues being considered in other phases of the conceptual framework project, such as the phase on the elements of financial statements (when considering liabilities and equity), and the phase on presentation and disclosure. In that context, further consideration should be given to the parent company approach.

Section 4: The common control model

17. Sections 1 to 3 above provided a summary of the main issues discussed by the boards in their initial deliberations on issues relating to the reporting entity phase. This section focuses specifically on the common control model. It concludes with some questions for participants at the Round-table to discuss.

18. Most constituents will be familiar with the controlling entity model described in Section 2, because some form of controlling entity model is applied in many jurisdictions today. However, the common control model is likely to be less familiar to constituents.

19. Some support the use of a common control model, because it would allow for the possibility of preparing general purpose external financial reports for a group of entities, even though the controlling entity/body might not be required (or choose) to prepare such reports. For example, suppose that there are five companies, all controlled by a natural person. That individual investor might not be required (or choose) to prepare general purpose external financial reports. A similar situation might arise when the parent entity/body is a group of people, such as a family, with no single family member holding a controlling interest in the companies.

20. Some would support the use of the common control model in limited circumstances only, such as the circumstances described above. In effect, they regard the common control model as a proxy or substitute for the controlling entity model in these circumstances.

21. However, others support the adoption of a more broadly applicable common control model. In particular, they argue that combined financial statements for two or more entities under common control would provide useful information to investors and creditors when those entities are managed together as a single economic unit. For example, suppose a parent company has two subsidiary companies that operate in the same industry, have the same management, and the net assets of the two companies are managed together in a highly integrated and synergistic manner. Suppose also that there are external investors and creditors with a financial interest in one or both companies. In this situation, it is argued that the provision of combined financial statements, prepared by combining the assets, liabilities and activities of the two companies and presenting them as a single economic unit, would provide useful information to present and potential investors and creditors. This conclusion holds, even though some—perhaps many—of the investors and creditors have claims against only one of the companies concerned. The degree of integration and interaction between the two companies means that the returns to each company's investors and creditors are being generated by the two companies' combined business operations. Thus, information provided in the combined financial statements would help these investors and creditors assess the amounts, timing and uncertainty of cash flows to them, such as dividends, interest, and the settlement of debt.

22. In essence, the above argument is based upon an extension of the rationale underlying the controlling entity model. Under the controlling entity model, when one entity has control over another legally separate entity, the legal boundary between the two entities is disregarded for financial reporting purposes. Instead, the two legally separate entities are regarded as a single economic unit. Similarly, when two entities under the control of the same parent entity are managed together in the manner described above, the combined operations of the two entities should be regarded as a single economic unit. As noted above, the degree of integration and interaction between the two companies means that the cash flows and other benefits following to each company's investors and creditors are being generated by the two companies' combined business operations. Thus, information provided in the combined financial statements would be helpful to investors and creditors. For example, it would help investors to assess the amounts, timing and uncertainty of cash flows.

Questions for participants at the Roundtable discussion

Please provide your views on the common control model. In particular, do you think that the common control model should be used in limited circumstances only, such as those described in paragraph 19 above, as a proxy or substitute for the controlling entity model in those circumstances?

Or should it be applied more broadly, as suggested in paragraph 21 above? If so, when should it be used, either alone or in addition to the controlling entity model? For example, should a parent entity prepare both:

(a) consolidated financial statements, which include all its subsidiaries, *and*

(b) combined financial statements, for particular subsidiary entities that are managed together in a highly integrated manner?

30 Cannon Street, London EC4M 6XH, England
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INFORMATION FOR OBSERVERS
WORLD STANDARD SETTERS MEETING, SEPTEMBER 2007, LONDON

Round-Table Discussion:
The Reporting Entity and Consolidations
Part 2—Joint Arrangements

Cover Note—ED 9 Joint Arrangements

Introduction

1. The Board will publish ED 9 *Joint Arrangements* on 13 September 2007—a near-final draft is attached. ED 9 proposes changes to accounting for interests in joint arrangements, and would replace IAS 31 *Interests in Joint Ventures*. It represents the first major proposed revision of accounting for joint arrangements since the publication of IAS 31 by the International Accounting Standards Committee in 1990.

2. The Board's proposals are detailed in the draft IFRS on pages 9-16 of the near-final draft, and the Board gives its reasons for those proposals in the Basis for Conclusions on pages 26-30. Examples illustrating the application of the proposals to joint arrangements are included on pages 32-43.

Questions for discussion

3. The exposure draft includes six questions of particular interest to the Board. For the purposes of this discussion at the World Standards Setters meeting, we are interested in your comments on the following two questions:

    a. *Question 1:* The Board proposes that a party to a joint arrangement should recognise its contractual rights and obligations arising from the arrangement.

        Do you agree with this principle and do you think that the proposals in the exposure draft meet this principle?

    b. *Question 2:* The Board proposes enhanced disclosure requirements for joint arrangements, and more consistent disclosure requirements across the range of investment types (ie, associates, joint ventures and subsidiaries).

        Do you think that the disclosure requirements proposed will provide useful information to users of financial statements? If not, what disclosure requirements would you suggest?

Exposure Draft

ED 9 JOINT ARRANGEMENTS

Comments to be received by 11 January 2008

CONTENTS

Invitation to Comment

The International Accounting Standards Board invites comments on any aspect of the exposure draft of its proposed IFRS *Joint Arrangements*. It would particularly welcome answers to the questions set out below. Comments are most helpful if they:

(a) comment on the questions as stated,

(b) indicate the specific paragraph or paragraphs to which the comments relate,

(c) contain a clear rationale, and

(d) describe any alternative the Board should consider.

Respondents need not comment on all of the questions and are encouraged to comment on any additional issues.

The Board will consider all comments received in writing by **11 January 2008**. In considering the comments, the Board will base its conclusions on the merits of the arguments for and against each alternative, not on the number of responses supporting each alternative.

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?

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?*

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?

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?

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?

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?

[Draft] International Financial Reporting Standard X *Joint Arrangements* ([draft] IFRS X) is set out in paragraphs 1-44 and Appendices A-C. All of the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the [draft] IFRS. Definitions of other terms are given in the Glossary for International Financial Reporting Standards. [Draft] IFRS X should be read in the context of its core principle and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

Reasons for issuing the [draft] IFRS

IN1 [Draft] International Financial Reporting Standard X *Joint Arrangements* sets out requirements for the recognition and disclosure of interests in joint arrangements. The objective of the [draft] IFRS is to enhance the faithful representation of joint arrangements that an entity provides in its financial statements. It does that by requiring an entity:

(a) to recognise its contractual rights and obligations that arise from a joint arrangement. The form of an arrangement is no longer the most significant factor in determining the accounting.

(b) to provide enhanced disclosures about its interests in joint arrangements.

IN2 The [draft] IFRS is part of the Short-term Convergence project undertaken by the Board and the Financial Accounting Standards Board (FASB) in the United States. The objective of the project is to reduce differences between International Financial Reporting Standards (IFRSs) and US generally accepted accounting principles (GAAP). Short-term convergence focuses on differences that can be resolved in a relatively short time and can be addressed outside major projects.

Main features of the [draft] IFRS

IN3 The [draft] IFRS supersedes IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities—Non-Monetary Contributions by Venturers* and is effective for annual periods beginning on or after [date to be inserted after exposure]. Earlier application is permitted.

Core principle

IN4 Parties to a joint arrangement recognise their contractual rights and obligations arising from the arrangement.

General requirements

IN5 The [draft] IFRS applies to interests in joint arrangements, except interests in joint ventures held by venture capital organisations, mutual funds, unit trusts and similar entities when those interests are measured at fair value, with changes in fair value recognised in profit or loss in the period of the change.

IN6 A joint arrangement is a contractual arrangement whereby two or more parties undertake an economic activity together and share decision-making relating to the activity. The [draft] IFRS classifies joint arrangements into three types—joint operations, joint assets and joint ventures.

IN7 The [draft] IFRS requires a party to a joint arrangement to recognise its contractual rights and obligations as assets and liabilities (and recognise the related income and expenses) in accordance with applicable IFRSs. Contractual rights to individual assets and contractual obligations for expenses or financing represent interests in joint operations or joint assets.

IN8 A party recognises 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. When a party has an interest in only a share of the outcome generated by the activities of a group of assets and liabilities that it jointly controls, the only asset it controls is its investment in the joint venture. That asset is recognised using the equity method.

IN9 The [draft] IFRS requires an entity to disclose a description of the nature of operations it conducts through joint arrangements, as well as a description of, and summarised financial information relating to, its interests in joint ventures.

[Draft] International Financial Reporting Standard X *Joint Arrangements*

Core principle

1 ***Parties to a joint arrangement* recognise their contractual rights and obligations arising from the arrangement.**

Scope

2 **This [draft] IFRS shall be applied by all entities to interests in *joint arrangements*, except interests in joint ventures held by:**

(a) venture capital organisations, or

(b) mutual funds, unit trusts and similar entities including investment-linked insurance funds

that upon initial recognition are designated as at fair value through profit or loss or are classified as held for trading and accounted for in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. Such investments shall be measured at fair value in accordance with IAS 39, with changes in fair value recognised in profit or loss in the period of the change. An entity holding such an investment shall provide the disclosures required by paragraph 37 and paragraph 39(a) and (d) of this [draft] IFRS.

Types of joint arrangement

3 Joint arrangements can have different forms and structures. This [draft] IFRS classifies joint arrangements into three types—joint operations, joint assets and joint ventures.

4 Parties to a joint arrangement may have an interest in a joint operation or joint asset, and also have an interest in a joint venture.

5 The type of joint arrangement an entity is a party to depends on the rights and obligations that arise from the contractual arrangement. A party has a joint operation or joint asset if it has contractual rights to individual assets, or contractual obligations for expenses or financing, ie if the contractual arrangement gives the parties an interest in individual assets and liabilities of the arrangement. An entity is a party to a joint venture if it has rights only to a share of the outcome generated by a group of assets and liabilities carrying on an economic activity.

6 Among the factors that a party considers in assessing the type of arrangement is the legal form of the arrangement. The form of the arrangement can affect the rights and obligations of the parties, but is not always the determining factor. For example, the shareholders of a limited liability company are not usually obliged to pay for expenses incurred by, and financing of, the company. However, a contract (such as a guarantee contract) can negate the effect of limited liability.

7 Shared decision-making is established by contractual arrangement, which can take various forms. For example, the parties could establish shared decision-making by contract or by discussions documented in minutes. In some cases, the arrangement is incorporated in the articles or other by-laws of the joint arrangement. Whatever its form, the contractual arrangement is usually in writing and deals with such matters as:

(a) the activity, duration and reporting obligations of the joint arrangement.

(b) the appointment of any board of directors or equivalent governing body of the joint arrangement and the voting rights of the parties.

(c) capital contributions by the parties.

(d) the sharing by the parties of the output, income, expenses or results of the activities of the joint arrangement.

Joint operation

8 A joint operation is a joint arrangement, or part of a joint arrangement, that involves the use of the assets and other resources of the parties, often to manufacture and sell joint products. Each party uses its own assets, such as property, plant and equipment and inventories. It also incurs its own expenses and liabilities and raises its own finance. The contractual arrangement specifies the basis on which the revenue from the sale of joint products and expenses incurred in common are shared among the parties.

9 Each party controls its own assets and has obligations for expenses it incurs. Therefore, each party recognises those assets and liabilities in its financial statements in accordance with applicable IFRSs.

10 An example of a joint operation is when two or more parties combine their operations, resources and expertise to manufacture, market or distribute jointly a particular product. For example, two pharmaceutical companies enter into an agreement whereby one of them develops a drug and the other distributes the drug to customers. Each party uses its own assets, incurs its own expenses and receives an agreed share of the revenue from the sale of the drug.

Joint asset

11 A joint asset is an asset to which each party has rights, and often has joint ownership. Each party takes a share of the output from the asset and each bears an agreed share of the costs incurred to operate the asset.

12 Each party has exclusive rights to a share of the asset and the economic benefits generated from that asset. The parties arrange their own financing for their interest in the asset. They could be obliged, either individually or jointly, to pay for the liabilities and expenses of the joint arrangement.

13 A party's rights to a share of a joint asset might be demonstrated in any of the following ways. The list is not exhaustive.

(a) The party has the right to sell its interest in the asset.

(b) The party has the right to use the asset for its own purposes for some or all of its useful life.

(c) The party has the right to pledge its interest in the asset against its own financing.

(d) The party is contractually obliged to pay for its share of the cost of the joint asset, and consequently has contractual rights to that share of the asset.

14 An example of a joint asset arrangement is when several telecommunication companies jointly operate a network cable. Each party uses the cable for data transfer in return for which it bears an agreed proportion of the costs of operating the cable.

Joint venture

15 A joint venture is a joint arrangement, or part of a joint arrangement, that is jointly controlled by the *venturers*. The venturers do not have rights to individual assets or obligations for expenses of the venture. Rather, each venturer is entitled to a share of the outcome (eg profit or loss) of the activities of the joint venture.

16 A joint venture includes those assets and liabilities (and related income and expenses) that are not controlled by, or present obligations of, the venturers, ie those assets and liabilities of a joint arrangement that are not joint operations or joint assets of the venturers.

17 A joint venture often involves the establishment of a legal entity, such as a corporation. A joint venture controls assets, incurs liabilities and expenses and earns revenue. The joint venture might enter into contracts in its own name and raise finance for the joint venture activity.

18 A *business* usually involves assets and resources working together to achieve an outcome, which requires decisions of a financial and operating nature. A business that is subject to *joint control* is, therefore, a joint venture, unless circumstances indicate otherwise. Such circumstances would indicate that the parties have contractual rights to the assets of the business and have contractual obligations for the expenses of the business.

19 An example of a joint venture is when an entity starts a business in a foreign country in conjunction with an entity incorporated in that country. Neither entity controls the individual assets or is obliged to pay for the liabilities and expenses of the venture. Rather, the entities together govern the financial and operating policies of the venture; each is entitled to a share of the profit or loss generated by the activities of the venture.

20 Each venturer usually contributes cash or other resources to the joint venture. These contributions are recognised in the financial statements of the venturer as an investment in the joint venture.

Financial statements of parties to a joint arrangement

Joint operation

21 **In respect of its interest in a joint operation, a party shall recognise, in accordance with applicable IFRSs:**

(a) the assets it controls and the liabilities it incurs;

(b) the expenses it incurs; and

(c) its share of the revenue and expenses from the sale of goods or services by the joint arrangement.

Joint asset

22 **In respect of its interest in a joint asset, a party shall recognise, in accordance with applicable IFRSs:**

(a) its share of the joint asset, classified according to the nature of the asset;

(b) any liabilities it incurs;

(c) its share of any liabilities incurred jointly with the other parties relating to the joint arrangement;

(d) any revenue from the sale or use of its share of the output of the joint asset; and

(e) any expenses it incurs in respect of its interest in the joint arrangement.

Joint venture

23 **A venturer shall recognise its interest in a joint venture using the *equity method* except when:**

(a) the interest is classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*;

(b) the exception to paragraph 10 of IAS 27 *Consolidated and Separate Financial Statements*, allowing a parent that also has an interest in a joint venture not to present consolidated financial statements, applies; or

(c) all of the following apply:

(i) the venturer is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the venturer not applying the equity method;

(ii) the venturer's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);

(iii) the venturer does not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation, for the purpose of issuing any class of instruments in a public market; and

(iv) **the ultimate or any intermediate parent of the venturer produces consolidated financial statements available for public use that comply with International Financial Reporting Standards.**

24 A venturer that in accordance with paragraph 23(c) is exempt from applying the equity method may present *separate financial statements* as its only financial statements.

25 A venturer recognises its interest in a joint venture using the equity method, as described in IAS 28 *Investments in Associates*, irrespective of whether it also has investments in subsidiaries and describes its financial statements as consolidated financial statements. In applying the equity method, a venturer reads each reference to an associate in paragraphs 20-34 of IAS 28 as applying to a joint venture.

26 When a venturer's interest in a joint venture is reduced to zero, paragraph 30 of IAS 28 requires a venturer to continue to recognise losses, and thus recognise a liability, if the venturer has legal or constructive obligations or made payments on behalf of the joint venture. Because venturers share control of the joint venture, a venturer will often have a legal or constructive obligation to support financially the activities of the joint venture.

27 When a venturer enters into a transaction with a joint venture, it recognises gains or losses resulting from the transaction in accordance with paragraph 22 of IAS 28. Those transactions would include, for example, the sale, purchase or contribution of assets, including the contribution of a non-monetary asset to a joint venture in exchange for an equity interest in the joint venture.

Loss of joint control

28 An entity shall discontinue the use of the equity method from the date on which it ceases to have joint control over a joint venture, except when it retains *significant influence*.

29 When an entity ceases to have joint control over a joint venture, it shall account for any remaining interest in accordance with IAS 39 from that date, provided that the former joint venture does not become a subsidiary or associate. From the date on which a joint venture becomes a subsidiary of an entity, the entity shall account for its interest in accordance with IAS 27 and IFRS 3 *Business Combinations*. When a joint venture becomes an associate of an entity, the entity shall continue to account for its interest using the equity method in accordance with IAS 28.

30 Except when it continues to use the equity method, the entity shall, on the loss of joint control, measure at fair value any interest it retains in the former joint venture. The entity shall recognise in profit or loss any difference between:

(a) **the fair value of the retained interest and any proceeds from disposing of a part interest in the joint venture; and**

(b) the carrying amount of the interest at the date joint control is lost.

31 When an interest ceases to be a joint venture and is accounted for in accordance with IAS 39, the fair value of the interest when it ceases to be a joint venture shall be regarded as its fair value on initial recognition as a financial asset in accordance with IAS 39.

32 Except when an entity retains significant influence and continues to use the equity method, if an entity loses joint control of a joint venture, all amounts recognised in other comprehensive income and accumulated as a separate component of equity in relation to that joint venture shall be recognised by the entity on the same basis that would be required if the joint venture had disposed of the related assets or liabilities directly. Therefore, if a gain or loss recognised previously in other comprehensive income would be reclassified to profit or loss on the disposal of the related assets or liabilities, the entity reclassifies to profit or loss the gain or loss from the separate component of equity (as a reclassification adjustment) when an interest ceases to be a joint venture. For example, if a joint venture has available-for-sale financial assets and the interest ceases to be a joint venture, the entity shall reclassify to profit or loss the gain or loss recognised previously in other comprehensive income in relation to those assets. If an entity's ownership interest in a joint venture is reduced, but the interest continues to be a joint venture, the entity shall reclassify to profit or loss only a proportionate amount of the gain or loss recognised previously in other comprehensive income.

Joint venture held for sale

33 A venturer shall account for an interest in a joint venture that is classified as held for sale in accordance with IFRS 5.

34 When an interest in a joint venture no longer meets the criteria to be classified as held for sale, a venturer recognises its interest in the joint venture using the equity method from the date of its classification as held for sale. A venturer amends its financial statements for the periods since classification as held for sale accordingly, so that it presents those financial statements as if the venture had not been classified as held for sale.

Separate financial statements of an entity

35 In its separate financial statements, an entity shall apply paragraphs 37-42 of IAS 27 to its interests in joint ventures, if it is required or chooses to prepare such financial statements.

Disclosure

36 An entity shall provide a description of the nature and extent of its operations conducted through each of the three types of joint arrangement—joint operations, joint assets and joint ventures.

37 An entity shall disclose the aggregate amount of the following commitments separately from other commitments:

(a) any capital commitments it has relating to its interests in joint arrangements; and

(b) its share of capital commitments incurred jointly with other parties.

38 In accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, an entity shall disclose:

(a) any contingent liabilities incurred relating to its interests in joint arrangements; and

(b) its share of contingent liabilities incurred jointly with other parties.

39 A venturer shall disclose information that enables users of its financial statements to evaluate its activities conducted through joint ventures. To meet this objective, a venturer shall disclose the following information:

(a) a list and description of interests in significant joint ventures and the proportion of ownership interest held.

(b) for each individually material joint venture, and in total for all other joint ventures, summarised financial information, including, but not necessarily limited to, the venturer's interest in the amount of each of:

(i) current assets,

(ii) non-current assets,

(iii) current liabilities,

(iv) non-current liabilities,

(v) revenues, and

(vi) profit or loss.

(c) the end of the reporting period of the financial statements of a joint venture, when such financial statements are used in applying the equity method and are as of a date or for a period that is different from that of the venturer, and the reason for using a different date or different period.

(d) the nature and extent of any significant restrictions (eg resulting from borrowing arrangements or regulatory requirements) on the ability of joint ventures to transfer funds to the venturer in the form of cash dividends, or repayment of loans or advances.

(e) the unrecognised share of losses of a joint venture, both for the period and cumulatively, if a venturer has discontinued recognition of its share of losses of a joint venture.

40 A venturer shall disclose separately its share of the profit or loss of joint ventures accounted for using the equity method, and the carrying amount of those interests. The venturer shall also disclose separately its share of any discontinued operations of such joint ventures. These disclosures are presented in total for all joint ventures.

41 A venturer shall recognise in other comprehensive income its share of changes recognised in other comprehensive income by joint ventures.

Effective date

42 An entity shall apply this [draft] IFRS for annual periods beginning on or after [date to be inserted after exposure]. Earlier application is permitted. If an entity applies this [draft] IFRS in its financial statements for a period beginning before [date to be inserted after exposure], it shall disclose that fact.

Withdrawal of other IFRSs

43 This [draft] IFRS supersedes IAS 31 *Interests in Joint Ventures* (revised in 2003).

44 This [draft] IFRS supersedes SIC-13 *Jointly Controlled Entities—Non-Monetary Contributions by Venturers*.

Appendix A
Defined terms

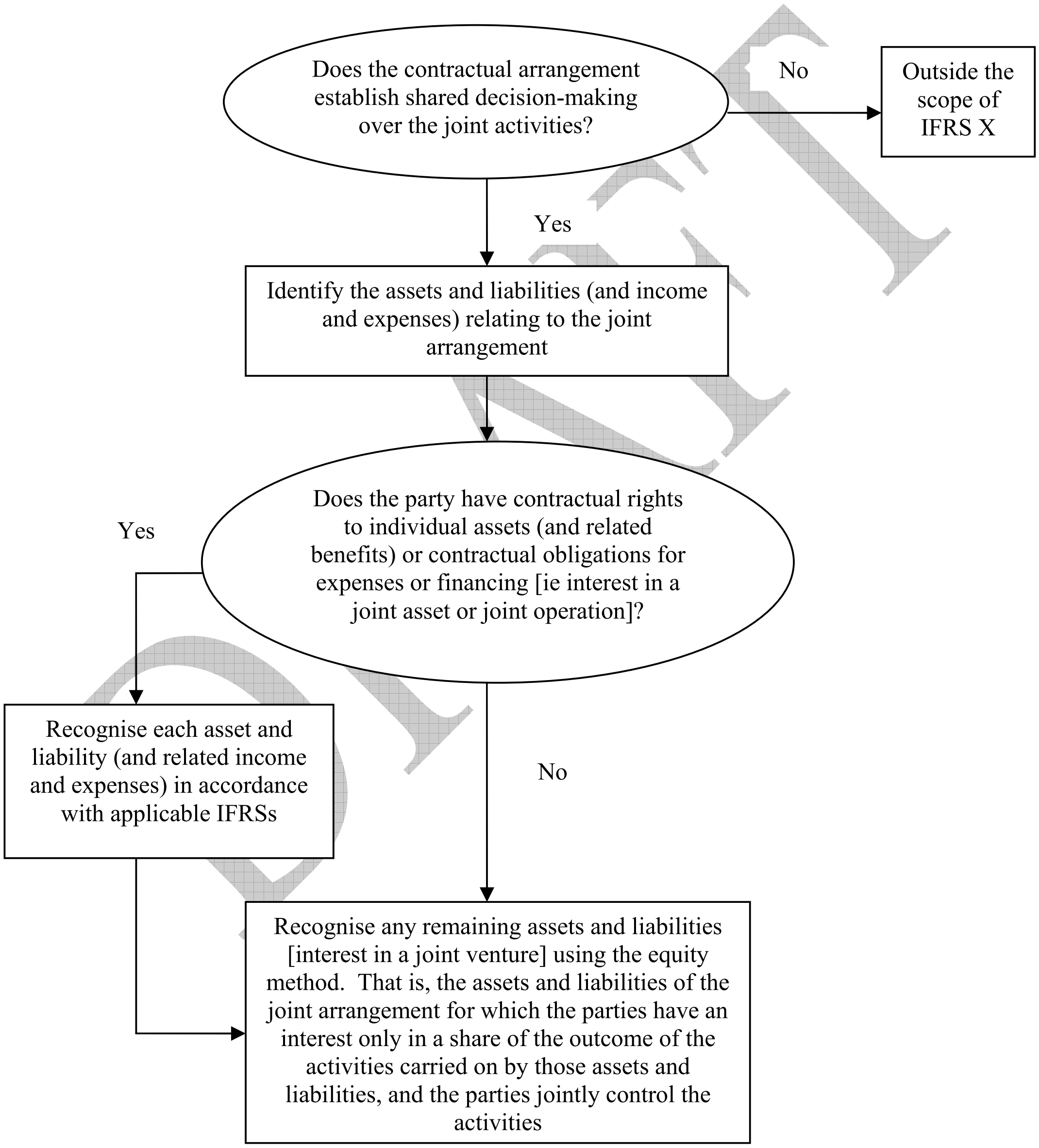
This Appendix is an integral part of the [draft] IFRS.

business	An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants.
control	The power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.
equity method	A method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of net assets of the investee. The profit or loss of the investor includes the investor's share of the profit or loss of the investee.
joint arrangement	A contractual arrangement whereby two or more parties undertake an economic activity together and share decision-making relating to that activity.
joint control	The contractually agreed sharing of the power to govern the financial and operating policies of a venture so as to obtain benefits from its activities.
party to a joint arrangement	An entity that participates in **shared decisions** relating to the **joint arrangement**.
separate financial statements	Financial statements presented by a parent, or an investor in an associate or joint venture, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees. Separate financial statements are those presented in addition to consolidated financial statements, or in addition to financial statements in which investments are accounted for using the equity method.
shared decisions	Decisions that require the consent of all of the parties to a **joint arrangement**.
significant influence	The power to participate in the financial and operating policy decisions of an entity, but not **control** or **joint control** over those policies.
venturer	A party to a joint venture that has **joint control** over that joint venture.

Appendix B
Application guidance

This appendix is an integral part of the [draft] IFRS.

AG1 The following flow chart illustrates how a party to a joint arrangement recognises its interests in the arrangement.



Appendix C
Amendments to other IFRSs

The amendments in this [draft] appendix shall be applied for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies this [draft] IFRS for an earlier period, these amendments shall be applied for that earlier period. Amended paragraphs are shown with the new text underlined and deleted text struck through.

C1 In International Financial Reporting Standards (including International Accounting Standards and Interpretations), the following references are amended as described below, unless otherwise stated in this appendix.

- 'IAS 31 *Interests in Joint Ventures*' is amended to 'IFRS X *Joint Arrangements*'.
- 'jointly controlled entity' is amended to 'joint venture', and 'jointly controlled entities' to 'joint ventures'.

C2 In IFRS 7 *Financial Instruments: Disclosures*, paragraph 3 is amended as follows.

3 This IFRS shall be applied by all entities to all types of financial instruments, except:

(a) those interests in subsidiaries, associates and joint ventures that are accounted for in accordance with IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates* or ~~IAS 31 *Interests in Joint Ventures*~~ <u>IFRS X *Joint Arrangements*</u>. However, in some cases, IAS 27, IAS 28 or ~~IAS 31~~ <u>IFRS X</u> permits an entity to account for an interest in a subsidiary, associate or joint venture using IAS 39; in those cases, entities shall apply the ~~disclosure requirements in IAS 27, IAS 28 or IAS 31 in addition to those in~~ <u>requirements of</u> this IFRS. Entities shall also apply this IFRS to all derivatives linked to interests in subsidiaries, associates or joint ventures unless the derivative meets the definition of an equity instrument in IAS 32. …

C3 In IAS 1 *Presentation of Financial Statements*, paragraph 119 is amended as follows.

119 In deciding whether a particular accounting policy should be disclosed, management considers whether disclosure would assist users in understanding how transactions, other events and conditions are reflected in the reported financial performance and financial position. Disclosure of particular accounting policies is especially useful to users when those policies are selected from alternatives allowed in IFRSs. ~~An example is disclosure of whether a venturer recognises its interest in a jointly controlled entity using proportionate consolidation or the equity method (see IAS 31 *Interests in Joint Ventures*). Some IFRSs specifically require disclosure of particular accounting policies, including choices made by management between different policies they allow.~~ For example, IAS 16 requires disclosure of the measurement bases used for classes of property, plant and equipment.

C4 In IAS 7 *Statement of Cash Flows*, paragraphs 37 and 50 are amended and paragraph 38 is deleted as follows.

37 When accounting for an investment in an associate or a ~~subsidiary accounted for by use of~~ joint venture using the equity or cost method, or accounting for an investment in a subsidiary using the cost method, an investor restricts its reporting in the statement of cash flows to the cash flows between itself and the investee, for example, to dividends and advances.

~~38~~ [Deleted] ~~An entity which reports its interest in a jointly controlled entity (see IAS 31 *Interests in Joint Ventures*) using proportionate consolidation, includes in its consolidated statement of cash flows its proportionate share of the jointly controlled entity's cash flows. An entity which reports such an interest using the equity method includes in its statement of cash flows the cash flows in respect of its investments in the jointly controlled entity, and distributions and other payments or receipts between it and the jointly controlled entity.~~

50 Additional information may be relevant to users in understanding the financial position and liquidity of an entity. Disclosure of this information, together with a commentary by management, is encouraged and may include:

(a) the amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities;

~~(b)~~ [deleted] ~~the aggregate amounts of the cash flows from each of operating, investing and financing activities related to interests in joint ventures reported using proportionate consolidation;~~

(c) the aggregate amount of cash flows that represent increases in operating capacity separately from those cash flows that are required to maintain operating capacity; and

(d) the amount of the cash flows arising from the operating, investing and financing activities of each reportable segment (see IFRS 8 *Operating Segments*).

C5 In IAS 21 *The Effects of Changes in Foreign Exchange Rates*, paragraphs 3 and 44-46 are amended as follows:

3 This Standard shall be applied:

(a) …

(b) in translating the results and financial position of foreign operations that are included in the financial statements of the entity by consolidation~~, proportionate consolidation~~ or the equity method; and …

44 Paragraphs 45-47, in addition to paragraphs 38-43, apply when the results and financial position of a foreign operation are translated into a presentation currency so that the foreign operation can be included in the financial statements of the reporting entity by consolidation~~, proportionate consolidation~~ or the equity method.

45 The incorporation of the results and financial position of a foreign operation with those of the reporting entity follows normal consolidation procedures, such as the elimination of intragroup balances and intragroup transactions of a

subsidiary (see IAS 27 and IAS 28 *Investments in Associates* ~~IAS 31 *Interests in Joint Ventures*~~). …

46 When the financial statements of a foreign operation are as of a date different from that of the reporting entity, the foreign operation often prepares additional statements as of the same date as the reporting entity's financial statements. When this is not done, IAS 27 allows the use of a different date provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or other events that occur between the different dates. In such a case, the assets and liabilities of the foreign operation are translated at the exchange rate at the end of the reporting period of the foreign operation. Adjustments are made for significant changes in exchange rates up to the end of the reporting period of the reporting entity in accordance with IAS 27. The same approach is used in applying the equity method to associates and joint ventures ~~and in applying proportionate consolidation to joint ventures~~ in accordance with IAS 28 ~~*Investments in Associates*~~ and ~~IAS 31~~ IFRS X *Joint Arrangements*.

C6 In IAS 24 *Related Party Disclosures*, paragraph 9 is amended as follows.

9 The following terms are used in this Standard with the meanings specified:

…

***Joint control* is the contractually agreed sharing of ~~control over an economic activity~~ the power to govern the financial and operating policies of a venture so as to obtain benefits from its activities. …**

C7 IAS 27 *Consolidated and Separate Financial Statements*, paragraphs 4 and 40 are amended as follows.

4 The following terms are used in this Standard with the meanings specified:

…

***Separate financial statements* are those presented by a parent, or an investor in an associate or ~~a venturer in a jointly controlled entity~~ joint venture, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees.** …

40 The following disclosures shall be made in consolidated financial statements:

…

(ba) a list of significant subsidiaries, including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held; …

C8 In IAS 28 *Investment in Associates*, paragraphs 3-5 are deleted, paragraphs 2, 18, 19A and 37 are amended, and paragraph 16A is added as follows.

2 The following terms are used in this Standard with the meanings specified:

…

***Joint control* is the contractually agreed sharing of ~~control over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers)~~ the power to govern the financial and operating policies of a venture so as to obtain benefits from its activities.**

***Separate financial statements* are those presented by a parent, or an investor in an associate or ~~a venturer in a jointly controlled entity~~ joint venture, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees. Separate financial statements are those presented in addition to consolidated financial statements, or in addition to financial statements in which investments are accounted for using the equity method.** …

16A An entity that in accordance with paragraph 13(c) is exempt from applying the equity method may present separate financial statements as its only financial statements.

18 An investor shall discontinue the use of the equity method from the date that it ceases to have significant influence over an associate and shall account for the investment in accordance with IAS 39 from that date, provided the associate does not become a subsidiary or a joint venture as ~~defined~~ described in ~~IAS 31~~ IFRS X. On loss of significant influence, the investor shall measure at fair value any investment the investor retains in the former associate, except when it continues to use the equity method. …[1]

19A Except when an investor continues to use the equity method, if an investor loses significant influence over an associate, the investor shall recognise all amounts recognised in other comprehensive income in relation to that associate on the same basis ~~that~~ as would be required if the associate had directly disposed of the related assets or liabilities. …[1]

37 The following disclosures shall be made:

(a) the fair value of investments in associates for which there are published price quotations~~;~~.

(aa) a list and description of investments in significant associates and the proportion of ownership held.

(b) summarised financial information of associates, including the ~~aggregated amounts of~~ investor's interest in the amount of each of current assets, non-current assets, current liabilities, non-current

[1] Paragraphs 18 and 19A of IAS 28 included herewith anticipate the changes made to those paragraphs as consequential amendments by IAS 27 (as amended in 2007).

liabilities, revenues and profit or loss. This disclosure is presented in total for all associates~~;~~.

(c) the reasons why the presumption that an investor does not have significant influence is overcome if the investor holds, directly or indirectly through subsidiaries, less than 20 per cent of the voting or potential voting power of the investee but concludes that it has significant influence~~;~~.

(d) the reasons why the presumption that an investor has significant influence is overcome if the investor holds, directly or indirectly through subsidiaries, 20 per cent or more of the voting or potential voting power of the investee but concludes that it does not have significant influence~~;~~.

(e) the end of the reporting period of the financial statements of an associate, when such financial statements are used in applying the equity method and are as of a date or for a period that is different from that of the investor, and the reason for using a different date or different period~~;~~.

(f) the nature and extent of any significant restrictions (eg resulting from borrowing arrangements or regulatory requirements) on the ability of associates to transfer funds to the investor in the form of cash dividends, or repayment of loans or advances~~;~~.

(g) the unrecognised share of losses of an associate, both for the period and cumulatively, if an investor has discontinued recognition of its share of losses of an associate~~;~~.

~~(h) the fact that an associate is not accounted for using the equity method in accordance with paragraph 13; and~~

~~(i) summarised financial information of associates, either individually or in groups, that are not accounted for using the equity method, including the amounts of total assets, total liabilities, revenues and profit or loss.~~

C9 In IAS 32 *Financial Instruments: Presentation*, paragraph 4 is amended as follows.

4 This Standard shall be applied by all entities to all types of financial instruments except:

(a) those interests in subsidiaries, associates and joint ventures that are accounted for in accordance with IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates* or ~~IAS 31 *Interests in Joint Ventures*~~ IFRS X *Joint Arrangements*. However, in some cases, IAS 27, IAS 28 or ~~IAS 31~~ IFRS X permits an entity to account for an interest in a subsidiary, associate or joint venture using IAS 39; in those cases, entities shall apply the ~~disclosure requirements in IAS 27, IAS 28 or IAS 31 in addition to those in~~ requirements of this Standard. Entities shall also apply this Standard to all derivatives linked to interests in subsidiaries, associates or joint ventures. …

C10 In IAS 39 *Financial Instruments: Recognition and Measurement*, paragraph AG3 of the Application Guidance is amended as follows.

AG3 Sometimes, an entity makes what it views as a 'strategic investment' in equity instruments issued by another entity, with the intention of establishing or maintaining a long-term operating relationship with the entity in which the investment is made. The investor entity uses IAS 28 or IFRS X to determine whether the equity method of accounting is appropriate for such an investment. ~~Similarly, the investor entity uses IAS 31 to determine whether proportionate consolidation or the equity method is appropriate for such an investment.~~ If ~~neither~~ the equity method ~~nor proportionate consolidation~~ is not appropriate, the entity ~~applies~~ designates the strategic investment as at fair value through profit or loss or classifies it as held for trading, and accounts for it in accordance with this Standard ~~to that strategic investment~~.

DRAFT

Approval of ED 9 by the Board

The exposure draft ED 9 *Joint Arrangements* was approved for publication by eleven of the thirteen members of the International Accounting Standards Board. Mr Cooper and Dr Zhang abstained in view of their recent appointment to the Board.

Sir David Tweedie	Chairman
Thomas E Jones	Vice-Chairman
Mary E Barth	
Stephen Cooper	
Philippe Danjou	
Jan Engström	
Robert P Garnett	
Gilbert Gélard	
James J Leisenring	
Warren J McGregor	
John T Smith	
Tatsumi Yamada	
Wei-Guo Zhang	

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the draft IFRS.

INTRODUCTION

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in ED 9 *Joint Arrangements*. Individual Board members gave greater weight to some factors than to others.

BC2 ED 9 results from the Board's Short-term Convergence project. The project is being conducted jointly with the United States standard-setter, the Financial Accounting Standards Board (FASB). The project was added to the Board's agenda to reduce differences between IFRSs and US generally accepted accounting principles (GAAP) that are capable of resolution in a relatively short time and can be addressed outside of major projects.

BC3 This part of the Short-term Convergence project relating to joint arrangements was undertaken by the Board. The proposals were not deliberated by the FASB. The objective of the project is to improve financial reporting for those activities within the scope of IAS 31 *Interests in Joint Ventures*. The proposals in the exposure draft are concerned principally with remedying two aspects of IAS 31 that the Board considers to be an impediment to high quality reporting of joint arrangements—namely, that the form of the arrangement is the primary determinant of the accounting and that an entity has a choice of accounting treatment for interests in jointly controlled entities.

BC4 The Board did not reconsider all of the requirements in IAS 31. For example, the Board did not reconsider the equity method, nor did it reconsider the scope exclusion for venture capital organisations, mutual funds, unit trusts and similar entities. Accordingly, this Basis for Conclusions does not discuss requirements of IAS 31 that the Board did not reconsider. When the Board develops its Basis for Conclusions on the IFRS arising from this exposure draft, it intends to include relevant paragraphs from the Basis for Conclusions on IAS 31.

THE PROBLEMS WITH IAS 31

BC5 The two main concerns that the Board is addressing in the exposure draft are to change from treating the form of the arrangement as the most significant factor in determining the accounting, and to eliminate the choice of accounting that IAS 31 offers.

BC6 Accounting for interests in joint arrangements in accordance with IAS 31 follows the form of an arrangement (ie the accounting can differ depending on whether a legal entity is established). The Board acknowledges that the form of an arrangement affects the rights and responsibilities of an entity. For example, an entity might transfer an asset that it owns into an entity that it controls with the effect that the owner has limited its liability in relation to that asset by using a legal structure. Equally, however, an owner could reverse the effects of that legal structure through guarantees or indemnities.

BC7 IAS 31 permits a choice of using the equity method or proportionate consolidation to account for interests in jointly controlled entities. The Board has indicated that it will exclude options of accounting treatment from accounting standards when possible. Such options can lead to similar transactions being accounted for in different ways and, therefore, impair comparability.

The problem

BC8 The accounting requirements of IAS 31 can lead to the recognition of assets that are not controlled and liabilities that are not obligations. When a party to an arrangement has joint control of an entity, it shares control of the activities of the entity. It does not, however, control each asset nor does it have a present obligation for each liability of the jointly controlled entity. Rather, each party has control over its investment in the entity. If the party uses proportionate consolidation to account for its interest in a jointly controlled entity, it recognises as assets and liabilities a proportion of items that it does not control or for which it has no obligation. These supposed assets and liabilities do not meet the definition of assets and liabilities in the *Framework*. The *Framework* (paragraph 49) defines an asset as 'a resource controlled by the entity…' and a liability as 'a present obligation of the entity…'. Consequently, the amounts recognised are not a faithful representation of the entity's assets and liabilities.

BC9 The Board concluded that proportionate consolidation is not an appropriate method of accounting for jointly controlled entities. Recognising a proportionate share of each asset and liability of an entity is not consistent with the *Framework*, which defines assets in terms of exclusive control and liabilities in terms of present obligations. It leads to the recognition of amounts that do not represent faithfully an entity's assets and liabilities. For example, it could lead to a venturer recognising cash balances that it does not have the ability to direct or deploy, and from which it cannot obtain benefit, without consultation with other parties. Proportionate consolidation might generate information similar to recognising contractual rights and obligations, but that is by coincidence rather than by design.

BC10 In addition, IAS 31 can lead to an entity not recognising its assets and liabilities. When a jointly controlled entity is similar in substance to jointly controlled operations or jointly controlled assets, a party controls assets and has obligations relating to the activities of the joint arrangement. These assets and liabilities should be recognised in the party's financial statements. However, if the party accounts for such jointly controlled entities using the equity method (because IAS 31 emphasises the form of the arrangement), the party does not recognise the assets that it controls and its liabilities.

BC11 Therefore, the Board also concluded that recognising a net interest in a joint arrangement (for example, when using the equity method) is not appropriate when the parties have contractual rights and obligations relating to individual assets and liabilities of the joint arrangement.

BC12 Some argue that proportionate consolidation is a practical way to present a venturer's interest in a joint venture, particularly when the activities of the venture are an integral part of the venturer's operations. Despite its conceptual flaws, their view is that proportionate consolidation better meets the information needs of users of financial statements by providing a better representation of the performance of an entity's management and an improved basis for predicting future cash flows. The Board noted these arguments but concluded that the practical argument does not refute the fundamental inconsistency with the *Framework*. The Board believes that it is misleading for users of financial statements if an entity recognises as assets items that are not controlled, and as liabilities items that are not present obligations, and presents these together with items that it controls or items that are present obligations.

BC13 The Board's view is that the enhanced disclosure requirements of the proposed IFRS would provide better information about the assets and liabilities of a joint venture than is provided by using proportionate consolidation. An entity presents, in its statement of financial position, a proportion of each asset and liability of jointly controlled entities when using proportionate consolidation. However, it is not possible to distinguish which assets the entity controls from those that the entity has the ability to direct and deploy only on agreement by other parties. The exposure draft proposes the disclosure of summarised financial information for all individually material joint ventures to help meet the needs of users of financial statements.

BC14 The Board also considered the views of some who point out that joint control and significant influence are different. They argue that it is inappropriate to account for an associate and a joint venture in the same way, using the equity method. Although the Board acknowledges that significant influence and joint control are different, the equity method has been used to account for joint ventures in jurisdictions around the world for many years. The consideration of the equity method, and any alternative to it, is outside the scope of this short-term project.

The proposals

BC15 The Board therefore proposes to eliminate proportionate consolidation. The Board proposes that a party to a joint arrangement should recognise its contractual rights and obligations arising from the arrangement. In meeting this principle, the descriptors of joint arrangements in IAS 31 require change so that the focus of the IFRS is not on the form of an arrangement.

BC16 The Board proposes to use 'joint arrangement', rather than 'joint venture', to describe joint activities subject to the requirements of the IFRS. The Board also proposes that 'jointly controlled operations' and 'jointly controlled assets' should be described as 'joint operations' and 'joint assets'. The exposure draft retains 'joint venture' to describe joint arrangements that are subject to joint control and in which the parties have an interest only in a share of the outcome of the economic activities.

BC17 The proposed definition of a joint arrangement requires shared decision-making by all of the parties to the arrangement, rather than joint control. The Board is proposing this change because control is defined in IAS 27 *Consolidated and Separate Financial Statements* in the context of having power over financial and operating policies of an entity. This definition of control does not translate well to an asset or operation. Joint control is retained for a joint venture. It is an appropriate description of arrangements in which there is a separate business or economic activity over which the parties to the arrangement share the power to govern the financial and operating policies of the arrangement. Venturers do not often establish financial and operating policies for a joint operation or joint asset arrangement.

BC18 The definition of an asset in the *Framework* requires an entity to control it—'an asset is a resource controlled by an entity' (paragraph 49). Therefore, an entity can recognise only assets that it controls. If an entity shares an asset, it recognises only those rights to the asset that it controls. Similarly, if an entity shares an obligation, it recognises only that portion of the obligation that it currently has.

THE LOSS OF JOINT CONTROL

BC19 If an investor loses joint control but retains significant influence, the Board's proposals mean that the investor accounts for its investment using the equity method both before and after the loss of joint control. The Board proposes, for practical reasons, that in such circumstances an investor should not measure at fair value the investment it retains on the loss of joint control. The Board will readdress this proposal at such time as it reconsiders the use of the equity method.

SIC-13 INCORPORATED INTO THE DRAFT IFRS

BC20 The Board has a policy of incorporating into a IFRS the consensus of any interpretation that is capable of incorporation within a single standard. Guidance on a topic is easier to find and use if it is located in one pronouncement. In accordance with this policy, the Board proposes to incorporate into the IFRS the consensus of SIC-13 *Jointly Controlled Entities—Non-Monetary Contributions by Venturers*.

BC21 The consensus of SIC-13 regarding non-monetary contributions made by a venturer to a joint venture is consistent with the requirements in paragraph 22 of IAS 28 *Investments in Associates* regarding upstream and downstream transactions with associates. The Board has incorporated the consensus of SIC-13 by referring to the requirements of IAS 28.

DISCLOSURE

BC22 The Board understands that users of financial statements would find it useful to have information about the nature and extent of an entity's operations conducted through joint arrangements. The Board, therefore, proposes to require an entity to disclose such information.

BC23 The Board also proposes to align the disclosures required by the IFRS regarding interests in joint ventures with the disclosure requirements in IAS 28 for investments in associates. Both associates and joint ventures are investments that an entity does not control but for which it has the power to influence strategic decisions. Both are recognised using the equity method and the additional disclosures proposed relate mainly to the application of the equity method. The Board's view, therefore, is that the disclosure requirements of interests in joint ventures should be aligned with those required by IAS 28 for investments in associates in order to meet the needs of users of financial statements.

ASSESSMENT OF NET BENEFITS

BC24 The proposals are intended to benefit financial reporting in three ways. First, an entity would be required to recognise only those assets that it controls and only those liabilities that are present obligations. Second, the removal of an optional accounting treatment would improve comparability. Third, the proposals would achieve convergence in principle with US GAAP, which generally requires the use of the equity method to account for jointly controlled entities. The Board believes that these benefits would exceed any costs of implementation.

[Draft] IFRS X *Joint Arrangements*
Illustrative Examples

Contents

Illustrative Examples

This [draft] guidance accompanies, but is not part of, the [draft] IFRS.

Introduction

IE1 A party determines the type of joint arrangement on the basis of its rights and obligations that arise from the contractual arrangement. A joint operation or joint asset arrangement involves a party having contractual rights and obligations for individual assets and liabilities. A joint venture involves the parties having rights to a share of the outcome generated by the economic activities of the venture (paragraph 5).

IE2 Examples 1-6 illustrate the application of the requirements of the [draft] IFRS to arrangements in which parties have interests in joint operations, joint assets and joint ventures. Example 7 provides illustrative disclosures of joint arrangements.

Example 1—Joint construction operations

IE3 Companies A and B form a company, C, to tender for a public contract with a government to construct a motorway between two cities. A and B have joint control of the activities of C.

IE4 A will construct three bridges needed to cross rivers on the route; B will construct all of the other elements of the motorway. A and B will each use their own equipment and employees in the construction activity.

IE5 C enters into a contract with the government for delivery of the motorway. It also enters into a contract with A and B for performance of the government contract. A and B will invoice C for their respective shares of the total amount invoiced by C to the government.

Analysis

IE6 The arrangement is a joint operation, formed to facilitate bidding for a contract that the parties could not bid for individually. A and B have retained control of the assets they use to perform the contract requirements and are responsible for their respective liabilities. They meet their respective contractual obligations by providing services to C.

IE7 A and B recognise in their financial statements their own property, plant and equipment and operating assets and their share of any liabilities resulting from the joint arrangement (such as performance guarantees). They also recognise the income and expenses associated with providing construction services to C.

IE8 A and B also have an interest in C, which is recognised using the equity method. It is likely that their interests in C would be close to zero because C does not have any activities other than the contract with the government and the service agreements with A and B.

Example 2 – Joint interest in a jet aircraft

IE9 Five advertising companies (the parties) jointly buy a jet aircraft. They enter into an agreement whereby each party has the right to use the aircraft for its own purposes some days each year. The parties may decide to use that right, or, for example, lease it to a third party. The parties share decision-making regarding maintenance and disposal of the aircraft. The decisions require the agreement of all of the parties.

IE10 Each party is able to sell its interest to a third party, with the approval of the other parties. The agreement covers the expected life of the aircraft and can be changed only if all of the parties agree.

Analysis

IE11 The arrangement involves a joint asset. The joint arrangement is a way to share the costs of having access to an aircraft. Each party has a unilateral right to use the jet aircraft for its own purposes some days each year, and would also have rights to its share of any residual value of the aircraft. It is those rights that the parties control and would recognise in accordance with applicable IFRSs.

Variation - the asset is transferred to an entity

IE12 Continuing the example, suppose the parties set up a company to purchase the jet aircraft. They continue to have an operating agreement that gives them the same rights to the aircraft as in the original example, ie the same rights of use. The operating agreement also includes the same disposal powers as in the original example.

IE13 The aircraft is purchased in the name of the company, financed by cash contributions made by the parties. Any strategic operating and financing decisions made by the company require the agreement of all shareholders.

IE14 A party can sell its interest in the aircraft by selling its shares in the company. The same restrictions on sale exist as in the original example (ie that all of the parties must approve the sale). Any new shareholder becomes a party to the operating agreement.

Analysis

IE15 The modification to the example should have little effect on the accounting by the five advertising companies. The operating agreement ensures that the parties each have the same rights of use as in the original example. Each party would recognise its rights to the jet aircraft.

IE16 What is different is that the parties also have an interest in the company. The company has legal ownership of the aircraft, and rights to the residual value of the aircraft. However, the rights of use have been transferred to the parties. The company structure might affect the responsibilities of the parties, by providing a liability shield. Each party would recognise its interest in the company using the equity method (ie the company is a joint venture). The aircraft asset recognised by the company will have been affected by the contractual allocation of rights of use to the parties. In other words, the company would recognise an aircraft asset that excludes the rights of use transferred to the parties. The result should be that there is no double-counting of the aircraft.

Example 3 – Jointly held office building

IE17 Three companies (the venturers) jointly buy a 15-floor office building. Each floor in the building has a separate legal title, which allows a floor to be sold separately. Each venturer takes title (ownership) of five of the floors, one of which it uses for its own purposes. Each has a right to use that one floor for whatever purpose it chooses.

IE18 The venturers set up a company and each transfers its ownership of four floors of the building to the company. The 12 floors are rented to third parties. The company employs a management team to manage the rental business.

IE19 The company is controlled jointly by the venturers. The venturers are not liable for any costs of the company.

Analysis

IE20 The venturers each have a direct interest in one floor and an interest in the company.

IE21 The company is a joint venture. It operates as a separate business. The venturers have an interest in the profit generated by the operations of the company. They do not have a present obligation for costs nor do they have rights to the individual assets of the venture. They each have exchanged their rights to four floors of the building for an interest in the company.

IE22 Each partner recognises its interest in one floor. Each also recognises its investment in the joint venture, using the equity method.

IE23 The joint venture itself (the company) would recognise all of the remaining assets and liabilities of the joint arrangement, including the building (12 floors), furniture, rent receivables, and operating liabilities.

First variation – right of use through a lease

IE24 Suppose that the venturers set up the company to purchase all 15 floors. Financing for the acquisition of the building is arranged in the name of the company, secured by the building.

IE25 Each venturer leases one floor from the company. Each has the right to use that floor for its own purposes or to sublease it independently to third parties. The lease term is for all of the expected useful life of the building.

IE26 The company rents the remaining 12 floors to third parties and employs a management team as detailed in paragraph IE18. The venturers jointly control the company.

Analysis

IE27 The venturers each have a direct interest in one floor and an interest in the company (an interest in a joint venture).

IE28 The change in the fact pattern (the venturers owned the three floors in the original example, whereas the company owns the three floors in this variation) does not change the venturers' rights to use or sublease those three floors. In both situations, the venturers have a contractual right to use or sublease one floor.

IE29 Each venturer recognises its interest in one floor in accordance with applicable IFRSs, ie IAS 17 *Leases*.

IE30 The venturers also recognise their interest in the company using the equity method.

Second variation – only one venturer has use of some floors

IE31 Suppose that rather than all three venturers each having a right to use a floor, only one of them, company B, has that right (either through direct ownership or by way of a lease). Company B has use of three of the floors for its own purposes, and the remaining 12 floors are rented to third parties by the company set up by the venturers.

Analysis

IE32 The change in the fact pattern does not change the nature of the joint arrangement, but the interests of the individual venturers are affected. In this case company B has an interest in three floors of the building that it recognises in accordance with applicable IFRSs. Company B also recognises its investment in the joint venture using the equity method.

IE33 The other two venturers recognise their interest in the company using the equity method.

Example 4 – Jointly owned shopping centre

IE34 Two real estate companies (the parties) jointly buy the land and buildings that constitute a shopping centre. The parties have separately financed their share of the shopping centre acquisition.

IE35 They set up a limited partnership for the purpose of operating the shopping centre business and transfer their ownership of the shopping centre to the partnership. The activities of the shopping centre business include renting the retail units, managing the car park, maintaining the centre and equipment such as lifts, and building the reputations and customer numbers for the centre as a whole. Strategic decisions relating to the operations require the consent of both parties.

IE36 The terms of the limited partnership are such that each party receives a share of the income from the shopping centre (which is the rental income net of the operating costs). The parties have the right to sell or pledge their interest in the partnership.

Analysis

IE37 The partnership is a joint venture. The parties have given up their interest in the shopping centre and exchanged it for an interest in the partnership. The partnership operates as a separate business, generating profit from the shopping centre. The parties cannot sell, pledge or otherwise access directly their share of the shopping centre. They do not have contractual rights to the shopping centre, but have an interest in the partnership.

IE38 The parties recognise their interest in the partnership using the equity method.

Example 5 – Mining unitisation arrangement

IE39 Four entities (the parties) each have rights to extract minerals from adjacent areas. The entities have financed their respective acquisitions. The parties enter into a contract to explore, develop and extract minerals from the combined area (the field). Each entity retains its legal ownership of the extractive rights for its defined area.

IE40 The contract is for the economic extraction life of the defined area. The participation percentage of each party is based on the mineral reserves expected to be extracted from that party’s acreage held and contributed to the geological area. The respective participation percentages are subsequently adjusted on the basis of the findings of an independent survey of the reserves. The parties receive output from the joint arrangement in the form of minerals that each can then hold, use or sell at its own discretion.

IE41 One party has been designated as the operator. The parties establish a five-year strategic plan, which is updated annually on approval of all of the parties. The operator acquires equipment and allocates employees to the joint activities according to the strategic plan. The operator invoices the other parties for their share of expenses and capital expenditure based on their respective participations. The terms of the arrangement are such that each party is contractually responsible for a share of all costs and therefore each party has rights to a share of any assets purchased for the joint activities. Parties have joint and several liability for obligations such as decommissioning and environmental clean-up.

Analysis

IE42 The joint arrangement involves joint assets. It is set up for the purposes of sharing costs. The arrangement is an extension of each party’s operating activities to produce and sell minerals. The exploration activity represents a major input to the parties’ businesses but is not itself a business.

IE43 The parties retain their right to the economic benefits generated from the mineral rights—the benefits (usually received in the form of minerals) are directly related to the amount of mineral reserves contributed by each party to the arrangement. The parties have joint and several liability for obligations such as decommissioning, and also have obligations to reimburse their share of the costs incurred by the operator.

IE44 Each party has rights to its share of the joint production equipment and other resources by directing the use of the equipment for the extraction of minerals. That share of the equipment and resources is equivalent to each party’s mineral rights as a proportion of the total mineral rights of the field. Put another way, each party receives benefits from the assets in proportion to that party’s mineral rights relative to the mineral rights of the combined field.

IE45 The 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. The operator recognises receivables from the other parties (representing the other parties’ share of expenses and capital expenditure borne by the operator). The non-operator parties recognise payables to the operator.

First variation – the parties share costs and risks

IE46 Suppose that rather than the participation percentage of each party being based on the mineral reserves expected to be extracted from that party's acreage held, all parties participate equally in the costs of and benefits obtained by the arrangement (that is, the participation percentages of the parties are not adjusted). The parties agree to share equally the risks that one of the areas contributed to the arrangement does not have economically viable reserves.

Analysis

IE47 The joint arrangement involves joint assets. The change in the fact pattern (the parties share costs and risks) does not change the type of arrangement. However, the joint asset in which the parties have an interest has changed. Each party has exchanged its mineral rights in one area for a percentage of the mineral rights in the combined area (the field). This exchange of assets does not mean that each party does not have an interest in a joint asset. Rather, each party has given up its sole right to minerals found in one area in exchange for a right to a share of minerals found in the field.

IE48 The parties' contractual rights to the joint production equipment and contractual obligations are similar to those in the main example in paragraphs IE39-IE45. Each party is directly responsible for its share of the operating costs, including decommissioning and environmental obligations. Each party has rights to a share of the benefits obtained from the production equipment equal to its percentage interest in the mineral rights of the field.

Second variation – the parties share costs and risks and outsource the exploration activities to a company

IE49 Continuing the first variation, suppose that the parties decide to set up a company to carry on the exploration, development and extraction activities. They become shareholders in the company; their percentage shareholdings are equal to their percentage interest in the combined field. As shareholders, they each have a seat on the board that determines the operating and financing policies of the company.

IE50 The parties retain their ownership interest in the mineral rights. The company purchases the production equipment and employs a team to operate that equipment to explore and extract minerals from the field. On an ongoing basis, the company invoices the parties for their share of the exploration, development and extraction costs.

IE51 The parties each have rights to receive their share of any minerals extracted from the field.

Analysis

IE52 The parties have an interest in a joint asset (the mineral rights in the field) and an interest in a joint venture (the company).

IE53 The change in the fact pattern means that the parties have outsourced the exploration and extraction activities to a company that they own and control jointly. The parties' rights and obligations have changed. The parties no longer have a direct interest in the production assets used in the activities, nor are they directly obliged to pay for costs of the company.

IE54 The parties recognise the exploration costs invoiced by the company (these costs might be capitalised by the parties in accordance with IFRS 6 *Exploration for and Evaluation of Mineral Resources*). They also recognise their interest in the company using the equity method. The parties retain their rights to extract minerals from the combined field, and each party recognises its percentage share of the mineral rights of the field. The parties own and recognise as an asset the minerals extracted from the field.

Example 6 – Oil and gas 'farm-in' arrangement

IE55 An oil and gas company (B) has rights to carry on exploration activities in one field, and digs two exploration wells. The company enters into an agreement with two other oil and gas companies (C and D) to share the costs and risks associated with the exploration activities. C and D each contribute CU2 million and in return receive a 25 per cent working interest in the exploration field. All future costs of the exploration activities are shared 50:25:25 by the three parties to the arrangement, with B being contractually responsible for 50 per cent of the total costs. B is appointed as the operator. It purchases equipment, recruits employees and manages the exploration activities in accordance with the agreement, approved annually by the three parties.

Analysis

IE56 The arrangement involves joint assets. It is a cost-sharing and risk-sharing arrangement whereby B sells an interest in exploration assets and C and D buy an interest in exploration assets.

IE57 As in example 5, the parties are contractually obliged to pay for their share of the operating costs. They have contractual rights to a percentage of the exploration field including the exploration equipment that is constructed on the field.

IE58 C and D recognise their interest in the exploration assets and operating costs, and any financing of the operations. C and D would also recognise payables to B for their share of costs incurred and not yet paid.

IE59 At the time of the agreement, B recognises a gain or loss on disposal of exploration assets in accordance with applicable IFRSs. Thereafter, B recognises its ongoing 50 per cent interest in the assets and operating costs. B also recognises receivables from C and D for their share of costs incurred and not yet reimbursed.

Variation – exploration, development and extraction

IE60 Continuing the example, suppose that in addition to exploration, the arrangement also relates to development and extraction of any oil and gas found in the field. The terms of the agreement are similar to those noted above—the parties receive a 50:25:25 interest in the exploration assets and also a proportionate share of any oil and gas extracted from the field. The parties are also responsible for their share of all costs.

Analysis

IE61 The arrangement involves joint assets. The change in fact pattern (by extending the arrangement to include development and extraction) does not change the nature of the interests that the parties have in the assets and liabilities of the arrangement (although the assets and liabilities themselves may change as the operations move to the development and extraction phase).

Example 7 – Illustrative disclosures of joint arrangements

Joint Arrangements—joint operations and joint ventures

IE62 Construct plc (the Company) participates in joint operation and joint venture arrangements. The Company has several construction joint operations. The largest of those is a joint operation with Build plc for the construction of the Olympic underground line in London, including three new underground stations. The Company is responsible for the construction of the stations. The arrangement commenced in March 2007, and is due for completion in 2011. The arrangement is expected to generate revenue of CU220 million for the Company in the period to 2011. *[paragraph 36 of IFRS X]*

IE63 The Company also has a joint venture, Bridge Limited, with two other parties, in which it has a 33 per cent interest. Bridge Limited's main activity is the construction of bridges spanning motorways. *[paragraph 36]* The Company has advanced funds of CU5 million to Bridge Limited which, according to a bank covenant, will be repaid to the Company after settlement of all other obligations of Bridge Limited. *[paragraph 39(d)]* The Company has agreed to advance a further CU2 million to Bridge Limited over the next two years. *[paragraph 37(a)]*

IE64 The assets and liabilities of Bridge Limited are as follows.

	CU'000		CU'000
Non-current assets	30,000	Revenue	8,000
Current assets	6,000	Profit	2,700
Total assets	36,000		
Non-current liabilities	24,500		
Current liabilities	5,500		
Total liabilities	30,000		
Equity	6,000		

The Company's net interest in the joint venture is CU2,000. The Company's share of profit is CU900. *[paragraph 39(b)]*

Joint Arrangements—joint assets

IE65 Drill Co (the Company) conducts all of its exploration activities through joint asset arrangements. Two of those arrangements are significant. The first is an arrangement with X Co and Y Co to explore and develop oil and gas fields in Kicking Horse Canyon, an area of 30,000 acres east of Hot Springs. Exploration work commenced in 2007. *[paragraph 36]* The Company will provide funding of CU4 million to the joint asset arrangement over the next five years. *[paragraph 37(a)]*

IE66 The second arrangement with Z Co is to explore and develop a gas field in Propane Valley. The Company acts as the operator. Two wells drilled during the year identified gas reserves in the field. *[paragraph 36]* The Company has agreed to drill a further four wells over the next two years at a cost of CU6 million. *[paragraph 37(a)]*

Appendix
Amendments to Guidance on other IFRSs

This [draft] appendix contains amendments to guidance on other IFRSs that are necessary in order to ensure consistency with [draft] IFRS X. In the amended paragraphs, new text is underlined and deleted text is struck through.

IGA1 In Guidance on Implementing International Financial Reporting Standards (including International Accounting Standards and Interpretations), the following references are amended as described below.

- 'IAS 31 *Interests in Joint Ventures*' is amended to 'IFRS X *Joint Arrangements*'.
- 'IAS 31' is amended to 'IFRS X'.

IGA2 In the Guidance on Implementing IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates* and IFRS X *Joint Arrangements*, paragraphs IG2 and IG7 are amended as follows.

IG2 Paragraph 4 of IAS 27 defines control as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Paragraph 2 of IAS 28 defines significant influence as the power to participate in the financial and operating policy decisions of the investee but not to control those policies. ~~Paragraph 3 of IAS 31~~ Appendix A of IFRS X defines joint control as the contractually agreed sharing of ~~control over an economic activity~~ the power to govern the financial and operating policies of a venture so as to obtain benefits from its activities. …

IG7 IAS 39 *Financial Instruments: Recognition and Measurement* does not apply to interests in subsidiaries, associates and ~~jointly controlled entities~~ joint ventures that are consolidated~~,~~ or accounted for using the equity method ~~or proportionately consolidated~~ in accordance with IAS 27, IAS 28 and ~~IAS 31~~ IFRS X respectively. …

Table of Concordance

This table shows how the contents of IAS 31 and ED 9 correspond. Paragraphs are treated as corresponding if they address similar matters even though the guidance may differ.

IAS 31 paragraph	ED 9 paragraph	IAS 31 paragraph	ED 9 paragraph
1	2	41	28
2	23	42	33
3	Appendix A	43	34
4	None	44	None
5	Appendix A	45	29, 30
6	24	45A	31
7	3	45B	32
8, 9	None	46	35
10	7	47	None
11, 12	None	48-50	27
13	8	51	29
14	10	52, 53	None
15	21	54	38
16, 17	None	55	37
18	11	56	39(a), (b)
19, 20	None	57	None
21	22	58	42
22, 23	None	59	43, 44
24	None	None	1
25	15, 17	None	4-6
26	19	None	9
27, 28	None	None	12-14
29	20	None	16, 18
30-37	None	None	26
38	23	None	36
39	25	None	39(c)-(e)
40	None	None	40, 41

30 Cannon Street, London EC4M 6XH, England
Phone: +44 (0)20 7246 6410, Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: http://www.iasb.org

International Accounting Standards Board

This document is provided as a convenience to observers at the World Standard Setters meeting, to assist them in following the discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

Note: These notes are based on the staff papers prepared for the World Standard Setters meeting. Paragraph numbers correspond to the paragraph numbers in the staff papers.

INFORMATION FOR OBSERVERS
WORLD STANDARD SETTERS MEETING, SEPTEMBER 2007, LONDON

Round-Table Discussion: The Reporting Entity and Consolidations Part 3—Consolidation

Introduction

1. This paper is structured as follows:

   a. Section 1 summarises the objectives of the Consolidation project and the Board's tentative decisions to date (paragraphs 2 to 15).

   b. Section 2 explains one aspect of the project that has proved difficult for the Board and staff—investment companies (paragraphs 17 to 30). Paragraphs 29 to 30 ask for your views on the approach the Board should take to investment companies in the discussion paper on consolidation.

Section 1: The Consolidation project and tentative decisions to date

The project

2. The goal of the Consolidation project is to publish a single IFRS on consolidation to replace IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities* such that the control criteria within a single IFRS should be developed for all entities.

3. The next milestone in this project is to issue a discussion paper on consolidation. The discussion paper will address the control criteria and principles. The Board expects to publish the discussion paper in the first quarter of 2008.

4. The Board has been developing the project with the following principles in mind:

    a. Consolidation should be driven by the principle of reporting a parent and its subsidiaries as if it were a single economic entity.

    b. Identifying whether an entity is a subsidiary should be based on the notion of control, ie an entity's control of another entity should be used as a proxy for identifying the assets controlled by the first entity. Thus the concept is linked to access to economic benefits, and associated exposure to risks.

    c. Only one entity can control another entity. In other words, control must be unilateral or non-shared.

    d. There should be no exemption from consolidation because a subsidiary's operations are dissimilar to that of its controller's or because an entity adopts measurement models different to those of the controller.

    e. Consistent control criteria and a single comprehensive IFRS (to replace IAS 27 and SIC-12) should be developed for all entities, including SPEs.

Tentative decisions to date

The definition of control

5. The Board has tentatively decided that a parent entity has a controlling interest in another entity when it has exclusive rights over that entity's assets and liabilities which give it access to the benefits of those assets and liabilities and the ability to increase, maintain or protect the amount of those benefits. Therefore, to control an entity the potential controller must satisfy three tests:

    a. it must have the ability to direct the strategic financing and operating policies of the entity (the 'Power Criterion');

    b. it must have the ability to access the benefits flowing from the entity (the 'Benefits Criterion'); and

c. it must be able to use its Power so as to increase, maintain or protect the amount of those benefits.

Power with less than a majority of the voting rights

6. IAS 27 clearly contemplates that there are circumstances in which one entity can control another entity without owning more than half the voting power. During its deliberations, the Board has confirmed its view that an entity holding a minority interest can control another entity in the absence of any formal arrangements that would give it a majority of the voting rights. For example, control is achievable if the balance of holdings is dispersed and the other shareholders have not organised their interests in such a way that they exercise more votes than the minority holder. This is sometimes referred to as 'de facto control'.

7. During those deliberations, the Board has made it clear that, in its view, the control concept in IAS 27 includes de facto control. The Board accepts that it would have been helpful if IAS 27 had included guidance to assist preparers in exercising the judgement to apply the control concept. Any proposals to replace IAS 27 would include guidance on de facto control.

Potential voting rights (options over an entity)

8. The Board tentatively decided that when an option holder holds sufficient options that, if exercised, would place it in control of another entity, that is not sufficient, in itself, to establish that the option holder meets the Power criterion. However, there might be situations in which the holding of options, taken in conjunction with other facts and circumstances, indicate that the option holder currently has power over the entity.

9. The Board has also tentatively concluded that whether or not exercise of potential voting rights is economically favourable to the holder of those rights is not relevant to the assessment of whether the Power criterion is satisfied.

Veto rights

10. Parties such as minority shareholders or lenders may have the right to veto decisions or their consent may be a prerequisite to some decisions. The Board has tentatively concluded that veto rights, even if limited to the ability to block actions, may negate control if those rights relate to operating and financing policies. To negate control those veto rights must also relate to decisions in the ordinary course of business—rather than being limited to fundamental changes in the organisation (such as disposals of business units or acquisitions of significant assets).

11. The Board has also tentatively concluded that veto rights may in some circumstances be sufficient to enable holders to exercise control.

Parties acting as agent for another party (de facto agents or ‘strawmen’)

12. The Board has tentatively concluded that the holdings of interests of parties effectively acting as agent for another entity should be considered in assessing whether that other entity is a controller.

Applying the control concept to fiduciaries

13. The Board has tentatively decided that the proposals should clarify how the control concept should apply to fiduciaries by specifying those aspects of a fiduciary relationship that differentiate the particular circumstances of a fiduciary from those of a controller.[1]

Investment companies

14. The Board affirmed that investment companies (such as private equity entities and venture capital organisations) should not be excluded from the scope of the proposed standard. The Board concluded that the information needs of users are best served by financial statements that consolidate investments under the control of the reporting entity.

Temporary control

15. The Board has tentatively concluded that the fact that control of an entity might be temporary does not of itself change the assets controlled by an entity. During the time that control is held and until such time as control ceases, the controlled assets are part of the economic entity and should be recognised as such.

Section 2: Investment companies

The problem

16. US GAAP has a scope exception that excuses investment companies from the requirement to consolidate investment entities. During the Improvements Project, some respondents to the suggested improvements to IAS 27 stated that investment companies (such as venture capital organisations) should not be required to consolidate the investments they control in accordance with the requirements in IAS 27. The basis of the argument is that these entities manage their investments on a net basis and that presenting the underlying assets and liabilities is misleading and uninformative.

[1] A fiduciary relationship exists when one party (the fiduciary) is required to work for the benefit of one or more other parties to whom it owes fiduciary responsibilities under common law, equitable principles, contract, statute or regulation.

17. The Board rejected that argument. IAS 27 BC22 states:

> The Board concluded that for investments under the control of private equity entities, users' information needs are best served by financial statements in which those investments are consolidated, thus revealing the extent of the operations of the entities they control. The Board noted that a parent can either present information about the fair value of those investments in the notes to the consolidated financial statements or prepare separate financial statements in addition to its consolidated financial statements, presenting those investments at cost or at fair value. By contrast, the Board decided that information needs of users of financial statements would not be well served if those controlling investments were measured only at fair value. This would leave unreported the assets and liabilities of a controlled entity. It is conceivable that an investment in a large, highly geared subsidiary would have only a small fair value. Reporting that value alone would preclude a user from being able to assess the financial position, results and cash flows of the group.

Staff analysis of a scope exclusion

18. Some constituents, including many investment companies, believe that these investments should not be consolidated with the investment company. Instead, they suggest that the investments should be recognised as a net investment and measured at fair value.

19. Those who argue that the investments should not be consolidated appear to suggest that consolidation fails to reflect the intentions of the management of the investing company and that it fails to represent how the business is operated. Although those intentions are relevant and important to users, IFRSs do not normally state that the accounting should reflect the intentions of management. One of the more important roles of IFRSs is to enhance comparability between entities. This requires the development of objective principles for recognising and measuring economic activities.

20. In developing IFRSs, we assume that the contractual and economic arrangements entered into by a reporting entity are rational and reflect the intentions of management. The requirements in a standard are then based on accounting for what is observable, rather than management intentions.

21. In the case of consolidation, and the definition of control, if the application of the principles leads to accounting for investments that is less useful to users than would be achieved by applying some other accounting treatment then it might be that there are factors that the standard has missed. That is to say, it might not be a flaw in the concepts underpinning the standard, but a flaw in how those concepts are implemented.

22. In this case, however, we think that the concept of control is core to how an investment is characterised. If an investment entity is controlled by the investor then that entity is a subsidiary of the investor and, by definition, part of the group. Treating an investment as if it is not part of the group and excluding it from the consolidation model, such as what happens in the US, conflicts with this basic concept.

23. The Board and staff think that there is no basis for excluding the investment company from consolidation. We have, however, given some thought to the apparent conflict between reporting the assets and liabilities of the investee and the fact that many investment companies focus on the net investee.

A different way of thinking—the unit of account (or aggregation)

24. Once an entity meets the definition of a subsidiary it should be consolidated into the group financial statements. Consolidating the entities requires the elimination of transactions between that entity and the group. One of the disadvantages of exempting an entity from being consolidated is that the intra-group transactions and balances are not eliminated even though the parent entity has power over both sides of the transactions.

25. If there is any merit in thinking about presenting a venture capital organisation as a ‘net investment’, we think that this should be done from within the consolidated financial statements, after all intra-group eliminations have been made. Once those transactions have been eliminated the net activities could be aggregated into a net investment. This would establish as a unit of account, being the net assets and liabilities of the venture capital organisation (adjusted for intra-group transactions). That unit of account could then be measured at fair value, for example.

26. IFRSs already provide guidance about when it is appropriate to aggregate information. Traditionally, the basis for aggregating data is the relative homogeneity of the components. A simple example is property, plant and equipment, which is aggregated into classes. In the case of a venture capital organisation, a case would need to be made for aggregating the underlying assets or assets and liabilities of each venture capital investment on the grounds that they are managed as a net investment.

27. We think that there is no merit to exempting entities from consolidating other entities that they control. Rather, it is a matter of determining whether it is more beneficial to present information in a different way within the boundaries of the consolidated financial statements.

28. To summarise, the current staff thinking is that:

    a. there are no grounds for excluding from consolidation an investment company, given the emphasis on a control model;

    b. intra-group transactions and balances should be eliminated on consolidation; and

    c. if it is appropriate for the primary financial statements to present investment companies as a net investment, that decision should be based on principles of aggregation. That is to say, it might be appropriate for the assets and liabilities of an investment company to be viewed as a 'class' and presented as a net investment.

Questions for discussion

29. Do you believe that there are any grounds for excluding from consolidation an investment company that is controlled?

30. If you agree with the staff that an entity should consolidate all entities that it controls, what are your views on presenting an investment company as a net investment within the boundaries of the consolidated financial statements?