IASB Meeting | Agenda reference **11A**

Staff Paper | Date **Week beginning 15 March 2010**

Project **Joint Arrangements**

Topic **Transitional provisions**

1. This Agenda Paper discusses the transitional provisions to be included in the final standard on Joint Arrangements.

2. The changes that the new standard will introduce will mostly affect the accounting for existing jointly controlled entities (JCEs) that are currently accounted for under proportionate consolidation and that will, in accordance with the new standard, become *joint ventures* accounted for under the equity method. We think that fewer JCEs that are currently equity-accounted will be *joint operations* under the new standard.

3. In the case of JCEs that will have to transition their accounting from proportionate consolidation to the equity method, we propose to collapse, at their respective carrying values, all assets and liabilities that were previously proportionate consolidated into a single line item at the period in which the standard is applied and at the corresponding comparative periods presented. This proposal is explained in more detail in paragraphs 18-25 of this Agenda Paper and it applies to all existing JCEs on the date of transition.

4. In the case of JCEs that will have to transition from the equity method to the accounting for shares of assets and liabilities, we propose that the entity derecognises the investment and recognises its shares of the assets and liabilities in the joint operation at their corresponding carrying values at the date the standard is applied and at the corresponding comparative periods presented. The carrying values of the assets and liabilities recognised correspond to the fair values of the assets and liabilities of the joint operation at the date of the acquisition, adjusted for subsequent events such as depreciation, impairment,

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

etc. This proposal is explained in more detail in paragraphs 26-**Error! Reference source not found.** of this Agenda Paper and it applies to all existing JCEs on the date of transition.

5. Our recommendation is to require the transitional provisions summarised in paragraphs 3 and 4 and described in more detail in paragraphs 18-41 of this Agenda Paper at the beginning of the comparative period. The analysis performed in this paper supports this conclusion. Here are the main reasons for our recommendation:

   (a) Adjusting retrospectively some of the differences between proportionate consolidation and equity method could result in applying a high amount of hindsight. The exercise of changing the accounting method retrospectively for some of these arrangements might additionally become costly and complex. Please refer to Appendix 1 of this Agenda Paper;

   (b) We suggest applying the proposed transitional provisions at the beginning of the comparative period. We think that the benefits of presenting comparative information should outweigh any related costs, especially for those cases where the effect in the financial statements of accounting for arrangements using the equity method instead of proportionate consolidation is material.

6. This Agenda Paper is structured as follows:

   (a) Proposed transitional provisions in ED 9 *Joint Arrangements*

   (b) Subsequent analysis performed and staff's recommendations

   (c) Appendix 1 – This appendix analyses the complexities associated with requiring retrospective application of the requirements of the standard

Proposed transitional provisions in ED 9

7. ED 9 proposes retrospective application of the new standard, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Because of this, the exposure draft does not include transitional provisions.

Subsequent analysis performed by the staff

Different options: Fully retrospective application, Prospective for new arrangements only and Proposed transitional approach

Fully retrospective application

8. A few respondents to ED 9 expressed their concern about applying the resulting IFRS retrospectively, which would involve the reassessment of old transactions and circumstances accounted for under IAS 31 *Interests in Joint Ventures*. They felt that this would be extremely difficult, and would require undue cost and effort. These respondents proposed applying the resulting IFRS prospectively for new transactions and circumstances that were within the scope of the exposure draft. The respondents expressing this view were professional bodies from South Africa and Asia-Pacific and a preparer from the telecoms industry based in Europe.[1]

9. These views, however, contrast with those of some preparers that we have contacted in the last few weeks. We have learnt that a few preparers have already implemented retrospectively the accounting changes that the new standard will require to their current interests in JCEs.

10. We have been directly or indirectly[2] in contact with these preparers and listened to their experience of going through the exercise of adjusting retrospectively the accounting for their JCEs. In all cases we were informed that it was not a highly technically complex exercise as they did not have complex transactions, or extensive instances of the following complicating factors:

    (a) some of these preparers did not have goodwill, or if they did, no goodwill impairment had been previously recognised [paragraphs 4-13 of Appendix 1 of this Agenda Paper];

[1] These comments correspond to comment letters 34, 95 and 111.

[2] One of these preparers was contacted by the London office of the accounting firm that audits the preparer's financial statements.

(b) there were no hedging relationships between the reporting entity and the JCE [paragraphs 24-25 of this Agenda Paper and 17-18 of Appendix 1 of this Agenda Paper]; and

(c) they had no capitalised interest [paragraphs 14-16 of Appendix 1 of this Agenda Paper].

11. For these preparers, the hardest work either consisted in processing the necessary changes into the reporting systems so that they were up to date, or in ensuring that all of their subsidiaries received clear instructions relating to the procedures to be performed for investments held in JCEs at their level.

12. Consequently, we acknowledge that in some cases in which a reporting entity does not have to deal with the most complex adjustments, applying the accounting changes retrospectively is feasible. However, the reasons that have carried more weight in our decision are:

(a) Based on the adjustments identified between proportionate consolidation and equity method in Appendix 1 of this Agenda Paper, we have assessed that the amount of hindsight that would be needed to carry them out and the cost to be incurred can be high. We think that the costs of requiring entities to apply the requirements retrospectively might not be outweighed by its benefits, and it might not always be practicable.

(b) We have considered the option of requiring retrospective application unless an entity concluded that it was impracticable, along the lines of the transitional provisions in IFRIC 12 *Service Concession Arrangements*. However, we think that this option would reduce comparability for users and would trigger many entities to consider their circumstances as impracticable, and consequently choose to apply the suggested transitional provisions of this paper. As a result, we questioned whether we should instead propose the same requirements to be applied in all circumstances for all entities, on the grounds that these requirements could provide a reasonably satisfactory way for transitioning in all cases at a lower cost.

Prospective for new arrangements only

13. We think that the option of requiring prospective application only to joint arrangements established after the effective date of the new standard (ie 'new arrangements') would not contribute to creating comparability among similar arrangements. This is because inconsistency would still exist among the arrangements established before the implementation of the new standard and those that were established afterwards.

14. The paragraphs below describe the preferred approach, setting out the recommended transitional provisions for adopting the requirements of the final standard on Joint Arrangements.

Our recommendation

Proposed transitional approach

15. We set out in detail below the approach recommended for each of the changes that the standard will represent to arrangements currently being accounted for under IAS 31. These changes are for:

    (a) JCE accounted for proportionately in IAS 31 that will become a Joint Venture under the new standard (ie *proportionate consolidation to equity method*);

    (b) JCE accounted for under the equity method in IAS 31 that will become a Joint Operation under the new standard (ie *equity method to accounting for (share of) assets and liabilities*); and

    (c) JCE accounted for proportionately in IAS 31 that is a Joint Operation under the new standard (ie *proportionate consolidation to accounting for (share of) assets and liabilities*).

16. We have additionally considered transitional provisions affecting the entities' separate financial statements in paragraphs 36-41 of this Agenda Paper in the case the JCE is a Joint Operation under the new standard.

17. We note that the changes that the new standard will introduce (paragraphs 15(a) – (c)) in the accounting for some of these arrangements are not a consequence of

a change in the nature of the relationship between the parties and their arrangements, and do not therefore represent a change in the nature of the investment. We are therefore not proposing that the assets and liabilities, or the investment that might arise as a result of these changes, should be remeasured to fair value when the new standard is first applied.

JCE accounted for proportionately in IAS 31 is a Joint Venture under the new standard (ie proportionate consolidation to equity method)

18. As discussed above, in this particular case, once the standard becomes effective, entities will have to transition from proportionate consolidation to equity method. In the following paragraphs we describe how the starting (and comparative) balance of an entity's investment in an arrangement that was previously proportionate consolidated, and that is now classified as a Joint Venture (ie equity accounted for), can be determined.

19. The entity's investment balance could be established by collapsing all assets and liabilities that were previously proportionate consolidated (including goodwill arising from the acquisition) into a single line item at their respective carrying values at both the period for which the standard is applied and corresponding comparative period. This balance would represent the 'deemed cost' of the investment for IAS 28.

20. We have been informed that JCEs can be part of larger cash-generating units (ie the JCE itself is not a cash-generating unit but forms part of a cash-generating unit). In the case where the JCE is part of a larger cash-generating unit, goodwill to be included within the starting balance of the investment will be measured on the basis of the relative carrying value of the JCE compared to the carrying value of the cash-generating unit to which it belonged. The methodology of this approach is consistent with the requirements included in paragraphs 86 and 87 of IAS 36 *Impairment of Assets*, with one exception: goodwill that was initially allocated to a cash-generating unit of which an operation will be disposing can be allocated to the unit to be disposed of by measuring it based on the *relative fair value* of the operation disposed of compared to the *recoverable amount* of the portion of the cash-generating unit

retained.[3] The procedure we are proposing would, however, allocate goodwill to the JCE belonging to a larger cash-generating unit based on the *relative carrying values* of the JCE and the cash-generating unit to which it belonged. We think that this would be a sensible requirement for the purposes of transitioning from one accounting method to another.

21. Disclosure of the breakdown of the investment balance of this single line item (ie the starting balance of the investment) should be required for the period where the new standard has been first applied. Disclosures should be on aggregate for all JCEs.

22. As required by IAS 28 *Investments in Associates*, the balance of the investment will also need to be tested for impairment in accordance to IAS 36, but only if the IAS 39 indicators of impairment are present. Any impairment resulting from this test (ie impairment on the new financial asset recognised as a result of the change in the standard) should be recognised in retained earnings and disclosed.

23. If collapsing all assets and liabilities into a single line item results in a negative net asset, the entity should recognise the negative net asset in retained earnings and disclose this fact. The entity would need, however, to assess whether it has a legal or constructive obligation towards the negative net assets of the arrangement. If the entity does have a legal or constructive obligation towards the negative net assets, the corresponding liability shall be recognised. If the entity does not have a legal or constructive obligation towards the negative net assets (ie net liabilities), no liability would need to be recognised. Instead, the negative net asset recognised in retained earnings will be adjusted within equity. Disclosure of the unrecognised share of losses of the joint venture at the date the standard is first applied shall be provided.

24. Another point to consider relating to the transitional provisions for this case is hedge accounting. Under proportionate consolidation, an entity might be able to apply hedge accounting to assets, liabilities, revenues, etc. of the JCE. An entity applying the equity method to account for its interest in a JCE would only be

[3] This requirement is reflected in the example included in IAS 36 in paragraph 86.

able to apply hedge accounting to the equity-accounted investment as a whole. In other words, an entity can hedge specific transactions of the JCE that can be incorporated when the entity proportionate consolidates the JCE but might not be allowed to do so when the entity accounts for the JCE under the equity method.

25. Depending on how the hedge was structured and documented, it may give rise to a difference, because the hedged items will be completely different. We presume that in many cases the hedged accounting would be discontinued as the hedged item (ie the proportionate consolidated hedged assets, liabilities, revenues, etc.) would not longer exist. In these cases we propose to discontinue on the date of transition and to reclassify any balances relating to cash flow hedging from other comprehensive income into retained earnings at the beginning of the comparative period.

Question 1
Does the Board agree with the transitional provisions recommended for the case of JCEs that will have to transition from proportionate consolidation to the equity method? [Paragraphs 18-25]?

JCE accounted for under the equity method in IAS 31 is a Joint Operation under the new standard (ie equity method to accounting for (share of) assets and liabilities)

26. We think that fewer JCEs that are equity-accounted-for under IAS 31 will be *joint operations* under the new standard.

27. However, in these circumstances, the entity would have to derecognise the investment, and recognise its share of the assets and liabilities in the arrangement. The investment might include goodwill arising from the acquisition of the JCE. Goodwill included in the investment accounted for under the equity method shall be recognised separately along with the remaining shares of assets and liabilities in the arrangement. The shares of assets and liabilities to be recognised should be determined based on the interest that the entity has on the carrying value of each of the assets and liabilities of the joint operation in accordance with the agreement. The carrying value corresponds to the fair values of the assets and liabilities of the joint operation at the date of the

acquisition, adjusted for subsequent events such as depreciation, impairment, etc. We assume that the entity has financial information available on the joint operation for which it was previously accounting for under the equity method.

28. We note that an interest in a JCE accounted for under the equity method is the carrying amount of the investment in the JCE, together with any long-term interests that, in substance, form part of the investor's net investment in the JCE. Any long-term interests that an investor has in its equity-accounted JCE, apart from the carrying amount of the investment shall be carried forward at the carrying amounts that these long-term interests had at the date of the accounting change.

29. We note, however, that the amount to be recognised in relation to these long-term interests might nevertheless change, as a result of accounting for the interest in the JCE as a joint operation. For example, an investor might have granted a long-term loan to the JCE (ie a long-term receivable for the investor and a long-term payable for the JCE). In the case where the arrangement is a joint operation, the investor would have a long-term receivable relating to the other investors' share in the joint operation (ie, in essence, the investor has financed the other parties to the joint operation with the funds needed to undertake the activities), which will be less than the 100 per cent of the amount receivable that it had when accounting for its interest in the JCE under the equity method.

Question 2
Does the Board agree with the transitional provisions recommended for the case of JCEs that will have to transition from the equity method to the accounting for shares of assets and liabilities [Paragraphs 26-29]?

Transition of JCE accounted for under the equity to accounting for (share of) assets and liabilities: an additional complexity

30. We think that the transition from equity method to the accounting for shares of assets and liabilities could become more complex in the case where there was an impairment in the investment. If the impairment was at the JCE's assets level,

the entity would have incorporated the impairment into the valuation of its investment, as discussed in paragraph 4 of Appendix 1 of this Agenda Paper.

31. As described in paragraph 5 of Appendix 1, the impairment process does not, however, stop here, but it continues as follows:

> IAS 28.32 The investor also applies the requirements of IAS 39 to determine whether any additional impairment loss is recognised with respect to the investor's interest in the associate that does not constitute part of the net investment and the amount of that impairment loss.
>
> IAS 28.33 Because goodwill that forms part of the carrying amount of an investment in an associate is not separately recognised, it is not tested for impairment separately by applying the requirements for impairment testing goodwill in IAS 36 *Impairment of Assets*. Instead, the entire carrying amount of the investment is tested for impairment in accordance with IAS 36 as a single asset, by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount, whenever application of the requirements in IAS 39 indicates that the investment may be impaired. An impairment loss recognised in those circumstances is not allocated to any asset, including goodwill, that forms part of the carrying amount of the investment in the associate.

32. Based on the paragraphs of IAS 28 cited above, any impairment resulting from the application of IAS 36 to the carrying amount of the investment is not allocated to any asset, but to the investment as a whole. We think that even though the requirements of IAS 28 are applied to the investment as a whole, an entity would have supporting information relating to its share of the underlying assets and to any impairment adjustments performed related to specific underlying assets, and also to any additional impairment arising from IAS 36 that was allocated to the investment as a whole.

33. When changing the accounting of this equity-accounted investment to the accounting of share of assets and liabilities, any difference between the carrying amount of the investment and the carrying amount of the individual assets and liabilities should first be off-set against any goodwill with any balance recognised in retained earnings.

Question 3
Does the Board agree with the recommendation proposed to deal with the additional complexity observed for the transition from equity method to the accounting for (share of) assets and liabilities [Paragraphs 30-33]?

JCE accounted for proportionately in IAS 31 is a Joint Operation under the new standard

34. We do not perceive major differences in this case, except that the assets, liabilities, revenues and expenses will also be recognised in the party's separate financial statements. Consequently, the investment recognised at cost or under IFRS 9 / IAS 39 in the separate financial statements will be derecognised, and the assets and liabilities will need to be recognised accordingly at their carrying value at the effective date of the standard. Any difference should be recognised in retained earnings and should be disclosed. Please refer to paragraphs 36-41 of this Agenda Paper.

Jointly Controlled Operation / Asset in IAS 31

35. No transitional provisions are provided for these cases, because we do not expect that the new requirements will change the accounting of parties in these arrangements. These arrangements will be *joint operations*, and parties will continue to account for their assets, liabilities, revenues and expenses as agreed in their contractual arrangements.

Question 4
Does the Board agree with: (a) the transitional provisions recommended for the case of JCEs that will have to transition from proportionate consolidation to the accounting for shares of assets and liabilities? [Paragraph 34]? (b) not providing transitional provisions in the case of Jointly Controlled Assets / Operations that will become Joint Operations under the new standard? [Paragraph 35]?

Separate financial statements

36. The transitional provisions below are applicable for the accounting of JCEs in the separate financial statements of the parties in the case of those arrangements that at the date the standard is applied have been assessed to be Joint Operations. Please note that these transitional provisions are independent from the accounting method previously used by the parties to those arrangements in their consolidated or individual[4] financial statements before the standard was applied.

37. The paragraphs of IAS 31 below apply to an entity's separate financial statements. These procedures would need to

> 46. 'An interest in a jointly controlled entity shall be accounted for in a venturer's separate financial statements in accordance with paragraphs **38-43 of IAS 27**.
>
> 47. This standard does not mandate which entities produce separate financial statements available for public use'.

38. In addition, IAS 27.38 states the following:

> 38. 'When an entity prepares separate financial statements, it shall account for investments in subsidiaries, jointly controlled entities and associates either:
>
> (a) at cost, or
>
> (b) in accordance with IFRS 9 and IAS 39'.

39. In its separate financial statements, an entity with an interest in a joint operation will have to account for its corresponding assets and liabilities. An entity's interests in joint operations will therefore be recognised the same way in its consolidated, individual and separate financial statements.

40. If the entity had recognised its investment in the arrangement at cost or under IFRS 9 / IAS 39, in its separate financial statements, it will have to derecognise this investment, and recognise corresponding assets and liabilities at their carrying value at the effective date of the standard. In its separate financial statements, an entity will have to recognise in retained earnings any difference arising from its investment recognised at cost or under IFRS 9 / IAS 39, and its

---

[4] The term *'Individual financial statements'* has been introduced at the revised version of IAS 24 *Related Party Disclosures* and it refers to financial statements that are neither consolidated nor separate financial statements as defined in IAS 27.

share of the assets and liabilities of the arrangement. Any difference recognised in retained earnings should be disclosed.

41. We propose to clarify in the standard that the accounting for interests held by an entity in joint operations will be the same in the party's separate, individual and consolidated financial statements. We additionally propose to replace the term 'jointly controlled entities' in IAS 27 with 'joint ventures', so that the requirements for the accounting for investments in joint arrangements in the separate financial statements of the parties refer exclusively to the 'joint ventures' type of arrangement. This will be the only type of arrangement that will present a different accounting, depending on whether the entity prepares consolidated/individual or separate financial statements.

Question 5
Does the Board agree with the transitional provisions recommended for the separate financial statements of entities that are parties to joint operations [Paragraphs 36-41]?

Appendix 1

1. In the paragraphs below, we assess what would be required for an entity to apply the new requirements retrospectively.

2. We start this analysis with the change that we think will probably affect a higher number of arrangements and that will represent the most significant shift in the accounting. These are those *jointly controlled entities* (JCEs) that are currently proportionate consolidated, and that under the new standard will be *joint ventures* accounted for under the equity method.

3. In these cases, retrospective application of the requirements would mean that an entity that recognises its investment in a JCE proportionately would have to present this investment on the effective date as if it had been accounting for this investment under the equity method ever since it established, or entered into, the JCE. Because of differences between equity method and proportionate consolidation, an entity with the same interest in a JCE could potentially have a different 'net investment' depending on the method that it used to recognise this interest. We analyse below the main adjustments that an entity converting from proportionate consolidation to equity method might have to carry out to account for its interest in the existing JCE in accordance with the new requirements. We also give our conclusion on the degree of difficulty in performing the adjustments analysed.

Goodwill impairment

4. Under the equity method, goodwill is not treated as a separate asset. Instead, it is included within the investment accounted for under the equity method. The total equity-accounted investment would have considered any impairment of the underlying assets at the investee level, together with any other impairment affecting the fair value assigned to the investee's identifiable assets and liabilities at the date of the acquisition.[5]

---

[5] Paragraph 23 of IAS 28 states: '[…] Appropriate adjustments to the investor's share of the associate's profits or losses after acquisition are also made to account, for example, for depreciation of the depreciable assets based on

5. Additionally, IAS 28 requires the equity-accounted investment to be tested for impairment when there is objective evidence that the investment is impaired, under the requirements of IAS 39.[6] If objective evidence of impairment exists, the investment is tested for impairment in accordance with IAS 36 *Impairment of Assets*. That is, the entire equity-accounted investment, not merely goodwill, would be tested for impairment.

6. Paragraph 114 of IAS 36 states that: 'An impairment loss recognised in prior periods for an asset other than goodwill shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised'. Consequently, a previously-recognised impairment of an investment in a JCE that is accounted for under the equity method is reversible.

7. Entities that proportionately consolidate their investments in JCEs would most probably perform an impairment test for the goodwill associated to the JCE (assuming the JCE is itself the cash-generating unit that is being tested for impairment) under IAS 36. Under proportionate consolidation, because there is no investment asset, an additional impairment test of the investment using IAS 36 will not be required. However, any impairment that is recognised for goodwill relating to an entity's investment in a proportionate consolidated JCE would be irreversible, in accordance with IAS 36.

8. The difference in the treatment of goodwill impairment between proportionate consolidation and equity method would imply that an entity accounting for its JCE proportionately, and then transitioning to equity method, would need:

---

their fair values at the acquisition date. Similarly, appropriate adjustments to the investor's share of the associate's profits or losses after acquisition are made for impairment losses recognised by the associate, such as for goodwill or property, plant and equipment.'

[6] Paragraph 59 of IAS 39 states: '[…] Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the holder of the asset about the following loss events: (a) significant financial difficulty of the issuer or obligor; (b) a breach of contract, such as a default or delinquency in interest or principal payments; (c) the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider; (d) it becoming probable that the borrower will enter bankruptcy or other financial reorganisation; (e) the disappearance of an active market for that financial asset because of financial difficulties; or (f) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including: (i) adverse changes in the payment status of borrowers in the group […]; or (ii) national or local economic conditions that correlate with defaults on the assets in the group […].

(a) to reverse any impairment to goodwill that had been previously recognised;

(b) to assess any impairment relating to the equity-accounted investment in the JCE; and

(c) to assess whether any impairment recognised over the equity-accounted investment in the JCE would have reversed.

9. We think that step (a) included in paragraph 8 should be straightforward. In relation to step (b), if the entity was previously proportionately consolidating its interest in a JCE, it would have performed a corresponding impairment test to goodwill associated to the JCE and to the assets that were proportionately consolidated. Consequently these procedures would cover the requirements set out in paragraph 23 of IAS 28 (see paragraph 4 of this Appendix 1). The entity would subsequently need to assess whether during the period adjusted there was any objective evidence that the financial asset (ie the investment in the JCE accounted for under the equity method) would have been further impaired in accordance with the guidance provided in IAS 39 and, if so, the entity would perform the corresponding impairment test under IAS 36.

10. The entity would, however, also have to assess whether any impairment recognised would have reversed (ie step (c) of paragraph 8). Using the information available when the entity proportionately consolidated its interest in the JCE, the entity should be able to deduce the amount of any impairment reversed under proportionate consolidation relating to any underlying assets that were previously impaired.

11. We think that, even though, an entity could potentially infer the impairment amount under equity method and assess any possible subsequent reversals relating to goodwill, the amount of hindsight to be applied might be high. Hindsight would potentially need to be applied in the following circumstances:

(a) to assess any additional impairment arising from the impairment test on the investment asset to be performed under IAS 36, taking into consideration any objective evidence that the impairment was impaired under the requirements of IAS 39; and,

(b) to estimate any amounts that could have been reversed from previously-impaired goodwill.

12. An additional challenge relating to adjusting goodwill impairment retrospectively will depend on whether the JCE is, or is not, its own cash-generating unit. We have assumed above that it was. However, in the case where the JCE forms part of a larger cash-generating unit for which goodwill has been allocated, no impairment might have been recognised, because a larger cash-generating unit could potentially 'delay' the recognition of any impairment. If the JCE itself was never tested for impairment because it did belong to a larger cash-generating unit, the test could imply a considerable amount of hindsight.

13. Based on the analysis above, we think that adjusting for goodwill impairment could imply that a preparer would need to carry out a significant amount of hindsight.

Capitalisation of borrowing costs

14. Under proportionate consolidation, if the JCE itself did not incur any borrowing costs, the entity would capitalise its own borrowing costs in respect of all qualifying assets of the proportionate-consolidated JCE. However, under equity method, an entity with an interest in such an equity-accounted-for JCE would not be able to capitalise its borrowing costs. This is because investments accounted for under the equity method are not qualifying assets.[7]

15. Retrospective application of the standard would mean that an entity that was proportionately consolidating its interests in JCEs would now have to reverse all amounts of borrowing costs that had been capitalised, as well as all of its related effects (ie depreciation, and past impairment assessments).

16. We have been informed that, even though its preparation might become complicated, this is a feasible adjustment to prepare. We note that with the

[7] IAS 23 *Borrowing Costs* defines a *qualifying asset* as 'an asset that necessarily takes a substantial period of time to get ready for its intended use or sale'.

revised IAS 23 issued in March 2007, a potentially higher number of entities would need to prepare this adjustment.

Hedging

17. As mentioned in paragraphs 24-25 of the Agenda Paper, under proportionate consolidation, an entity might be able to apply hedge accounting to assets, liabilities, revenues, etc. of the JCE. An entity applying the equity method to account for its interest in a JCE would only be able to apply hedge accounting to the equity-accounted investment as a whole.

18. Depending on how the hedge was structured and documented, it may give rise to a difference, because the hedged items will be completely different. In these circumstances, we would be unable to determine how this difference could be reconciled when changing from proportionate consolidation to equity method, and presume that in many cases the hedged accounting would be discontinued as the hedged item (ie the proportionate consolidated hedged assets, liabilities, revenues, etc.) would not longer exist.

Intercompany balances

19. Under proportionate consolidation, intracompany balances (receivables and payables) and intracompany transactions (revenues and expenses) are eliminated by the venturer's percentage of participation. Under the equity method, there is no elimination of intracompany balances and intercompany transactions by the venturer's percentage of participation.

20. This adjustment when changing to equity method will require rebooking all intracompany balances and transactions that had been eliminated. We have been informed by a preparer and by the accounting firms that this adjustment could potentially be time-consuming. Please note that although the net impact of this adjustment is nil; it does affect the gross presentation of assets, liabilities, revenues and expenses.

Recognition of losses below zero

21. Under the equity method, a party ceases to recognise its share of losses in a JCE as soon as the investment has been written down to zero, unless the investor has a legal or constructive obligation to fund the losses of the JCE. Under proportionate consolidation, there is no such restriction.

22. An entity changing to equity method would be required to identify its share of any losses recognised under proportionate consolidation for which it does not have a legal or constructive obligation, and reverse its effect. This share of losses will need to be removed from the starting balance of the investment accounted for under equity method at the date upon which the standard becomes effective.

23. This adjustment should not be a costly adjustment by itself. It may only become complex when also considering the effect of other adjustments that have been carried out.

Further complexity of performing the adjustments above

24. In the case where the investment is owned by a not-wholly-owned subsidiary, the adjustments could also have an impact on the amounts allocated to non-controlling interests. This is not an additional adjustment, but an additional consequence of the adjustments performed, which adds complexity to the process of changing the accounting retrospectively.