

AGENDA PAPER

IFRS Foundation Trustees' meeting—Due Process Oversight Committee

Washington DC 11 July 2012

Agenda ref

4Gii

DPOC: Correspondence with BusinessEurope

The papers for this agenda item are attached as follows:

- i. Staff report to the DPOC;
- ii. Business Europe's letter of 11 June;
- iii. Business Europe's original letter of 10 October 2011;
- iv. David Sidwell's letter of 21 February 2012, plus IASB staff report

AGENDA PAPER

IFRS Foundation Trustees' meeting—Due Process Oversight Committee

Washington DC 11 July 2012

Agenda paper 4Gii

To: Due Process Oversight Committee

From: David Loweth

Date: 29 June 2012

Re: Correspondence: Response to a letter from Business Europe

Introduction

1. The purpose of this paper is to respond to the matters raised in a letter of 11 June 2012 Business Europe sent to the Trustees raising concerns about certain aspects of the IASB's due process, following earlier correspondence about the due process followed when the IASB developed IFRS 11 *Joint Arrangements*.

Background

2. In October 2011, Business Europe sent a letter to the Trustees raising concerns about several aspects of the due process followed when the IASB developed IFRS 11. A report from IASB staff responding to the matters raised in that letter was submitted to the Committee and considered at its meeting in January 2012. Following that meeting, David Sidwell responded to Business Europe on 21 February 2012 noting that the DPOC had discussed the report and was satisfied with the explanations provided to it by the staff. In that letter, David also highlighted that the Committee will keep in mind Business Europe's concerns in its review of the *Due Process Handbook*.

Business Europe's latest letter

3. In its latest letter, Business Europe notes that it is not convinced by several of the points raised by IASB staff in response to their October 2011 letter. However, it notes that it does not want to enter into further technical debate on the IASB's staff feedback. Instead, the

latest letter focuses on aspects of due process which, in their view, are not addressed in the draft *Due Process Handbook*. These matters are considered below.

Public discussions

4. Business Europe believes that DPOC discussions should take place in public. In his DPOC Chairman's report in the IFRS Foundation's *Annual Report 2011* David Sidwell highlighted that, during the course of this year, the DPOC will consider holding parts of its meetings in public session. Our plan is for the DPOC to discuss this at its October meeting. To my mind, there is a clear link to the proposals in the draft *Due Process Handbook*, in particular paragraph 2.15, which states that "The DPOC must operate transparently and with fair consideration of issues raised by stakeholders".

5. Business Europe also expresses a view that discussions about due process are difficult to follow and find on the website. In 2010 we established a dedicated DPOC section on the IASB website, which is accessible from the IFRS homepage via a 'Quick Link'. The DPOC landing page has links that allow an interested party to access DPOC related material, including pages dedicated to 'Correspondence with third parties', with a further sub-division between 'Active' and 'Closed' correspondence (the latter category includes the earlier correspondence with Business Europe). We have not reviewed the layout since these links were developed and if people are having difficulty finding material we should consider if there are better ways to present the information. I will ensure that we review the presentation of information on the DPOC pages and ask Business Europe if it has any specific suggestions as to how ease of access on the website might be improved.

The role of the IASB

6. Business Europe expresses its view that it should be for the IASB itself, rather than the staff, to respond to concerns raised on the due process. Paragraph 8.3 of the draft *Due Process Handbook* notes that it is the appropriate IFRS Foundation staff that prepare a report for the DPOC in response to complaints about due process, but this simply reflects our working arrangements for the concerns to be addressed in an effective and timely manner. The responsibility for due process remains very clearly that of the Board itself or the Interpretations Committee, as appropriate, and the fact that the Chairman and Vice-Chairman of the IASB attend the meetings of the DPOC and are answerable to the Committee on all aspects of due process is clear evidence of that.

7. Business Europe expresses 'regret' that the DPOC does not think that *Feedback Statements* and *Effect Analyses* should be approved by the Board and plans to raise this in its response to the draft *Due Process Handbook*. I think we should look at how this is expressed in the draft *Due Process Handbook*. I have discussed this with Alan Teixeira and he is working with the staff and Board to ensure that the potential effects of new IFRSs are

considered throughout the development of an IFRS and presented as part of the basis for conclusions. I think the fact that effects should be considered throughout the development of a Standard is clear in the draft handbook but references to a separate *Effect Analysis* could suggest that it is a separate process.

8. The *Feedback Statement* is intended to be drawn from the basis for conclusions. There should be nothing new in that document. Similarly, any summary of the main effects of a new IFRS should be drawn from the effects analysis discussed by the Board. I think it is important to give the IASB the flexibility to develop press releases, conference presentations and feedback statements without requiring formal sign-off by the Board. I would be concerned if there are discrepancies between these communications documents and the formal IASB documents, but we should monitor that.

9. The development of effect analyses is a new process for the IASB and has evolved since the first such summary was prepared in 2008. I think the criticisms made by Business Europe would be more valid if we were at the end of the development phase. But the IASB is still working on its methodology. We are in the process of establishing an international consultative working group, chaired by the IASB, to help the IASB develop a robust process. I am confident that we will be able to address Business Europe's concerns through the continuing work the IASB is undertaking and the establishment of the methodology group review.

10. Business Europe also points out that it continues to think that they think that the IASB needs to have a more robust process in place to conclude on the necessity, or otherwise, of re-exposure. This is in line with its earlier concerns that the changes in IFRS 11 from the Exposure Draft (ED 9) warranted a re-exposure. The draft *Due Process Handbook* (paragraphs 6.25 and 6.26) sets out the criteria the IASB has to address in considering whether there is a need for re-exposure, with any decision on whether or not to publish revised proposals for another round of comment being made in a public IASB meeting. It is would be helpful if Business Europe was asked to set out in more detail what it would like to add to the process of considering whether or not there should be a re-exposure.

Confidentiality

11. Business Europe acknowledges the difficulties we face in having a transparent process for outreach while respecting the need to maintain confidentiality, but believes it should be possible for the substance and conclusions drawn from outreach to be explained without endangering participants' legitimate concerns about confidentiality. That is an issue the IASB is grappling with, especially in relation to how the results of focused consultation with investors should be summarised and considered and assessed. But Business Europe raises a valid point in how the results are reported of any outreach (not just with investors) are summarised and the conclusions drawn from them. For example, the sections in the draft

Due Process Handbook on fieldwork and public hearings are silent on how the results of such activities are reported to, and assessed by, the Board.

Business Europe's overall comment

12. In its covering letter, Business Europe states its view that “issues are of such importance that some immediate changes to the process should be envisaged by the Trustees”. I agree that the issues are important, but my preference is to consider them in the context of the review of the draft *Due Process Handbook*, which is consistent with the line in David Sidwell’s letter of 21 February.



Trustees of the IFRS Foundation
IFRS Foundation
30 Cannon Street
London EC4M 6XH
United Kingdom

11 June 2011

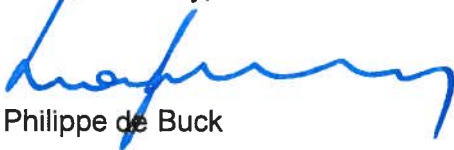
Dear Sirs,

We are writing to express our concerns about the process applied by the Due Process Oversight Committee (DPOC) with respect to the process followed when the IASB developed IFRS 11. We raised some initial concerns about this point in October 2011 (letter enclosed for ease of reference) to which the Chairman of the DPOC responded in late February 2012. In that response, the Chairman explained that he had asked the IASB Staff to report to the DPOC on the matters raised by us. The letter concluded that the DPOC was satisfied with the explanations provided to it by the IASB Staff and that it will review the Due Process Handbook for the IASB, keeping our comments in mind.

We do not want to enter into a further technical debate on the merits of the feedback the IASB Staff provided, except for saying that we are not convinced by several of the points raised by the IASB Staff. In particular, we are of the opinion that the response by the IASB Staff does in our view not adequately address our most significant concern, which is that we believe that the meaning of "other facts and circumstances" could only be fully understood in the educational session shortly before the finalisation of the standard and not by any other official communication before that date.

Having said that, we do want to raise our concerns about how such issues are currently addressed by the DPOC. These concerns are further explained in the appendix to this letter. Overall, we believe that the current document open for public comment with respect to the Due Process Handbook does not address our concerns and that they are of such importance that some immediate changes to the process should be envisaged by the Trustees. We remain at your disposal should you wish to discuss this subject further.

Yours sincerely,



Philippe de Buck



APPENDIX: DUE PROCESS OVERSIGHT COMMITTEE

Public discussions

- First of all, BUSINESSEUROPE believes that the DPOC discussions should more prominently take place in public and that not only the initial request to the Trustees / DPOC but, more importantly, also the outcome of the debate should be made publicly available on the IASB website.

On such important issues as the credibility of the IASB due process, the Trustees should apply highest standards of openness, in order not to impair the process as a whole. Currently such issues are difficult to follow and find on the website (for example, we were not able to find on the website any discussion or outcome of the debate in connection with our letter).

The role of the IASB

- Secondly, BUSINESSEUROPE does not believe that it is appropriate that the IASB Staff is asked to respond to concerns raised on the due process. It is the IASB and not the IASB Staff that is responsible for issuing new accounting standards or interpretations and, therefore, any concerns with respect to the way in which such accounting pronouncements were developed and published need to be answered by the IASB itself and not its staff. If in fact the IASB Staff is the relevant and appropriate body to respond to such concerns, then we believe that the IASB needs to make that point clearer in its Due Process Handbook and Constitution and to the public. Even though we would then wonder what role the Board actually plays in the overall process.

In particular, BUSINESSEUROPE believes that the IASB has to respond to questions on how the concerns raised by constituents were addressed in its re-deliberations of exposure drafts and why the IASB (and not the Staff) eventually concluded in the way that the final pronouncement reads. While we appreciate that the detailed work on the comment letters is naturally done by the Staff, it is the IASB's responsibility to ensure that comments are appropriately taken into account.

BUSINESSEUROPE therefore disagrees with the current practice that the Feedback Statements and Effect Analyses are not formally approved by the Board. Our concern is not that we were not able to identify by whom the Feedback Statements are issued, but that we believe that it is not the responsibility of the IASB Staff. We regret to see that seemingly the DPOC holds a different view on this, especially in view of the fact that both documents are required by the Due Process Handbook. We will raise this concern during the handbook review. In this connection, we would like to point out that we continue to think that the IASB needs to have a more robust process in place to conclude on the necessity, or otherwise, of re-exposure.

Confidentiality

- Finally, the Chairman of the DPOC indicates that the Board and the Staff have struggled to ensure that they have a transparent process while respecting the need to maintain confidentiality, sometimes being required to sign confidentiality agreements. We understand this concern, as some of our members have participated in the outreach activities and have probably asked the Staff to sign such agreements.

However, it was not our ability to participate in any outreach activity which was our concern, and the DPOC response letter therefore misses our point which is unease with the role outreach activities have in the due process. Our recurring observation is that it is usually not clear what conclusions have been drawn from these activities and on what basis. It is consequently impossible for a constituent to react on a timely basis and provide a contradictory or balancing view when a constituent believes that the facts and conclusions drawn from the outreach activities are inappropriate.

BUSINESSEUROPE believes that, notwithstanding the concerns about confidentiality, it is essential that the outreach activities be as transparent a part of the due process as any other, and it should be possible for the substance and conclusions drawn to be explained without endangering participants' legitimate concerns about confidentiality.

* * *



Trustees of the IFRS Foundation
IFRS Foundation
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United Kingdom

10 October 2011

Dear Sirs,

We write to you regarding due process issues with IFRS 11. Earlier this year, on 11 January 2011, we wrote to Sir David Tweedie to raise some concerns about the unclear role of staff papers and the fact that they are not formalised in the due process. In particular we raised the issue of the staff draft on Joint Arrangements and its related outreach for which we considered that it was not clear how companies participating in the outreach had been selected and which, we believed, could have resulted in unfair and unequal treatments. You will find enclosed a copy of the letter for ease of reference.

Now that our members are analysing IFRS 11 in view of its application, our concerns have materialised into implementation issues which are further explained in the appendix to this letter.

Firstly, we would like to explain the due process issues of IFRS 11, but not to discuss the technical merits of the decision that the Board took during the re-deliberation of ED 9 even if we have to refer to some technical decisions for illustrative purposes. Secondly, we would like to discuss the current due process which IFRS 11 was based on and to make proposals to improving it.

We trust that the Trustees will be able to play an active and constructive role in ensuring that such improvements indeed come about and would like to refer to the appendix for a more extensive discussion on these issues. We remain at your disposal should you wish to discuss this subject further.

Yours sincerely,

Philippe de Buck

APPENDIX: DUE PROCESS ISSUES WITH IFRS 11

Introduction

BUSINESSEUROPE raised some concerns about the unclear role of staff papers and the fact that they are not formalised in the due process in its letter of 11 January 2011 (enclosed). In particular it raised the issue of the staff draft on Joint Arrangements and its related outreach for which we considered that it was not clear how companies participating in the outreach had been selected and which, we believed, could have resulted in unfair and unequal treatments. Now that our members are analysing IFRS 11 in view of its application, our concerns have materialised into implementation issues which we explain in this letter. We also consider that the explanations that the Staff of the IFRS Foundation has given in its Project Summary and Feedback Statement of May 2011 and its Effect Analysis of July 2011 are not entirely convincing and that the development of IFRS 11 highlights due process issues that should be corrected.

We are also surprised to note that the above-mentioned two documents are disclaimed as representing the views “*of the staff who prepared the document[s]*” and that those documents “*do not purport to represent the views of the IASB and should not be considered as authoritative*”. While we would acknowledge that those documents are not authoritative accounting literature, we have difficulty understanding why the explanations on the due process and the effect analysis, which are both of utmost importance for the IASB constituents, are disclaimed in such a way, especially bearing in mind that they are required by § 50 of the Due Process Handbook.

Therefore the purpose of this letter is twofold. Firstly we would like to explain the due process issues of IFRS 11, but not to discuss the technical merits of the decision that the Board took during the re-deliberation of ED 9 although we have to refer to some technical decisions for illustrative purposes. Secondly we would like to discuss the current due process which IFRS 11 was based on and to make proposals to improving it.

ED 9 Background

In accordance with its due process, the Board published ED 9 (the ED) on Joint Arrangements in September 2007 and exposed it for comments during a 120 day period ending on 11 January 2008. The ED required Joint Arrangements to be classified and accounted for as follows¹ :

- Joint Operations, where each party should recognise the assets it controls and the liabilities it incurs;
- Joint Assets, where each party should recognise its share of the assets and the liabilities; and
- Joint Ventures, which should be accounted for using the equity method, because the parties did not have the rights to the individual assets and liabilities of the JV.

¹ ED9 §§ 21, 22 and 23.

ED 9 Re-deliberation

In pages 9 and 10 of the above-mentioned Project Summary and Feedback Statement, the Staff explains that it did not consider it was necessary to re-expose any aspect of the proposals because the changes consisted merely in adding application guidance and narrowing the classes of joint arrangements from three to two. The staff also adds that it conducted outreach and field testing. We believe that this raises three issues:

- (i) did the Board introduce new requirements in the application guidance?
- (ii) were the outreach and field tests conducted in a transparent manner so that all the IASB constituents could openly express their opinions? and
- (iii) was it correct not to re-expose the proposals?

(i) Introduction of new requirements

When the Board prepared IFRS 11, we consider that it did not limit itself to reducing the number of classes of joint arrangements as said above but it also introduced a very fundamental concept for the classification of Joint Arrangements, that is the consideration of “other facts and circumstances” (§§ 12 and 13 and B15 (b) (iii)). Furthermore application guidance has grown from one paragraph in ED 9 to 37 paragraphs in IFRS 11.

By adding the “other facts and circumstances” criterion, the overall (convergence) aim to eliminate the choice of either applying the proportionate consolidation or the equity method of accounting was, softened. IFRS 11, by presenting several examples (in particular Example 5), tries to illustrate when other facts and circumstances lead to the determination of a joint operation even though the arrangement is conducted through a separate legal entity with equal residual rights for each venture partner, whereas under current guidance (IAS 31) it is accounted for as a jointly controlled entity and either proportionately consolidated or accounted for using the equity method of accounting.

While the Board concluded in May 2009 that “all relevant facts and circumstances” needed to be considered to assess whether an arrangement is a joint operation or a joint venture and that there is a rebuttable presumption that an arrangement is a joint venture when it consists of an entity, the consequences of this - to a certain extent - obvious statement was first clarified via an Education Session in early 2011 and eventually became fully clear only upon publication of the standard in May 2011. All constituents did not have an opportunity to follow the development of this important newly-introduced concept by reading the general IFRS Updates or similar publications, and accordingly did not have a chance to share their understanding and concerns about this substantial change in guidance.

Since the new “other facts and circumstances” criterion is not based on a clear and understandable principle and, accordingly, provides only insufficient and unclear guidance, interpretations of these facts and circumstances will vary significantly, leading to divergence in practice and a corresponding loss of overall comparability. We may take this matter up directly with the IASB at a later date.

We are also very surprised about the apparent lack of an impact assessment for those companies that currently account for their arrangements as joint ventures under IAS 31

using the equity method of accounting and that will now be required to account for these arrangements as joint operations under IFRS 11.

These companies will face implementation issues including, but not limited to the following:

- Companies will be required to obtain necessary information in respect of joint operations for a complete set of financial statements (including note disclosures) while only having to provide more limited information if they are accounted for using the equity method. Those companies that utilise IFRS financial statements for internal analysis, controlling and management purposes (monthly reporting, management information systems), and consequently base their transactional systems on IFRS, will have to fully integrate joint operations in their systems on a line by line basis.
We do not believe that the additional information provides significant benefits to users while making preparation processes more complicated, longer and expensive for preparers.
- The preparation of this additional information may not have been contractually agreed and would require renegotiation of contracts with partners.
- Additional discussions with auditors and regulators about the classification of joint arrangements and treatment of insignificant joint operations will have a negative impact on preparer processes, closing timelines and costs. In addition, audit fees will increase due to the additional audit work required if a company is proportionately consolidated.

The costs described above are especially critical for start-up companies with research and development or production activities that are completely integrated into the supply chains of the jointly controlling partners. Usually, these companies operate on a break-even level or slightly above. Equity accounting is comparatively easy, quick and not expensive under these circumstances. The equity income is negligible, the carrying amount of the investment is calculated once and will remain fairly unchanged on the basis of the break-even level. Under the new guidance, such companies do not only face the burden of full external reporting requirements but also the potential consequences on management reporting as described above. This will lead to a disproportionately high amount of accounting staff and systems in these companies and therefore increase costs.

When requiring preparers to assess the facts and circumstances the Board limits such assessment to joint arrangements that are structured in the form of a separate vehicle but it does not require the same assessment for joint arrangements that are not structured in the form of a separate vehicle. The Board justifies that discrepancy in BC27 by saying that such possibility would be “very rare” and on grounds of simplification. We consider that, in doing so the Board has created a rule-based requirement.

We also would like to understand how the Staff derived the following conclusion on page 19 of the July 2011 Effect Analysis:

“We expect that most ‘jointly controlled entities’ in IAS 31 will be ‘joint ventures’ in accordance with IFRS 11. This is because we expect that, in most cases, if the



arrangement is structured in a separate vehicle that can be considered in its own right, neither the terms of the contractual arrangement nor the consideration of other facts and circumstances will reverse the rights and obligations that the legal form of the separate vehicle confers on the parties.

However, the contractual arrangement between the parties and, when relevant, other facts and circumstances, might establish that the parties have rights to the assets and obligations for the liabilities held in the separate vehicle in which the arrangement has been structured. In this case the former 'jointly controlled entity' in IAS 31 could be a 'joint operation' in accordance with IFRS 11."

As a result of this assessment, the IASB did not pursue any further consultation with entities which, in the future, would have to account for their arrangements as joint operations rather than as joint ventures, but instead only focused on the other direction of the change. Given our observation that some of our member companies are affected by the new proposals to change from equity accounting to proportionate consolidation, we would like to understand how the conclusion was made that the overall impact of the new guidance for these cases could be neglected in the impact study.

(ii) Transparency of the outreach

While we favour (and will always strongly recommend) outreach, hearings, field tests and similar procedures because they facilitate achieving high quality financial reporting that enhances the communication between preparers and users, we consider that (as said in our letter of 11 January 2011 quoted above) that staff draft and related outreach and similar procedures should be carried out in connection with the due process and in a transparent manner, thus allowing all the IASB constituents to take part in such activities. In respect of the elaboration of IFRS 11, the problem was that outreach was conducted at the discretion of the Staff and we cannot determine whether the Board had adequately considered the remarks of its constituents before and during the outreach process.

On page 10 of the Project Summary and Feedback Statement it states that the Staff met with 40 respondents out of 111 (36%) which had submitted a comment letter. The Staff also met with other interested parties in several industries (natural resources, real estate, aerospace and defence, telecom and banking). However the Staff does not discuss how it selected the respondents and the companies it contacted. The Staff did not publish any progress report on its contacts with its selected constituents and there were no comments thereon in the IASB Update until January 2011 when the Board decided to provide an overview of the main requirements of the forthcoming IFRS in an education session as mentioned above. Our members who participated in the outreach told us that the documents that they received from the Staff were marked "DRAFT" and some others were classified as confidential. While we understand that at times there may be restrictions on what is disclosed to the public, we consider that the Board should have informed its constituents about the development of the standards resulting from the outreach much earlier than in January 2011, which was far too late because, at that date, the publication of the IFRS was quite close.

***(iii) Re-exposure of the proposals***

The Project Summary and Feedback Statement of May 2011 concludes that “it was not necessary to re-expose any aspects of the proposals” because the main changes consisted of application guidance, adjustments of the terminology and the reduction of joint arrangements from three to two.

As explained in sections (i) and (ii) above, ED 9 had almost no application guidance and the Board issued a substantive application guidance, following on from an obscure outreach process. The Board also did not consider that the introduction of the “other facts and circumstances” criterion would considerably impact the reporting of several entities while we have demonstrated under section (i) that it does. This should have, in our opinion, warranted a re-exposure to test whether those requirements would be practicable for all constituents and not with a limited number of constituents selected at the discretion of the Staff.

Way forward and conclusions

We strongly recommend that the Trustees perform a review of the standard development process for IFRS 11 and determine whether the requirements of the due process were appropriately considered during the development of the standard. In our opinion, particular focus should be put on the determination as to whether affected constituents were appropriately consulted on the impact of the suggested changes given the complete change in guidance compared to IAS 31. As far as we are concerned, we do not believe that the Board has entirely complied with its due process because it did not post the changes to ED 9 on its website (contrary to the Due Process Handbook § 45) but only published a presentation during an education session that took place far too late in January 2011. Moreover, the outreach procedure was not transparent as explained above under section (ii) above.

While the Board and the Staff may have acted in good faith, we consider that the issues that we have raised in this letter demonstrate that the current due process is no longer adequate for the current complexity of financial reporting, as even a single phrase may have consequences on the reporting of corporates. More importantly, substantial changes and / or increases in the volume of the Application Guidance should be a reason for re-exposure, possibly with a short consultation period, because the guidance is an integral part of an IFRS that the auditors constantly refer to in order to determine whether the preparers have complied with the standard. The review of the Application Guidance also allows one to test whether the future IFRS would be practicable.

Finally we highly recommend that any staff draft, outreach or field test procedure that is carried out after preparing an Exposure Draft of a Standard should be made available to all the IASB constituents via the IASB Website in order to allow them to take a position thereon. Since we understand that the Trustees are currently reviewing the IASB strategy, we respectfully recommend that they take the above proposals into consideration.

* * *

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21 February 2012

Philippe de Buck Esq.
Director General
Business Europe
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Belgium

Dear Mr de Buck

In October you sent a letter to the Trustees raising concerns about several aspects of the due process that was followed when the IASB developed IFRS 11 *Joint Arrangements*. I chair the Due Process Oversight Committee (DPOC), which is a committee of the Trustees of the IFRS Foundation.

I asked the staff to report to the DPOC on the matters that you raised in your letter, a copy of which is attached. We discussed that report at our meeting on 11 January 2012.

The DPOC was satisfied with the explanations provided to it by the staff.

Having said that, we do understand the concerns that you have about the transparency of how the staff select parties to include in their outreach activities. The staff and Board have struggled at times to ensure that they have a transparent process while respecting the need to maintain confidentiality. In the case of the Joint Arrangements project, the staff were required to sign confidentiality agreements and were given access to very detailed contracts between parties. In the Financial Statement Presentation project, the staff and Board members faced challenges dealing with disclosure regulations in different countries, because individuals were given access to information that was not widely available. In the consolidations project, individuals from large organisations participated in field testing of the proposals on the understanding that they were speaking as individuals.

The Board and its staff would simply not be able to gain access to so many knowledgeable people who are willing to speak openly and frankly if details of these meetings were to be disclosed. In many cases, the individuals would be prevented from helping us by their employers if the name of the employer were to be shared.

The staff are developing different ways in which to present summaries of who they spoke to and what motivated that contact. It is for this reason that the effect analysis prepared for IFRS 11 was so extensive. Our staff will continue to work with EFRAG on how best to communicate the outcome of field work, given the importance to the European Commission of effect analyses. The DPOC will continue to monitor these developments.

I also think that it is important to emphasise that IASB staff will respond to any reasonable request to engage in outreach. The involvement of constituents, such as those in your membership, is important in the development of IFRSs.

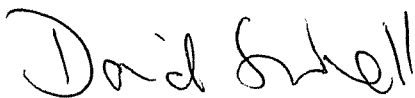
In your letter you also question why the feedback statements and effect analyses are not formally approved by the Board. The due process requirements relate to the development of IFRSs and Interpretations—including discussion papers and exposure drafts. Supporting educational material, communications documents such as press releases, Board presentation packs (such as Microsoft PowerPoint® slides), feedback statements and effect analyses are not subject to the formal voting mechanisms reserved for the standards and interpretations.

To avoid any confusion, the communications and supporting documents clearly state that they have been prepared by the staff.

The DPOC is reviewing the due process handbook for the IASB. That review will include a public consultation. We will keep your comments in mind when that review takes place, in the first half of 2012.

Thank you for taking the time to express your concerns.

Yours sincerely



David Sidwell

Chairman, Due Process Oversight Committee



ADMIN PAPER
IFRS Foundation Trustees

11 January 2012

Agenda paper 3Eii

To: David Sidwell, Chairman - Due Process Oversight Committee
From: Alan Teixeira
Date: 22 December 2011
Re: Response to letter from Business Europe

In October Business Europe sent a letter to the Trustees raising concerns about several aspects of the due process followed when the IASB developed IFRS 11 *Joint Arrangements*. This report responds to the matters raised in that letter.

Selection of companies participating in the outreach when developing the IFRS

During the development of IFRS 11 the staff and Board of the IASB undertook extensive outreach. The letter questions the selection process, saying that it is not transparent.

The objective of the outreach was to get a better understanding of concerns that had been raised to the IASB during the development of the proposals. The staff undertook this additional outreach with representatives from 41 companies. About half of the companies contacted had submitted comment letters on the exposure draft ED 9 *Joint Arrangements*.

The selection was skewed towards companies that were critical of the proposals. Around 13 per cent of the companies were approached at the suggestion of audit firms and about 25 per cent were contacted independently by the project staff. These companies were selected because of the relevance of joint arrangements in the industries in which they participate (eg the mining industry) or because joint arrangements feature prominently in their financial statements. In some cases they were approached because they had already made the transition from proportionate consolidation to the equity method and the staff wanted to learn more about their experience. Finally, 12 per cent of the participants did not send in a comment letter but contacted the project staff directly.

The companies covered a wide geographical spread: Europe 63 per cent, Asia-Pacific 5 per cent, Africa 5 per cent, North America 24 per cent and Global 3 per cent. The industries represented were Energy 27 per cent, Mining 15 per cent, Construction 10 per cent, Banking 7 per cent, Telecommunications 5 per cent, Aerospace & defence 5 per cent, Food & beverage 5 per cent, Representative bodies 5 per cent, Conglomerates 5 per cent and Other (pharmaceuticals, industrial engineering, advertising, environmental services, agriculture, automotive and healthcare) 16 per cent.

The outreach allowed the staff to access joint arrangement contracts and discuss how the new requirements would be applied. The project leader had many face-to-face and telephone meetings.

Need for re-exposure

The letter questions whether the Board should have considered re-exposure of ED 9. The arguments used by Business Europe relate mainly to the increase in guidance in the IFRS compared to the ED and the perception that the IFRS includes new requirements that were not exposed in the ED. These concerns are discussed in more detail below. However, in simple terms, the Board decided that re-exposure was not necessary because the IFRS respects the core principle presented by the ED for the recognition by parties of their interests in joint arrangements.

More guidance in the IFRS than in the ED

IFRS 11 includes more guidance than was exposed in ED 9. However, this was in response to comment letters on ED 9. The guidance provided in the IFRS aims to assist preparers to apply the core requirements of the IFRS, which deal with the classification of the arrangements. The fatal flaw reviews and extensive balloting processes did not generate any concerns about the guidance. None of the principles changed. In addition, the number of people and organisations included in the fatal flaw review was significantly greater than in our normal processes. The fatal flaw reviewers included many preparers.

Introduction of new requirements

The letter suggests that the term *other facts and circumstances* introduces new requirements to IFRS 11, which do not have a clear principle and for which constituents did not have a chance to follow their development.

The requirement in IFRS 11 to consider *other facts and circumstances* is aligned to the principle for parties to recognise their rights and obligations arising from the arrangements. These are not new requirements. ED 9 acknowledged the possibility that arrangements being accounted for using the equity method could end up being

accounted for on a gross basis. The relevant paragraphs of ED 9 are as follows (emphasis added):

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.**

No respondents expressed concerns about these statements. The change made from ED 9 to IFRS 11 is that the term *other facts and circumstances* was introduced as a convenient shorthand term.

The letter also refers to Illustrative Example 5, which was published along with IFRS 11 as an example that aims to *illustrate other facts and circumstances*. This is incorrect. Example 5 aims to illustrate that the contractual terms of the agreement between the parties are able to modify or reverse the effects that the legal form can have on the parties' rights and obligations. This is not something new introduced by IFRS 11. ED 9 had introduced this possibility in the following paragraphs (emphasis added):

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.**

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.

***Other facts and circumstances* is developed on the basis of a clear and understandable principle**

As mentioned above, the letter states that *other facts and circumstances* does not reflect a clear principle. In IFRS 11 *other facts and circumstances* relates to the circumstances in which a party to a joint arrangement has interests in the assets and liabilities of the arrangement. IFRS 11 states:

- B31 When the activities of an arrangement are primarily designed for the provision of output to the parties, this indicates that the parties have rights to substantially all the economic benefits of the assets of the arrangement. The parties to such arrangements often ensure their access to the outputs provided by the arrangement by preventing the arrangement from selling output to third parties.
- B32 The effect of an arrangement with such a design and purpose is that the liabilities incurred by the arrangement are, in substance, satisfied by the cash flows received from the parties through their purchases of the output. When the parties are the only source of cash flows contributing to the continuity of the operations of the arrangement, this indicates that the parties have an obligation for the liabilities relating to the arrangement.

This is not a 'new' principle for recognition of assets and liabilities in IFRSs. IFRIC 4 *Determining whether an Arrangement contains a Lease* gives similar economic reasons that give evidence of whether an arrangement is, or contains, a lease.¹

Companies will face implementation issues

The letter also mentions that companies will face implementation difficulties when applying the requirements relating to 'other facts and circumstances'. The main examples that are provided of implementation difficulties are:

Additional information required

In our view, the need for additional information for the recognition of assets and liabilities arising from joint operations should not be a major constraint, because the

¹ Relevant paragraphs in IFRIC 4 are paragraphs 9, BC30-BC39.

information required should already have been available to entities when accounting for those interests under the equity method.

Contracts might need to change

We think that this is a possibility if the parties think that their contracts do not reflect the rights and economic substance they thought sought. In that case, this could be a positive effect of the IFRS.

Additional discussions with auditors about the classification

The letter states that the new IFRS generates additional audit costs. This is acknowledged in the Effect Analysis. All new IFRSs imply implementation costs for constituents.

The letter also mentions that application costs will be particularly high for start-up companies with research and development or production activities. The letter suggests that these cost considerations justify retention of the equity method for some joint operations. The purpose of the reforms was to increase the usefulness of the information presented in relation to joint arrangements. Unfortunately the letter from Business Europe does not provide any analysis of decision-usefulness, which is the basis for the Board's decision. This concern was also not raised in Business Europe's comment letter responding to ED 9.

Other matters

The letter mentions that joint arrangements that are not structured in entities are joint operations. This is perceived as being a rule. This requirement has not changed from either IAS 31 or ED 9 and this aspect of the exposure draft did not cause major concerns to constituents responding to ED 9. This matter was not mentioned in the comment letter written by Business Europe in response to ED 9.

Conclusion reached in the *Effect Analysis*

The letter also questions some of the conclusions reached in the Effect Analysis document; in particular, the expectation by the staff and Board that most 'jointly controlled entities' will be 'joint ventures' in accordance with IFRS 11.

The staff assessment has not changed. The staff have continued to discuss the new requirements with interested parties over the last few months. Their assessment remains that more jointly controlled entities will be joint ventures than joint operations. In addition, the staff assessment is that 'other facts and circumstances' will affect the classification of only very specific types of arrangements (only those designed as described in paragraphs B32 and B33 of IFRS 11). The purposes for which joint arrangements are established are many and the requirements in paragraphs B32 and

B33 relate to arrangements with a specific purpose that are designed in such a way that parties have rights to the assets, and obligations for the liabilities, of the arrangement.

For this specific type of arrangement, outreach was carried out with constituents in the oil and gas, mining, automotive and pharmaceutical industries. These industries will be some of the main industries affected.

In addition, all the major audit firms were also involved in all the stages of the development of IFRS 11.