

Stig Enevoldsen
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Avenue des Arts 13-14
B1210 Brussels
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15 January 2008

Dear Stig,

Please find attached the comment letter Mazars has sent to the IASB, as part of the Exposure Draft ED9 "Joint Arrangements".

Should you have any question related to our comments, please do not hesitate to contact Edouard Fossat or myself.

Best regards,



Jean-Louis Lebrun

ED 9 Comment Letters
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

11 January 2008

Dear Sir/Madam,

Exposure Draft ED9 - Joint Arrangements

Mazars welcomes the opportunity to comment on the Exposure Draft ED 9 - *Joint Arrangements* (referred to as the Exposure Draft or ED 9). Our general comments are given below together with a summary of our main concerns on the changes to IAS 31 proposed by the Exposure Draft. Detailed responses to the specific questions included in the Exposure Draft are attached to this letter.

We share the goals of ED 9

We support the general goals of ED 9 that are as follows:

- Convergence with US GAAP: we share the general support for convergence by the improvement of both sets of standards. As of today, we believe there are significant theoretical differences as regards the accounting treatment of joint arrangements, and it is sensible to try and eliminate these differences;
- Removal of the options offered under IFRS: we believe that the IASB's suggestion of removing the options included in the standards would improve the quality of financial information, by increasing comparability of companies' financial statements;
- Consistency of IFRS, particularly as regards the relationship between the standards and the *Framework*: while we do not wish to comment on whether or not proportionate consolidation is consistent with the *Framework*, we understand the Board's concerns regarding an accounting method which mixes exclusively-

controlled elements and portions of elements under joint control in the balance sheet.

As a consequence, we believe that IAS 31 could benefit from being revised. Such a revision is to be carried out through a comprehensive project on joint arrangements, shared with the FASB in respect of the Boards' engagement to achieve qualitative convergence.

However, we disagree with the IASB's approach to the project

While we agree IAS 31 could be improved, we strongly disagree with the IASB's approach to this project.

It appears to us that the entire project has boiled down to the removal of one type of accounting treatment for joint ventures – proportionate consolidation – in order to achieve convergence with US GAAP, without passing through any of the intermediate stages that we believe are necessary to such a project.

The necessary stages are as follows:

- *An in-depth assessment of the specific characteristics of joint arrangements.*
The Exposure Draft's Basis for Conclusions does not show any evidence of an in-depth assessment of what constitutes joint control, its specific characteristics, and what differentiates it from exclusive control or significant influence.
In fact, ED 9 proposes changes in the terminology and definitions for different forms of joint arrangements, without justifying them in the Basis for Conclusions. We feel that this confuses the definition of joint control as given in IAS 31 (the strategic financial and operating decisions require the unanimous consent of the venturers).
- *Analysis of the needs of the financial statements' users.*
Once again, the issue seems to have been reduced to the need to remove options from IFRSs in order to achieve convergence with US GAAP. The qualitative goals of financial statements, and particularly the quality of financial information and its utility in decision-making, seem to have been pushed to one side. In any case, the Basis for Conclusions does not give any indication that the Board considered usefulness of information or representation of the economic substance of operations when making its main decisions on ED 9.
- *Comparative analysis of the advantages and disadvantages of the two methods currently permitted under IAS 31 for recognising joint ventures in the accounts.*
We believe that such an analysis is absolutely essential before any decision is made to remove either of the options. The IASB has done no research into the relative benefits of the two methods. Only the proportionate consolidation method has

been analysed, and then only from the angle of consistency with the *Framework*. The IASB even admits, in BC 4 and BC 14, that the relevance of the equity method as the method to account for joint arrangements, or even its consistency with the *Framework*, has not been considered in this project.

Finally, we feel that ED 9 is simply the result of the wish to remove one accounting option with a view to making IFRSs converge with US GAAP. By doing this, the Exposure Draft has overlooked one of the key tenets of convergence, i.e. improving the quality and usefulness of financial information.

The removal of proportionate consolidation results in a drop in the quality of financial information

Current IAS 31 was revised in December 2003. This version states in paragraph 40: *“Some venturers recognise their interests in jointly controlled entities using the equity method, as described in IAS 28. The use of the equity method is supported by those who argue that it is inappropriate to combine controlled items with jointly controlled items and by those who believe that venturers have significant influence, rather than joint control, in a jointly controlled entity. This Standard does not recommend the use of the equity method because proportionate consolidation better reflects the substance and economic reality of a venturer’s interest in a jointly controlled entity, that is to say, control over the venturer’s share of the future economic benefits. Nevertheless, this Standard permits the use of the equity method, as an alternative treatment, when recognising interests in jointly controlled entities.”*

In the ED, the Board states the issue of consistency with the *Framework* as its justification for the removal of the proportionate consolidation method for recognising joint ventures.

In 2003, the Board did not address the issue of whether or not proportionate consolidation was consistent with the *Framework*. It simply noted that it was problematic to mix elements controlled exclusively and jointly in the same section.

It now appears to have changed its mind, although the Basis for Conclusions does not give any reason for this U-turn. What was once a mere issue of presentation is now deemed to be an inconsistency with the *Framework*, and consistency has taken precedence over a more accurate representation of the economic reality of operations in the context of joint ventures. BC 12 is clear on this point:

“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.”

We share the Board’s previous opinion, i.e. that proportionate consolidation represents the economic substance of an entity’s investment in a joint venture more accurately than the equity method, particularly in cases where the investment represents a strategic business.

With this in mind, we would like to remind the Board that joint ventures are the only way for Western companies to gain a foothold and expand in certain areas of the world. Removing proportionate consolidation would effectively mean that these groups cannot represent these development projects in their financial statements.

In our opinion (which the Board would seem to share according to paragraph BC 12 of the Exposure Draft or IAS 31.40), the removal of proportionate consolidation would result in a fall in the quality of information provided in the financial statements, which cannot be completely offset by additional disclosures required in the notes. Users of financial statements tend to focus on the primary financial statements, rather than the notes, as they give an overall summary of the company’s financial situation and performance.

Thus we cannot support such a downgrading of quality of financial information, only justified by ensuring consistency with the *Framework*. Besides we wonder whether the proposals in ED 9 are themselves consistent with the *Framework*, which deals with the qualitative characteristics of financial statements. The Board’s approach in ED 9 is difficult to reconcile with the *Framework’s* principles of *Relevance*, *Faithful representation* and *Substance over form*.

ED 9 seems to anticipate decisions which are dependent on the results of longer-term projects

If the proportionate consolidation method is inconsistent with the *Framework*, but nevertheless provides better financial information than the equity method, this can be understood in two ways:

- either it is necessary to develop a new method for recognising joint ventures in the accounts, which would both be consistent with the *Framework* and provide high-quality financial information;
- or it is necessary to modify the *Framework*, as its definition of assets and liabilities may be inappropriate.

In any case, we note that there is a current project to rework the *Framework*, which should address the definition of assets and liabilities. Therefore we feel it is premature to make changes to a standard like IAS 31 which is of key importance for the presentation of

financial statements, as the *Framework* project could subsequently call the changes into question.

Similarly, the concept of control is at the very heart of the *Consolidation* project. We feel that this project should address all types of control or influence, in order to define the precise and distinctive characteristics of exclusive control, joint control and significant influence. This would then form the basis for an accounting approach that would allow for appropriate recognition of investments in all three situations.

Finally, in the Draft Illustrative Examples, ED 9 states that rights of use should be recognised in the accounts. Once again, we believe that this decision is premature, given that:

- the accounting treatment of rights of use is only partially addressed under IFRSs;
- according to IFRIC 4 and IAS 17, the accounting treatment does not always result in the recognition of an asset in the accounts.
Moreover, the Board has not considered the consequences of applying these two regulations to the situations described in ED 9's Draft Illustrative Examples;
- the issue of rights of use is currently being examined by the Board in the context of its *Leases* project.

We thus believe it would be better to await the conclusions of this project, rather than introducing such an accounting treatment for rights of use, which could be extended by analogy to many other situations.

The removal of proportionate consolidation could have potential negative effects

Complex accounting treatments, difficult to implement and to explain

ED 9 claims that the legal form of a joint arrangement will have little impact on the accounting treatment of operations, and the Draft Illustrative Examples attempt to demonstrate this.

Take example 2, on joint interest in a jet aircraft. Leaving aside any questions over the relevance of the proposed solution, or the possibility of adapting the example for other situations (such as variations in the method used to finance the aircraft, or whether or not the venturers have to pay fees for usage), we feel that the accounting treatment becomes extremely complicated when the aircraft is owned by a joint venture.

The example effectively dissociates usufruct from bare ownership of the aircraft, in order to recognise the first as a right of use and the second as an interest in a joint venture accounted for under the equity method. This seems to go all around the houses in order

to achieve a very similar result to that which would have been achieved using proportionate consolidation. In this case, the cost/benefits ratio would seem to count against the solution proposed by the Board.

“Non-GAAP measures” expected to gain ground

Groups which chose proportionate consolidation to present their joint venture activities under IAS 31 are often much attached to this form of presentation, and measure the performance of the entity by taking account of the impact of proportionate consolidation in the various profitability ratios.

In the context of IFRS 8, a large number of these groups will continue to use proportionate consolidation to present their segment reporting - which will reduce comparability with the primary financial statements - and will develop, in the notes and the management commentary, non-GAAP measures which they feel better represent performance.

We feel that this approach is likely to reduce the clarity of financial statements and will certainly not make it easy for users to understand them.

Development of a purely legal approach to joint arrangements

Some of our clients, which regularly use joint arrangements in their operational structures, told us that they have subjected their contracts to legal analysis in order to identify the modifications to be made so that they can be considered as joint operations while maintaining the contracted economic balance.

This proves, if necessary, that ED 9 will emphasise the legal form of operations to the detriment of economic reality. This seems to us to be inconsistent with the *Framework*.

Joint ventures may be used as vehicles for derecognition of financial liabilities

Once joint ventures can no longer contribute to performance ratios, some groups may be tempted to use these entities, now accounted for under the equity method, as vehicles for derecognition of financial liabilities.

These groups, which opted for proportionate consolidation as they wished to emphasise profit and loss ratios over the gearing, could divert some financial liabilities into joint ventures, meaning these liabilities would no longer appear as liabilities on the balance sheet.

Moreover, when the venturers act as guarantors for a joint venture's liabilities, these liabilities do not appear on the balance sheet under the equity method. These would only come to light if the joint venture were to default.

We are convinced that this method of representation does not truly reflect the venturer's operational and financial commitments.

ED 9 does not achieve its convergence goals

While ED 9 appears to achieve its aim of convergence in principle with US GAAP, the Board appears to have overlooked the interpretation EITF 00-1, which permits oil-and-gas-producing entities and entities in the construction industry to use a form of proportionate consolidation ("equity method on a proportionate gross basis").

These two sectors frequently use joint ventures in their operational structures, in both the US and Europe, and a large majority of companies in these sectors have opted for proportionate consolidation, under both US GAAP and IFRSs.

Removing the proportionate consolidation option from IFRSs, while the FASB does not suppress reference to the sectors' exception permitted under EITF 00-1, would actually introduce a new divergence between US GAAP and IFRSs for sectors where joint ventures are frequently used.

Conclusion : an alternative method

In conclusion, while we share the general goals of the project, we believe that the Board has failed to provide adequate justification for its proposed changes, which would result in an impairment of the quality of financial information.

This is not surprising as the Board has not addressed all the aspects of joint arrangements; rather, it has only looked at a single element, the arbitrary removal of one optional method in order to achieve convergence.

We believe it is premature to modify IAS 31 at all, given that no in-depth analysis has been carried out into the specific characteristics of joint control and into the financial information on joint arrangements which is required by users of financial statements.

On the other hand, we agree with the Board that proportionate consolidation is not a perfect method, although it provides users with more relevant information than the equity method. The issues raised by ED 9 should be used as a starting point for the development of a new method for recognising and presenting joint ventures.

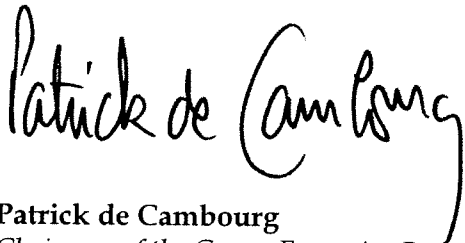
We suggest that the Board should look into an "expanded equity method", under which the venturer's share of the current and non-current assets and liabilities of a joint venture would be presented as assets and liabilities, but separately from other assets and liabilities. The profit from ordinary activities produced by joint ventures and the operating costs related to joint ventures, along with financial elements and tax, could be presented in the income statement, separately from other elements.

Under this method, activities carried out through joint ventures would still be taken into account in sub-headings of the income statement and the assets and liabilities of the joint ventures would be recognised in their respective part of the balance sheet. However they would not be mixed up with elements that are exclusively controlled.

In any case it is the Board's duty, as part of the *Joint Arrangements* project, to assess the relevance of the equity method as well as of proportionate consolidation, and of any other method which might be considered for recognising the specificities of joint control.

We would be pleased to discuss our comments with you and remain at your disposal should you require further clarification or additional information.

Yours sincerely



Patrick de Cambourg
Chairman of the Group Executive Board

Appendix

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?

Mazars' comments

- 1.1. In the current IAS 31, we note that specificities of joint control are assessed in the definitions, right after the scope of the standard and before going through the characteristics of joint arrangements. This gives weight to the notion of control and to the differences between control, joint control and significant influence.
- 1.2. On the contrary, in ED 9, the Board proposes to start by describing the types of joint arrangements that may exist, and then to break down the core principle of ED9 into accounting rules applicable to each type of arrangement. This leads in our opinion to a rule-based approach that focuses on the legal form of the arrangement rather than on its economic substance.
- 1.3. Moreover, the defined terms are addressed only in Appendix A. Joint control and its specific characteristics are thus relegated to the background, whereas we believe these issues are at the very heart of joint arrangements. Moreover, the definition of joint control has been altered, in such a way as to water it down, as it now only refers to situations involving “*shared decisions*”, rather than situations where “*the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers)*”.
- 1.4. We feel it is highly necessary to provide definitions relating to joint control before entering into the analysis of the three different forms of joint arrangements. We also think that the Board should explain in the *Basis for Conclusions* why it proposes to change the definition of joint control.
- 1.5. Moreover, the accounting arrangements for different types of joint arrangements proposed in ED 9 make reference to the concepts of “rights to assets” and “rights of use”, which have not previously been defined.

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?

Mazars' comments

- 2.1. Fundamentally, it seems reasonable that an entity should recognise its contractual rights and obligations relating to an arrangement in its financial statements.
- 2.2. However, we note that other IFRSs do not necessarily apply this general principle. For example, IAS 17 does not require recognition of contractual rights (the right to use a leased asset) and obligations (the obligation to pay rent) in the case of operating leases.
We believe that the principle of recognising contractual rights and obligations should be integrated into IFRSs on the condition that its application results in a faithful representation of the substance of the contracts.
- 2.3. We cannot give a definitive opinion on whether this principle will achieve the above aim in the case of ED 9. We feel that the concepts relating to this general principle, and to its consequences for the accounts, have not been sufficiently clearly defined.
- 2.4. In particular, there does not seem to be a clear distinction between the concepts of the right to use an asset, and interest in an asset. Similarly, ED 9 is not clear on the obligations that must be recognised in the case of a joint arrangement: is it limited to legal and contractual obligations, or should implicit obligations also be taken into account? How should one deal with solvency guarantees provided by one venturer,

particularly in relation to the commitments made by the other partners in the joint venture?

- 2.5. Answers to these questions are not given in the Draft Illustrative Examples, which describe extremely over-simplified situations and yet sometimes provide extremely complicated and confusing solutions.

We feel that the Draft Illustrative Examples reflect the overriding emphasis placed on the legal form of the arrangement when deciding on the accounting treatment. This does not seem to us to be compliant with the Board's objective as defined in IN 1 and that we described in paragraph 2.2 above.

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?

Mazars' comments

- 3.1. We do not agree that proportionate consolidation should be eliminated, for the following reasons:
- 3.2. No analysis has been carried out to determine whether the equity method is appropriate to joint venture accounting.
Proportionate consolidation is presented in the current IAS 31 as the preferred method, in that it provides better financial information than the equity method. We believe that a comparative analysis of the advantages and disadvantages of both methods, with reference to the ultimate aims of the financial statements, needs to be carried out before either of them is eliminated. In particular, the chosen method must faithfully reflect the economic reality of the joint venture operations and provide relevant financial information to the users of the financial statements.
- 3.3. The elimination of proportionate consolidation results in a fall in the quality of financial information.
We believe that the characteristics of joint control are very different from those of significant influence, and that the equity method does not allow a faithful representation of the specificities of joint control and the economic substance of joint venture transactions. In fact, it results in a loss of information for the users of financial statements, as the transactions carried out in the context of joint ventures do not show on the face of the balance sheet or under the entity's operational performance indicators, on which financial communication is generally based. Providing additional information in an appendix does not make up for this loss of quality of the primary financial statements.
- 3.4. It has not been demonstrated that proportionate consolidation is not compliant with the *Framework*.

In 2003, when the current IAS 31 came into effect, the Board did not mention the issue of non compliance of proportionate consolidation with the *Framework*. In contrast, it did note that proportionate consolidation had the disadvantage of combining exclusively-controlled and jointly-controlled elements in the same section. Now, the Board seems to have changed its mind, apparently considering proportionate consolidation not to comply with the *Framework*, but without giving any justification for this turnaround in the *Basis for Conclusions*. While we agree that proportionate consolidation is problematic as regards presentation, we feel that this method fulfils the objective for financial standards as stated in the *Framework*, i.e. providing information on financial performance that will be useful to users. In particular, where joint venture operations are concerned, the information provided under proportionate consolidation meets the demands of the *Framework* in terms of qualitative characteristics (understandability, relevance, reliability and comparability). This is not true of the equity method, in our opinion.

We believe that the main objective of ED 9 should not simply have been to remove proportionate consolidation altogether, in favour of a method which provides an inferior quality of financial information; rather, it should have proposed modifications which could be made to proportionate consolidation in order to retain its advantages while overcoming the balance sheet presentation issues mentioned in the current IAS 31. On this subject, see our proposal for an alternative method at the end of our cover letter.

- 3.5. We believe it is premature to eliminate proportionate consolidation on the grounds of non compliance with the *Framework*, considering that a project to re-work the *Framework* and a Consolidation project (dealing with the issue of control) are currently under way.

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?

Mazars' comments

- 4.1. First of all, we would like to reiterate that we are opposed to the elimination of proportionate consolidation.
- 4.2. However, if the Board sticks to its decision to impose the equity method on joint ventures, we believe that ED 9 does not require enough disclosures as regards jointly controlled entities.
- 4.3. Indeed, the venturer's involvement, which is stronger than involvement in an associate, must be taken into account at least in the notes to the financial statements by requiring additional disclosures on sub-headings used by the venturer in the income statement or to measure the entity's performance. Thus, in our opinion, the mere disclosure of summarised financial information for each individually material joint venture is not appropriate:
 - we believe that information should not be provided individually for each material joint venture, but as a total for all joint venture operations;
 - the information provided should not be limited to total current and non-current assets and liabilities, in the income statement and the balance sheet, but should present the whole impact of joint ventures using a summarised balance sheet and income statement presentation, with particular emphasis on the main operating performance indicators.

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?

Mazars' comments

5. Yes, we believe this information would be useful. Moreover, a large number of entities still provide this information even though it is no longer compulsory under IFRS.

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?

Mazars' comments

6. While we believe information on current and non-current assets and liabilities is important – and still insufficient – as regards joint ventures, we are not convinced that it is relevant where associates are concerned. As far as we are aware, users do not expect anything of the sort.

Other issue:

We note that no transitional provision is set out in the exposure draft.