

# Rådet för finansiell rapportering

## The Swedish Financial Reporting Board

RFR-rs 2008:1

International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

### ED 9 Joint Arrangements

We appreciate the opportunity to respond to the International Accounting Standards Board's Exposure Draft ED 9 Joint Arrangements. This letter represents the views of the Swedish Financial Reporting Board.

We have serious concerns with the proposal in the ED 9 Joint Arrangements to remove proportionate consolidation and to make equity accounting mandatory.

Our main concerns are as follows:

- equity accounting will in many joint control situations not lead to accounting that is relevant. The IAS 31 states, and we concur, that proportionate consolidation better reflects the substance and economic reality of a venturer's interest in a jointly controlled entity
- the ED does not in sufficient detail consider and evaluate the difference between significant influence and joint control
- the ED does not convincingly explain why the preferred approach in IAS 31 is now not acceptable
- radically changing accounting for joint control by prohibiting proportionate consolidation is a too big step to deal with in a short term convergence project
- the ED is based on a too narrow interpretation of the Framework's definition of assets
- the ED does not result in convergence with US GAAP

## General Remarks

### Accounting will not be relevant

Many Swedish national as well as multinational companies are part of joint arrangements and use to a large extent the option recommended by IAS 31, proportionate consolidation, as they are of the view that this method is much more suited for reporting the extent of its operations and exposure. Swedish industry is very clear about that eliminating proportionate consolidation would impair faithfully representing joint arrangements. Proportionate consolidation is by many preparers and users seen as a method well suited for reporting of performance (including margins), extent of operations and risk exposure of joint arrangements. Joint ventures are as of today the only alternative when considering establishment in an emerging market such as China. The removal of the option to report a joint arrangement according to the proportionate method would result in a "one-line"- effect in the financial reports irrespective of the size of the new establishment.

In BC12 the IASB acknowledges that there are 'some' that 'argues' in favour of proportionate accounting for 'practical' purposes and then dismissed the use of proportionate accounting with the statement: '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 recognizes 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.' If the case would be that IAS 31 creates misleading information, it is very hard for us to understand why IAS 31 did ever give proportionate consolidation the status of the 'preferred option', and remained the preferred option even though IAS 31 was part of the Improvement Project. We urge IASB to

- take users and preparers views more serious, than what at least the wording in BC 12 implies
- use a more constructive approach and explore new alternative routes
- not use the Framework as an overriding tool based on applying just one aspect of the Framework ignoring other important parts of the Framework, especially as the Framework is currently under revision and has not been followed in that detail in a number of Standards developed during the last years and
- more thoroughly investigate the user's views on the current practice before suggesting removal of well established financial reporting principles

Joint arrangements are used to a large extent for various reasons and we believe that cooperation between companies using different forms of joint arrangements will rather increase than decrease, as business becomes more and more global, more

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sophisticated and involving more of multi-element deliverables. It is not unlikely that the a big part of the business many companies will conduct will be in the form of joint ventures. We do not believe that using equity accounting for these business models will enhance the value of financial reporting, rather will the the opposite be the case.

## **Difference between significant influence and joint control**

There are three basic levels of control and influence to consider for financial reporting purposes in consolidated financial statements, control, joint control and significant influence. As these three concepts in many cases represent three very different situations in substance, we believe they also merit three different ways to be presented in financial statements. We have full consolidation for controlled entities, equity accounting for significant influence and proportionate consolidation or a similar method to be developed as the joint control consolidation model. At least we believe that such an approach should be explored before eliminating the IAS 31 proportionate consolidation option. It is our impression that the IASB has not in enough detail evaluated the differences between significant influence and joint control and the implications for financial reporting of the differences.

## **Preferred approach in IAS 31 now not considered acceptable**

The IASB states that the objective of ED 9 is to remediate two aspects of IAS 31 that the Board considers are an impediment to high quality reporting of joint arrangements. Those aspects are that the form of the arrangement is the primary determinant of the accounting and that an entity has a choice of accounting treatment for interests in jointly controlled entities. In our view the IASB is exaggerating the deficiencies of IAS 31.

The view presented in IAS 31 regarding the preferred method to account for joint ventures is the following: 'IAS 31 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 recognizing interests in jointly controlled entities.' Now the IASB in the ED takes the totally opposite view, declaring proportionate consolidation inappropriate referring just to one aspect of the Framework, see BC 8-9. We believe this is a too simplistic way to handle an important financial reporting issue, prohibiting future use of a well established and accepted way of presenting joint ventures. We urge the IASB, to further analyze the complicated presentation issues involved in accounting for joint ventures, before moving forward to make changes to IAS 31.

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### **The Swedish Financial Reporting Board**

Box 7680 SE-103 95 STOCKHOLM Sweden  
Tel: +46-8-50 88 22 79 Fax: +46-8-32 12 50  
[www.radetforfinansiellrapportering.se](http://www.radetforfinansiellrapportering.se)

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## **Changes are too radical to be part of a short term convergence project**

The IASB has 'indicated' that it will exclude options of accounting treatment from accounting standards when possible. We agree in principle that options should be taken out of Standards, when the options provide an opportunity to report similar transactions in more than one way. Still, it is very important that before eliminating alternatives, thorough investigations should be made of both current alternatives and new possible solutions, that could be preferable. Short-term convergence projects do not include all these steps and should for this reason, only be used for less complicated issues than reporting for joint arrangements. There can also be situations where options are warranted, due to that very different situations are reported based on the same standard, as in our view the case is for joint ventures.

## **A too narrow interpretation of the Framework's definition of assets**

While we agree that individual assets of a joint venture are not controlled by the individual venturer and, due to lack of control, does not conform with the Framework definition of assets, in our view the Framework should be considered from a broader perspective, evaluating accounting issues and changes to Standards. There are several aspects to consider, when evaluating whether or not an accounting treatment is in accordance with the Framework, such as qualitative characteristics of financial statements where important aspects are users information needs, understandability, faithful representation, relevance and comparability requirements included in the Framework.

## **No convergence with US GAAP**

ED 9 is part of the Short-term Convergence project. The proposals have not been deliberated by the FASB and will, as we understand it, not lead to any changes in financial statements based on US GAAP. Some analysis carried out comparing ED 9 with the equivalent US GAAP points to that ED 9 will not lead to converged reporting of joint arrangements, in a number of cases such as the Illustrative Examples 3, 5 and 6.

BC24 argues that ED 9 would in principle achieve convergence with US GAAP. US GAAP generally requires the use of the equity method to account for jointly controlled entities. Yes, US GAAP generally requires the equity method, but the deliberations of the Task Force in EITF 00-1 recognized the longstanding practice in the extractive and construction industries of displaying equity-method investments in separate legal entities on a proportional basis in the financial statements of the investor. The AICPA Audit and Accounting Guide, Construction Contractors, provides that in accounting for joint ventures, the use of the pro rata consolidation method is acceptable if the

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investment represents a bona fide undivided interest. Also, the AICPA Audit and Accounting Guide, Entities with Oil and Gas Producing Activities, notes that pro rata consolidation of unincorporated joint ventures is often used in the oil and gas industry. The proportionate consolidation practice in the construction and extractive industries is also recognized in AIN-APB 18. Thus the removal of one option as suggested in ED 9 will only create partial convergence. We doubt that convergence, in this case, is such a strong argument as the IASB implies in the Basis for Conclusions.

Convergence should be a two way route. We believe ED 9 is a one way route through which the IASB is accepting parts of old US GAAP principles without thoroughly investigating how reporting of joint ventures could be improved.

## **Concluding comments**

As indicated above we disagree with the IASB's proposals. To propose such significant changes as a result of a short-term, limited scope, convergence project we do not consider to be appropriate. Any possible positive effects of an implementation of these proposals will be significantly exceeded by the negative effects that will be the result of companies changing their reporting for joint ventures in a manner that will result in a less relevant financial reporting that, in our opinion, will be unfaithful. In our view the part of ED that proposes elimination of the option to use proportionate consolidation to account for joint ventures should be withdrawn.

As we consider that our comments above well represent our views we are not responding to your questions. However, we provide below certain proposals for matters to consider in the future for changes in the reporting for joint ventures. These proposals are provided based on the assumption that any such proposals for changes will provide a more appropriate and robust basis of accounting for joint ventures. In addition, we also comment on Illustrative Example 6.

## **Matters to consider in a future change in the reporting for joint ventures**

- Clarifying that a reporting entity can not chose between the two options without any underlying clear principle, clearly prohibiting using different options for joint arrangements with similar characteristics.
- If proportionate consolidation would be eliminated, we believe that many reporting entities, based on the management approach in IFRS 8, would continue to use proportionate consolidation for internal reporting, and hereby segment reporting would increasingly differ from the primary financial statements.

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- Exploring, if it would be possible and desirable, to create principles for what types of joint arrangements that should be accounted for based on proportionate consolidation and what types of joint arrangements that should be accounted for using equity accounting. A possible approach for this test could be as follows:
  - Proportionate consolidation to be made mandatory for joint arrangements, where the arrangement is an extension of the key operations of the entity and is a part of its strategic cooperations with other parties
  - Equity accounting to be made mandatory for joint arrangements, not being an extension of the key operations of the entity, but rather financial arrangements, in such cases where the key operations of the reporting entity not being financial services
- Using extended disclosure requirements to remediate the IASBs concern that proportionate consolidation is in conflict with the Framework

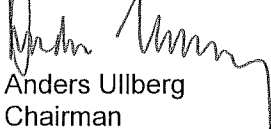
## Comments to the Illustrative Example 6 - Oil and gas "farm-in" arrangement

We note that in this example there is a gain in connection with a change in interest, as a result of a farm-in arrangement. The GAAP presently used by many oil & gas companies, including those using US GAAP, would not allow for a gain to be recorded, but would require the investment to be reallocated to the retained share in the field. We consider that this accounting procedure should be reviewed as part of the Extractive Industries project, which also could include a convergence with US GAAP, and, as a consequence, we recommend that the example be deleted.

If you have any questions concerning our comments please address our Executive member Carl-Eric Bohlin by e-mail to: [carl-eric.bohlin@radetforfinansiellrapportering.se](mailto:carl-eric.bohlin@radetforfinansiellrapportering.se)

Stockholm, January 28, 2008  
Yours faithfully,

THE SWEDISH FINANCIAL REPORTING BOARD

  
Anders Ullberg  
Chairman

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