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Le Président
JFL/PhS
N°06

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The ED9 Project Manager
IASB
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ED9 JOINT ARRANGEMENTS

Dear Sir/Madam,

I am writing on behalf of the CNC to give you our comments on the above-mentioned Exposure Draft. Our detailed comments are set out in the Appendix.

The CNC considers the accounting treatment of joint arrangements to be of strategic importance for its constituents. Joint arrangements and in particular joint ventures are widespread business models, essential to gain access to certain geographical markets and an important source of growth in many activities.

For this reason, we subscribe to the main objective of ED9 which is to "enhance the faithful representation of joint arrangements that an entity provides in its financial statements" including the principle that "The form of an arrangement is no longer the most significant factor in determining the accounting." We also support the objective of convergence to the extent that it contributes to the comparability of financial statements.

However we do not believe that the changes proposed by ED9 will achieve the above objectives:

Core principle

The core principle defined in IN4 is that "Parties to a joint arrangement recognise their contractual rights and obligations arising from the arrangement." However, the related accounting concepts are not clearly defined in the Exposure Draft.

The core principle appears difficult to apply in practice because the definitions of joint arrangements are unclear or complex to implement:

- It is unclear , in the case of joint assets , whether the assets to be accounted for by the parties to the arrangement are intangible assets or portions of tangible assets
- The Exposure Draft would appear, as illustrated in Example 2, to introduce a two-tier recognition mechanism for assets, broken down into rights of use and residual value .After recognition of the individual rights directly held , each party then recognises his share in the residual value held via the joint venture entity. Joint venture assets and liabilities would therefore appear to be defined by difference.

Faithful representation of joint arrangements

ED9 proposes the elimination of the option to use proportionate consolidation as a method of accounting for a joint venture .Under the proposals in ED9 the "equity method" is the only method allowed.

However, ED9 does not demonstrate that the "equity method" provides a more faithful representation of the economic substance of joint ventures:

- The IASB considers in BC14 that the question of the relevance of the equity method compared to possible alternatives is outside of the scope of ED9.
- The IASB, when revising IAS 31 in December 2003, considered that proportionate consolidation was the better method of accounting for joint ventures, in that it more faithfully represents the economic substance of these arrangements (see IAS 31.32). No evidence to the contrary is produced in support of the proposals of ED9.
- The Board recognises in BC14 that joint control and significant influence are different. However, according to ED9, joint ventures and associates should be accounted for in the same way (i.e. using the equity method), although no conceptual analysis is provided in support of a common accounting treatment. We are not convinced that applying a unique accounting treatment to very different situations represents an improvement of the quality of the financial statements.
  Indeed, no analysis of the specific characteristics of joint control is carried out in ED9 as a preliminary to demonstrate that the equity method is the relevant one for joint ventures. Instead, according to BC14 the Board appears to support the equity method "because it has been used to account for joint ventures in jurisdictions around the world for many years". We could answer that proportionate consolidation also has been used to account for joint ventures in many other jurisdictions around the world for many years.
- In spite of the objectives set out above, under ED9 the legal form of joint arrangements determines the proposed accounting treatment as illustrated by Examples 2 and 4. Transactions of similar economic substance may receive different

accounting treatment, as shown clearly by Example 4.Once again this is not an indication that ED9 provides an improvement of the quality of the financial reporting.

- A consequence of the elimination of proportionate consolidation is that key operating information on the joint venture activities such as turnover, operating result, joint venture assets and liabilities will not be presented in the primary financial statements, but in the notes. Therefore, the primary financial statements will be less relevant for users, and groups will be obliged to compensate in the notes.
  This could lead, for example, groups to develop non-gaap measures in their information on operating segments, and focus their management commentary on information outside the primary financial statements .In our view this results in a downgrading of the primary financial statements which no longer represent the substance of the activities under joint arrangement.

Convergence

Moreover, we are not convinced that the second objective of ED9, which is short term convergence with US GAAP, has been fully attained.

Indeed, under US GAAP, EITF 00-1 permits the use of proportionate consolidation for certain industries (oil-and-gas and construction industries) where joint ventures represent a significant and strategic part of their activity. Since these exemptions are not envisaged in ED9, the elimination of proportionate consolidation in IFRS will create divergence for these specific industries, instead of convergence.

The existence of the above exemptions under USGAAP also tends to confirm the view that proportionate consolidation is an appropriate accounting method for joint ventures, in particular where the latter represent a significant and strategic part of the activity.

Timing in relation to key projects

We already noted that before issuing ED9, the Board did not analyse the specific characteristics of joint control. Such an analysis would have enabled the relevant accounting treatment for joint ventures to be determined.

Without this analysis, the Board's main argument against proportionate consolidation, set out in BC8, is that, when a party accounts for its interest in a jointly controlled entity under this method, "it recognises as assets and liabilities a proportion of items that it does not control or for which it has no obligation. These supposed assets and liabilities do not meet the definition of assets and liabilities in the Framework."

We are not convinced by this argument .It precludes, for example, recognising a party's share in a joint venture liability because it is not a present obligation of the party. This would not seem consistent with recognising a liability in a full consolidation which is not an obligation of the holding company e.g. a liability of a subsidiary not guaranteed by the holding company. Furthermore, this argument makes reference to the concept of control and the definitions of assets and liabilities which are currently under review in the IASB's Consolidation, and Conceptual Framework projects.

ED9 also requires an entity to recognise its contractual rights and obligations arising from a joint arrangement. However, these concepts as applied to joint arrangements and more particularly to joint assets are unclear .The ED stipulates, for example, that a party shall recognise its share in joint assets according to the applicable IFRS, through a right of use, although IFRSs do not deal with portions of assets and the "Leases" project, dealing with the concept of right of use, is still in progress.

Given the disruption which will be caused by the implementation of ED9's proposals because of their impact on corporate communication, as stated above, and business strategies (see below), we question whether it is advisable to anticipate the outcome of these key projects, or to significantly amend a standard which would need further changes after these projects are completed.

Undesirable consequences on business strategy

Some of our constituents have indicated that the introduction of the proposals in ED9 will have undesirable effects on business strategy, as follows:

- Some of them are seeking to convert their joint arrangements into joint operations in order to continue to apply a form of proportionate consolidation ; this indicates that the proposals in ED9 are perceived as linking the accounting treatment to the legal form of the arrangement, as stated above;
  The loss of key data in the primary financial statements under equity accounting will influence management decisions with respect to project selection;
- Some joint ventures could be used by entities as vehicles for deconsolidation of liabilities through the equity method.

Conclusions

In conclusion, we believe that the proposals in ED9 will lead to a deterioration of the quality of financial reporting of those groups for which joint arrangements represent a major part of their activity or a strategic means of development.

Moreover, as stated above, there may be undesirable consequences on the business strategy of our constituents.

The proposed changes, including the elimination of proportionate consolidation, are not supported by a conceptual analysis of the specific characteristics of joint control and joint arrangements, which should be carried out in conjunction with the IASB projects on Consolidation and Conceptual Framework. These reflections are a necessary preliminary to determining the relevant accounting treatment, whether the model currently exists or needs to be created.

Therefore , in our view no changes should be made to IAS 31 until the concepts of joint control and asset definition are clarified .Only then can an appropriate accounting treatment be determined for joint arrangements.

We hope you find these comments useful and would be pleased to provide any further information you might require.

Yours sincerely,

Jean-François Lepetit

APPENDIX

Exposure Draft
ED 9 JOINT ARRANGEMENTS

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?

CNC'sComments

1.1. We are not aware of any difficulties with the current definitions in IAS 31.We do not see the advantages arising from the new definitions, in particular because they introduce the concept of rights and obligations in a joint arrangement which require clarification as stated below.

1.2.We feel concerned with the new definition of "joint control", which appears to us less explicit than the existing one in IAS 31 .In the new definition , the notion of "**strategic** financial and operating decisions **relating to the activity** " is replaced by "financial and operating policies of a venture". The reference to the **"unanimous consent of parties sharing control"** is omitted in the new definition although this is captured in the definition of "shared decisions".

1.3. We are, however, uncertain about the exact meaning of the definition of joint assets .The use of the term "rights" or "rights to a share of the asset "in §11 to §13 as opposed to a "share of the asset" suggest that the reference here is to a right of use rather than a direct share of the particular asset .A clarification of this point is required as it has consequences on the resulting accounting treatment.
1.4. The distinction made in Example 2 between the "right to use" an asset and its "residual value" seems to suggest that ED9 is splitting down assets into component parts and introducing a two-tier recognition mechanism where the right of use held by each party is recognised directly in their respective financial statements, whereas the residual value held by the joint venture is incorporated into their financial statements via their interest in the joint venture by the equity method.ED9 would ,therefore, appear to be introducing un-validated concepts which lead to a more complex recognition process.

1.5. We understand that a party may recognise his portion of a joint asset and that the IASB considers this to be consistent with the Framework. However, where this portion is held via a joint venture entity the venturer cannot consolidate his proportion of the asset, even where the substance of the arrangement is fundamentally the same.ED9 argues that proportionate consolidation of the asset in inconsistent with the Framework. On this point the proposals of ED9 would appear to be inconsistent and give pre-eminence to legal form over economic substance in determining the accounting treatment .We further suggest ,that if the strict application of the Framework does not permit the recognition of the economic substance of a transaction, it may mean the Framework needs revising.

1.6. Where the entity’s rights correspond to a right of use, we believe that the accounting treatment should be consistent with the other IFRSs or IFRIC dealing with the subject. “Rights of use” is a general issue that goes far beyond joint arrangements, and is already dealt within IFRIC 4 and IAS 17. We are not convinced that an IFRIC 4 analysis could lead to the same accounting treatment as that proposed in ED9.

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?

CNC’s Comments

2.1. As a general principle, we agree that an entity should recognise its contractual rights and obligations in its financial statements. However, we are not able to conclude that this approach is relevant in the case of a joint arrangement, because we think that the underlying concepts are not clearly defined in ED9. (See our comments in 1 above.)

2.2. As stated in our answer to question 1, we believe that ED9 does not recognise joint control as a specific concept with a specific accounting treatment.
This specific treatment should lead to a faithful representation of the entity’s activities and the economic substance of the arrangement.
Although, as stated in BC14, the Board recognises joint control is quite a different concept to significant influence, no attempt is made to differentiate the accounting treatment since the equity method is proposed in both situations.

2.3. We do not consider that the proposals in ED9 ensure this faithful representation. The legal form of the arrangement seems to be the most significant factor in determining the accounting treatment according to ED9, which seems inconsistent with the objectives of the ED.
We refer to example IE2, which shows that the legal form of the arrangement modifies the accounting treatment under ED9:

1. In the case of direct ownership of the aircraft by the parties to the joint arrangement, Example 2 requires them to recognise of a right of use of the aircraft and a right to a share of any residual value of the aircraft.
   If the aircraft is transferred to an entity, the right of use will be still recognised by the venturers, but the right to the residual value will remain within the joint venture entity, and recognised by the equity method.

2. The difference of accounting treatment between the two legal situations would be even greater if the joint venture entity carried the financing of the aircraft. In this case, the debt would not appear directly in the venturer's accounts, but could result in a negative equity value.

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?

CNC’s Comments

3.1. In our view, it is premature to eliminate proportionate consolidation. A full study is required to determine the appropriate accounting treatment taking into account the specific characteristics of joint control. We do not believe that the IASB has demonstrated that the equity method is the appropriate accounting treatment.

3.2. We consider, as explained below, that the proposals contained in ED9 will lead to a deterioration of the quality of financial reporting and will not therefore meet the objective set out in IN1 which is to “enhance the faithful representation of joint arrangements that an entity provides in its financial statements”.

3.3. Joint venture operations are an integral part of the core business of many of our constituents and represent in some cases 70% or more of their turnover and operating results. These operations are generally consolidated proportionally .According to the proposals in ED9, the primary financial statements of such entities will no longer reflect the net assets, turnover and operating result of their core activities derived from joint ventures. We, therefore, agree with the view expressed in BC12 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.” That view is already reflected in the current version of IAS 31, which stipulates that reflecting the economic substance of a joint arrangement is a priority which supersedes the conceptual problem of recognising jointly controlled items (IAS 31.40).

3.4. Constituents have indicated that, in view of the consequences indicated in 3.3 above, the introduction of ED9 could have a negative impact on both business and financial communication strategies .Certain constituents will reconsider the legal structure of existing joint ventures or future joint venture projects, with the risk that some projects may be abandoned if such a restructuring is not possible.

3.5. In order to make up for the loss of information indicated above, groups will need to adapt their communication strategy, through segment reporting or management commentary.
One of the main consequences of the proposals in ED9 is that all the key operating information on the joint venture activities, assets and liabilities will not be presented in the primary financial statements. Therefore, the primary financial statements will be less relevant for users, and groups will be obliged to compensate in the notes.
This can lead to undue costs and efforts for entities currently applying proportionate consolidation: these entities will need to develop specific information for primary financial statements while maintaining current consolidation procedures for internal reporting and relevant information in the notes.

3.6. We also wish to underline the difference between joint control and significant influence and suggest that such different economic arrangements merit different accounting treatment. Although this difference is acknowledged by the Board, as stated in BC14, the consideration of an alternative to the equity method is stated to be outside the scope of ED9.The IASB provides no conceptual justification for retaining the equity method as an appropriate representation of joint control .Instead the Board relies on the pragmatic argument that "the equity method has been used to account for joint ventures in jurisdictions around the world for many years".

3.7. We note that proportionate consolidation has also been used to account for joint ventures in many other countries over the world for many years. We also note that in US GAAP, requiring the use of equity method for joint ventures, there exists a specific exemption for certain activities where joint arrangements are a common business model.

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?

CNC's Comments

4. We refer to our previous remarks that ED9 leads to relegating key operating information to the notes and as such renders the primary financial statements less relevant for users.

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?

CNC's Comments

5.1 We note that many of our constituents continue to disclose a list of their main subsidiaries, associates and joint ventures, as it is useful information. We support the Board proposal in ED9.

5.2. The requirement of §39(b) to provide information "for each individually material joint venture" may lead to the disclosure of commercially sensitive information.

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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?

CNC's Comments

6. We make a clear distinction between joint ventures and associates, with regard to the nature and level of control/influence. We disagree with the Board's proposal to apply the same accounting treatment to joint venture and associates. We equally disagree with having the same disclosure requirements for both.

We do not believe that the distinction current/non current is relevant for associates since significant influence does not necessarily enable the entity with influence to control the allocation of assets and liabilities.

Other comments

Loss of joint control without retaining significant influence (§28 to §32 of ED9)

The Draft revised IAS 27 (to be published in January 2008 within the Business Combinations project) requires re-measurement at fair value of the residual investment remaining after loss of control of a subsidiary, joint control in a joint venture or significant influence in an associate. Any difference arising on re-measurement should be dealt with through profit and loss. The CNC already expressed its disagreement with this treatment in its comment letter.

The above treatment is justified by the Board in the Basis for Conclusions (BC 27 Y):
"Measuring the [remaining] investment at fair value reflects the Board's view that loss of control of a subsidiary is a significant economic event. The parent-subsidiary relationship ceases to exist and an investor-investee relationship begins that differ significantly from the former parent-subsidiary relationship. Therefore, the new investor-investee relationship is recognised and measured initially at the date when control is lost."
The Board further argued that (BC 27 AH) "the loss of control of a subsidiary, the loss of significant influence over an associate and the loss of joint control in a jointly controlled entity are economically similar events ; thus they should be accounted for similarly. The loss of control as well as the loss of significant influence or joint control represents a significant economic event that changes the nature of an investment."

ED9 proposes an amendment to these requirements by eliminating re-measurement on loss of joint control where the residual investment is under significant influence on the grounds that there is no change in accounting treatment.
This proposition appears to be in contradiction with the revised IAS 27 to the extent that the latter standard recognises that joint control and significant influence are different situations and that going from one to the other is a significant economic event that gives rise to re-measurement. The fact that the accounting method remains unchanged does not mean that the economic event is less significant.

This point illustrates the idea that if "economically similar events should be accounted for similarly" (IAS 27 BC 27 AH), we believe that the accounting treatment for such dissimilar situations as joint control and significant influence should, in any case, be different.