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Accounting Standards Committee of Germany
Der Standardisierungsrat

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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
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Berlin, 07 January 2008

Dear David,

Exposure Draft ED 9 Joint Arrangements

We appreciate the opportunity to comment on the International Accounting Standards Board's Exposure Draft ED 9 Joint Arrangements. This letter represents the view of the German Accounting Standards Board.

In general, we support the objective of convergence of IFRSs and US GAAP. However, we disagree with the way how this is achieved in the context of ED9. This is because convergence does not mean the mere adoption of existing accounting standards by another standard setter. Rather, a critical analysis of accounting alternatives is needed to select the most appropriate one. We believe that ED9 does not contain a sufficient analysis. In the end, the proposals of ED9 go beyond the scope of a short-term convergence project.

Our main concerns are as follows:

- Within the joint venture project it seems that only the proportionate consolidation method was analysed with regard to its conceptual validity. We do not believe that it is sufficiently compelling to eliminate the proportionate consolidation method merely, because that method is assumed to fail the test, when on the other hand the equity method or other alternatives were not analysed in the same way.
- The core principle of ED9, which leads to splitting up assets into rights, seems to change underlying accounting concepts and principles such as the definition of an asset and its boundaries that should be codified in the Framework rather than on a standard's level. It appears that ED9 prejudges the outcome of *Phase B: Elements and Recognition* of the *Framework Project*.

- Moreover, the IASB is undertaking a number of further projects, which are based on underlying concepts such as the recognition of assets and the definition of control, e.g. the projects *Framework Phase D: Reporting Entity, Consolidation* or *Leases*. We are not sure to what extent the IASB has considered the affects of the changes ED9 will bring about on other projects.
- We believe that splitting up assets into rights will cause a lot of complex issues on initial accounting and even more so on subsequent accounting. We seriously doubt that the core principle can be implemented in practice as many complex valuation issues arise.
- Finally, the primary objective of the joint venture project, being convergence with US GAAP, is still not fully achieved. I.e., exceptions under US GAAP still allow oil- and gas-producing entities and entities in the construction industry to apply proportionate consolidation. Further, in case of a joint venture established by a legal entity US GAAP does not require recognising direct interests in the assets of that entity by the venturer as proposed by ED9.

Overall, we disagree with the proposals in ED9. In particular, we disagree with the elimination of proportionate consolidation, because ED9 does not give compelling criteria showing that the equity method is conceptually superior to proportionate consolidation.

For the detailed comments we refer to the appendix to this comment letter.

If you would like to discuss any aspects of this comment letter in more detail, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr

Liesel Knorr

President

APPENDIX

Question 1: Do you agree with the proposal to change the way joint arrangements are described? If not, why?

1 We have some concerns regarding relabelling the generic term, the IASB's understanding of control and the descriptions of the different types of joint arrangements.

Relabelling the generic term

2 We learned from discussions with constituents that it depends on the industry and the country whether the term joint venture in the past was used solely for jointly controlled entities only or generically for different types of joint ventures. We, therefore, believe that changing the meaning of a 'joint venture' will lead to clarity for some and to confusion for others.

Concept of Control

3 With regard to changing the term 'jointly controlled assets/operations' by deleting the word "controlled" we note that the definition of an asset in par. 49(a) of the Framework does not explicitly require "exclusive" control as stated in BC9 of ED9.

4 We believe that different views are possible depending on the understanding what an asset represents. It, therefore, is a question of the definition of an asset / unit of account.

5 In our view the common understanding of the current asset definition – for instance in the case of the aircraft in Illustrative Example 2 – is that the "complete" aircraft is the asset. Based on that understanding we believe that the aircraft can be jointly controlled: If an asset (aircraft) is used by more than one party, than no party has exclusive control over the asset (aircraft), but that does not mean that nobody has control over the aircraft. Rather the parties jointly control the aircraft by monitoring and sharing the use of the aircraft for a certain time.

6 Another example would be an intangible asset (patent) which can be used by several parties at the same time. Again, the asset (patent) can be jointly controlled by the parties.

7 ED9 seems to change the asset definition by splitting up assets into rights. Based on this understanding not the "complete" aircraft, but the <u>right</u> to use the aircraft is the asset. In this view each party has exclusive control over its right.

8 We are not sure whether the IASB has fully considered the arguments regarding such a concept of control – in the context of assets as well as entities – and the consequences and implications for accounting in general.

9 Furthermore, it seems that ED9 anticipates the outcome of the current *Framework Project* where the definition of an asset is still under discussion.

10 Moreover, the IASB is undertaking a number of related projects based on the concepts for e.g. the recognition of assets and the definition of control, namely the projects *Framework Phase D: Reporting Entity, Consolidation*, and *Leases*. We are not sure whether the IASB has considered to what extent the changes brought about by ED9 may affect other projects.

Description of joint assets

11 The descriptions of joint assets and joint ventures are not clear. E.g., in case of joint assets, three similar but in the end different phrases are used within the description: *asset to which each party has rights* (par. 11), *rights to a share of the asset* (par. 12), and *rights to a share of a joint asset* (par. 13). The phrases should be converged to avoid confusion, particularly with regard to the recognition set out in par. 22 of ED9. (In this regard please see our detailed comments regarding question 2.)

Description of joint ventures

12 In addition, the description and definition of a joint venture could be misleading. On the one hand, IN8 of ED9 describes an interest in a joint venture as *"an interest in a share of outcome generated by the <u>activities of a group of assets and liabilities</u>"*. This description seems to suggest that a joint venture is based on the existence of a business, because the definition of a business sounds quite similar. A business is defined in Appendix A of ED9 as *"An integrated <u>set of activities and assets</u> that is capable of being conducted and managed for the purpose of <u>providing a return</u> …"*.

13 On the other hand, the flowchart in Appendix B of ED9 says that remaining assets (liabilities) to which the parties do not have contractual rights (obligations) represent an interest in a joint venture as well. For instance, regarding the variation of Illustrative Example 2, the right to the residual value of the aircraft is recognised in the balance sheet of the entity that has the legal ownership. According to IE16 of ED9 that entity is a joint venture. In case the only asset the entity has was the right to the residual value we doubt whether the outcome of the joint venture represents an *"outcome generated by the activities of a group of assets and liabilities"*, which would follow the description of a joint venture as described in IN8 of ED9. In fact, the joint venture mentioned in Illustrative Example 2 is only a kind of residual and represents only a remaining asset.

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?

14 The core principle and the potential implications raise a number of concerns regarding the definition of an asset, the unit of account, the specific accounting consequences and the practicability. We therefore disagree with the proposal.

Definition of an Asset / Unit of Account

- Current Framework

15 According to the current Framework an asset is defined in par. 49 as a *"resource controlled by the entity"*. Our understanding of the Framework seems to be that – for instance in the case of an aircraft – the aircraft as a whole is the resource. Based on the definition in the Framework the aircraft itself seems to represent the asset, including all rights attached to it. It seems to be a common understanding that, hence, the unit of account is the "complete" aircraft.

- Approach of ED9

16 In contrast, the wording of the core principle in ED9 raises the question whether the definition of an asset and its boundaries as laid out in the Framework were modified by the new approach. As we understand the core principle and the recognition requirements of ED9, assets should be split into the related rights which are then to be recognised separately.

17 In case of the variation of Illustrative Example 2 the aircraft is a joint asset that is to be split up into rights to use (that are to be recognised by the parties) and the remaining right to the residual value (which is to be recognised by the entity as the legal owner of the aircraft). From our point of view the splitting up assets into their related rights and their separate recognition does not comply with our understanding of the current Framework.

- Framework Project

18 It seems that ED9 might comply with the definition of an asset and its boundaries as discussed in *Phase B: Elements and Recognition* of the *Framework Project*. According to the latest IASB´s working definition an asset is *"a present economic resource to which, through an enforceable right or other means, the entity has access or can limit the access of others"* (IASB Update, October 2007, p. 5). Furthermore, the issue regarding the boundaries of an asset was addressed by the IASB staff to the Board at a previous IASB Meeting with the remark that *"shared rights or shared access would also give rise to an asset"* (IASB Meeting, February 2006, Observer Notes, Agenda Paper 9, par. 16). From that it could be concluded that, based on the aircraft example, the rights to use the aircraft as well as the right to the residual value give rise to an asset.

19 Nevertheless, the boundary of the asset and the unit of account still remain unclear. In case the parties of the joint arrangement have direct rights to the joint asset 'aircraft' (without establishing an entity buying the aircraft), it is still open for discussion whether or not each party has to recognise each right separately (the right to use and the right to the residual value). In case each party has to recognise each right to the joint asset separately we wonder whether and how that would affect the accounting for assets in general, i.e. in cases where the legal owner has all rights to the aircraft asset. In the latter case it is our understanding that under the current Framework the complete aircraft would have to be recognised. We wonder whether it was the IASB's intention to change the accounting and to recognise each right to the aircraft asset (right to use, right to the residual aircraft) separately, so that the

recognition of assets in general would be consistent with the recognition of joint assets.

- Anticipation of the outcome of the Framework Project by ED9

20 In the *Framework Project* the definition of an asset and the issue of the unit of account are still under discussion. However, ED9 seems to anticipate the outcome of *Phase B: Elements and Recognition* of the *Framework Project*.

21 We note that the approach of ED9 – to recognise rights to assets – is not only a matter of ED9. Rather, it represents a fundamental change in accounting principles that we believe would have to be codified in the Framework rather than in ED9. We believe that as long as *Phase B* of the *Framework Project* has not been finalised the principles of ED9 lack a sound foundation and will cause unavoidable problems in their application.

22 Furthermore, since the core principle seems to be a superior principle that could equally be applied to the accounting for most aspects of assets and liabilities, we believe that the principle should be part of the Framework. The accounting standards should include an application of the core principle with regard to the respective accounting issue.

Specific accounting consequences

23 ED9 is confusing with regard to the asset and the related unit of account to be recognised, especially in the case of joint assets. For example, according to par. 11 of ED9 a joint asset is *"… an asset to which each party has rights"*. In case that a joint asset is identified, "*a party shall recognise, in accordance with applicable IFRSs … its share of the joint asset, classified according to the nature of the asset"* (par. 22(a) of ED9). Based on that guidance and by considering Illustrative Example 2 we conclude that each party should recognise its **share of the joint asset** aircraft as a **tangible asset**.

24 On the other hand, the core principle set out in par. 1 of ED9 says *"Parties to a joint arrangement recognise their contractual rights …."*. Furthermore, IE11 of ED9 states: *"Each party has a … right to use … and … rights to its share of any residual value… It is those rights that the parties control and would recognise in accordance with applicable IFRSs."* Based on the core principle and the guidance in Illustrative Example 2 we conclude that each party would not recognise its share of the asset aircraft but rather its **rights to the asset**. In case it is the rights that are to be recognised we wonder about the meaning of the phrase *"in accordance with applicable IFRSs"*: Is IAS 38 or IAS 16 the applicable IFRS, i.e. are the rights recognised as **tangible or intangible assets**?

25 In the end it remains unclear what item should be recognised, the asset/resource (aircraft) or the right to the asset/resource (aircraft). In case of the recognition of rights it remains unclear whether these rights are to be presented as an intangible asset or based upon the nature of the asset these rights refer to. Even the Illustrative Examples do not give an appropriate guidance. (For this issue we refer to our comments to the Illustrative Examples below.)

Practicability

26 We believe that splitting up assets into rights will cause a lot of complex issues on initial accounting and even more so on subsequent accounting. We have serious doubts with regard to the practicability of the core principle.

27 Specifically, in the case of the aircraft mentioned in the variation of Illustrative Example 2, the rights to use and the right to the residual value would have to be recognised and measured separately. But usually these rights to the aircraft are not acquired individually. Rather, a lump-sum price would be paid for the aircraft as a whole. Hence, market values for these rights are not available. Therefore, as soon as at initial recognition it is questionable how the acquisition cost of the aircraft would have to be allocated to the different rights. In addition, one issue does not seem to be addressed in ED9 at all and needs to be discussed: What is to be done when the total value of all individual rights exceeds or falls short of the price paid for the aircraft? Further problems will arise when accounting subsequently for enhanced capital expenditures, depreciation or impairment. In case of future enhanced capital expenditure the venturer has to consider which rights will benefit from that expenditure. I.e., the question is which part of the expenditure has to be allocated to the rights to use and which to the right to the residual value? Upon occurrence of an impairment it can be very complex to assign the impairment loss to the various components and to account for them separately.

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?

28 We disagree with eliminating proportionate consolidation, even bearing in mind that a party would recognise assets, liabilities, income and expenses if it had contractual rights and obligations relating only to individual assets and liabilities of a joint arrangement.

29 In principle, we accept the argument that proportionate consolidation may lead to conceptual problems. I.e., proportionate consolidation leads to the recognition of assets that are not controlled exclusively by one single party or entity and, therefore, may be inconsistent with the asset definition set out in the Framework.

30 In addition, some argue that proportionate consolidation could result in a mixed presentation of items that are not controlled and items that are controlled which is misleading for users. This, however, could be easily resolved by requiring their separate presentation in the balance sheet.

31 We are not sure whether the equity method can solve all conceptual problems and whether it is in compliance with the Framework. We believe that a decision regarding the elimination of one accounting method for joint ventures needs to consider an analysis of all other potential methods with respect to their conceptual validity. It seems that the IASB did not carry out such an analysis. ED9 does not give compelling criteria showing that the equity method is conceptually superior to

proportionate consolidation. Identifying conceptual inconsistencies of proportionate consolidation is not a persuasive argument to claiming the equity method as the better one.

32 In addition, the IASB's arguments for eliminating proportionate consolidation are solely related to presenting assets and liabilities in the balance sheet. We note that when applying the equity method, the income from the investment in a joint venture is to be presented in each venturers' consolidated income statement in one line only. We doubt whether the information given in the income statement is appropriate and useful to users.

33 Furthermore, requiring the equity method for accounting for joint ventures creates another important inconsistency: Associates and joint ventures will be accounted for in the same way by using the equity method even though the criteria 'significant influence' and 'control' are different. Even though the Board is aware of this fact (as stated in BC14 of ED9) we do not deem the reasoning persuasive that considering the merits of the equity method is outside the scope of the short-term project.

34 We believe that the proposals of ED9 should not be based on a short-term project activity. As already stated in par. 21 of our comment letter, the approach of ED9 seems to change underlying accounting concepts and principles; both should rather be codified in the Framework and not in ED9. In addition, as stated in par. 31 above, the elimination of an accounting method requires further analyses. Moreover, the results of ED9 might be short-lived as the IASB intends to address that issue in a subsequent long-term-project.

35 In addition, we note that the objective of the joint venture project regarding the convergence with US GAAP (as stated in BC24 of ED9) is not fully achieved. For instance, EITF 00-1 still permits using proportionate consolidation for certain major industries. Further, in case of a joint venture established by a legal entity US GAAP does not require recognising direct interests in the assets of that entity by the venturer as proposed in ED9.

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?

36 Bearing in mind our disagreement with the elimination of proportionate consolidation (as proposed in ED9) we agree with the proposed disclosures for the draft IFRS, because we believe this information to be useful to users, with one exception: We disagree with the proposed disclosures regarding the split of assets and liabilities into current and non-current. We doubt whether that disclosure requirement really gives additional useful information to investors. In addition, we doubt whether the required information are available. Gathering that information would cause costs that are likely to exceed their benefit.

37 Further, we note that the same method is used to account for associates and joint ventures, although the power to influence strategic decisions is different. Whilst a venturer has control over its investment in the joint venture, the investment in an

associate is characterised by significant influence only. Because of the different nature of influence we believe that the disclosures for investments in joint ventures should at least include those for associates. The alignment of the disclosures for joint ventures to those for associates complies with the minimum requirement.

38 Nevertheless, we wonder about the rationale for aligning the disclosure requirements for associates and joint ventures. BC23 of ED9 says: *"Both associates and joint ventures are investments that an entity does not control but for which it has the power to influence strategic decisions"*. That seems to run counter the description; it is quite contrary to the description of a joint venture given in IN8 (*"the only asset it controls is its investment in the joint venture"*).

39 Furthermore, par. 41 of ED9 represents a requirement for recognition and should be moved to the recognition section. Par. 41 of ED9 should only include the respective disclosure where required.

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?

40 We 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, because we believe this information to be useful to users.

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?

41 We disagree with the proposal, because – as already mentioned in our answer to question 4 – we doubt that such a disclosure requirement really gives additional useful information to investors. In addition, we doubt that the required information are always readily available. Gathering that information would cause costs that are likely to exceed their benefit.

Further Comments (not question-related)

SIC-13 incorporated into the draft IFRS

42 In principle we support incorporating the consensus of SIC-13 on non-monetary contributions by a venturer into ED9,

43 However, we have some concerns regarding the way of incorporation, so that ED9 actually reflects the requirements of SIC-13.

44 Firstly, BC21 of ED9 states that the consensus of SIC-13 was incorporated into ED9 by referring to the requirements of IAS 28 due to the consistency of SIC-13 and par. 22 of IAS 28. We cannot identify a consistency, because par. 22 of IAS 28 does not include refer to non-monetary contributions. The same applies to the exceptions listed in par. 5 of SIC-13. We wonder whether referring to par. 22 of IAS 28 will be sufficient guidance.

45 Secondly, in this connection pars. 48 – 50 of IAS 31 have been replaced by the reference in par. 27 of ED9 to par. 22 of IAS 28. We wonder whether this will be sufficient guidance. E.g., pars. 49 and 50 of IAS 31 include the recognition of losses representing an impairment loss. There is no corresponding requirement in par. 22 of IAS 28.

Loss of joint control

46 We are aware that the requirements in par. 29 of ED9 are consistent with the amendments to IFRS 3 and IAS 27 resulting from the project on phase II of *Business Combinations*. As we disagreed with these amendments in our comment letter on IFRS 3, we do not support this requirement in ED9, either.

Illustrative Examples

47 The Illustrative Examples of ED9 do not give the specific and explicit guidance expected from examples. They are confined to describing possible designs of joint arrangements. Moreover, the examples do not illustrate the accounting for joint arrangements sufficiently. The nature of the line items (e.g. tangible or intangible assets) as well as their presentation still need to be clarified. Phrases like *“recognise in accordance with applicable IFRS”* would have to be specified and the accounting described.

Operators of joint ventures

48 Pars. 52 and 53 of IAS 31 regarding the accounting for fees of operators of joint ventures have been removed from ED without any explanation in the Basis for Conclusions.