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Re: Exposures Draft ED 9 Joint Arrangements

Dear Sirs,

We have examined your draft comment letter, and we give our comments thereon below. EFRAG's draft comment letter addresses analytically the various aspects, and we are in agreement with its comments. Therefore, we have limited ourselves to highlighting some points that we believe to be important.

General comments

The OIC agrees with the goal of eliminating accounting options where possible both to enhance comparability between financial statements and also because accounting standards should be able to determine which the best criterion for reporting is among the various possibilities. If this were not the case, the IFRS would not achieve the goal of setting high-quality criteria for financial reporting.

However, in the present case, we do not agree with the IASB's proposal. The reasons given for the elimination of proportionate consolidation are not convincing and, therefore, we agree with the EFRAG's criticisms and concerns in this regard.

In particular, we should like to highlight some aspects, largely and in greater detail covered by you in Appendix 1 of the draft response, with which we are in full agreement. First, the Board starts from the premise that IAS 31 consider the form of the agreement to be a major factor in determining the method of accounting. It does not appear to us that the amendments proposed by ED 9 resolve this crucial aspect, assuming that it exists. In a "true" joint venture, the substance of the agreement is to share "pro quota" the risks and benefits of the activity undertaken, pooling assets that at the conclusion of the operation will be returned pro quota (physically or in monetary terms) to the venturers, who, similarly, bear pro quota responsibilities.

We do not believe that entities subject to significant influence can be treated in the same fashion as jointly controlled entities. Although in the latter the control is not exclusive, it is still a case of the power to govern the financial and operating policies of an entity, even though this power is shared with a limited number of other subjects. On the other hand, in the case of significant influence, the

investor is at the mercy of decisions made by others, being able to influence decisions only in part. Accounting for the two situations in the same way is not convincing and hides a real difference.

We are not convinced that the Framework defines an asset as a resource under the exclusive control of an entity. The adjective “exclusive” is not present in the definition. Control of a portion of the assets also respects the definition.

We agree with the Board’s comment that including assets and liabilities over which an entity has joint control with other subsidiaries in an exclusive way does make it difficult to analyse the financial statements and to estimate future cash flows. However, in our opinion, eliminating the information on jointly controlled assets and liabilities and imposing adoption of the equity method would not improve but rather worsen the situation, a situation that could be readily resolved through appropriate disclosures.

Last, we would point out that the use of the equity method for jointly controlled entities results in the omission from financial statements of important elements, such as financial indebtedness also including that part for which an entity is co-responsible (at least in terms of management if not legally – but nor in the case of subsidiaries is there a legal obligation on the controlling entity).

In important industrial sectors, business activity is principally carried on through joint ventures, often these are specially formed in order to undertake important projects in partnership. In these cases, the use of the equity method would lead to the elimination from the venturer’s financial statements of the revenues (and costs) that in fact constitute the representation of the business and its outcome, which instead would be reported a) only in net terms for contribution to profit, and b) as a share of profit of associates. We do not believe that this reporting would give a faithful representation of the business, or that it would be useful in predicting the venturer’s future cash flows and the related risks.

For the above reasons, and in support of the goal of reducing accounting options, the OIC believes that the accounting of jointly controlled entities should require measurement using the proportional method rather that the equity method. Alternatively, considering that other projects are underway (including the long-term convergence project with the USA) that could have significant effects on the issue in question, the OIC believes it would be appropriate in the meantime to retain the options provided for in IAS 31.

Comments on specific questions (summarized)

1) Do you agree with the proposal to change the way joint agreements are described? If not, why?

The EFRAG asks whether the definitions of joint venture given in IAS 31 have caused any problems in practice. To date, the OIC has not encountered any such problems, or at least is not aware of any.

However, the OIC believes that the new definition is somewhat confused and open to divergent interpretations in practice. Indeed, the new definition is based on the notion of shared decision-making, which is explained only in the Appendix (in the body of the main text would have been better), defining as such decisions that require the consent of all the participants in the joint arrangement. It is not clear what the “shared” decisions are. It would seem to be “all”, and this would not be feasible in practice. Probably, it means those decisions that have an effect on the

economic and financial governance of the joint venture, as indicated in the previous definition of IAS 31 (strategic financial and operating decisions).

We concur with all the other comments and concerns as presented by the EFRAG, and, in particular, we believe that the conclusions of SIC 13 should be incorporated in ED9.

2) Do you agree that a party to a joint arrangement should recognise its contractual rights and obligations relating to the arrangement?

We agree with all the comments made by the EFRAG.

3) Do you agree that proportionate consolidation should be eliminated?

We do not agree for the reasons given above in our General comments. In our opinion, proportionate consolidation provides for the best representation of the substance of a joint venture arrangement. IAS 31 clearly indicated proportionate consolidation as the preferred method, and we believe that practical experience has confirmed the validity of this statement. We agree with EFRAG's comments that give the reasons for this view.

The EFRAG asks whether we are aware of any companies that may be considering altering contractual arrangements in order to avoid adopting the equity method. The OIC is not aware of any such cases but is aware of the limited situations in which entities opt for the equity method rather than proportionate consolidation with a view to avoiding exposing their pro quota portion of the indebtedness of the joint venture. However, clearly, if the joint venture provide a significantly positive contribution to the accounts (as is often the case with construction entities), in particular in terms of revenue, it is realistic to imagine the inverse situation occurring. Such phenomena are quite frequent where there is the possibility of arbitraging between accounting options.

4) Do you agree with the disclosures proposed?

We agree with the EFRAG that it is necessary to have disclosure on the assets, liabilities, costs and revenues of joint ventures, information that would however be "lost" using the equity method. The formats proposed by the EFRAG represent a form of proportionate consolidation using additional columns or subtotals. However, if such information is deemed important (and also in our view, it certainly is), we fail to understand why there is the desire to eliminate proportionate consolidation, rather than prescribing it. "Shadow accounting" can never be the best solution.

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?

We agree with the EFRAG. We would note that currently this information is already an additional requirement under Italian legislation.

Yours sincerely

Prof. Angelo Provasoli
(OIC – Chairman)