International Accounting Standard IAS 31

Interests in Joint Ventures

January 2010

(incorporating amendments from IFRSs issued up to 31 December 2009 with an effective date no later than 1 January 2010)

BASIS FOR CONCLUSIONS

Basis for Conclusions on IAS 31 *Interests in Joint Ventures*

This Basis for Conclusions accompanies, but is not part of, IAS 31.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on revising IAS 31 *Financial Reporting of Interests in Joint Ventures* in 2003. Individual Board members gave greater weight to some factors than to others.

BC2 In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 27 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries* and IAS 28 *Accounting for Investments in Associates*. The project was undertaken in the light of queries and criticisms raised in relation to the Standards by securities regulators, professional accountants and other interested parties. The objectives of the Improvements project were to reduce or eliminate alternatives, redundancies and conflicts within Standards, to deal with some convergence issues and to make other improvements. Because of the changes that were to be proposed for the revised versions of IAS 27 *Consolidated and Separate Financial Statements* and IAS 28 *Investments in Associates*, the Board also proposed to make some important consequential amendments to IAS 31 *Financial Reporting of Interests in Joint Ventures*.

BC3 Because the Board's intention was not to reconsider the fundamental approach to the accounting for joint ventures established by IAS 31 and to reflect only those changes related to its decisions in the Improvements project, in particular in relation to IAS 27 and IAS 28, this Basis for Conclusions does not discuss requirements in IAS 31 that the Board has not reconsidered. However, because of the scale of the amendments to the Standard, the Board believes it will be helpful to users to issue IAS 31 along with the Standards that were previously identified for revision as part of the Improvements project.

Scope exclusion: investments in joint ventures held by venture capital organisations, mutual funds, unit trusts and similar entities

BC4 There are no specific requirements that address accounting for investments by venture capital organisations, mutual funds, unit trusts and similar entities. As a result, depending on whether an entity has control, joint control or significant influence over an investee, one of the following Standards is applied:

(a) IAS 27 *Consolidated and Separate Financial Statements*,

(b) IAS 28 *Investments in Associates*, or

(c) IAS 31 *Interests in Joint Ventures*.

BC5 The Board considered whether another approach is appropriate for these investors when they do not have control but have joint control or significant influence over their investees. The Board noted that use of proportionate consolidation or the equity method for investments held by venture capital organisations, mutual funds, unit trusts and similar entities often produces information that is not relevant to their management and investors and that fair value measurement produces more relevant information in these circumstances. As noted in the Basis for Conclusions on IAS 27, the Board confirmed that a subsidiary should not be excluded from consolidation on the basis of the nature of the controlling entity. Consolidation is based on the parent's ability to control the investee and should not be affected by whether management intends to hold an investment in an entity that it controls for the short term. The Board concluded that for investments under the control of private equity entities, users' information needs are best served by financial statements in which those investments are consolidated, thus revealing the extent of the operations of the entities they control.

BC6 In addition, the Board noted that there may be frequent changes in the level of ownership in these investments and that financial statements are less useful if there are frequent changes in the method of accounting for an investment.

Measurement at fair value in accordance with IAS 39

BC7 Accordingly, the Board decided that investments held by venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds should be excluded from the scope of IAS 31 when they are measured at fair value in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. The Board understands that fair value information is often readily available because fair value measurement is a well-established practice in these industries including for investments in entities in the early stages of their development or in non-listed entities.

Treatment of changes in fair value

BC8 The Board decided that if venture capital organisations, mutual funds, unit trusts and similar entities are to be excluded from the scope of IAS 31, it should be only when they recognise changes in the fair value of their interests in joint ventures in profit or loss in the period in which those changes occur. This is to achieve the same treatment as for investments in subsidiaries or associates that are not consolidated or accounted for using the equity method because control or significant influence is intended to be temporary. The Board's approach distinguishes between accounting for the investment and accounting for the economic entity. In relation to the former, the Board decided that there should be consistency in the treatment of all investments, including changes in the fair value of these investments.

BC9 The Board noted that if such investments were classified in accordance with IAS 39, they would not always meet the definition of investments classified as held for trading because venture capital organisations may hold an investment for a period of 3–5 years. In accordance with IAS 39 such an investment is classified as available for sale (unless the entity elects to designate the investment on initial recognition at fair value through profit or loss). Classification as available for sale would not result in recognising changes in fair value in profit or loss. To achieve a similar effect on income to that of applying proportionate consolidation or the equity method, the Board decided to exempt investments held by venture capital organisations, mutual funds, unit trusts and similar entities from this Standard only when they are measured at fair value through profit or loss (either by designation or because they meet the definition in IAS 39 of held for trading).

Reference to 'well-established' industry practices

BC10 The Exposure Draft of IAS 28 proposed to limit the availability of the scope exclusion to situations in which well-established industry practice existed. Some respondents noted that the development of industry practice to measure such investments at fair value would have been precluded in industries established in countries already applying IFRSs. The Board confirmed that the main purpose of the reference to 'well-established' practice in the Exposure Draft was to emphasise that the exclusion would apply generally to those investments for which fair value is already available.

BC11 Therefore, the Board decided that the availability of the exclusion from the scope of IAS 31 should be based only on the nature of an entity's activities and to delete the reference to 'well-established' practices. The Board understands that measurement of these investments at fair value is 'well-established' practice in these industries.

Definition of 'venture capital organisations'

BC12 The Board decided not to define further those 'venture capital organisations and similar entities' excluded from the scope of IAS 31. Apart from recognising the difficulties of arriving at a universally applicable definition, the Board did not want inadvertently to make it difficult for entities to measure investments at fair value. However, the Board decided to clarify that the reference to 'similar entities' in the scope exclusion includes investment-linked insurance funds.

Application of proportionate consolidation or the equity method

Temporary joint control

BC13 The Board considered whether to remove the exemption from applying proportionate consolidation or the equity method when joint control in a joint venture is intended to be temporary. The Board decided to consider this issue as part of a comprehensive standard dealing with asset disposals. It decided to retain an exemption from applying proportionate consolidation or the equity method when there is evidence that an interest in a joint venture is acquired with the intention to dispose of it within twelve months and that management is actively seeking a buyer. The Board's Exposure Draft ED 4 *Disposal of Non-current Assets and Presentation of Discontinued Operations* proposes to measure and present assets held for sale in a consistent manner irrespective of whether they are held by an investor in an associate, a joint venture or a subsidiary.*

Severe long-term restrictions impairing ability to transfer funds to the investor

BC14 The Board decided to remove the exemption from applying proportionate consolidation or the equity method for an interest in a joint venture that previously applied when severe long-term restrictions impaired a venture's ability to transfer funds to the venturer. It did so because such circumstances may not preclude the venturer's joint control over the venture. The Board decided that an investor should, when assessing its ability to exercise joint control over an entity, consider restrictions on the transfer of funds from the entity to the investor. In themselves, such restrictions do not preclude the existence of joint control.

Non-coterminous year-ends

BC15 The Exposure Draft of May 2002 proposed to limit to three months any difference between the reporting dates of the venturer and the venture when applying proportionate consolidation or the equity method. Some respondents to that Exposure Draft believed that it could be impracticable for the venturer to prepare financial statements as of the same date when the date of the venturer's and the venture's financial statements differ by more than three months. The Board noted that a three-month limit operates in several jurisdictions and it was concerned that a longer period, such as six months, would lead to the recognition of stale information. Therefore, it decided to retain the three-month limit.

Loss of joint control over a jointly controlled entity†

BC16 In the second phase of the Board's project on business combinations, the Board observed that the loss of control of an investee and the loss of joint control of an investee are economically similar events; thus they should be accounted for similarly. The loss of joint control represents an economic event that changes the nature of the investment. The Board concluded that the accounting guidance on the loss of control of a subsidiary should be extended to events, transactions or other changes in circumstances in which an investor loses joint control of an investee. Thus, when an investor loses joint control of an investee, the investor measures any retained investment at fair value. Any difference between the carrying amount of the jointly controlled entity when joint control is lost, the disposal proceeds (if any) and the fair value of any retained interest is recognised in profit or loss.

* In March 2004 the Board issued IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. IFRS 5 removes this scope exclusion and now eliminates the exemption from applying proportionate consolidation or the equity method when joint control of a joint venture is intended to be temporary. See IFRS 5 Basis for Conclusions for further discussion.

† This heading and paragraph BC16 were added as a consequence of amendments to IAS 27 *Consolidated and Separate Financial Statements* made as part of the second phase of the business combinations project in 2008.

Scope (2008 amendment)[*]

BC17 The Board identified an apparent inconsistency in the disclosure requirements for entities that are eligible and elect to account for their interests in jointly controlled entities at fair value in accordance with IAS 39. Those interests are excluded from the scope of IAS 31 and the entities are therefore not required to make the disclosures that the Standard would otherwise require. However, IAS 32 *Financial Instruments: Presentation* and IFRS 7 *Financial Instruments: Disclosures* both require entities that account for interests in jointly controlled entities in accordance with IAS 39 to make the disclosures required by IAS 31 in addition to the disclosures they require.

BC18 The Board decided to remove this inconsistency by deleting from IAS 32 and IFRS 7 the general requirement to make the IAS 31 disclosures, and instead identifying the specific disclosures that should be made. The Board noted that the specific disclosures identified would be relevant because of the significant interest venturers hold in such investments. The Board also decided to delete from IAS 32 and IFRS 7 the requirement to make the disclosures in IAS 27 because it duplicates the requirement in IAS 27.

[*] This section was added as a consequence of an amendment to IAS 31 by *Improvements to IFRSs* issued in May 2008.