COMITÊ DE PRONUNCIAMENTOS CONTÁBEIS

SAS Quadra 05. Bloco J. CFC
Brasília, Distrito Federal – Brazil
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International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

**RE: IFASS Outreach Request - elimination of intercompany profits**

Dear Board Members,

The Comitê de Pronunciamentos Contábeis - CPC (Brazilian Accounting Pronouncements Committee)[1] welcomes the opportunity to respond the IFASS Outreach Request - elimination of intercompany profits.

We are a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidance for Brazilian companies.

**1. Summary of the case**

An entity is a party to a joint arrangement that is classified as a joint venture under IFRS 11 *Joint Arrangement*. Therefore, the entity accounts for its interest in the joint venture using the equity method.

The entity enters into a finance lease transaction with the joint venture, where the entity leases assets to the joint venture; and the gains from this transaction exceed the entity's interest in the joint venture (please refer to the attached submission for more detail fact pattern).

The entity's share in the gains from this transaction would be eliminated as the transaction falls within the category of 'downstream' transactions as set out in paragraph 28 of IAS 28 *Investments in Associate and Joint Ventures* (as amended in 2011). However, this paragraph does not specify the accounting treatment in the circumstance where the amount of gains to be eliminated exceeds the amount of the entity's interest in the joint venture.

[1] The Brazilian Accounting Pronouncements Committee (CPC) is a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidances for Brazilian companies. Our members are nominated by the following entities: ABRASCA (Brazilian Listed Companies Association), APIMEC (National Association of Capital Market Investment Professionals and Analysts), BMFBOVESPA (Brazilian Stock Exchange and Mercantile & Future Exchange), CFC (Federal Accounting Council), FIPECAFI (Financial and Accounting Research Institute Foundation) and IBRACON (Brazilian Institute of Independent Auditors).

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The submitter observes paragraph 38 of IAS 28 (as amended in 2011) which states that if an entity's share of losses of an associate or joint venture equals or exceeds its interest in the associate or joint venture, the entity discontinues recognising its share of further losses. The submitter also notes paragraph 39 of IAS 28 (as amended in 2011) which states that after entity's interest is reduced to zero, additional losses are provided for, and a liability is recognised, only to the extent that the entity has incurred legal or constructive obligations or made payments on behalf of the associate or joint venture.

The submitter, thus, presented us with two views:

· Proponents of View A argue that paragraph 39 of IAS 28 can be applied by analogy to the transaction in issue. In that case, the gains from the lease transaction would be eliminated only to the extent they do not exceed the carrying amount of the entity's interest in the joint venture.

· Proponents of View B argue that analogising paragraph 39 of IAS 28 to the transaction in issue is not appropriate because elimination of gains from 'downstream' transactions have different characteristic than the recognition of additional losses of the associate or joint venture. Therefore, they argue that the remaining gains exceeding the carrying amount of the entity's interest in the joint venture should also be eliminated.

In addition, the submitter raised further comments:

· Some practitioners question whether the entity, having a 50 per cent of ownership interest in the joint venture, retains substantial risks and rewards associated with the leased asset from a consolidated perspective. Accordingly, they raise a question about whether the leased asset will qualify as finance lease because the consolidated group (the reporting entity) has not surrendered substantially all the risks and rewards incidental to ownership of the asset.

· Then, further question can be raised as to whether the classification of operating and finance lease differs depending on whether the lease transaction is viewed on a single entity or consolidated basis (ie when the equity method is applied).

**2. Questions**

I would very much appreciate your observations in your jurisdiction, regarding the following aspects of the concerns raised:

**Q1**. Is the fact pattern described in the submission common or relevant in your jurisdiction?

No. 'Downstream' transactions between the joint venture and the investor are common and relevant in our jurisdiction. However, the fact pattern described in the submission when the equity of the joint venture is smaller than the amount of gain to be eliminated from the transaction in the financial statements of the investor in our best know is not common in our jurisdiction.

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**Q2**. If you answered "yes" to Q1, what is the prevalent approach in your jurisdiction to account for elimination of gains described in the submission, and why? Also, if View B is the prevalent accounting in your jurisdiction, where is the corresponding entry recorded for the remaining gains to be eliminated that exceeding the carrying amount of the entity's interest in the joint venture, and why?

N/A

**Q3**. Do you see any diversity in practice in that accounting? If so, please explain how and why the accounting is diversified.

N/A

**Q4**. With regard to the further comments raised by the submitter, have you encountered the same concerns? If so, how have the concerns been addressed?

N/A

According to IAS 28 paragraph 28, gains and losses resulting from 'upstream' and 'downstream' transactions between an entity (including its consolidated subsidiaries) and its associate or joint venture are recognised in the entity's financial statements only to the extent of unrelated investors' interests in the associate or joint venture. The investor's share in the associate's or joint venture's gains or losses resulting from these transactions is eliminated.

In our view the investor's share in the associate's or joint venture's gains resulting from these transactions should be recorded as:

View 1: liability. The gain is a deferred income that should be recognized when realized by associate or joint venture.

View 2: other comprehensive income. The gain is recorded as other comprehensive while it is not realized by associate or joint venture. When the gain is realized by associate or joint venture it is recycled to profit and loss.

Yours sincerely,

Idésio da Silva Coelho Júnior
Chair of International Affairs
Comite de Pronunciamentos Contabeis (CPC)