Post-implementation review of IFRS 10, IFRS 11, and IFRS 12 Issues Paper - Update

Objective

1 Objective of this TEG session is to assess the completeness of the list of issues so far identified to be included in the PIR. This paper provides a summary of the recent discussions regarding the issues that should be considered by the IASB during its post-implementation review of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, and IFRS 12 *Disclosure of Interests in Other Entities* (the PIR).

2 In Appendix 2, the EFRAG Secretariat provides a summary table of the issues identified.

Background of the IASB project

3 In May 2011, as a part of a package of new standards on consolidation, the IASB published IFRS 10, IFRS 11, and IFRS 12 (the Standards), and revised IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and joint Ventures.*

4 The IASB introduced in IFRS 10 a single consolidation (control) model. In IFRS 11, compared to withdrawn IAS 31 *Interest in Joint Ventures*, the IASB eliminated the accounting options and introduced the classification, and accounting, of joint arrangements based on rights and obligations. IFRS 12 introduced combined and enhanced disclosure requirements.

5 In European Union, the effective date of the Standards was delayed from 1 January 2013 to 1 January 2014.

6 Following the publication of the Standards, the IASB issues the following amendments to the Standards:

(a) in June 2012: *Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities*: *Transition Guidance*, amendments to IFRS 10, IFRS 11 and IFRS 12;

(b) in October 2012: *Investment Entities*, Amendments to IFRS 10, IFRS 12 and IAS 27;

(c) in December 2014, *Investment Entities: Applying the Consolidation Exception*, amendments to IFRS 10, IFRS 12 and IAS 28;

(d) In September 2014, *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*, amendments to IFRS 10 and IAS 28.

7 In April 2019, the IASB initiated the post-implementation review of the Standards, with the following phases:

(a) In Phase 1, the IASB staff initially identify and assess of the matters to be examined in the PIR. This phase is expected to end in February 2020.

(b) In Phase 2, the IASB will publish a Request for Information (RFI), consider the evidence gathered from the RFI, and present the findings to the IASB.

(c) Finally, the IASB will publish a Feedback Statement presenting the IASB's findings and set out the steps it plans to take, if any, as a result of the PIR.

8 The post-implementation review does not cover revised IAS 27 nor revised IAS 28. However, the IASB may decide to amend those standards in response to the feedback received during the comment period.

Summary of the initial IASB Staff findings

9 The IASB Staff consulted the following constituents: IFRS Interpretations Committee, Global Preparers Forum, Capital Markets Advisory Committee, Accounting firms, Regulators, Users' groups, National standard-setters and regional groups, Preparers' groups from different industries. The general feedback summary included that the Standards are generally working well. The main areas recognised for further consideration include:

(a) Assessing control over an entity;

(b) investment entity accounting;

(c) Classification and accounting for joint arrangements;

(d) Disclosing information regarding unconsolidated structured entities; and

(e) Disclosures on significant NCI.

10 The list of the issues identified by the IASB Staff is provided in **Appendix 1** of this paper. The details of the issues can be found in the ASAF paper provided for December 2019, available on EFRAG's web page.

Recent discussions concerning the PIR

11 EFRAG discussed the issues related to implementation of the Standards at EFRAG User Panel meeting in November, at EFRAG TEG-CFSS meeting in December 2019, and at the EFRAG FIWG meeting in January 2020.

12 The main messages provided by EFRAG User Panel members were as follows:

(a) There is an area for improving IFRS 12 disclosures regarding measurement, valuation, and economics of non-controlling interest. This could include disclosing material totals e.g. revenues, cash flows, assets, liabilities, and other performance measures split per particular NCI. Moreover, in the cash flow statement, no information about NCI is now presented or disclosed. One of the members mentioned *proportionate EBITDA* to be a good example of voluntary disclosure to present information on NCI;

(b) In some sectors e.g. software, electronics, telecommunications, volatility of intangible assets' valuation significantly affects measurement of capital. For that reason, some investments accounted for under IFRS 11 *Joint Arrangements*, require more disclosures/ explanations regarding volatility of measurement of assets and the capital; and

(c) Regarding the definition of control in IFRS 10, more disclosures with justifications/ explanations why certain investments have been consolidated, and why other not, are needed.

13 In December, EFRAG TEG and EFRAG CFSS members pointed to the following areas of consideration:

regarding IFRS 10:

(a) notion of protective/substantive rights; de-facto control;

(b) principle vs agent assessment; in particular, for SPE in fund management industry; the maters of the right evidence, assessment of whether it's a variable return proves to be complex;

(c) accounting for a change in the type of investment; that includes gaining and losing control when assessing de-facto control.

regarding IFRS 11:

(d) assessment of other facts and circumstances; there is no clear cut whether the rights are substantive or protective; that included merits in considering whether a fact that investor made a guarantee for the joint arrangement's liability, is critical, and whether it should be classified as joint venture or rather as joint operation;

(e) arrangements that are not in the scope IFRS 11 e.g. arrangements not being jointly controlled and without a corporate wrapper, unincorporated associates;

(f) accounting for a joint operation's lease liabilities under IFRS 16 *Leases*, where the lead operator could be required to present the full lease liability as if it was for its own use;

(g) presenting meaningful information by operators on leased field assets in extractive industries; for example, by operators of many oilfields;

(h) accounting for a change of joint operation's activities over time e.g. moving from one phase to another may require remeasurement of the assets and liabilities whereas there is no change in the operation's structure;

(i) some stakeholders were against removal of the proportional consolidation and argued that replacing proportional with IFRS 11 decreases the information provided - for example, recent IFRS Interpretations Committee discussion regarding the presentation of a lease in joint operation;

(j) application of IFRS 11 in separate financial statements where, similarly to the controlled investments, a joint operation should be presented as investment;

(k) some types of arrangements are not within the scope of IFRS 11, despite of their economic substance being similar to the substance of joint operations; for example, arrangements without a corporate wrapper, or arrangements without joint control.

regarding IFRS 12:

(l) disclosing information for an associate that is also a listed company may create regulatory issues when the information is disclosed before the information is provided to the market by the associate.

14 In January 2020, EFRAG FIWG members provided the following comments:

(a) IFRS 11 issues are not prevalent in the banking industry; there are some examples where IFRS 11 is difficult to apply; IFRS 10 issues are more specific to banking industry the members thought that the IASB should rather focus on the consolidation package in general, and not on specific industries;

(b) It's not always clear whether a transaction should fall into the scope of IFRS 10 or rather of IFRS 11; that includes principle vs agent assessments where usually banks need to consider many types of remunerations, types of exposure, banks' dual roles, etc. – an example would be an arrange with a car manufacturer to finance its sales where it's difficult to assess main relevant activities; other examples include collaborative arrangement without clear joint control; another example would be an assessment of management fees of a fund manager for a monetary fund in low interest rate market conditions; the members see this assessment as continuum;

(c) The members agreed with the IASB's list of IFRS 10 implementation issues; however, they considered that the focus for the IASB should be to split the list of issues into implementation issues and real gaps in the standard what would deserve standard setting activity.

(d) The members observed that IFRS 10 control assessment results in a higher degree of complexity in the origination of M&A agreements, in order to achieve a desired accounting outcome; this would include drafting the servicing arrangements related to non-performing loan securitisation and splitting the service into “normal” servicing and “special” servicing, which would cover situations considering collaterals and forgiving the loans.

(e) IFRS 12 disclosure requirements provide relevant information for the banking industry, however, its application is complex; the PIR should therefore assess whether users find the current practices of IFRS 12 useful e.g. in a form of a benchmarking exercise of banks’ disclosures in this area.

ASAF meeting in December 2019

15 During the ASAF meeting in London, the ASAF members discussed the topic and provided the additional feedback to the IASB Staff. ASAF members generally agreed that the Standards provide useful information.

16 However, the members also mentioned that IFRS standards did not cover all patterns of changes in interests and highlighted the existing inconsistency of guidance on changes in classification of investments and whether it provides useful information. For example, remeasuring the retained interests to fair value and recognising any gains or losses when control was lost do not provide useful information because, for the retained interests, "nothing has changed". That issue also related to more complex transactions where an entity transfers a part of its interest in subsidiary to another party (e.g. a joint venture) and loses control over it but continues its engagement.

17 Moreover, some members pointed out that the main areas for consideration are found in IFRS 11 rather than in IFRS 10 or IFRS 12 (what has been repeated), and therefore the review of IFRS 11 should be done separately. That included both joint operation accounting and equity accounting as well.

The members also pointed to the following specific areas for consideration regarding (other than discussed by EFRAG CFSS and already identified by the IASB staff):

regarding IFRS 10:

(a) Providing information by investment entities (IE) specifically regarding group financing and leveraging;

Regarding: IFRS 11:

(b) arrangements which have their economic substance similar to joint arrangements’ substance, but are not in the scope IFRS 11, e.g. collaborative arrangements and risk sharing arrangements;

(c) the problem with accounting for joint arrangements in separate financial statements, where the investment should be accounted for in a similar way to fully controlled investments i.e. single line item investment;

(d) accounting for joint arrangements when the share of output of the joint arrangements taken by the parties is different from their share in the joint arrangement;

(e) the treatment of another party to a joint arrangement, when the arrangement is no longer considered to be a joint operation;

(f) whether an entity should remeasure its interest in joint operation’s assets and liabilities when the entity loses control over an asset or group of assets;

(g) classification of joint arrangements when considering the arrangement’s structure;

(h) contractual arrangement test;

Regarding IFRS 12

(i) Limited information provided on description of minority interests including how material NCI affect cash flows.

EFRAG Staff analysis

18 The EFRAG Staff initially assessed the issues and topics discussed by different groups of constituents. The summary of the identified issues is provided in Appendix 2. In general, the topics identified by EFRAG and the IASB Staff overlap. The EFRAG Secretariat has identified the following possible additional focus areas:

(a) Implementation issues of IFRS 11 guidance related to accounting for joint operations.

(b) Assessment whether the disclosures prepared under IFRS 12 are found useful by users of financial statements

Questions for EFRAG TEG members

19 Do you agree with the EFRAG Secretariat that the list of issues is complete (including the remarks of paragraph 18 above)?

20 What further activities should be considered by the EFRAG Secretariat in the course of the PIR?

Appendix 1: Focus areas identified by the IASB Staff

21 Regarding IFRS 10, the IASB Staff identified the following areas of focus:

(a) Identifying the relevant activity when two investors have right to direct different activities in different periods;

(b) Assessing if investor's rights are protective or substantive:

- lenders' rights to appoint majority of the board members upon occurrence of particular facts;

(c) Assessing control with less than majority of voting rights arising from:

- disperse shareholding,
- special relationship with the investee,
- *de facto* agent (without contractual arrangement);

(d) Assessing if an investor acts as a principal or an agent:

- assessing the magnitude of, and variability associated with its economic interest;

(e) Identifying investment entities (IEs):

- level of formalisation for exit strategy and performance measurement;

(f) IE parent with IE subsidiaries:

- information on indirectly held investments and liabilities;

(g) Accounting for changes in ownership interest:

- measurement of retained interest in a joint operation after loss of control (literature gaps).

22 Regarding IFRS 11, the IASB Staff identified the following areas of focus:

(a) Accounting for collaborative arrangements without joint control;

(b) Classification of joint arrangements according to 'other facts and circumstances';

(c) Accounting for interests in joint operations:

- disproportion between the share of economic output obtained by the joint operators and their share of economic interest,
- interaction with IFRS 16.

23 Regarding IFRS 12, the IASB Staff identified the following areas of focus:

(a) Identification of unconsolidated structured entities;

(b) More information on the impact of significant NCI on results and cash flows;

(c) More granular disclosures for:

- subsidiaries with significant NCI,
- joint ventures and associates.

Appendix 2: Summary table of the identified issues

24 Below, the EFRAG Secretariat provided a summary of the issues identified by the IASB Staff and during the EFRAG meetings.

IFRS 10		
Identifying the relevant activity	e.g. when two investors have right to direct different activities in different periods	IASB, FIWG, CFSS, ASAF
Assessing whether investor's rights are protective or substantive		IASB, FIWG, CFSS, ASAF
Lenders' rights to appoint majority of the board members upon occurrence of particular facts	Kick-out rights	IASB, FIWG
Assessing control with less than majority of voting rights arising from:		
Disperse shareholding		IASB, FIWG
Special relationship with the investee		IASB, FIWG
De facto control, de facto agent (without contractual arrangement)		IASB, FIWG, CFSS, ASAF
Principal vs agent assessment	Fund management Service fees	IASB, FIWG, CFSS/ASAF
Assessing the magnitude of, and variability associated with its economic interest		IASB, FIWG, CFSS
Identifying investment entities		IASB
Level of formalisation for exit strategy and performance measurement		IASB
IE parent with IE subsidiaries		IASB, ASAF
Information on indirectly held investments and liabilities, hidden group financing		IASB, ASAF, CFSS
Accounting for changes in ownership interest		IASB, CFSS, ASAF
IFRS 11		
Accounting for collaborative arrangements without joint control, risk sharing arrangements		IASB, FIWG, CFSS, ASAF
Classification of joint arrangements according to 'other facts and circumstances'	Guarantee for j.o. liability; No clear cut	IASB, CFSS, ASAF, FIWG
Accounting for interests in joint operations		IASB, CFSS
Disproportion between the share of economic output obtained by the joint operators and their share of economic interest		IASB, CFSS, ASAF
Test of contractual arrangement		CFSS, ASAF
Interaction with IFRS 16	Recognition of j.o. lease by the operator	IASB, CFSS, ASAF
Recognising assets from oil fields by field operators		CFSS
Accounting for change in the phase of joint operation		CFSS
Application of IFRS 11 in separate financial statements		CFSS, ASAF
Measurement of retained interest in a joint operation after loss of control (literature gaps)	Including	IASB, FIWG, CFSS, ASAF
Remeasurement after loss of control over some assets		ASAF
IFRS 12		
Identification of unconsolidated structured entities		IASB, CFSS

More information on the impact of significant NCI on results and cash flows		IASB, CFSS, ASAF
More granular disclosures for subsidiaries with significant NCI		IASB, UP, CFSS, ASAF
More granular disclosures for joint ventures and associates		IASB
Assessment whether the disclosures required by IFRS 12 are useful for users.		FIWG
Disclosures about an associate which is a public entity	European issue	CFSS