

## STAFF PAPER

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<b>Project</b>	<b>Post-implementation Review of IFRS 10 <i>Consolidated Financial Statements</i>, IFRS 11 <i>Joint Arrangements</i> and IFRS 12 <i>Disclosure of Interests in Other Entities</i></b>		
<b>Paper topic</b>	Work undertaken in the first phase		
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## Purpose of this paper

1. This paper summarises the work undertaken in the first phase of the Post-implementation Review (PIR) of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*. It includes a summary of the outreach performed and the academic review undertaken.
2. The staff do not intend to discuss this paper unless the Board members have questions.

## Structure of this paper

3. The paper is structured as follows:
  - (a) outreach conducted during the first phase (paragraphs 4–5);
  - (b) key messages from stakeholders, including messages from the consultative bodies (paragraphs 6–19);
  - (c) summary of the academic literature review (paragraphs 20–31);
  - (d) Appendix A—list of outreach meetings; and
  - (e) Appendix B—list of academic papers.

## **Outreach conducted during the first phase**

4. Between September to December 2019, the staff held more than 20 meetings, either in person or through conference calls, with stakeholders including preparers, auditors, investors, standard-setters and regulators. This included meetings with the IFRS Interpretations Committee (Committee) and consultative bodies. The list of the meetings is at Appendix A.
5. Stakeholders were asked to share their overall experience applying IFRS 10, IFRS 11 and IFRS 12 and to prioritise matters they think need to be considered in the PIR.

## **Key messages from stakeholders, including messages from the consultative bodies**

### ***Summary***

6. Overall, stakeholders thought IFRS 10 and IFRS 12 work well and improved financial reporting.
7. During outreach in the first phase of the PIR, stakeholders expressed support for the principles of IFRS 10. However, some stakeholders said applying the requirements of IFRS 10 to complex fact patterns requires significant judgement and may not result in consistent outcomes.
8. Stakeholders said implementation required an adjustment phase when practice had to develop.
9. Stakeholders pointed out several application issues relating to the accounting for interests in joint operations. This feedback is consistent with the number of submissions the Committee has received since IFRS 11 was issued.

### ***The IFRS Interpretations Committee and consultative bodies***

10. We have summarised the matters we heard at the meetings with the Committee and the consultative bodies. Links to the agenda paper and meeting summary for each meeting are included as footnotes.

#### ***The IFRS Interpretations Committee***

11. At the November 2019 Committee meeting, the staff presented the feedback received to date. Some Committee members concurred with the feedback presented in the agenda paper.
12. Other members commented on aspects including:
- (a) *de facto* control (summarised in paragraphs 27–28 of Agenda Paper 7A);
  - (b) identifying the agency relationships, in particular non-contractual relationships (summarised in paragraphs 55–57 of Agenda Paper 7A);
  - (c) identifying the relevant activities (summarised in paragraphs 20–23 of Agenda Paper 7A);
  - (d) classifying joint arrangements (summarised in paragraphs 102–104 of Agenda Paper 7A); and
  - (e) accounting for joint operations when output taken up by the parties is disproportionate to their economic interests (summarised in paragraphs 113–115 of Agenda Paper 7A).<sup>1</sup>

#### ***Global Preparers Forum (GPF)***

13. GPF members raised the following matters regarding application of IFRS 10, IFRS 11 and IFRS 12:
- (a) distinguishing between protective and substantive rights in the assessment of control requires significant judgement (summarised in paragraphs 29–30 of Agenda Paper 7A).

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<sup>1</sup> The Interpretations Committee meeting papers are available [here](#).

- (b) assessing ‘other facts and circumstances’ in relation to the classifying joint arrangements is burdensome (summarised in paragraphs 102–104 of Agenda Paper 7A).
- (c) stakeholders were concerned about the accounting for lease liabilities by a joint operator that is the legal obligor in a lease contract with a third-party lessor on behalf of a joint operation (summarised in paragraphs 116–119 of Agenda Paper 7A).<sup>2</sup>

### *Capital Markets Advisory Committee (CMAC)*

14. CMAC members said that they would like:
- (a) more disaggregated disclosure of assets and liabilities for significant joint ventures and associates (summarised in paragraphs 127–130 of Agenda Paper 7A); and
  - (b) additional disclosures on financial information of subsidiaries, such as information on material non-controlling interests, cash flow in subsidiaries and significant intragroup transactions (summarised in paragraphs 127–130 of Agenda Paper 7A).
15. There were mixed views on the removal of proportionate consolidation for joint ventures.<sup>3</sup> One CMAC member said that, especially in construction industry, proportionate consolidation would provide useful information. In contrast, another CMAC member said that information provided applying the equity method is more useful than information provided by various line-items applying proportionate consolidation (summarised in paragraphs 105–108 of Agenda Paper 7A).
16. Generally, CMAC members said that the consolidation exception for investment entities reduces cost of applying IFRS 10 and provides relevant information. One CMAC member said the criteria to qualify as an investment entity are not rigorous

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<sup>2</sup> The GPF meeting papers and meeting summary are available [here](#).

<sup>3</sup> IAS 31 *Interests in Joint Ventures* permits an accounting option for jointly controlled entities, ie proportionate consolidation or the equity method. IFRS 11 requires a joint venturer to account for the investment in a joint venture using the equity method.

enough such that entities may be able to achieve their preferred outcome (summarised in paragraphs 82–84 of Agenda Paper 7A).<sup>4</sup>

*Emerging Economies Group (EEG)*

17. EEG members said that IFRS 10 works well. However, EEG members suggested the Board consider:
- (a) identifying the relevant activities (summarised in paragraphs 20–23 of Agenda Paper 7A);
  - (b) distinguishing protective rights from substantive rights (summarised in paragraphs 29–30 of Agenda Paper 7A);
  - (c) identifying the agency relationships (summarised in paragraphs 50–54 of Agenda Paper 7A); and
  - (d) assessing when potential voting rights are substantive (summarised in paragraphs 36–38 of Agenda Paper 7A).
18. One EEG member said that it can be difficult for an investor to obtain relevant information from its unconsolidated structured entities to comply with the disclosure requirements in IFRS 12 (summarised in paragraphs 131–136 of Agenda Paper 7A).<sup>5</sup>

*Accounting Standards Advisory Forum (ASAF)*

19. The staff updated ASAF members on the feedback received from outreach in the first phase of the PIR and requested their views on potential issues to be considered in a request for information at its December 2019 meeting. Most ASAF members agreed the matters identified by the staff are consistent with information from their jurisdiction. Many ASAF members noted that IFRS 10 and IFRS 12 work well. IFRS 11, however, gives rise to application issues mostly in relation to the accounting requirements for joint operations.<sup>6</sup>

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<sup>4</sup> The CMAC meeting papers and meeting summary are available [here](#).

<sup>5</sup> The EEG meeting papers and meeting summary are available [here](#).

<sup>6</sup> The ASAF meeting papers and meeting summary are available [here](#).

## **Summary of the academic literature review**

20. Paragraphs 20–31 summarise the evidence from academic papers on IFRS 10, IFRS 11 and IFRS 12 obtained after a comprehensive search for papers on topics relevant to the PIR. This search was not confined to papers addressing specific questions or topics.
21. Nineteen published and seven working papers relevant to the PIR were identified using Google Scholar, the Social Science Research Network and other databases of academic studies. Although the results reported in working papers may change before their publication, these papers have been included in this review because they may be relevant to the PIR.
22. Sixteen papers were assessed as being of limited potential usefulness to the Board, either because they represent interpretative discussions of IFRS 10, IFRS 11 and IFRS 12 or because they use IFRS 10, IFRS 11 and IFRS 12 to develop theories on the implementation of accounting standards. Therefore, this review is based on the remaining 10<sup>7</sup> academic papers. These papers include empirical analyses or useful descriptive evidence relevant to the PIR and are listed in Appendix B.
23. The staff has considered the results of this literature review in recommending to the Board those areas of the Standards that warrant further investigation.

### ***Academic literature review on IFRS 10***

24. The academic literature on the implementation of IFRS 10 is narrow in scope, possibly because of limited implementation experience—IFRS 10 only came into effect in 2013.<sup>8</sup> The narrow focus of the available literature may also result from the need to manually collect large amounts of data to create a generalisable sample and, more significantly, the inherent difficulty in assessing the effectiveness of IFRS 10. For example, a change in the number of subsidiaries is

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<sup>7</sup> The literature reviews on IFRS 10, IFRS 11 and IFRS 12 are based on six, five and two academic papers, respectively. The sum of the academic papers does not equal 10 because some academic papers cover more than one Standard.

<sup>8</sup> The effective date for the European Union area was 1 January 2014.

difficult to interpret—it may be attributable to acquisitions or disposals in the year of implementation and unrelated to the implementation of IFRS 10.

25. Evidence relevant to the PIR of IFRS 10 is based on three published and three working papers. The findings are:

- (a) that applying the IFRS 10 concept of control resulted in a change to the number of subsidiaries consolidated. Some entities reported an increase in the number of subsidiaries consolidated while others reported a decrease.
- (b) that entities reported minor changes in assets, liabilities and profit or loss in the year of implementation relative to the previous year.
- (c) based on the only empirical evidence of the effects of IFRS 10 from a large sample of 500 Australian firms,<sup>9</sup> that:
  - (i) the implementation of IFRS 10 has not affected the value relevance of earnings and book values.
  - (ii) entities consolidated fewer non-majority-owned subsidiaries after implementing IFRS 10.
  - (iii) after implementing IFRS 10, entities reporting a decrease in the number of subsidiaries earned lower consolidated profits.
  - (iv) after implementing IFRS 10, there was no evidence of an association between the number of subsidiaries and factors such as leverage, auditor type, CEO ownership and profitability. Prior to the implementation of IFRS 10, there had appeared to be such an association.

26. At the IASB Research Forum 2019, it was discussed that the findings described in paragraph 25(c)(iv) implied that implementing IFRS 10 may have improved financial reporting by requiring a more objective assessment of control. The findings of this paper are subject to concerns about research design and sample construction that were also discussed at the IASB Research Forum 2019.

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<sup>9</sup> This evidence is from a 2019 working paper by Bugeja, Loyeung and Nelson, ‘The Impact of IFRS 10 on Consolidated Financial Reporting’.

## *Academic literature review on IFRS 11*

27. The literature review for IFRS 11 is based on four published academic papers and one working paper. The findings from these papers are:
- (a) that eliminating the accounting policy option for proportionate consolidation is associated with significant changes in entities' total assets, total liabilities and certain financial ratios, such as return on assets, profit margin and financial leverage.
  - (b) that proportionate consolidation is less strongly associated with stock prices and returns than the equity method in IAS 31 *Interests in Joint Ventures*, and that the equity method is more informative. The authors<sup>13</sup> came to this conclusion after comparing the value relevance of amounts reported applying either proportionate consolidation or the equity method. In their view, eliminating the accounting option would not adversely affect users' decision-making.
  - (c) that analysts' information environment is not affected by entities exercising the accounting policy option in favour of either proportionate consolidation or the equity method. The information environment was measured by forecast bias, accuracy and dispersion of earnings forecasts, target prices and stock recommendations. In the authors' view, this finding supports the Board's decision to eliminate the accounting policy option.<sup>14</sup>
  - (d) based on a sample of 26 jurisdictions which reported using IFRS Standards from 2005 to 2016 that, overall, comparability decreased after IFRS 11 was implemented.<sup>15</sup> The authors, Sarquis et al. (2019), measured comparability by the association between accounting amounts (total assets, liabilities, revenues and expenses) and economic outputs (price, return,

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<sup>13</sup> So, Wong, Shun, Zhang and Xu (2018).

<sup>14</sup> Inchausti, Sanchez and Fuentes (2017).

<sup>15</sup> These points were discussed in a 2019 paper by Sarquis, Santos, Lourenco and Braunbeck, (2019). This paper provided the most direct evidence of the effects of IFRS 11.

cash flow). To assess changes in comparability, the authors identified two groups of entities:

- (i) entities that switched from proportionate consolidation to the equity method; and
- (ii) entities that used the equity method both before and after the implementation of IFRS 11.

The researchers then examined whether comparability between the two groups of entities increased or decreased after the implementation of IFRS 11.

28. Sarquis et al (2019) analysed comparability further among seven clusters of jurisdictions, grouped on the basis of a number of cultural and institutional factors, such as religion, level of economic development, culture, legal system and political system. The authors’ findings were obtained by comparing clusters where the equity method option was prevalent before the implementation of IFRS 11 to control clusters where the proportionate consolidation option was prevalent before the implementation of IFRS 11. The authors’ conclusions are summarised in this table.

<b>Cluster</b>	<b>Control cluster</b>	<b>Comparability relative to control cluster</b>
<b>cluster one (South Africa and Philippines)</b>	cluster six (Hong Kong)	Increased
<b>cluster two (Belgium, Germany, Spain, France, Italy, and Poland)</b>	cluster three (Australia, Canada, Ireland, New Zealand, UK)	Increased
<b>cluster two (Belgium, Germany, Spain, France, Italy, and Poland)</b>	cluster six (Hong Kong)	Increased

Cluster	Control cluster	Comparability relative to control cluster
<b>cluster seven (Kuwait, Malaysia, Sri Lanka and Turkey)</b>	cluster three (Australia, Canada, Ireland, New Zealand, UK)	Increased
<b>cluster four (Brazil, Chile and Mexico)</b>	cluster three (Australia, Canada, Ireland, New Zealand, UK)	Decreased
<b>cluster four (Brazil, Chile and Mexico)</b>	cluster six (Hong Kong)	Decreased
<b>cluster five (Denmark, Finland, Netherlands, Norway and Sweden)</b>	cluster three (Australia, Canada, Ireland, New Zealand, UK)	Decreased
<b>cluster seven (Kuwait, Malaysia, Sri Lanka and Turkey)</b>	cluster six (Hong Kong)	Decreased
<b>cluster one (South Africa and Philippines)</b>	cluster three (Australia, Canada, Ireland, New Zealand, UK)	Inconclusive
<b>cluster five (Denmark, Finland, Netherlands, Norway and Sweden)</b>	cluster six (Hong Kong)	Inconclusive

29. The authors concluded that clusters four (Brazil, Chile and Mexico), cluster five (Denmark, Finland, Netherlands, Norway and Sweden) and cluster seven (Kuwait, Malaysia, Sri Lanka and Turkey) unduly influenced the results of the paper and have sent questionnaires to the accounting standards boards of each country in an attempt to understand the specifics of the accounting for joint ventures in these jurisdictions.

30. The authors also observed that some entities have continued to disclose information based on proportionate consolidation, such as segment information. The technical staff investigated this by performing a search, and identified a sample of 64 entities from 19 jurisdictions that disclose proportionate consolidation as a measurement basis for segment information.

### *Academic literature review on IFRS 12*

31. The evidence from academic research related to IFRS 12 is based on one published paper and one working paper. The findings in the papers were that the level of compliance with disclosure requirements in IFRS 12 is relatively low.

## Appendix A—list of outreach meetings

- Auditors
  - six large international audit networks
- Investors
  - Capital Markets Advisory Committee
  - User panels/user groups of national standard-setters and regional organisations
- Preparers
  - Global Preparers Forum
  - Association of preparers from the financial services industry
  - Group of preparers from the oil and gas industry
- Regulators
  - European Securities and Markets Authority
  - International Organization of Securities Commissions
- Standard-setters and regional organisations
  - European Financial Reporting Advisory Group
  - Asian-Oceanian Standard-Setters Group
  - Group of Latin American Accounting Standard Setters
  - National standard-setters
- Others
  - Emerging Economies Group
  - Accounting Standards Advisory Forum
- The IFRS Interpretations Committee

## Appendix B—list of academic papers

1. Ašenbrenerová, Petra (2016), ‘Disclosure of joint ventures and associates in financial statement under IFRS’, *European Financial and Accounting Journal*, 11 (3), 85–94.
2. Bugeja, Martin, Loyeung, Anna, and Nelson, Ma (2019), ‘The Impact of IFRS 10 on Consolidated Financial Reporting’, working paper.
3. Gluzová, Tereza (2015), ‘The adoption of IFRS 10 and its impact on the scope of consolidation’, *Acta Academica Karviniensia*, 4, 18–27.
4. Inchausti, Begoña Giner, Sanchez, Raul Iñiguez, and Fuentes, Francisco Poveda (2017), ‘Does the interaction between the accounting method choice and disclosure affect financial analysts’ information environment? The case of joint ventures under IAS 31’, *Spanish Journal of Finance & Accounting / Revista Espanola de Financiacion y Contabilidad*, 46 (3), 298–326.
5. Lopes, Ana Isabel and Lopes, Mariana (2019), ‘Effects of adopting IFRS 10 and IFRS 11 on consolidated financial statements: An exploratory research’, *Meditari Accountancy Research*, 27 (1), 91–124.
6. Morgado, Maria Salomé de Jesus Martins (2013), ‘Effect analysis on the application of IFRS 10 compared with the IAS 27’, working paper.
7. Sarquis, Raquel Wille and Santos, Arioaldo dos (2018), ‘Impacts of the elimination of the proportionate consolidation on Itaúsa financial statements’, *Revista Contabilidade & Finanças*, 29 (77), 213–28.
8. Sarquis, Raquel Wille, Santos, Arioaldo dos, Lourenco, Isabel and Braunbeck, Guillermo Oscar (2019), ‘Elimination of Accounting Choices and the Comparability of Financial Statements: The Adoption of IFRS 11—Joint Arrangements’, working paper.
9. So, Stella, Wong, Kar Shun, Zhang, Feida and Zhang, Xu (2018), ‘Value relevance of proportionate consolidation versus the equity method: Evidence from Hong Kong’, *China Journal of Accounting Research*, 11 (4), 255–78.
10. Vasek, Libor and Gluzová, Tereza (2014), ‘Can a new concept of control under IFRS have an impact on CCCTB’, *European Financial and Accounting Journal*, 9 (4), 110–27.