FEEDBACK STATEMENT

Responses to the Discussion Paper

Separate Financial Statements

15 April 2015

Introduction

In September 2014, the European Financial Reporting Advisory Group (EFRAG), the Spanish Instituto de Contabilidad y Auditoría de Cuentas (ICAC), the Italian Organismo Italiano di Contabilità (OIC) and the Dutch Raad voor de Jaarverslaggeving (RJ) issued a Discussion Paper *Separate Financial Statements* (the 'DP'). Comments were requested by 31 December 2014.

EFRAG, ICAC, OIC and RJ are now issuing a feedback statement, describing the main comments received. It will be used by EFRAG, ICAC, OIC and RJ as input for any future work on the topic. This feedback statement should be read in conjunction with the DP, which is available on EFRAG's website.

Why was this Discussion Paper written?

It is widely accepted that financial statements presented by a parent company or an investor, whether prepared under IFRS or local GAAP, provide decision-useful information. For example, they provide information about an entity's capability to generate cash flows to repay debt or distribute dividends, and information about existing guarantees.

In the European Union and European Economic Area, under the Regulation 1606/2002, member states have the option to allow or require the preparation of annual accounts in conformity with IFRS. For companies applying IFRS to the separate financial statements, it has been debated whether separate financial statements should have a different or modified objective from consolidated financial statements. There have also been practical concerns about the relevance of some of the requirements, or lack thereof, in relation to these statements. Similarly, as disclosure requirements in IFRS are often focused on consolidated financial statements, there is a question whether these requirements may have to be amended for separate financial statements.

To address these concerns EFRAG, in partnership with ICAC, OIC and RJ issued in September 2014 a DP which considers how financial statements are used in Europe for economic decision making, analyses the technical financial reporting issues that arise when entities prepare separate financial statements under IFRS, and proposes solutions to the identified issues (the DP is available here).

Responses from constituents and outreach activities

Seven comment letters were received in response to the DP. All comment letters received are available on EFRAG's website (to view comment letters received please click here). The comment letters received came from national standard-setters, professional organisations of accountants and auditing firms. More specifically, from:

- the Dutch Accounting Standards Board (DASB);
- Moore Stephens LLP;
- the Danish Accounting Standards Committee (DASC) set up by "FSR – danske revisorer";
- the Institute of Chartered Accountants in England and Wales (ICAEW);
- PricewaterhouseCoopers (PwC);
- the Swedish Financial Reporting Board (SFRB); and

- the Federation of European Accountants (FEE).

This feedback statement summarises the feedback received from outreach activities undertaken on the DP, including obtaining feedback from the:

- International Forum of Accounting Standard Setters (IFASS) on 30 September 2014;
- EFRAG User Panel on 18 November 2014;
- EFRAG Consultative Forum of Standard Setters (EFRAG CFSS) on 25 November 2014; and
- IASB's Capital Markets Advisory Committee (CMAC) on 27 February 2015.

Summary of the responses and feedback received

Most respondents and participants in meetings welcomed the initiative of EFRAG and its partners in issuing the DP as a way of stimulating the discussion on separate financial statements, a topic that historically has received little attention from the IASB.

In general, respondents agreed that it would be useful if the IASB reviewed its requirements on separate financial statements and developed a set of general principles that could be used as a basis to set requirements for them. Nonetheless, not all respondents and participants in meetings considered that, at present, there were significant problems related to the preparation of separate financial statements in Europe.

Many respondents considered that Chapter 1 reasonably set out the framework of separate financial statements in Europe. Nonetheless, some respondents noted that the legal structure in Europe was quite complex. Thus, there was a need for a more comprehensive analysis of the consequences of the proposals made in the DP and to encompass in the scope of the project a wider population of entities and potential users of IFRS for separate financial statements.

Many respondents considered that the description provided in Chapter 2 of the DP provided a reasonable picture of the use financial statements of a parent or an investor. However, many respondents and participants in meetings suggested a number of additional users (e.g. trade creditors, employees) and considered that tax authorities and other authorities that had the power to request additional information should not be regarded as primary users and their needs should not drive the accounting requirements for separate financial statements.

In general, respondents and participants in meetings agreed that the reason for differences in accounting treatment between separate and consolidated financial statements are derived from the fact that consolidated and separate financial statements reflect different views. Nonetheless, some of these respondents thought that, wherever possible, separate financial statements and consolidated financial statements should be prepared using the same accounting policies for entities within the same group.

In general respondents agreed that the accounting for investments in subsidiaries, joint ventures and associates was addressed in IAS 27 *Separate Financial Statements* and that the standard did not provide guidance of acquisition-related costs, the treatment of contingent consideration and common control transactions. Although there was some support for the proposals included in the DP, respondents provided mixed views on how such items and transactions should be accounted for.

On disclosures, some respondents considered that IFRS requirements could be improved to properly deal with disclosures within the context of both consolidated and separate financial statements (e.g. guarantees, distribution of dividend to shareholders, intra-group commitments). In addition, some suggested that an appropriate simplification of disclosure requirements in general could make separate financial statements under IFRS more attractive for preparers.

In terms of how the IASB should move forward on this topic, some participants thought that the role of separate financial statements and related guidance should be part of the IASB's agenda consultation. It was also considered that the DP could be useful for the IASB's ongoing work on the Conceptual Framework.

Analysis of responses

General comments from respondents

Most respondents and participants in meetings welcomed the initiative of EFRAG and its partners in issuing the DP as a way of "flushing out the debate" within the EU and "stimulating the discussion on the role of separate financial statements".

Two respondents considered that the DP was a significant contribution to a topic that historically has received little attention from the IASB. One of these respondents added that the DP was a good starting point for further dialogue on separate financial statements under IFRS; and the other, related issues such as common control and related party transactions. This respondent noted that the DP identified a number of issues that were relevant for users and preparers of separate financial statements, which are largely unaddressed in existing IFRS.

One respondent was not convinced that, at present, there were significant problems related to the preparation of separate financial statements in Europe and that the IASB's focus should be on consolidated financial statements. Nonetheless, this respondent acknowledged that IAS 27 could be helpful to those companies that prepare separate financial statements and that it could be useful for the IASB to review its requirements on separate financial statements and to develop a set of general principles that could form the basis for setting requirements for them. Such an approach might well lead to the IASB explicitly accepting that guidance in national GAAP might be appropriate to deal with specific local issues.

How to proceed in the future

Some respondents considered that separate financial statements was an important topic and that the IASB should undertake a project on separate financial statements to clarify their role and provide a more robust basis for the preparation of separate financial statements.

One respondent further detailed that EFRAG should encourage the IASB to assess the interest in, and perceived usefulness of, a comprehensive project on separate financial statements and related party transactions as part of the planned agenda consultation in 2015. Similarly, one other respondent believed that the role of separate financial statements and related guidance should be part of the IASB's agenda consultation.

One respondent considered that the DP may also be useful for the IASB in its ongoing work on the Conceptual Framework and in developing standards in general.

Question 1 - Introduction

European legislative framework on financial reporting

Most respondents considered that Chapter 1 appropriately set out the framework of separate financial statements in Europe. One respondent added that, perhaps more importantly, Chapter 1 raised conceptual issues that are fundamental to the DP. However, one other respondent considered that if EFRAG and its partners wished to influence the IASB on a subject, it would be beneficial to understand whether other non-European IFRS jurisdictions had similar problems and call their interest on the subject.

Nonetheless, one respondent thought that the framework set out in the DP seemed to be based on private sector companies with 'limited liability' and 'profit objective' and considered that real life was significantly more complex. Therefore, this respondent considered that the scope of the DP should encompass a wider population of entities and potential users of IFRS for separate financial statements. Similarly, one other respondent thought that the legal structure in Europe was quite complex. Therefore, there was a need for a more comprehensive analysis of the consequences of the proposals made in the DP and, more particularly, whether the proposals included in the DP are in conflict with the EU Directives. x

The legal role of separate financial statements

Some respondents and participants in meetings agreed that separate financial statements had a significant legal role in Europe. This is because individual entities, and not groups, have legal status. One of these respondents emphasised that separate financial statements were not only important from a European perspective, but also for all jurisdictions where separate financial statements are prepared by entities applying IFRS.

On the other hand, some respondents and participants in meetings noted that, in their jurisdiction, separate financial statements under IFRS were not allowed or that the decision as to when and how to issue separate financial statements should be left to individual jurisdictions. Still, one European respondent thought that more guidance on separate financial statements could hopefully promote changes to both EU Directives and local laws, and believed that the possibility to apply IFRS to annual accounts generally leads to better information and also to cost-saving for international groups.

Scope of the project

Two respondents and one participant in a meeting questioned why the analysis was restricted to the financial statements of parents and investors, and thought that the scope of the project should have included individual financial statements.

These respondents considered that many of the issues identified in the DP also applied to individual financial statements and considered that including individual financial statements in the DP would provide the opportunity to address other issues not yet addressed (e.g. share-based payment scheme where the parent entity grants shares or share options on its equity for goods or services acquired by another entity of the group). This was particularly relevant, when considering that there are jurisdictions in Europe that have opted to apply IFRS to all financial statements, regardless of whether they hold investments in other companies.

Questions 2.1, 2.2 and 2.3 - The use of financial statements of a parent or an investor, regardless of whether they are prepared under IFRS or Local GAAP

Many respondents and participants in meetings considered that the description provided in Chapter 2 of the DP provided a reasonable portrayal of the use financial statements of a parent or an investor. One of these respondents added that the discussion on how users use financial statements was important, since the accounting requirements to be applied in separate and consolidated financial statements are different.

Users of financial statements of an individual entity

Many respondents and participants in meetings considered that the DP provided a reasonable summary of who the users of separate financial statements are. Nonetheless, some of these respondents and participants in meetings added that:

- trade creditors, competitors, potential competitors, employees and equity providers were also main users of financial statements of a parent or investor;
- all the parties that intend to have or conclude a contract with the entity should be considered as primary users of separate financial statements;
- although investment analysts are usually interested in consolidated financial statements of listed entities, these investors would benefit from having separate and consolidated financial statements prepared under the same basis (IFRS) and a broad adoption of IFRS;
- although tax authorities, regulatory bodies and other authorities often have a significant interest in the separate financial statements of an entity, such entities have the power to request additional information. Therefore, authorities in general should not be regarded as primary users and their needs should not drive the accounting requirements for separate financial statements; and
- equity investors were usually focused on consolidated financial statements when making investment decisions, although separate financial statements were at times used to supplement the information found in consolidated financial statements.

Two respondents believed that the users of separate and of consolidated financial statements significantly overlap. One of these respondents considered that many of those who were interested in the financial situation of an entity would normally analyse both the group and the individual entity.

By contrast, one respondent did not think that separate financial statements were, in fact, significantly useful to most users, with the exception of some lenders.

Use of financial statements of an individual entity

Many respondents and participants in meetings considered that the DP provided a reasonable summary on how separate financial statements were being used. Nonetheless, some of these respondents:

- were not convinced by the approach of separating the users into primary and secondary categories, as the use of separate financial statements depended on a number of facts and circumstances, such as the type of industry the business operates in, local law, regulations and economic conditions;
- considered that one could not make a broad generalisation regarding the use of financial statements prepared under local GAAP, as they are directly affected by local legal and regulatory requirements;
- considered that it was not always clear to which set of financial statements the DP was referring to;
- considered that users of separate financial statements were more focused on taxes and distributable profits than on the overall financial performance;

- noted that tax rules had a significant impact on the pricing of transactions, especially those undertaken with related parties. Thus, the tax environment of the entity should be considered by users when analysing the financial statements and by management when structuring transactions;
- considered that the research on the needs of users should encompass the reasons behind the need for certain legal requirements for separate financial statements, such as those included in the accounting directives and local company law for distribution of dividends, rules on solvency, bankruptcy, etc; and
- thought that it would be useful if the DP had placed more emphasis on how the users and the users' needs influence the decision as to which accounting policies should be adopted in separate and consolidated financial statements and when there should be an alignment between them.

In contrast, one respondent did not agree, in general, with the description provided on the use of separate financial statements. This respondent considered that although some lenders made use of separate financial statements for creditworthiness, their decision was not primarily based on separate financial statements. In addition, this participant considered that only in some jurisdictions was the information presented in separate financial statements used to assess restrictions on the distribution of profits and assess tax obligations.

Question 3.1 - Accounting policies to be applied in separate and consolidated financial statements

In general, respondents and participants in meetings agreed that the value of separate financial statements and the reason for differences in accounting treatment between separate and consolidated financial statements are derived from the fact that the two reflect different views: the view of a group and the view of a legal entity.

When referring to whether the accounting policies applied to each set should differ, a number of respondents and participants highlighted that the accounting policies could differ and provided the following views:

- the 'objective of separate financial statements' was of paramount importance when developing accounting policies to be applied to them. If the objective of separate financial statements was to report the legal entity's financial position and performance, then the accounting policies to be applied in separate and consolidated financial statements need not necessarily be the same;
- separate financial statements had potentially a different informational use and accordingly the accounting policies could differ. It would be helpful if IFRS provided additional guidance on separate financial statements, including when the use of different accounting policies may be acceptable;
- the accounting policies applied in the separate financial statements of the different entities that make up part of the group may be different from each other and from those of the consolidated group;
- different accounting treatments in separate and consolidated financial statements may result from inconsistencies between different standards, rather than of the nature of the financial statements;
- the needs of users of separate and of consolidated financial statements are quite similar for most of the elements presented. Therefore, similar transactions and events should

normally be accounted for in the same way in both sets. However, some transactions should be accounted for differently, due to the different views that they provide. For example, from an owner-oriented point of view, transaction costs might be part of the initial measurement of an investment. However from a group point of view the acquisition of a business cannot be considered as an acquisition of an asset; and

- although the accounting policies could differ, there is no need for a different accounting framework (or fresh-start approach) for separate financial statements.

Some of these respondents thought that, wherever possible, separate and consolidated financial statements should be prepared using the same accounting policies for entities within the same group. One of these respondents considered that "the accounting policies for separate and consolidated financial statements should be aligned as much as possible".

By contrast, one respondent did not believe that it was possible to establish general rules as to when the accounting policies should differ or not. Each entity should adopt the accounting policies appropriate to its transactions and business models.

Questions 3.2 and 3.3 - Accounting for transaction costs and contingent consideration

In general, respondents agreed that the accounting for investments in subsidiaries, joint ventures and associates was addressed in IAS 27, but that the Standard did not provide any guidance on acquisition-related costs or the treatment of contingent consideration. However, respondents provided mixed views on how transaction costs and contingent consideration should be accounted for.

Transaction costs

Many respondents thought that acquisition-related costs should be part of the initial measurement of investments in subsidiaries, joint ventures or associates accounted for at cost in the separate financial statements. Some of them argued that there was not a significant difference between "investments in subsidiaries, joint ventures or associates accounted for at cost" and other "fixed assets" accounted for at cost in separate financial statements.

Nonetheless, one respondent considered that it would be important to clearly define what could be included in transaction costs. One other respondent noted that IFRS provided different accounting treatment for transaction costs (e.g. 'acquisition businesses' and 'acquisition of assets') and questioned whether this was necessary.

Finally, one respondent thought that the accounting treatment of acquisition-related costs should be the same in separate and consolidated financial statements and noted that IFRS 3 *Business Combinations* already required that transaction costs should be expensed when incurred.

Contingent consideration

Many respondents considered that contingent consideration should be accounted for as part of the initial and subsequent measurement of investments in subsidiaries, joint ventures or associates when such investments are accounted for at cost in separate financial statements. One of these respondents considered that the accounting treatment prescribed in IFRS 3 *Business Combinations* for contingent consideration should only be applied to transactions under the scope of IFRS 3, and justified a different accounting treatment of contingent consideration, due to the differing objectives of each set. Another respondent thought that the IFRS IC project on the treatment of variable cost of purchase of an asset should explicitly include the treatment of contingent consideration in separate financial statements when the cost method was chosen.

In contrast, one respondent thought that the accounting treatment of contingent consideration should be the same in separate and consolidated financial statements and in accordance with IFRS 3.

Other relevant comments

One respondent considered that it would be useful to consider, at European level, national accounting practices in separate financial statements (under IFRS and local GAAP) for the various issues discussed in the DP. This would demonstrate the variety of practice and might indicate the extent to which further guidance is needed.

Questions 3.4, 3.5, 3.6 and 3.7 - Sale or contribution of equity investments between entities under common control

Common Control Transactions

Some respondents agreed that the IASB needed to address common control transactions in separate financial statements. One of these respondents recalled that acquisition of investments from entities under common control was not uncommon. Two other respondents believed that common control transactions should be addressed in the context of a broad project.

One respondent thought that common control transactions was a very complex topic and it was difficult to address all different scenarios. Therefore, this respondent considered that it was appropriate for the preparer to select the most relevant accounting policy and disclosures based on the Conceptual Framework.

One other respondent considered that it would be useful to consider, at European level, national accounting practices in separate financial statements on common control transactions. This would demonstrate the variety of practice and might indicate the extent to which further guidance is needed.

Acquisition of investments from entities under common control

Two respondents favored the fair value approach for the acquisition of investments from entities under common control in separate financial statements. These respondents noted that, in a common control transaction, the parties involved “will not necessarily be acting in their independent interest and so this could result in the recognition of elements in the financial statements that are not reflective of the economics or business rationale of the transaction”. Therefore, these respondents considered that the fair value approach was the approach that would adequately reflect the economic resources available and provided the most meaningful information to users of separate financial statements. They acknowledged that this approach could be burdensome when applied in practice, as an entity would need to obtain fair values. Therefore, one of these respondents accepted a cost approach supported by disclosures, when fair values would be difficult to assess.

Finally, one of these respondents recommended accounting for the difference between the ‘transaction price’ and the amount of investment initially recognised at ‘fair value’ or ‘carrying amount’ in equity, while the other favored Other Comprehensive Income (OCI).

One respondent did not think that there was a need for the IASB to set out specific requirements for the sale or contribution of equity investments between entities under common control. This respondent also noted that if these transactions were to be measured at fair value, the additional costs to preparers would not outweigh the benefits and considered that the existing flexibility within IFRS was beneficial for preparers of separate financial statements. This respondent noted that, if fair value or the carrying amount approach were used, the difference with the transaction price should be accounted in equity as a contribution from, or distribution to, the shareholder.

Question 3.8 - Business combinations and separate financial statements

In general, respondents would welcome guidance for business combinations under common control ('BCUCC'), as it was a matter that affected both separate and consolidated financial statements. Nonetheless, these respondents provided different views:

- one respondent supported an approach that would be based on the facts and circumstances of each transaction. For example, this respondent considered that for intragroup transactions, the use of the carrying amount approach could provide decision-useful information, was easier to apply in practice, retained the historical trend analysis and better reflected the combination of individual entities from the perspective of the separate financial statement;
- one respondent considered that there was a need to develop a uniform approach to BCUCC. Nonetheless, this respondent considered that it would be useful to retain flexibility when dealing with local legal and regulatory requirements: "different facts and circumstances, for example differing legal and tax regimes, lead to different accounting consequences"; and
- one respondent believed that fair value was conceptually the best basis for accounting for BCUCC in separate financial statements. When it was not possible to accurately measure fair value, then the accounting treatment should be driven by the facts and circumstances.

Questions 3.9 and 3.10 - Legal mergers

Two respondents agreed with the proposals included in the DP, particularly with paragraph 3.113 a). One respondent added that, in his view, the treatment in paragraph 3.113 (a) was the most appropriate where the owning parties have the same interests as before the merger. The treatment in (b) was more likely to better represent the underlying commercial reality of the merger and also provide more meaningful information to users.

Two respondents considered that legal mergers should be accounted for in the same way as other (non-legal) mergers or similar transactions.

One respondent considered that existing diversity in practice properly reflected the differing circumstances and differing legal requirements for legal mergers. It is not an appropriate topic for standardisation by the IASB and different approaches are appropriate in different circumstances.

Questions 3.11 and 3.12 - Disclosures on distributions to equity holders in the separate financial statements

Disclosures on distributable dividends

Some respondents and participants in meetings considered that IFRS requirements could be improved to properly deal with disclosures within the context of separate financial statements. These respondents considered that:

- additional disclosures about distributable dividends and intragroup guarantees were necessary in the separate financials statements;
- additional disclosures should be always considered from a cost-benefit perspective; and
- a number of jurisdictions already require companies to disclose information on the impact of externally imposed capital requirements or the existence of any other restriction on the entity's ability to transfer funds to its shareholders in the form of cash dividends; on how much of an entity's income is to be allocated to the creation, or increase, of any type of reserves in order to comply with externally imposed capital requirements; and on an entity's total amount of income and reserves which are available to be distributed. Therefore, having similar disclosure requirements in IFRS would not be unduly burdensome and would assist users by providing comparability between jurisdictions.

Nonetheless, some respondents and participants noted that debt and equity analysts were mainly interested in consolidated financial statements of listed entities. Therefore relevant information about distributable reserves should be also disclosed in the consolidated financial statements.

One respondent thought that additional information about distributable dividends could be useful although what constitutes distributable profit is often defined by national legislation so it may not be feasible to include additional information about distributable dividends in IFRS.

In contrast, some respondents did not believe that there was a need for additional disclosure requirements in this area. One respondent highlighted that the UK Financial Reporting Lab had a project on "Disclosure of dividend policy and capacity" which was likely to indicate what the current best practice is. Another respondent believed that disclosures on distributions to equity holders should be left to individual regulators.

Presentation of line items in the statement of financial position reflecting accumulated amounts that may or not be recycled to profit or loss

Three respondents were not supportive of requiring the presentation of a separate component of equity for accumulated amounts of income and expenses recognised in OCI that may be reclassified to profit or loss. One of these respondents considered that the distinction between distributable and non-distributable profits was not so simple and considered that there was no general link between presentation in, or recycling from, OCI and the realisation of gains and losses. One other respondent considered that distributable dividends was a matter of local law and he did not believe that a requirement on the presentation of a separate component of equity for the accumulated amounts referred to above was necessary. Finally, one other respondent noted that the IASB was currently working on the definition of OCI and that further consideration on this issue should be deferred until the IASB has progressed its work on OCI.

By contrast, one respondent thought that it was relevant for users of separate financial statements that the entity provide information about the equity amounts that are distributable and the cumulative amounts of gains or losses recognised in OCI that will be reclassified to profit or loss.

Other relevant comments on disclosures

One respondent and some participants in meetings considered that an appropriate simplification of disclosure requirements in general could make separate financial statements under IFRS more attractive for preparers.

Question 3.13 - Clarification of the current terminology under IFRS

Many respondents and participants in meetings agreed that it was important to clarify the definition and purpose of separate financial statements. One of these respondents considered that, although this would not in itself resolve all application issues, it would provide a more robust basis for their preparation. One other respondent considered that it was important to clarify whether or not there should be a distinction between separate and individual financial statements and that it would be useful if the terminology used in IFRS and EU Directives were aligned. Finally, another respondent thought that the IASB should consider the usefulness of the guidance provided in IAS 27, which allows the presentation of separate financial statements in addition to the financial statements of an investor that does not have subsidiaries and where the investments are accounted for under IAS 28.

By contrast, one respondent noted that IAS 27 did not take a strongly prescriptive approach and considered this useful.

Questions 3.14 and 3.15 - Other issues

Some respondents considered that there were other significant issues regarding separate financial statements under IFRS, which had not been addressed in the paper. More specifically, these respondents would welcome more guidance on:

- whether the repayment of share capital should be accounted for differently when compared to dividends received from the distribution out of retained earnings. In their view, current IFRS was unclear on whether the repayments of capital were included in the income statement or not;
- the accounting for loans to and from common control parties in separate financial statements;
- how the derecognition criteria of IAS 39/IFRS 9 should be applied when a parent contributes a financial asset to a subsidiary and therefore indirectly retains all risk and rewards;
- whether an associate or joint venture should be remeasured to fair value when it becomes a subsidiary or vice-versa;
- whether business disposals from a parent to a subsidiary are within the scope of IFRS 5;
- the principles that should apply when the equity method of accounting is used to account for investments in separate financial statements; and
- share-based payment scheme where the parent entity grants shares or share options on its equity for goods or services acquired by another entity of the group or the treatment of the deferred tax asset/liability that occur when a business combination takes place.

Other relevant comments

One respondent noted that the evidence collected within the DP was restricted to Europe and, as a global standard setter, it would be inappropriate for the IASB to tackle an issue unless it can be proved to be a global issue rather than a purely local or regional one. This respondent considered that it would be helpful to have a survey encompassing non-EU countries to understand whether separate financial statements are indeed a global problem.

This respondent also considered that it would be useful if the IASB developed a principle or principles to govern its approach to this subject, without restricting the flexibility that currently exists for preparers so that they can reflect their particular circumstances in their reporting.