

Post-implementation Review IFRS 10, 11 and 12

Executive Summary

Project Type	Influencing
Project Scope	Significant
Purpose of the paper	
This paper seeks the board's approval to publish the UKEB secretariat's updated response to the IASB's Request for Information for its post-implementation review of IFRS 10, IFRS 11 and IFRS 12.	
Decisions for the Board	
Do board members approve the updated draft comment letter to the IASB on its post-implementation review of IFRS 10, IFRS 11 and IFRS 12? Do board members expect to view and approve the feedback statement ahead of publication?	
Summary of the Issue	
The Board discussed the secretariat's draft response at its April meeting. The draft response has been updated for members' comments and for suggestions in the responses to our public consultation. We are now seeking board approval to submit our response to IASB and publish it on the UKEB website.	
Recommendation	
That Board members consider and approve the draft comment letter to the IASB for submission to IASB and publication on the UKEB website.	
Appendices	
Appendix 1	UKEB secretariat draft response
Appendix 2	IASB's RFI
Appendix 3	IFRIC March 2015 Update

Background

1. The IASB published its Request for Information (RFI) for its post-implementation review of IFRS 10, IFRS 11 and IFRS 12 in December 2020 with a comment deadline of 10 May 2021. The UKEB secretariat commenced work on the project in January 2021. The secretariat's project approach was approved by the governance arrangements in place at the time.
2. The secretariat's draft response was published on the website for stakeholder comment on 19 April 2021 with a comment deadline of 5 May 2021. That draft response was also presented at the UKEB's April 2021 board meeting. At that meeting, Board members requested some amendments to the draft response before finalisation. The UKEB also directed the Secretariat to request an extended deadline from IASB's project team to allow review of the updated draft at the May 2021 meeting.
3. Subsequent to that meeting, the IASB project team agreed to an extended deadline of 1 June 2021.

Analysis of Key Issues

4. Two responses were received to our public consultation on the draft comment letter. These were from an audit firm and a preparer. The main points raised by stakeholders in their responses were: 1. That IFRS 10, IFRS 11 and IFRS 12 are successful overall; 2. That a review of the requirements for consolidating investment entities is needed; and 3. The extent to which disclosures on unconsolidated structured entities required by IFRS 12 paragraph 26 provide relevant information, and whether the cost of preparation exceeds the usefulness of the information.
5. Our draft comment letter to the IASB, at Appendix 1 to this paper, has been updated to reflect Board members' feedback and comments received during the consultation period. We have also edited the draft comment letter for flow and clarity.
6. The table below summarises the updates to our draft comment letter in response to board members' recommendations and comment letters received:

	Change	Paragraph reference	Source of change
1	Added reference to previous financial reporting standards being rules-based.	Covering letter, page 1.	Board member recommendation.
2	Removed recommendation to provide additional guidance where investor has options to buy shares from non-controlling interest.	Appendix to draft response 1 Paragraph A12.	Board member recommendation.
3	Added recommendation to apply investment entity exception at lowest level in a group.	Covering letter Paragraph 4. Appendix to response 2 Paragraph A20.	Board member recommendation.
4	Added recommendation that IASB assess whether application guidance for investment entities results in appropriate outcomes for real estate and renewables funds.	Covering letter paragraph 6. Appendix to response Paragraph A19.	Board member recommendation.
5	Removed recommendation to provide definitive guidance on the treatment of incremental costs on change between controlling and non-controlling interest.	Appendix to draft response Paragraph A24b.	Board member recommendation.
6	Added recommendation to include guidance where the contractual terms of a joint operation provide a joint operator with a right of use asset.	Covering letter paragraph 10. Appendix to response Paragraph A42.	Recommendation in comment letter received; consistent with our response to Q10.
7	Added recommendation that IASB considers the extent to which IFRS 12 disclosures for unconsolidated structured entities have proved useful as an indicator of risk.	Covering letter paragraph 12. Appendix to response Paragraph A43	Board member recommendation. Recommendation in comment letter received.
8	Removed requests for users to consider the value of potential disclosures.	Appendix to draft response Paragraph A44	Board member recommendation.
9	Added recommendation to include IFRIC explanatory material on assessment of other facts and circumstances in IFRS 11.	Covering letter, paragraph 9. Appendix to response Paragraph A35.	Board member recommendation.
10	Removed reference to dividend traps.	Appendix to draft response Paragraph A45d.	Board member recommendation.

Question for the Board

7. Board members are asked to consider and approve the updated draft comment letter at Appendix 1 for submission to the IASB.

¹ Draft response refers to the draft response published for public consultation

² Response refers to the updated response attached as appendix 1 to this paper

Next Steps

8. We intend to finalise and submit the comment letter to the IASB by 1 June 2021. It will also be published on the UKEB website. If the Secretary of State has not delegated powers to the UKEB by that date, the response will be submitted in the name of the UKEB Secretariat.
9. A feedback statement based on the table under paragraph 6 will be published within 30 days of publication of our response. We do not intend to bring the feedback statement to the Board before publication, as there is no Board meeting in June. However, we seek the Board's views on whether they expect to view and approve the feedback statement ahead of publication.

Question for the Board
10. Does the board expect to view and approve the feedback statement ahead of publication?

Appendices

Appendix 1

UKEB secretariat draft response

Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board
7 Westferry Circus
Canary Wharf
London
E14 4HD

(Date)

Dear Mr Hoogervorst

Invitation to Comment: Post-implementation Review of IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities

Following the UK's exit from the European Union, the Department for Business, Energy and Industrial Strategy (BEIS) has set up the UK Endorsement Board (UKEB) to fulfil statutory functions of influencing the development and subsequent adoption of International Accounting Standards for use in the UK. The UKEB secretariat has begun influencing activities in preparation for the delegation of those statutory functions to the UKEB. This letter forms part of those influencing activities and is intended to contribute to the International Accounting Standards Board's (IASB) due process. The views expressed by the UKEB secretariat in this letter are separate from, and will not necessarily affect the conclusions in, any endorsement and adoption assessment on new or amended International Accounting Standards to be provided to the Secretary of State or the UKEB, once powers have been delegated.

The UKEB secretariat welcomes the opportunity to contribute to the IASB's post-implementation review of IFRS 10, IFRS 11 and IFRS 12 (the Standards). To develop our response, we have gathered evidence from stakeholder roundtables and interviews, desk-based reviews of annual reports from a sample of UK listed companies, and public consultation on our draft response. Our conclusions and recommendations in response to the IASB's consultation are outlined below. For detailed responses to the questions in the IASB's Request for Information (RFI) please see Appendix 1.

Our overarching conclusion is that the Standards have achieved their objectives by introducing a principles-based approach to accounting for consolidation and joint arrangements and replacing the rules-based approach of earlier standards

The Standards provide a framework for applying judgement effectively

1. We agree with the IASB's statement that 'financial reporting standards are most effective when they set out clear objectives and requirements and establish a framework for applying judgement effectively across a wide range of structures and regulatory regimes'³. We believe that the Standards meet these criteria and that this has allowed preparers to operationalise accounting treatments in a manner that best fulfils the objective of each standard.
2. We therefore recommend retaining the clear objectives and requirements of the Standards and requiring the application of judgment. Our recommendations are therefore limited to those few areas where the application of the Standards can be significantly improved. Where we recommend additional guidance is included in the Standards, it should be principles-based so that the Standards do not become cumbersome or difficult to apply to new arrangements, or encourage structuring and financial engineering.

IFRS 10 and identifying and assessing factors to establish whether there is control

3. We conclude that IFRS 10 provides robust guidance for applying the principle of control as the basis for consolidation. Application of the guidance by preparers enables identification of relevant activities, principal or agent relationships, de facto agents, and de facto control and to determine whether rights are substantive or protective rights. This is the case even where fact patterns are complex.

IFRS 10 and the investment entity exception

4. We conclude that the investment entity exception delivers consistent outcomes. We recommend that the investment entity exception is applied at the lowest level in an investment entity group, rather than at the highest level, so that liabilities held in intermediate investment entity subsidiaries are visible at group level. (See Appendix 1 paragraph A20).
5. We recommend a review of the disclosure requirement on why an investment entity is classified as such when it does not exhibit the typical characteristics of an investment entity, as it may lead to limited value disclosures. (See Appendix 1 paragraph A18).
6. We recommend that IASB reassesses whether the application guidance for identifying investment entities results in appropriate outcomes for certain funds, e.g. real estate funds without an exit strategy, and renewables funds requiring substantial strategic advice and management services. (See Appendix 1 paragraph A19).

IFRS 10 and changes in the nature of the relationship between an investor and an investee

7. We conclude that circumstances where there are changes in the nature of the relationship between an investor and an investee which are not covered by requirements in the Standards are infrequent.

³ Post-Implementation Review of IFRS 10, IFRS 11 and IFRS 12 paragraph 8.

8. We are aware of two situations where there is diversity in accounting treatment and we make recommendations to improve consistency and comparability:
- a. IFRS 10 does not contain guidance on how to determine the value of a non-controlling interest when a subsidiary is partly owned by an associate of the parent. Some preparers determine the value of the non-controlling interest by applying the proportion of shares in the subsidiary not owned directly by the parent to the fair value of the subsidiary's net assets. Others determine the value of the non-controlling interest by applying only the proportion of shares in the subsidiary owned by third party interests in the associate to the fair value of the subsidiary's net assets. We recommend that the first method is mandated as it is a more faithful representation of the non-controlling interest. (See Appendix 1 paragraph A23).
 - b. Some entities account for the acquisition of a controlling interest in a single-asset entity by applying IFRS 3 paragraph 2 and recording the asset at fair value. Other entities account for the same transaction by applying IFRS 10 and recognising non-controlling interest and goodwill. Our initial view is that recognising non-controlling interest and goodwill in relation to the acquisition of a single asset does not represent the substance of the transaction, and that these transactions should be accounted for in accordance with IFRS 3 paragraph 2 (See Appendix 1 paragraph A27). We recommend that the IASB undertakes a separate project to explore the divergent practice in this area with the aim of improving consistency, comparability and providing faithful representation.

Collaborative arrangements outside the scope of IFRS 11

We conclude that the existence of collaborative arrangements outside the scope of IFRS 11 is widespread. However, we do not recommend a change to the scope of IFRS 11 as such arrangements are faithfully represented by the application of other IFRS Standards.

IFRS 11 and the consideration of other facts and circumstances

9. We conclude that the guidance on other facts and circumstances is not always sufficient since agenda decisions published by the IFRS Interpretations Committee are frequently referred to. We recommend that the IFRS Interpretations Committee explanatory material is incorporated into IFRS 11 to facilitate application of the guidance on other facts and circumstances. (See Appendix 1 paragraph A36).

IFRS 11 and reporting joint operations in a relevant and faithful manner

We conclude that IFRS 11 generally leads to the reporting of joint operations in a relevant and faithful manner.

Interaction of IFRS 11 with other standards

10. We note that there is interaction between IFRS 11 and both IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases*. The interaction between IFRS 11 and IFRS 16 arises when a joint operator may also be the lessor of an asset to the joint operation. The interaction between IFRS 11 and IFRS 15 arises on the accounting of

revenue by a joint operator and in situations when a collaborator or partner in a joint arrangement may be a customer within the terms of IFRS 15.

11. We recommend that IASB includes additional guidance in the standard to address any diversity of application (See Appendix 1 paragraphs A49, A51).

IFRS 12 and the adequacy of disclosures

12. We conclude that IFRS 12 has generally achieved its objective. However, we recommend:
- a) IASB considers the extent to which disclosures for unconsolidated structured entities have proved useful as an indicator of potential risk (see Appendix 1 paragraph A43).
 - b) IASB considers including guidance on the level of aggregation and disaggregation of disclosures on interests in other entities as part of its Primary Financial Statements project (see Appendix 1 paragraph A46).
 - c) Enhanced disclosures for subsidiaries with material non-controlling interests (see Appendix 1 paragraph A47).

If you have queries on any of the points raised above, please contact the project team at PIR10-12@endorsement-board.uk

Yours sincerely

Pauline Wallace
Chair
UK Endorsement Board

Appendix 1 Questions on *Post-implementation Review of IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities*

Appendix I: *Post-implementation Review of IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities*

Question 1: Your background

To understand whether groups of stakeholders share similar views, the Board would like to know:

- (a) your principal role in relation to financial reporting. Are you a user or a preparer of financial statements, an auditor, a regulator, a standard-setter or an academic? Do you represent a professional accounting body? If you are a user of financial statements, what kind of user are you, for example, are you a buy-side analyst, sell-side analyst, credit rating analyst, creditor or lender, or asset or portfolio manager?
- (b) your principal jurisdiction and industry. For example, if you are a user of financial statements, which regions do you follow or invest in? Please state whether your responses to questions 2–10 are unrelated to your principal jurisdiction or industry.

A1 See cover letter.

Question 2(a): In your experience:

- (i) to what extent does applying paragraphs 10–14 and B11–B13 of IFRS 10 enable an investor to identify the relevant activities of an investee?
- (ii) are there situations in which identifying the relevant activities of an investee poses a challenge, and how frequently do these situations arise? In these situations, what other factors are relevant to identifying the relevant activities?

A2 Our outreach indicates that investors are able to identify the relevant activities of an investee by applying IFRS 10 paragraphs 10 – 14 and B11 – B13.

A3 We explored with stakeholders⁴ areas of potential difficulty in identifying relevant activities (see paragraph A4). Our conclusion is that the standard provides sufficient guidance to allow use of judgement in reaching valid conclusions in these areas.

A4 Areas of potential difficulty in identifying relevant activities explored in outreach were:

a. Returns are not defined in IFRS 10.

IFRS 10 defines relevant activities as ‘the activities that significantly affect the investee’s returns,’⁵ but ‘returns’ are not defined in the Standard. However, IFRS 10 application example 1 specifies that profit margin, revenue and value of the investee should be considered when determining whether an investor has power, and this is considered sufficient guidance.

b. Identifying relevant activities in structured entities

⁴ Stakeholders consulted include preparers, auditors, users and regulators.

⁵ IFRS 10, paragraph 10.

Structured entities may have a narrowly defined purpose and design, making the identification of relevant activities difficult. However, stakeholders concluded that relevant activities can be identified even in such circumstances. Stakeholders noted that the requirement to consider the purpose and design of the entity and the guidance in IFRS 10 paragraph B23 can be helpful in identifying its relevant activities.

- c. Where there are two or more investors and rights change over time, it may be difficult to identify the investor with the current ability to direct relevant activities (and therefore the controlling investor). However, our stakeholders confirmed that IFRS 10 paragraph B13 provides sufficient guidance as it requires an assessment to determine which investor has the current ability to direct the relevant activities that *most* significantly affect the investee's returns and it clarifies that those activities (and therefore the controlling investor) may change over the lifecycle of the investee. For example, research and development activities may most significantly affect returns in the early stages of the investee's life cycle whereas marketing and distribution activities may most significantly affect returns later in the investee's life cycle.

Question 2(b): In your experience:

- | | |
|------|--|
| (i) | to what extent does applying paragraphs B26–B33 of IFRS 10 enable an investor to determine if rights are protective rights? |
| (ii) | to what extent does applying paragraphs B22–B24 of IFRS 10 enable an investor to determine if rights (including potential voting rights) are, or have ceased to be, substantive? |

- A5 Our outreach indicates that IFRS 10 paragraphs B26 – B33 enable an investor to determine whether rights are protective rights.
- A6 Our outreach identified certain circumstances where the assessment of whether rights are protective or substantive is complex. However, despite these complexities, judgement can be applied to reach a valid conclusion. The circumstances identified were:
- Different investors have rights to appoint different members of the investee's key management personnel.
 - Veto powers apply.
 - Rights under a franchise agreement substantially restrict the ability of other parties to direct relevant activities.
 - Deadlock clauses affect the nature of the rights held by the investor.
- A7 We understand that some preparers use quantitative thresholds to establish whether rights are protective or substantive. We do not think that quantitative thresholds should be provided in IFRS 10 as they could create bright lines, increasing the risk of structuring and financial engineering.
- A8 Paragraphs B22 – B24 of IFRS 10 are effective in enabling investors to determine whether rights, including potential voting rights, are, or have ceased to be substantive.

Some stakeholders were concerned that if the requirement to consider whether there are any barriers that prevent the holder from exercising rights⁶ were applied in isolation, it could lead to frequent changes in the assessment of control due to changes in market prices of equity instruments. However, the requirement in IFRS 10 paragraph B23, to take into account all facts and circumstances, ensures that a change in market conditions alone would not typically lead to a change in control.

Question 2(c): In your experience:

- (i) to what extent does applying paragraphs B41–B46 of IFRS 10 to situations in which the other shareholdings are widely dispersed enable an investor that does not hold a majority of the voting rights to make an appropriate assessment of whether it has acquired (or lost) the practical ability to direct an investee’s relevant activities?
- (ii) how frequently does the situation in which an investor needs to make the assessment described in question 2(c)(i) arise?
- (iii) is the cost of obtaining the information required to make the assessment significant?

A9 Our outreach indicates that applying IFRS 10 paragraphs B41 - B46 enables investors that do not hold majority voting rights to make an appropriate assessment of their practical ability to direct an investee’s relevant activities.

A10 We further identified from outreach and from financial statement reviews that investors need to make this assessment in only a small minority of cases.⁷

A11 Our outreach activities indicated that the cost of obtaining the information required to make the assessment is not disproportionate.

Question 3(a): In your experience:

- (i) to what extent does applying the factors listed in paragraph B60 of IFRS 10 (and the application guidance in paragraphs B62–B72 of IFRS 10) enable an investor to determine whether a decision maker is a principal or an agent?
- (ii) are there situations in which it is challenging to identify an agency relationship? If yes, please describe the challenges that arise in these situations.
- (iii) how frequently do these situations arise?

A12 Our outreach indicates that IFRS 10 paragraph B60, the application guidance in paragraphs B62 – B72, and the application examples are effective in enabling investors to determine whether a decision maker is a principal or an agent. This is the case even where there are complex fact patterns and significant judgement is required.

A13 Significant judgement is required to assess whether a relationship is that of a principal or agent where remuneration agreements include a high level of variability of returns and depend on assumptions about future events. Such agreements feature in the fund

⁶ IFRS 10 paragraph B23 (a) requires investors to consider ‘Whether there are any barriers (economic or otherwise) that prevent the holder (or holders) from exercising the rights. Examples of such barriers include ... ii) an exercise price or conversion price that creates a financial barrier that would prevent (or deter) the holder from exercising its rights.’

⁷ In a review of annual reports from 16 FTSE 250 entities, none were identified as having de facto control over a subsidiary.

management, property and construction, hospitality and leisure, and outsourcing sectors.

- A14 Significant judgement is also required where there are contradictory indications regarding principal or agent status. For example, in fund management, a fund manager may only have authority to make decisions within narrowly defined parameters, which is an indicator of agent status. However, controlling investment decisions gives control over the activity that most affects future returns for the fund, and this is an indicator of principal status.
- A15 Our research also indicates that such scenarios do not occur frequently.⁸ Additionally, our outreach indicates that judgement can be applied to reach a satisfactory conclusion, so we do not recommend any changes.

Question 3(b): In your experience:

- (i) to what extent does applying paragraphs B73–B75 of IFRS 10 enable an investor to assess whether control exists because another party is acting as a de facto agent (ie in the absence of a contractual arrangement between the parties)?
- (ii) how frequently does the situation in which an investor needs to make the assessment described in question 3(b)(i) arise?
- (iii) please describe the situations that give rise to such a need.

- A16 Our outreach indicates that applying paragraphs B73 to B75 of IFRS 10 enables an investor to assess whether control exists because another party is acting as a de facto agent. Our research indicates that such assessments are infrequent.⁹
- A17 The most common situation in the UK where an assessment of de facto control is needed is where a parent has two subsidiaries, both of which have an ownership interest in a sub-subsidiary.

Question 4(a): In your experience:

- (i) to what extent does applying the definition (paragraph 27 of IFRS 10) and the description of the typical characteristics of an investment entity (paragraph 28 of IFRS 10) lead to consistent outcomes? If you have found that inconsistent outcomes arise, please describe these outcomes and explain the situations in which they arise.
- (ii) to what extent does the definition and the description of typical characteristics result in classification outcomes that, in your view, fail to represent the nature of the entity in a relevant or faithful manner? For example, do the definition and the description of typical characteristics include entities in (or exclude entities from) the category of investment entities that in your view should be excluded (or included)? Please provide the reasons for your answer.

- A18 Our outreach indicates that applying the investment entity definition in IFRS 10 paragraph 27 and the typical characteristics of an investment entity in paragraph 28

⁸ In a sample of 16 annual reports for FTSE 250 entities selected from sectors where we understand the assessment of a relationship to decide whether the investor is acting as a principal or an agent is likely to be more common, we identified 1 entity that had undertaken such an assessment.

⁹ In a sample of 16 annual reports for FTSE 250 entities selected from sectors where control arising from another party acting as a de facto agent might be expected to exist, we did not identify entities where this was the case.

leads to consistent outcomes. In addition, the guidance in IFRS 10 further helps achieve consistent outcomes. In particular, B85A's requirement to consider all facts and circumstances when assessing whether an entity is an investment entity, specific guidance in paragraph B85I on prohibited activities of an investment entity, and paragraph B85J guidance on permitted activities of an investment entity were all referenced by stakeholders. However, we recommend that the IASB reviews the requirement to disclose the rationale for concluding that an entity is an investment entity in the absence of the typical characteristics. This disclosure requirement can lead to limited value disclosures.

A19 We also recommend that the IASB undertakes a project to assess whether the application guidance in IFRS 10 paragraphs B85B to B85H remains valid for assessing whether entities meet the business purpose criteria of an investment entity¹⁰, given the recent emergence of different types of fund, specifically:

- i. Some renewables investment funds require the provision of extensive management services and strategic advice to investees, given in order to maximise the investment return. However, the extent of this service may represent a separate substantial business activity or a separate substantial source of income.¹¹ Where this is the case, paragraphs B85B to B85H guidance on assessing whether entities meet the business purpose criteria of an investment entity¹², means that these funds cannot be classified as investment entities.
- ii. It is common for real estate investment funds not to have exit strategies¹³. The application of IFRS 10 B85F would prohibit the classification of these funds as investment entities.

Question 4(b): In your experience:

- (i) are there situations in which requiring an investment entity to measure at fair value its investment in a subsidiary that is an investment entity itself results in a loss of information? If so, please provide details of the useful information that is missing and explain why you think that information is useful.
- (ii) are there criteria, other than those in paragraph 32 of IFRS 10, that may be relevant to the scope of application of the consolidation exception for investment entities?

A20 The IASB's rationale for the investment entity consolidation exception was that it is more relevant for investment entities to report fair value performance. Some stakeholders observe that there is a loss of information when an investor measures at

¹¹ IFRS 10 paragraph B85D states that 'An investment entity may ... participate in the following investment-related activities ... if they are undertaken to maximise the investment return ... from its investees and do not represent a separate substantial business activity or a separate substantial source of income to the investment entity: (a) providing management services and strategic advice to an investee and (b) providing financial support to an investee, such as a loan, capital commitment or guarantee.'

¹² IFRS 10 paragraph 27b states that an investment entity is an entity that 'Commits to its investors that its business purpose is to invest funds solely for return from capital appreciation, investment income, or both.'

¹³ IFRS 10 paragraph B85F states that 'An investment entity shall have an exit strategy documenting how the entity plans to realise capital appreciation from substantially all of its equity investments and non-financial asset investments.'

fair value its investment in an intermediate investment entity subsidiary that holds a range of investment funds (structured as subsidiaries) and the intermediate subsidiary's main purpose is to hold these investments and related debt funding. Any assets or liabilities held in the intermediate subsidiary are not visible in the consolidated financial statements. We therefore recommend that the investment entity exception is applied at the lowest level in a group, rather than the highest level. This would mean that in the scenario described, the investment entity consolidation exception would be applied by the intermediate investment entity subsidiary to the investments it holds, but not by the investor when consolidating the intermediary investment entity subsidiary. As a result, the consolidated financial statements would report the underlying investments in the investment funds at fair value and the debt held by intermediate investment entity subsidiary would also be visible.

Question 5(a): In your experience:

- (i) how frequently do transactions, events or circumstances arise that:
 - (a) alter the relationship between an investor and an investee (for example, a change from being a parent to being a joint operator); and
 - (b) are not addressed in IFRS Standards?
- (ii) how do entities account for these transactions, events or circumstances that alter the relationship between an investor and an investee?
- (iii) in transactions, events or circumstances that result in a loss of control, does remeasuring the retained interest at fair value provide relevant information? If not, please explain why not, and describe the relevant transactions, events or circumstances.

A21 Our understanding is that transactions, events or circumstances which alter the relationship between an investor and an investee, and which are not addressed in IFRS Standards arise infrequently.

A22 Where there is loss of control, carrying the retained interest at fair value provides relevant information because:

- a. It facilitates comparison by maintaining consistency with the requirements in IAS 28 *Investments in Associates and Joint Ventures* or IFRS 9 *Financial Instruments*; and
- b. The profit or loss recorded on disposal will be more faithfully presented.

A23 We note that IFRS 10 does not contain guidance on how to determine the value of a non-controlling interest when a subsidiary is partly owned by an associate of the parent. Some preparers determine the value of the non-controlling interest by applying the proportion of shares in the subsidiary not owned directly by the parent to the fair value of the subsidiary's net assets. Others determine the value of the non-controlling interest by applying only the proportion of shares in the subsidiary owned by third party interests in the associate to the fair value of the subsidiary's net assets. We recommend that the first method is mandated as it is a more faithful representation of the non-controlling interest.

Question 5(b): In your experience:

- (i) how do entities account for transactions in which an investor acquires control of a subsidiary that does not constitute a business, as defined in IFRS 3? Does the investor recognise a non-controlling interest for equity not attributable to the parent?
- (ii) how frequently do these transactions occur?

- A24 Our research and outreach highlighted that there is divergent practice when an investor acquires a controlling interest in an entity that does not constitute a business. Single-asset entities do not meet the definition of a business in IFRS 3 and are frequent in the property, pharmaceutical and wealth management sectors. Our research also indicates that single-asset entities are becoming more common in these sectors.
- A25 Divergent practice arises because IFRS 3 paragraph 2 requires acquisitions which do not constitute a business to be accounted for by allocating the consideration paid to identifiable assets and liabilities based on their relative fair values. For an investor applying this approach to a single-asset subsidiary, the consideration would therefore be equal to the fair value of the asset acquired and there would be no goodwill and no non-controlling interest.
- A26 By contrast, preparers applying IFRS 10 consolidate the single-asset subsidiary, thereby recognising non-controlling interest and recognising goodwill if the consideration exceeds the fair value of the single asset.
- A27 We recommend that IASB undertakes a separate project to explore the divergent practice in this area with the aim of improving consistency and comparability and providing faithful representation to these arrangements provides a faithful representation of them.

Question 6: In your experience:

- (a) how widespread are collaborative arrangements that do not meet the IFRS 11 definition of 'joint arrangement' because the parties to the arrangement do not have joint control? Please provide a description of the features of these collaborative arrangements, including whether they are structured through a separate legal vehicle.
- (b) how do entities that apply IFRS Standards account for such collaborative arrangements? Is the accounting a faithful representation of the arrangement and why?

- A28 We observe that collaborative arrangements outside the scope of IFRS 11 are widespread in some sectors. From our initial desk-based review of annual reports we conclude that applying IFRS standards to these arrangements provides a faithful representation of them.
- A29 We reviewed a selected sample of annual reports of six FTSE 100 companies in the extractives, utilities, aerospace, oil and gas and beverages sectors. It revealed that all had some form of collaborative arrangement outside the scope of IFRS 11. These were predominantly equity holdings where participants exercise either significant influence

or no significant influence (thereby, no joint control as defined in IFRS 11¹⁴). Our tentative conclusion is that such collaborative arrangements are widespread within those sectors in the UK.

- A30 Our desk-based review also suggests that collaborative arrangements that do not meet the definition of joint control and are structured using a separate vehicle are common in the mining and extractives industries. For example, we identified examples of collaborative arrangements where no joint control was present which had the following features:
- a. Legal structure of a joint venture, but decisions over financial and operating decisions are made by 'simple majority' rather than by unanimous agreement between the parties; and
 - b. Parties have collective control, but decisions are determined on an aggregate voting interest that could be achieved by several combinations of the parties (thus making difficult the identification of a single combination of parties jointly controlling the arrangement).
- A31 Our review of annual reports did not identify common features of collaborative arrangements structured in separate vehicles. However, our outreach suggests that the objective of these arrangements is similar to that of other joint arrangements. For instance, parties in the collaborative arrangements:
- a. Share the risks and costs associated with a particular project or to bring in specialist skills, expertise or knowledge;
 - b. Share responsibility for all the activities of a collaborative arrangement, or for specific activities; and
 - c. May act as an active participant or have a more passive role. For example, a local government may act as an active participant when local regulations require the government to hold a share in the collaboration agreement¹⁵.
- A32 Our review of annual reports revealed that interests in collaborative arrangements outside the scope of IFRS 11 are accounted for by applying other relevant IFRS Standards. Consequently, if participants in an arrangement:
- a. Hold an equity interest, they may account for that interest using equity accounting in accordance with IAS 28 *Investments in Associates and Joint Ventures* or fair value accounting in accordance with IFRS 9 *Financial Instruments*.
 - b. Do not hold an equity interest or are participating in a joint operation but do not have joint control they would apply the relevant IFRS Standards to account for their share or interest.

¹⁴ "Joint control" is defined in paragraph 7 of IFRS 11 as: "the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control".

¹⁵ Our review of one UK aerospace company's annual report showed that the UK government has held alliances or partnerships with the private sector, for example, in building vessels.

- A33 Applying relevant IFRS Standards faithfully represents the economic substance of collaborative arrangements. This is because the requirements in those Standards prompt entities to analyse the rights and obligations arising from each collaborative arrangement and apply the principles of each IFRS Standard to each one of its arrangements. For example:
- a. Applying IAS 28 provides a faithful representation of an interest in a collaborative arrangement structured through a separate vehicle where a party has no control or joint control over the financial and operating policies of the separate vehicle, by showing that an entity has only the power to participate in those policies.
 - b. Applying IAS 16 *Property, Plant and Equipment* provides a faithful representation of share in a commonly-owned asset where the contractual arrangement does not specify that unanimous consent is required by the parties for using the asset.
 - c. Applying IFRS 3 *Business Combinations* provides a faithful representation of an interest in an arrangement that is a business where one of the parties has control over the rights to the net assets¹⁶.

Question 7: In your experience:

- (a) how frequently does a party to a joint arrangement need to consider other facts and circumstances to determine the classification of the joint arrangement after having considered the legal form and the contractual arrangement?
- (b) to what extent does applying paragraphs B29–B32 of IFRS 11 enable an investor to determine the classification of a joint arrangement based on ‘other facts and circumstances’? Are there other factors that may be relevant to the classification that are not included in paragraphs B29–B32 of IFRS 11??

- A34 Our stakeholder outreach indicated that the assessment of ‘other facts and circumstances’ using the guidance in IFRS 11 paragraphs B31¹⁷ and B32¹⁸ occurs frequently where there are complex joint arrangements structured through separate vehicles. Such arrangements are commonplace in the extractives, telecoms, and pharmaceuticals sectors. Companies consider this guidance useful:
- a. In situations where the terms of the contractual arrangements do not specify the parties’ rights to the assets and obligations; and

¹⁶ IFRS 11 paragraph B33A states that ‘When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in IFRS 3, it shall apply, to the extent of its share in accordance with paragraph 20, all of the principles on business combinations accounting in IFRS 3, and other IFRSs, that do not conflict with the guidance in this IFRS and disclose the information required by those IFRSs in relation to business combinations.’

¹⁷ Paragraph B31 states that “when the activities of an arrangement are primarily designed for the provision of output to the parties, this indicates that the parties have rights to substantially all the economic benefits of the assets of the arrangement. The parties to such arrangements often ensure their access to the outputs provided by the arrangement by preventing the arrangement from selling output to third parties”.

¹⁸ Paragraph B32 states that “the effect of an arrangement with such a design and purpose is that the liabilities incurred by the arrangement are, in substance, satisfied by the cash flows received from the parties through their purchases of the output. When the parties are substantially the only source of cash flows contributing to the continuity of the operations of the arrangement, this indicates that the parties have an obligation for the liabilities relating to the arrangements”.

- b. To identify whether, despite the legal form and contractual terms suggesting that a joint arrangement may be a joint venture, other facts and circumstances may indicate that the arrangement is in fact a joint operation.
- A35 This was further confirmed by our review of a selected sample of six annual reports for FTSE 100 entities.¹⁹ Two out of the six annual reports referred to the guidance in IFRS 11 on 'other facts and circumstances' when determining the classification of their joint arrangements. One of these companies also referred to the evaluation of particular facts and circumstances derived from their own contractual relationships with other entities.
- A36 We have received mixed feedback from stakeholders on the extent to which applying IFRS 11 paragraphs B29-B32 enables an investor to determine the classification of a joint arrangement based on other facts and circumstances. Some stakeholders find the guidance in IFRS 11 paragraphs B29 – B31 sufficient, but others observe that it does not clearly address the principles behind the assessment of 'other facts and circumstances'. This has led them to seek additional explanatory material from different sources²⁰.
- A37 We therefore recommend that the guidance in paragraphs IFRS 11 B31-B32 is supplemented with the explanatory material issued by the IFRS Interpretations Committee in March 2015 covering:
- a. what the objective should be in the assessment of 'other facts and circumstances'; and
- b. how and why particular facts and circumstances create rights and obligations
- A38 We recommend that where supplementary material is added to IFRS 11 on other facts and circumstances it should be principles-based so that the application of IFRS 11 continues to require the use of judgement since , if accounting standards become more prescriptive and detailed, applying them to the specific features associated with complex joint arrangements is less likely to provide a faithful representation.

Question 8: In your experience:

- (a) to what extent does applying the requirements in IFRS 11 enable a joint operator to report its assets, liabilities, revenue and expenses in a relevant and faithful manner?
- (b) are there situations in which a joint operator cannot so report? If so, please describe these situations and explain why the report fails to constitute a relevant and faithful representation of the joint operator's assets, liabilities, revenue and expenses.

- A39 Applying the requirements in IFRS 11 generally enables a joint operator to report in a relevant and faithful manner its assets, liabilities, revenue and expenses. This is because the accounting for joint arrangements reflects the substance of the rights and

¹⁹ The annual reports were from the extractives, utilities, aerospace and beverages sectors.

²⁰ For example: a) application/illustrative examples in IFRS 11; b) March 2015 agenda decision issued by the IFRS Interpretations Committee on the assessment of 'other facts and circumstances' 3; and c) additional views from accounting firm manuals.

obligations that parties have in the arrangement as a result of their interests in the arrangements, regardless of those arrangements' structure or legal form²¹.

A40 Some of our stakeholders observe that when accounting for a joint operator's interest in a joint operation, they found the meaning of 'share' in IFRS 11 paragraph 20²² is unclear. They identified the following situations:

- i. the rights and obligations of a joint operator, as specified in the contractual arrangement, differ from its ownership interest in the joint operation; or
- ii. a joint operator, acting as the manager of a joint operation has a direct legal liability for the *entire* balance of specific liabilities in a joint operation (and not just for its 'share').

A41 We disagree that the term 'share' is unclear in the situations above, because IFRS 11 paragraph BC38 states that the contractual arrangement is the basis for recognition and measurement. Furthermore, paragraph B26 states that when there is a conflict or inconsistency between rights and obligations in contractual arrangements and those conferred by the legal form, 'the parties use the contractual arrangement to reverse or modify the rights and obligations conferred by the legal form of the separate vehicle in which the arrangement has been structured.'

A42 However, we recommend that additional guidance is provided when the contractual terms of joint operations provide a joint operator with a right-of-use asset as defined in IFRS 16, as the term 'share' is difficult to interpret in that scenario.

Question 9: In your experience:

- (a) to what extent do the IFRS 12 disclosure requirements assist an entity to meet the objective of IFRS 12, especially the new requirements introduced by IFRS 12 (for example the requirements for summarised information for each material joint venture or associate)?
- (b) do the IFRS 12 disclosure requirements help an entity determine the level of detail necessary to satisfy the objective of IFRS 12 so that useful information is not obscured by either the inclusion of a large amount of detail or the aggregation of items that have different characteristics?
- (c) what additional information that is not required by IFRS 12, if any, would be useful to meet the objective of IFRS 12? If there is such information, why and how would it be used? Please provide suggestions on how such information could be disclosed.
- (d) does IFRS 12 require information to be provided that is not useful to meet the objective of IFRS 12? If yes, please specify the information that you consider unnecessary, why it is unnecessary and what requirements in IFRS 12 give rise to the provision of this information.

A43 Our outreach indicated that generally the IFRS 12 disclosure requirements assist an entity to meet the objective of IFRS 12.

²¹ However, we note that when the legal form of the separate vehicle does not confer separation between the parties and the vehicle, the joint arrangement is a joint operation in accordance with IFRS 11 paragraph B24.

²² IFRS 11 paragraph 20 requires (emphasis added) the recognition of a joint operator's assets, liabilities and expenses including its *share* of any assets, liabilities and expenses incurred jointly. It also requires the recognition of its revenue from the sale of its *share* of the output arising from the joint operation and from its *share* of the revenue from the sale of the output by the joint operation.

- A44 However, some stakeholders recommend a reconsideration of the current disclosure requirements for unconsolidated structured entities. They note that the disclosure requirements for unconsolidated structured entities in IFRS 12 paragraphs 26 and 29 do not differentiate between sponsored and unsponsored unconsolidated structured entities. They suggest that greater differentiation between the disclosure requirements for assets in sponsored and unsponsored unconsolidated structured entities would provide more useful insight into the risk profile of the reporting entity. They also note that the costs of providing the required disclosures may exceed the usefulness of the information.
- A45 We have had limited opportunity to explore this recommendation in terms of costs and practicalities of implementation. However, in our view there is merit in further exploration of the proposal, which should consider:
- a) Requiring the entity to set out the basis on which it has determined an entity is a sponsored entity, or development and field-testing of a definition of *sponsored*, since IFRS 12 does not currently provide such a definition.
 - b) The extent to which the disclosure of total assets for unsponsored unconsolidated structured entities has proved to be useful as an indicator of potential risk.
 - c) The extent to which IFRS 12 paragraph 3 already requires such disclosures.²³

Additional guidance on aggregation/disaggregation

- A46 We agree with the principle in paragraph B2 of IFRS 12 that allows entities to judge the level of detail required in the disclosures to satisfy the needs of users. However, users observe that the level of detail varies amongst entities. Whilst some entities provide highly aggregated information, others provide highly detailed but irrelevant information. We recommend that the IASB develops further guidance that would help entities disclose information at the relevant level of detail that would meet users' needs. This guidance could be developed in the form of principles of aggregation and disaggregation as part of the IASB's Primary Financial Statements project.

Additional disclosures about subsidiaries with material non-controlling interests

- A47 We recommend enhanced disclosures to explain the composition of the material NCIs. For example, users think that it would be useful if the IASB requires the reporting entity to:
- a. Indicate which subsidiaries the material NCI relates to.

²³ IFRS 12 paragraph 3 states: If the disclosures required by this IFRS, together with disclosures required by other IFRSs, do not meet the objective in paragraph 1, an entity shall disclose whatever additional information is necessary to meet that objective. IFRS 12 paragraph 1 states The objective of this IFRS is to require an entity to disclose information that enables users of its financial statements to evaluate (a) the nature of, and risks associated with, its interests in other entities; and (b) the effects of those interests on its financial position, financial performance, and cash flows.

- b. Disclose the proportionate share of operating cash flows attributable to material NCIs.
- c. Provide more disaggregated information of assets and liabilities held by subsidiaries with material NCIs.
- d. Provide more information on significant restrictions on the tax consequences of distributions and the subordination of debt in subsidiaries.

Question 10: Are there topics not addressed in this Request for Information, including those arising from the interaction of IFRS 10 and IFRS 11 and other IFRS Standards, that you consider to be relevant to this Post-implementation Review? If so, please explain the topic and why you think it should be addressed in the Post-implementation Review.

- A48 There is significant interaction between both IFRS 16 *Leases* and IFRS 15 *Revenue from Contracts with Customers* and IFRS 11 *Joint Arrangements*.
- A49 We recommend that additional guidance is added to the standard to reduce any diversity arising in practice. The guidance provided by the IFRS Interpretations Committee on these interactions could be considered in the development of this additional guidance.

Appendix 2

[IASB's RFI](#)

Appendix 3

[IFRIC March 2015 Update](#)