7 May 2021

Hans Hoogervorst
Chair
IFRS Foundation
Columbus Building, 7 Westferry Circus
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United Kingdom
Via website: www.ifrs.org

Dear Hans

Request for Information – *Post-implementation Review of IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities*

As the representatives of over 280,000 professional accountants in Australia, New Zealand and around the world Chartered Accountants Australia and New Zealand (CA ANZ) and CPA Australia thank you for the opportunity to comment on the above Request for Information (RFI).

We have conducted outreach activities with our members and other key stakeholders to obtain their views on the RFI and highlight below some of the key messages around their experiences in implementing and applying IFRS 10, 11 and 12.

Overall, the feedback we received indicates that these standards are working well in practice and are meeting their stated objectives. While their principles-based nature requires the application of significant levels of judgement, the benefits associated with this approach appear to outweigh the associated costs. Instances of inconsistent application appear to be limited.

Notwithstanding this overall feedback, our outreach activities have identified the need for further action by the IASB in some specific areas to better address some of the challenges and inconsistencies being encountered in interpreting and applying the standards.

Such action includes:

- The development of additional guidance, including a more sophisticated suite of examples, for IFRS 10, 11 and 12 to promote consistency in applying the principles to more complex scenarios where significant judgement needs to be exercised. The areas that require additional guidance include;

    - identifying relevant activities
    - assessing rights that provide power
    - distinguishing between principals and agents.

  We understand many of the examples currently provided are simplistic and do not cater for many of the complex business arrangements that are entered into in practice. It can therefore be challenging for preparers and auditors to be confident that the principles have been correctly and consistently applied to complex scenarios, especially when they involve the application of multiple principles.

- A reconsideration of the implementation guidance and associated disclosures for the IFRS 10 investment entities consolidation exception which can give rise to application challenges.

- The development of new/revised requirements or improved guidance in areas where feedback we have received indicates the current requirements are deficient or inconsistent. Key areas of concern are partial acquisitions of subsidiaries that do not constitute a business (IFRS 10), accounting for changing ownership interests (IFRS 10 and 11), changing from joint ventures to joint operations and vice-versa (IFRS 11) and applying the IFRS 11 requirements to joint operations.

We have provided our responses to the specific questions raised in the RFI in the **Attachment** to this letter. If you have any questions about our submission, please contact either Amir Ghandar (CA ANZ) amir.ghandar@charteredaccountantsanz.com or Ram Subramanian (CPA Australia) at ram.subramanian@cpaaustralia.com.au.

Yours sincerely

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Attachment

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?

CA ANZ and CPA Australia are professional accounting bodies representing over 280,000 professional accountants in Australia, New Zealand and around the world.

(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.

Our members are principally located in Australia and New Zealand and are involved in a range of industries in the for-profit, not-for-profit and public sectors.

IFRS 10 *Consolidated Financial Statements*

Question 2(a) Control – Power over an investee

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?

Feedback we have received indicates that identifying ‘relevant activities’ can present challenges in situations where:

- the activities, and the decision makers who have rights over those different activities, change over the life span of an entity. For example, when an entity moves from the research phase to the development phase of a product, if different decision makers have power over the investee in respect of each of the research phase and development phase, this could give rise to a shift in the power over an investee. Our feedback is that the current guidance is unclear about whether ‘relevant activities’ should be viewed at a point in time or over an entity’s entire life span.
- single asset vehicles or predetermined activities are involved.
- entities have veto powers over decisions that have greater bearing on meeting the ‘relevant activities’ test than the corresponding positive decision-making powers.

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While we support the principles-based requirements and associated guidance in the standard, further guidance would assist consistent application of the necessary judgement. The provision of comprehensive examples that apply the key principles to a range of the more common, and more complex scenarios, would more clearly direct the exercise of professional judgement on these matters and give confidence to stakeholders that these principles are being applied as intended.

While the IFRS Interpretations Committee (IFRIC) provides some assistance in this area, the fact patterns of the specific matters it often deals with can limit application to a broader range of complex scenarios. However, the step by step analysis which is set out in the IFRIC Agenda Decisions does provide a model for the kind of educational guidance we are seeking from the IASB.

Question 2(b) Power over an investee—Rights that give an investor power

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?***

While feedback we received suggests that the principles enunciated in this section are adequate, the level of judgement required is considerable and some more comprehensive examples would assist the consistent application of the relevant principles.

Similar to the feedback received by the IASB that is highlighted in the RFI, feedback we received also indicates concerns around the guidance in paragraphs B29-B33 of IFRS 10 when assessing the protective and other rights that a franchisor may have in a franchise arrangement.

In practice, the following features can exist in franchise arrangements:

- a contractual requirement for the franchisee to purchase their supplies from the franchisor
- business marketing of the franchisee being determined by the franchisor
- debt support provided to the franchisee by the franchisor

These features could contribute to an assessment that the franchisor controls the franchisee. However, we understand it is uncommon for franchisors to include franchisee operations in consolidated financial statements because they rely on the 'protective rights' conclusions in paragraphs B29 and B30 of IFRS 10.

Accordingly, we suggest a review of the guidance provided in paragraphs B29-B33 to make it clear that there are aspects of a franchise arrangements, other than 'protective rights', that might influence the conclusion that a franchisor has power over a franchisee.

Question 2(c) Power over an investee—Control without a majority of the voting rights

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?***

Similar to our responses to questions 2(a) and 2(b), feedback we have received suggests that the principles enunciated in this section are adequate, but the level of judgement required when assessing this issue can be considerable. We therefore recommend that the IASB consider the development of comprehensive examples to support the application of the key principles to some of the more common complex scenarios.

Whilst we understand that it is not uncommon for the situation to arise where there is exercise of control without a majority of the voting rights, we have not received feedback that allows quantification of the frequency of such occurrence. We have also not received any feedback around costs of obtaining the information required to make the assessment.

Question 3(a) Control—The link between power and returns – principals and agents

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?***

Feedback we have received is that distinguishing between principal/agent relationships remains an area where significant judgement needs to be applied, and that there is evidence of growing diversity in practice when applying such judgement.

The provision of more comprehensive examples dealing with the application of the key principles involved to common complex scenarios would more clearly direct the exercise of that judgement. Such examples could consider additional dimensions that establish the link between power and returns, other than the percentage based 'bright lines' approach used in the current application examples (examples 13 -16).

Question 3(b) The link between power and returns—Non-contractual agency relationships

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 (i.e. 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.***

Feedback we have received indicates that these paragraphs of IFRS 10 are rarely relied on in practice, as other principles in the standard can more readily be applied when making the control decision in these circumstances. However, we understand that when these principles are applied, they are not well understood, due to their complexity.

Question 4(a) Investment entities—Criteria for identifying an investment entity

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.***

Although CA ANZ and CPA Australia have previously supported the IASB decision to provide a consolidation exception for investment entities, recent feedback we received is that this exception is difficult to apply in practice. In particular, there is lack of clarity around how the typical characteristics of an investment entity in paragraph 28 should be assessed in conjunction with the definition in paragraph 27. The open-ended statement at the end of paragraph 28 that says “The absence of the typical characteristics in the paragraph does not necessarily disqualify an entity from being classified as an investment entity” leaves the requirements open to interpretation and results in inconsistent application. We suggest revising paragraphs 27 and 28 to ensure they are better aligned and clearer with respect to how the definition should be applied in the context of the typical characteristics. In particular, we suggest providing guidance on what characteristics might exist, in addition to those described in paragraph 28, that would qualify an entity for the investment entity exception.

Concern has also been expressed about the lack of clarity around the evidence that is necessary to conclude on matters such as business purpose (paragraph B85B) and exit strategies (paragraph B85F), both of which are fundamental aspects of the investment entity definition. We suggest consideration be given to developing and providing additional guidance to assist entities determine what evidence is necessary when determining whether it is an investment entity.

Question 4(b)Investment entities—Subsidiaries that are investment entities

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?***

Some concern has been raised with us about the loss of information that arises from the use of fair values when the exception is applied in respect of subsidiaries that are investment entities. The Australian Securities Exchange (ASX) compensates for this loss of information by requiring (as per ASX Listing Rules 4.8 and 4.8.1) that if securities in an unlisted entity are a listed entity's main asset, the listed entity is to provide separate financial statements of the investees to the ASX, and to shareholders on request.

We therefore recommend that the IASB revisit this exception and consider how best to address the concerns raised around the loss of information that occurs when the exception is applied, perhaps through requiring additional disclosures about the underlying net assets.

Question 5(a) Accounting requirements—Change in the relationship between an investor and an investee

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.***

Feedback we have received indicates that changes in the relationship between investors and investees occur frequently and that a variety of accounting practices are adopted to account for such changes. The accounting is further complicated when the investments do not meet the definition of a business, scoping them out of IFRS 3 (e.g. single asset vehicles).

Further diversity in practice is also associated with the ongoing indefinite deferral of the IASB's 2014 narrow scope amending standard *Sale or Contribution of assets between an investor and its associate or joint venture*, which sought to resolve inconsistencies between IFRS 10 and IAS

28 *Investments in Associates and Joint ventures* when dealing with transactions that did and did not involve a business.

We therefore recommend that the IASB considers how it might develop principles for accounting for changes in ownership (in both subsidiaries and joint arrangements) on a more holistic basis than those which are currently available. These principles should also include guidance on acquisitions of investments that do not constitute a business. We discuss this issue further in our response to Question 8.

Question 5(b)—Partial acquisition of a subsidiary that does not constitute a business

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?***

We understand that partial acquisitions of subsidiaries that do not constitute a business occur regularly and that there are a variety of accounting practices that are adopted in addition to the acquisition method prescribed by IFRS 3. We also understand that these accounting practices do not always result in the allocation of fair values based on the relative values of the assets and liabilities acquired. For example, there can be an allocation of fair values to assets for which fair values are readily determinable and where the difference is allocated on a residual basis to other assets, where values are less readily ascertainable.

To address these issues, we suggest that the IASB develops and provides more guidance in this area.

IFRS 11 *Joint Arrangements*

Question 6 Collaborative arrangements outside the scope of IFRS 11

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?

It is our understanding that collaborative arrangements are common and the requirements of IFRS 11 are generally applied by analogy. Since, for the most part, activities undertaken as part of such arrangements are similar to those that can arise through a joint operation, this approach is considered to provide a faithful representation of the activities arising from such arrangements.

Question 7 Classifying joint arrangements

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?

Feedback we have received indicates that the "other facts and circumstances" guidance provided in paragraphs B29-B32 of IFRS 11 is used frequently in practice when classifying joint operations. We understand that the requirements in the standard are considered adequate to support the appropriate exercise of professional judgement in making the necessary decisions about the relevant joint arrangement.

Question 8 Accounting requirements for joint operations

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.

Feedback we have received indicates that the application of the requirements in IFRS 11 can sometimes present challenges in practice, especially when the conceptual principles underlying equity accounting for joint ventures interact with the legal form of various contractual arrangements that are involved in joint operations. While IFRIC has provided some guidance in this area, including its March 2019 Agenda Decision on the recognition of lease liabilities in a joint operation, concerns remain about how to balance and adequately disclose substance over form issues arising in joint operations. We therefore consider that the development of more complex examples relating to some more common fact patterns would guide the application of the necessary judgement.

We also understand that there are challenges associated with determining the appropriate accounting when there are changes in either the ownership of the joint arrangement, or the vehicle that is used to operate the joint arrangement. We therefore also recommend that the IASB considers developing principles for accounting for changes in ownership on a more holistic basis than those which are currently available. These principles should also include guidance on how to account for acquisitions of entities that do not constitute a business.

Finally, we support the continuation of the IASB's current *IAS 28 Investments in Associates and Joint ventures* Research project, but would prefer that its scope was expanded to address some more fundamental issues with the application of equity accounting to joint ventures, including reconsideration of the proportionate consolidation approach that was removed when IFRS 11 was issued.

IFRS 12 *Disclosure of Interests in other entities*

Question 9 Disclosure of interests in other entities

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.

We are unaware of any significant concerns in practice with the level and adequacy of these disclosure requirements in meeting the objectives of the standard.

Question 10 Other topics

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.

We have no further issues to raise

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