

**EXCERPT FROM THE SUMMARY RECORD OF THE
MEETING OF
THE ACCOUNTING REGULATORY COMMITTEE AND CONTACT COMMITTEE
OF 23 JULY 2007**

Relationship between the IAS Regulation and the 4th and 7th Company Law Directives: consolidation rules under the 7th Directive and IFRS

At the last meeting, the Commission presented Document ARC/16/2007 in which it set out its view on the relationship between the IAS Regulation and the 7th Company Law Directive when consolidation rules are concerned. During the discussion, one delegation indicated it would be submitting its observations in writing. These written observations were subsequently provided to the Commission, which sent them to ARC members. This delegation was invited to present them to other ARC members.

This delegation considered that the main question that should be answered is whether a parent company that controls only subsidiaries considered as non significant should draw up consolidated accounts. They noted that the IAS Regulation does not determine which company should draw up consolidated accounts and that the 7th Directive too is primarily about consolidated accounts. They also highlighted that Article 13 of the 7th Directive is included in Section 1 "Conditions for the preparation of consolidated accounts", which is the Section that determine whether a company is obliged to draw up consolidated accounts. Therefore, they considered that, even if only Articles 1 to 12 of the 7th Directive explicitly refer to the obligation to draw up consolidated accounts or to exemption to this obligation, Article 13 should be seen in substance as a test to determine if parent companies are obliged to draw up consolidated accounts, depending if there still are material subsidiaries within the scope of consolidation. This delegation finally noted the practical outcomes of an interpretation obliging parent companies which have only non material subsidiaries to prepare consolidated accounts under IFRS. They considered that the resulting consolidated accounts will provide no additional meaningful information that was not in the parent company accounts. This may even create confusion by providing redundant but dissimilar information with individual company accounts set up using national GAAP.

Many Member States supported the position and legal analysis of the Commission. On Member State noted that one the main objective of the IAS Regulation is to make financial information disclosed by listed companies comparable. Therefore, they should not be given the possibility to avoid providing financial information not comparable to those from other listed companies. Financial information using IFRS has an added value. There will be no additional information compared to annual (individual) accounts if consolidated ones are prepared under national GAAP when there is no material subsidiary. Therefore, the political objective of applying IFRS to all listed companies should be supported. As national GAAP applying to annual (individual) accounts remain different, this would not create fiscal problem. Another Member State agreed with this opinion and disagreed with the reasoning of the first delegation . This Member State noted that annual accounts of listed companies using national GAAP would be very different from consolidated accounts under IFRS, which would undermine comparability. This Member State highlighted the contradiction to endorse IAS 27 on one side and to try to avoid applying it

using the 7th Directive on the other side. Finally, one Member State highlighted that the question is of legal nature. Therefore, the response should not be driven only by practical considerations. The same Member State wondered if there would be so many companies impacted by the opinion expressed by the Commission. If it is the case, potential impacts in terms of transparency objectives should be taken into account before proposing regulatory changes, so that beyond legal and practical considerations altogether there would be issues of principle at stake.

Many other Member States supported this point of view. One Member State noted that Article 13 also provides exemption to the consolidation scope when shares of a subsidiary are held exclusively with a view to their subsequent resale, which should also be applied. This Member State added that comparability is in any case not completely ensured as the IAS Regulation does not oblige IFRS to be applied to annual (individual) accounts. One Member State noted that its considerations were not only practical but legal in terms of determining where there are exemptions to the obligation to draw up consolidated accounts, which could contradict a political objective to extend the implementation scope of IFRS. Another Member State highlighted that negotiations related to the elaboration of the IAS Regulation resulted in not making use of IFRS compulsory for unlisted companies or for annual (individual) accounts. Finally, one Member State noted that in Annex 4 section 5 of its communication on simplification, the Commission proposes to clarify whether a parent company with only non material subsidiaries should fall under the IAS Regulation and prepare its consolidated accounts using IFRS.

The Commission Services answered that, as indicated in the previous meeting, they have addressed this question related to relationship between two legal texts primarily from a legal point of view. Practical aspects as well as political objectives have not been given prominence. Commission Services have carefully analysed the observations by one Member State and have noted two main arguments raised by that delegation. The first main argument is that Article 13 of the 7th Directive is included in Section 1 "Conditions for the preparation of consolidated accounts", that the delegation considers as a section dealing with circumstances under which companies shall draw up consolidated accounts. The second main argument is that there is no obligation to draw up consolidated accounts, both from a legal basis and from a usefulness perspective, when there is nothing else than the parent company to consolidate.

Concerning the first main argument, the opinion of the Commission Services is that Section 1 of the 7th Directive does not deal exclusively with circumstances under which a company shall draw up consolidated accounts. As the note presented by the Commission at the previous meeting already highlighted, some articles included in this Section 1 "require...to draw up consolidated accounts" (Articles 1 and 12) or are related to the application of these articles (Articles 2, 3 and 4.1). Other Articles include "exemption from the obligation imposed in Article 1.1" (Articles 4.2, 5, 6, 7, 8 and 11) or are related to the application of these articles (Article 9 and 10). Articles 13 and 15 (as well as Article 14, which has been removed) do not include such wordings. The opinion of the Commission Services is that the wording concerning exemption from obligation to draw up consolidated accounts has been repeated by the legislator to make it clear that the concerned articles provide such exemption. The fact that there is not the same wording in Articles 13 to 15 is not an accident. It does mean that the purpose of these articles is not to provide an exemption to draw up consolidated accounts, but only to provide some exemption to the scope of consolidation. In most cases, the application of Article 13 will not result in having no material subsidiary to consolidate, and hence there will be no doubt that consolidated accounts should be drawn up. Some Member States have interpreted the application of Article 13 resulting in no material subsidiaries to consolidate as an additional exemption from the obligation to draw up consolidated accounts. This interpretation has been made before the IAS Regulation exists and therefore without taking the impact of the relationship between the IAS Regulation and the 7th Directive into account. As the IAS Regulation is now in force, its impact

should be fully taken into consideration. The second main argument raised by the first delegation should be analysed in such a perspective.

The second main argument that a scope of consolidation including only non material subsidiaries would allow exemption to draw up consolidated accounts is an interpretation of the Directive that cannot be made before the scope of consolidation is determined. The opinion of the Commission Services, as explained above, is that the determination of the consolidation scope is not part of the conditions to the general obligation to draw up consolidated accounts, but the first milestone of the preparation of the consolidated accounts. As the IAS Regulation requires listed companies to prepare their consolidated accounts using endorsed IFRS, the Commission Services believe that listed European parent companies which control other companies as defined by Article 1.1 of the 7th Directive and are not subject to the exemptions provided by Article 4.2, 5, 6, 7, 8 or 11 of this Directive must determine their scope of consolidation in conformity with endorsed IFRS. This opinion is reinforced by the fact that in some circumstances, the determination of the scope of consolidation via provisions of the 7th Directive or via provisions of endorsed IFRS will not achieve the same result. This could be the case when shares of a subsidiary are held exclusively with a view to their subsequent resale. As noted by one Member State Article 13 of the 7th Directive provides a general exemption to consolidate such entities. IAS 27 is more restrictive in accepting this exemption (it refers to the strict conditions of IFRS 5 on discontinued operations). Another case could be the inclusion of Special Purpose Entities in the consolidation scope. Interpretation SIC 12 may result in a large consolidation scope in this perspective. Therefore, application of provisions of endorsed IFRS to determine the consolidation scope could result in having material entities included in this scope where application of provisions of the 7th Directive to the same parent company could result in no material entity to be consolidated. Finally, if the application of endorsed IFRS results in no material subsidiary to be included in the consolidation scope, the question whether the parent company is then obliged to prepare consolidation accounts is a matter of interpretation of IFRS. As the policy of the Commission is not to interpret IFRS, this question should be rather submitted to the IFRIC.