
Introduction, background and conclusions

Attachment 1: Effect study prepared by the European Financial Reporting Advisory Group (EFRAG)

Attachment 2: Endorsement advice prepared by EFRAG
1. **Effect Study**

The European Commission has agreed with the European Parliament that effect studies should be prepared for new accounting standards and interpretations up for endorsement in the European Union (EU). The Commission Services together with the European Financial Reporting Advisory Group (EFRAG) prepare these studies containing description of the accounting issues involved, results from stakeholder consultations as well as analysis of effects of using the new accounting rules in the EU.

EFRAG has prepared an effect study for IFRS 10 *Consolidated Financial Statements* (IFRS 10), IFRS 11 *Joint Arrangements* (IFRS 11), IFRS 12 *Disclosure of Interests in Other Entities* (IFRS 12), IAS 27 *Separate Financial Statements* (IAS 27 (2011)) and IAS 28 *Investments in Associates and Joint Ventures* (IAS 28 (2011)) (the Standards). As the EFRAG effect study refers to the endorsement advice, we also included it in attachments.

This cover note contains background information, comments and a conclusion by the Commission Services on EFRAG’s effect study and endorsement advice.

2. **Background on IFRS 10 Consolidated Financial Statements (IFRS 10), IFRS 11 Joint Arrangements (IFRS 11), IFRS 12 Disclosure of Interests in Other Entities (IFRS 12), IAS 27 Separate Financial Statements (IAS 27 (2011)) and IAS 28 Investments in Associates and Joint Ventures (IAS 28 (2011))**

In May 2011 the IASB issued IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*, IAS 27 *Separate Financial Statements* (IAS 27 (2011)) and IAS 28 *Investments in Associates and Joint Ventures* (IAS 28 (2011)) (the Standards). The Standards are effective for annual periods beginning on or after 1 January 2013, with earlier application permitted.

The IASB added a project on consolidation to its agenda to deal with divergence in practice in applying IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation — Special Purpose Entities* (for example, in circumstances in which a reporting entity controls another entity but holds less than a majority of the voting rights of the entity). The project also sought to resolve a perceived conflict between IAS 27 — which required the consolidation of entities that are controlled by a reporting entity, and defined control as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities, and SIC-12 — which interpreted the requirements of IAS 27 in the context of special purpose entities, and placed greater emphasis on risks and rewards. The objective of the project on consolidation was to publish a single IFRS on consolidation to replace the consolidation requirements of IAS 27 and SIC-12. In 2008, the global financial crisis highlighted the lack of transparency about the risks to which investors were exposed from their involvement with ‘off balance sheet vehicles’ (such as securitisation vehicles). As a result, the G20 leaders, the Financial Stability Board and others also asked the IASB to review the accounting and disclosure requirements for such ‘off balance sheet vehicles’.

IFRS 10 *Consolidated Financial Statements* establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. It replaces IAS 27 and SIC-12 and provides a revised definition of control and related
application guidance so that a single control model can be applied to all entities. IFRS 10 defines control as consisting of three elements: power, exposure to variable returns, and the investor's ability to use that power to affect its amount of variable returns. IFRS 10 provides guidance and illustrative examples regarding situations in which control might exist without a majority of voting rights, including situations of de facto control, agent/principal relationships and relationships with entities that are designed so that voting rights are not the dominant factor in assessing control (structured entities).

IFRS 11 Joint Arrangements establishes principles for the financial reporting by parties to a joint arrangement. IFRS 11 supersedes IAS 31 Interests in Joint Ventures and SIC-13—Jointly Controlled Entities—Non-monetary Contributions by Venturers. IFRS 11 is concerned principally in addressing two aspects of IAS 31: first, that the form of the arrangement was the main determinant of the accounting and, second, that an entity had a choice of accounting treatment for interests in jointly controlled entities (proportionate consolidation or equity method). IFRS 11 requires a party to a joint arrangement to determine the type of joint arrangement in which it is involved by assessing its rights and obligations arising from the arrangement. Under IFRS 11, the method of accounting will depend on the type of joint arrangement.

IFRS 12 combines, enhances and replaces the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities.

As a consequence of these new IFRSs, the IASB also issued amended and retitled IAS 27 Separate Financial Statements and IAS 28 Investments in Associates and Joint Ventures.

EFRAG consultations

EFRAG published its initial draft endorsement advice and effect study report on 9 February 2012 and finalised its advice on 30 March 2012. Overall, commentators to EFRAG's consultation agreed with EFRAG's assessment of the benefits of implementing the Standards and the associated cost involved for preparers and users and supported EFRAG's recommendation that the Standards should be adopted for use in Europe. Notwithstanding its positive recommendation that the Standards should be adopted in Europe, EFRAG recommends the mandatory effective date of the Standards to be 1 January 2014 with early adoption permitted. Finally, given the interaction between the Standards, EFRAG also believes that the mandatory effective date should be the same for all the Standards.

3. Effect Study

Main points identified in the EFRAG effect study

Relevance, reliability, comparability and understandability

EFRAG's overall assessment is that the Standards satisfy the criteria of relevance, reliability, comparability and understandability. In performing its overall assessment, EFRAG focused on the impact of the new requirements introduced by the Standards. IFRS 10 introduces new elements that affect the following areas when assessing control: a) ability to direct the investee's relevant activities; b) de facto control; c) potential voting rights; d) agency/principal relationships; and; e) structured entities. In EFRAG's view, the requirements in IFRS 10 on those areas satisfy the relevance, reliability, comparability and understandability criteria. In
performing its assessment of IFRS 11, EFRAG focused on the impact of the new following elements introduced by IFRS 11: a) core principle for classification and accounting for interest in joint arrangements; b) parties without joint control having an interest in a joint operation, and; c) accounting for interests in joint operations in separate financial statements. In EFRAG's view, the requirements in IFRS 11 in relation to those elements meet the relevance, reliability, comparability and understandability criteria. In performing its analysis of IFRS 12, EFRAG focused on the impact of the requirements introduced by IFRS 12 that involve new elements to existing disclosure requirements. EFRAG overall assessment of IFRS 12 is that IFRS 12 satisfies the relevance, reliability, comparability and understandability.

Changes in IAS 27 result from the developments of IFRS 10 and IFRS 11. EFRAG's assessment is that IAS 27 (2011) satisfies the criteria of relevance, reliability, comparability and understandability.

The changes to IAS 28 mainly result from the development of IFRS 11. EFRAG's assessment is that IAS 28 (2011) also satisfies the criteria of relevance, reliability, comparability and understandability.

Costs and benefits for preparers and users

EFRAG's assessment is that all preparers will incur additional costs to implement the requirements in IFRS 10, and for some preparers (particularly companies operating in the financial industry and insurance industry), the initial costs of implementation and conducting the required analysis will be significant, with on-going costs being less significant and decreasing over time. EFRAG's assessment is that preparers and users are likely to benefit from IFRS 10. In particular, in areas where current standards provided limited guidance, the new requirements should enhance consistency of application and increase comparability for users, in a significant way. EFRAG's overall assessment is that the benefits that are expected to arise from the implementation of IFRS 10 will exceed the costs expected to be incurred.

EFRAG's assessment is that IFRS 11 is likely to result in incremental one-off costs for preparers, which for some preparers could be significant. Preparers which expect to be most impacted are those that have interest in joint operations structured through separate vehicles, which were previously accounted for under the equity method, and those that have interest in numerous joint operations structured through separate vehicle and which prepare only separate financial statements. In EFRAG's view IFRS 11 is unlikely to result in significant costs for users. However, in EFRAG's view the benefits for users are likely to outweigh the costs of implementation.

In EFRAG's view, IFRS 12 is likely to result in one-off and on-going costs for preparers. The one-off costs are likely to be significant for some preparers, mainly those with interest in numerous structured entities, joint ventures and associates, and particularly when getting access to the required information is difficult. EFRAG's assessment is that IFRS 12 is likely to result in significant one-off costs for users (particularly in those cases where detailed changes to their models are needed). EFRAG's assessment is that preparers are also likely to benefit from implementing IFRS 12, as the standard requires the provision of more robust disclosures about nature and extent of risks an entity is exposed to, and as such, improve financial reporting and communication with users. Finally, in EFRAG's view, IFRS 12 will bring
significant long term benefits to users. Overall benefits of enhanced financial information are likely to outweigh the costs involved.

EFRAG's overall assessment of IAS 27 (2011) is that the new standard will not involve any significant change in costs or benefits for preparers or users (excluding the amendment relating to the accounting for joint operations in the separate financial statements of a joint operator, which is assessed as part of the assessment of IFRS 11). EFRAG's overall assessment of IAS 28 (2011) is that overall the benefits to be derived from the new standards are likely to outweigh any incremental costs associated with them.

4. **OVERALL EFRAG ENDORSEMENT OPINION ON THE STANDARDS**

EFRAG's assessment is that it supports the adoption of the Standards and has concluded that they meet the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards in that they:

- are not contrary to the principle of "true and fair view" set out in Article 16(3) of Council Directive 78/660/EEC; and

- meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

For these reasons, EFRAG believes that it is in the European interest to adopt the Standards. Notwithstanding the positive recommendation that the standards meet the endorsement criteria, EFRAG does not support the effective date of 1 January 2013 for the following reasons:

(a) Some constituents raised concerns about the effective date of the Standards shortly after the Standards were published. These standards were published in May 211, rather than in the beginning of 2011 as had been originally expected. From the final wording of the Standards, it had become clear to those constituents that developing a common understanding of how the principles should be applied would require more effort and time than they had originally expected.

(b) A further concern of EFRAG is that the IASB is currently consulting on two exposure drafts (*Amendments to the transition guidance in IFRS 10* and *Investments entities*) that will amend the requirements of IFRS 10, and are expected to be incorporated into the Standards prior to their effective date. In particular, the Exposure Draft *Investment Entities* has the potential to change consolidation decisions and might lead to unnecessary cost and uncertainty for constituents.

(c) With regard to IFRS 11, some constituents have raised concerns with EFRAG that they will need to collect additional information about assets, liabilities, revenue and expenses of the joint arrangements classified as joint operations. In some cases, this will be challenging.

(d) EFRAG has conducted field-tests of the requirements of IFRS 10, IFRS 11 and IFRS 12. These tests confirm the concerns listed under (a), (b) and (c). Some participants to the field-tests noted that they have concerns that the mandatory effective date of 1 January 2013, wold
not allow them sufficient time to implement the new requirements and make the required assessments.

As a result, EFRAG recommends the mandatory effective date of the Standards to be 1 January 2014 with early adoption permitted. Given the interaction between the Standards, EFRAG believes that the mandatory effective date should be the same for all the Standards.

5. **OVERALL COST-BENEFIT CONSIDERATIONS AND COMMISSION SERVICES CONCLUSIONS ON THE BASIS OF EFRAG'S EFFECT STUDY**

On the basis of EFRAG's effect study, the Commission Services have considered the main costs and benefits of endorsing the Standards. The Services conclude that the benefits of the Standards outweigh the costs incurred. The Commission Services believe that the Standards will have positive cost-benefits effects and that they should therefore be endorsed in the EU. For the reasons given above, the Commission Services also believe that the mandatory effective date of the Standards should be 1 January 2014 with early adoption permitted.
Attachment 1: Effect study prepared by the European Financial Reporting Advisory Group (EFRAG)


Introduction

1. Following discussions between the various parties involved in the EU endorsement process, the European Commission decided in 2007 that more extensive information than hitherto needs to be gathered on the costs and benefits of all new or revised Standards and Interpretations as part of the endorsement process. It has further been agreed that EFRAG will gather that information in the case of IFRS 10, IFRS 11, IFRS 12, IAS 27 and IAS 28.

2. EFRAG first considered how extensive the work would need to be. For some Standards or Interpretations, it might be necessary to carry out some fairly extensive work in order to understand fully the cost and benefit implications of the Standard or Interpretation being assessed. In the case of IFRS 10, IFRS 11, IFRS 12, IAS 27 and IAS 28, EFRAG’s view is that the cost and benefit implications could be assessed by carrying out a field-test. The results of the consultations that EFRAG has carried out seem to confirm this. Therefore, as explained more fully in the appendices of this report, the approach that EFRAG has adopted has been to carry out detailed initial assessments of the likely costs and benefits of implementing IFRS 10, IFRS 11, IFRS 12, IAS 27 and IAS 28 in the EU, to consult on the results of those initial assessments, and to finalise those assessments in the light of the comments received.

3. In order to get evidence to support its overall assessment of IFRS 10, IFRS 11 and IFRS 12, EFRAG considered the effect analysis published by the IASB, held meetings with the various groups of constituents and conducted field-testing activities. The details of EFRAG’s initial consultations and field-testing activities undertaken by EFRAG are included from paragraph 4 to paragraph 16.

EFRAG’s initial consultations

4. EFRAG sought feedback from different groups of constituents, including preparers, auditors and users to obtain a more comprehensive understanding of costs and benefits of implementing the new requirements.

5. EFRAG discussed IFRS 10, IFRS 11 and IFRS 12 with its Insurance Accounting Working Group (IAWG) to understand how the new standards affect insurers. IAWG members indicated that the main impact on insurers resulted from the requirements on de facto control, agent/principal relationships, structured entities and
disclosures. They also noted that the investment entity consolidation exemption proposed by the IASB would affect insurers.

6 To gather feedback from banks and assets managers, EFRAG discussed the requirements of IFRS 10, IFRS 11 and IFRS 12 with its Financial Instruments Working Group (FIWG). The FIWG focused on the requirements set out in IFRS 10 and IFRS 12 in the context of investment structures that are common in the financial services industry.

7 EFRAG also discussed the new proposals with the representatives of users during the September 2011 meeting of its User Panel, in order to understand users’ views on the new requirements.

8 To gather feedback from the audit profession, EFRAG held a workshop in July 2011 with audit firms to discuss IFRS 10, IFRS 11 and IFRS 12.

**EFRAG’s field-tests**

9 The field-tests of the new requirements in IFRS 10, IFRS 11 and IFRS 12 were conducted by EFRAG staff from September to November 2011, in partnership with the staff from some European National Standard Setters.

10 EFRAG staff invited companies to participate in the field-tests via a news item on EFRAG’s website. In addition, a separate email was sent to National Standard Setters asking them to help identify participants. All companies that requested to participate in the field-tests were included in the study.

11 The field-tests were conducted by way of two separate questionnaires; one for IFRS 10 and the related disclosures in IFRS 12 and another for IFRS 11 and the related disclosures for joint arrangements in IFRS 12.

12 Participants were asked to review the main changes introduced by IFRS 10, IFRS 11 and IFRS 12 and to apply the new requirements to a representative sample of their investees (i.e. a selection of investees that are reflective of the range of interests that the participant holds) and their joint arrangements (i.e. a selection of joint arrangements that are reflective of the various structures and types of joint arrangements they are involved with).

13 In both questionnaires participants were asked to report any implementation and operational issues that they experienced in applying the new requirements.

14 EFRAG staff received overall 53 questionnaires (27 on IFRS 10 and 26 on IFRS 11) from the companies operating in various industry classes and in different countries. After receiving the completed questionnaires, EFRAG staff analysed them and, where necessary, contacted participants by email or phone to obtain further clarifications. The feedback reports on the results of the field-tests were presented to EFRAG TEG members and representatives of European National Standard Setters on the joined meeting of EFRAG TEG and Consultative Forum of National Standard Setters (CFSS) in December 2011.

15 Participants in the field-tests provided information to EFRAG staff on the condition that the information was kept confidential. Therefore, the reports generated from the field-tests have been written in such a way that no individual company or person could be identified.
The results of the field-tests were considered by EFRAG in developing its draft endorsement advices and effect study reports on the Standards. EFRAG’s draft endorsement advices and effect study reports do not refer directly to the results of the field-tests, but rather incorporate the arguments and issues identified by participants. However, the feedback statements on the field-tests of IFRS 10, IFRS 11 and IFRS 12 were published on EFRAG’s website.

**EFRAG’s endorsement advice**

EFRAG also carries out a technical assessment of all new and revised Standards and Interpretations issued by the IASB against the endorsement criteria and provides the results of those technical assessments to the European Commission in the form of recommendations as to whether or not the Standard or Interpretation assessed should be endorsed for use in the EU. As part of those technical assessments, EFRAG gives consideration to the costs and benefits that would arise from implementing the new or revised Standard or Interpretation in the EU. EFRAG has therefore taken the conclusion at the end of this report into account in finalising its endorsement advice.

**A SUMMARY OF IFRS 10, IFRS 11, IFRS 12, IAS 28 and IAS 27**

A summary of IFRS 10, IFRS 11, IFRS 12, IAS 28 and IAS 27 are set out in the following appendices:

(a) IFRS 10 is set out in Appendix 1A.
(b) IFRS 11 is set out in Appendix 2A.
(c) IFRS 12 is set out in Appendix 3A.
(d) IAS 27 is set out in Appendix 4A.
(e) IAS 28 is set out in Appendix 5A.

**EFRAG’s INITIAL AND FINAL ANALYSIS OF THE COSTS AND BENEFITS OF IFRS 10, IFRS 11, IFRS 12, IAS 28 and IAS 27**

EFRAG’s initial and final analysis of the costs and benefits of IFRS 10, IFRS 11, IFRS 12, IAS 28 and IAS 27 are set out in the following appendices:

(a) IFRS 10 is set out in Appendix 1B.
(b) IFRS 11 is set out in Appendix 2B.
(c) IFRS 12 is set out in Appendix 3B.
(d) IAS 27 is set out in Appendix 4B.
(e) IAS 28 is set out in Appendix 5B.
APPENDIX 1A – SUMMARY OF IFRS 10

Background

1 Existing IFRSs provide two sets of guidance that an entity should apply to assess control of an entity – IAS 27 Consolidated and Separate Financial Statements (IAS 27) uses ‘control’ as the basis for consolidation, while SIC-12 Consolidation – Special Purpose Entities focuses on ‘risks and rewards’. Some believe that there is a perceived conflict between the guidance in IAS 27 and SIC-12, which has resulted in divergent application of the control definition in IAS 27.

2 The IASB’s effect analysis explains that the IASB’s outreach work confirmed that there are several causes for the potential inconsistent application of IAS 27 and SIC-12. In some cases, entities found it difficult to determine which investees are within the scope of IAS 27 and which are within the scope of SIC-12. As stated by the IASB, entities also noted that because the requirements are different in IAS 27 and SIC-12, they could reach different consolidation conclusions depending on which guidance is applied.

3 In addition, the existing literature lacks specific guidance with regard to some situations involving less than the majority of voting rights in investees (such as de facto control situations) and agent/principal relationships.

4 The recent financial crisis has highlighted the importance of the information provided in the notes to the financial statements, including transparency about the risks to which an entity is exposed from its involvement with other entities. These risks are mainly related to ‘off-balance sheet vehicles’ which an entity has set up or sponsored.

Objective of IFRS 10

5 IFRS 10 Consolidated Financial Statements (IFRS 10) considers the concerns expressed by users on consolidation and aims to address the diversity in practice (of assessing which consolidation model applies), by introducing a model for consolidation based on an ‘ability to control’ approach and provides guidance for applying that model.

6 In its Effect analysis, the IASB explains that the reason it issued IFRS 10 and the related disclosure requirements in IFRS 12 Disclosure of Interests in Other Entities (IFRS 12) is to articulate more clearly the principle of control. IFRS 10 defines control as consisting of three elements: power, exposure to variable returns, and the investor’s ability to use that power to affect its amount of variable returns. The IASB discusses these three elements in detail throughout the standard. Existing IAS 27 and SIC-12 do not contain a detailed discussion of the concept of control, nor do they provide application guidance.

7 IFRS 12 sets out the disclosure requirements for an entity’s relationships with interests in other entities (including unconsolidated structured entities) which include assumptions and judgement applied to assess control and risks an entity is exposed to through its involvement in another entity. The objective is primarily to address the concerns raised by users about lack of transparency in information about interests in other entities.
Taken together, IFRS 10 and the more comprehensive disclosures in IFRS 12, aim to ensure consistent application of the control definition and improve transparency of information.

What has changed?

IFRS 10 builds on the requirements and concepts in IAS 27 and SIC-12 with regard to the concept of control and sets out a consolidation model that applies to all investees including entities that are accounted for under SIC-12. In doing so, IFRS 10 provides additional context, explanations and application guidance on how to assess control, without changing the fundamental concept of control in IAS 27, which is based on the ability the control.

IFRS 10 provides guidance and illustrative examples regarding situations in which control might exist without a majority of voting rights, including situations of de facto control, agent/principal relationships and relationships with entities that are designed so that voting rights are not the dominant factor in assessing control (structured entities).

Under IFRS 10, assessment of control may not be the same compared to IAS 27 and SIC-12; in some cases ‘more’ entities might be consolidated and in other cases ‘fewer’ entities might be consolidated. This is primarily because of the shift in focus from ‘majority of risks and rewards’, to ‘ability to control’, and introducing a control model that applies to all investees.

IFRS 10 explains that there are different ways in which an investor can have power (ability to control) over an investee. In the most straightforward cases, control arises by owning more than 50 per cent of the voting rights. However, the standard explains that it is also possible that an entity controls another entity even though it has less than a majority (or half) of voting rights over the investee. This possibility depends on the assessment of all facts and circumstances affecting the investor and investee relationship.

Based on its assessment of the new requirements, EFRAG has considered the following new elements in the way entities will be consolidated:

(a) Ability to direct the investee’s relevant activities.

(b) Power without a majority of voting rights of an investee (de facto control).

(c) Circumstances when the existence of potential voting rights give an investor power.

(d) Agent/principal relationships.

(e) Consolidation of structured entities (previously called special purpose entities ‘SPEs’).

Each of these new elements is discussed in turn below.
For control to exist over an investee under IFRS 10, an entity must have the ability to direct the investee’s relevant activities through its ability to use power to affect its amount of variable returns.

The concept of ‘relevant activities’ is generally broader than the reference to operating and financing activities in existing IAS 27, although IFRS 10 indicates that operating and financing activities can (in some cases) be relevant activities.

The standard explains that for an entity to be able to apply the control model to all investees, there was a need to broaden the focus on the activities that an investor can direct (or has the ability to do so), as looking only at the operating and financing activities might not always be helpful when assessing control of some investees (such as structured entities).

For example, IFRS 10 explains that relevant activities include: sale of goods or services, management of financial assets, selection and acquisition or disposal of assets, management of research and development activities, and determination of funding structures. Typically, such activities are common in more conventional types of entities governed by voting rights, but perhaps less common in structured entities, which might be created with a predetermined purpose. In those entities, it might be that more than one party has decision making authority over different activities of an investee and each activity may significantly affect the investee’s returns. Examples of these activities include multiple seller conduits, multi seller securitisations, and investors for which the assets are managed by one party and the funding is managed by another.

Furthermore, the relevant activities of an entity can change over time; and investors will need to reconsider their assessment when facts and circumstances change.

De facto control

Existing IAS 27 does not include guidance on de facto control, and different interpretations exist in practice. IFRS 10 extends the ‘ability’ to control approach to include other situations that would result in controls without a majority of voting rights. Contractual rights must be included in the assessment of control, and all substantive rights are considered by the holder of those rights in relation to an investee. Factors to consider include:

(a) Whether there are any barriers that prevent the holder from exercising the rights or, when the rights are held by more than one party.

(b) Whether the party or parties that hold the rights would benefit from the exercise of those rights (e.g. synergies).

To assess the existence of de facto control, IFRS 10 requires a two-step approach; in the first step, an investor should consider:

(a) size of the investor’s holding of voting rights relative to the size and dispersion of the holding of other vote holders;

(b) potential voting rights held by the investor, other vote holders or other parties; and
In the second step, if the above factors alone are not conclusive to determine de facto control, the following additional facts and circumstances are considered:

(a) voting patterns at previous shareholder’s meetings;
(b) evidence of power;
(c) any special relationships; and
(d) level of investor’s exposure to variability in returns.

IFRS 10 explains that, the smaller the size of the investor’s holding of voting rights and the less dispersion of the holding of other vote holders, the more reliance is placed on the additional facts and circumstances, for example agreements between shareholders other than the dominant shareholder.

In addition, when considering the voting patterns at previous shareholder’s meetings, an entity should consider the usual quorum in shareholders’ meetings, and how the other shareholders vote (e.g. whether they usually vote the same way).

Potential voting rights

An investor might own options, convertible instruments or other instruments that, if exercised, would give the investor voting rights. These are referred to as ‘potential voting rights’.

Similar to IAS 27, the existence of potential voting rights must be considered in assessing control under IFRS 10. However, IFRS 10 focuses on rights that are substantive in nature and does not refer to voting rights that are ‘currently exercisable’ at the reporting date.

Assessment of control is based on the purpose, design and terms of the potential voting rights and an entity’s reasons for agreeing to those terms (e.g. whether the holder of such potential voting rights has the contractual right to ‘step in’ and exercise its voting power to direct the relevant activities).

(a) The intention of the writer or buyer of the instrument would be considered, while under IAS 27, the intent was irrelevant.

(b) Market conditions relating to the potential voting rights are taken into account (e.g. whether or not the option is in the money), while in IAS 27 this was not considered, unless, the options lacked economic substance.

Agent/principal relationships

Sometimes an investor is appointed as an agent and acts on behalf of a principal. Typical examples are investment managers, asset managers and fund managers that act on behalf of a fund (e.g. real estate funds, mutual funds, pension funds and other types of investment funds).

Neither existing IAS 27 nor SIC-12 provide specific guidance about situations in which power is delegated to an agent and about how to assess whether a decision maker is an agent or principal. On page 27 of its effect analysis the IASB explains
that the lack of guidance has resulted in diversity in practice as investors with
decision making rights arrived at different interpretations about whether or not they
control an investee or the fund which they manage. The IASB explains that it was
often difficult to determine whether such situations were within the scope of IAS 27
or SIC-12, and a different consolidation outcome could be reached depending on
which guidance was applied.

30 IFRS 10 introduces the concept of delegated power and provides a range of factors
to consider when determining whether a decision maker is using its power as a
principal (to generate returns for itself) or an agent (and uses the delegated power
for the benefit of others).

31 When a single party holds substantive removal rights and can remove the decision
maker without cause, this is alone sufficient to conclude that the decision maker is
an agent. In the absence of such unilateral removal rights, investors would have to
consider the following factors:

(a) Scope of the decision-making authority.

(b) Rights held by other parties (does any single party holds substantial removal
rights).

(c) Remuneration (whether it is at market rates).

(d) The decision maker’s exposure to variability of returns from other interests
that it holds in the investee.

Consolidation of structured entities

32 IFRS 10 reduces the use of ‘bright-lines’ and increases the degree of judgement by
requiring an assessment of the relevant activities of an investee rather than which
investor, if any, obtains a majority of the risks and rewards of the investee. This
assessment applies to all investees, including structured entities. IFRS 12 defines a
structured entity as an entity where voting rights are not necessarily dominant to the
assessment of control.

33 Similar to the requirements described above in relation to agent/principal
relationships, in order to control a structured entity, an investor would need to have
the ability to direct its relevant activities, have exposure to significant risks and
rewards or rights to variable returns and the ability to affect those returns.
Therefore, control conclusions could be different from those of SIC-12, which
focused on which investor, if any, obtained a majority of the rewards or was
exposed to a majority of the risks of the investee.

When does IFRS 10 become effective?

34 IFRS 10 becomes effective for annual periods beginning on or after 1
January 2013. Earlier application is permitted. If an entity applies IFRS 10 earlier, it
shall disclose that fact and apply IFRS 11 Joint Arrangements, IFRS 12, IAS 27
Separate Financial Statements (IAS 27 (2011)) and IAS 28 (2011) at the same
time.

35 There are no specific transitional requirements. Therefore, in accordance with IAS 8
Accounting Policies, Changes in Accounting Estimates and Errors, retrospective
application is required. Although relief is provided in situations where retrospective application is impracticable.

APPENDIX 1B – ANALYSIS OF THE COSTS AND BENEFITS OF IFRS 10
EFRAG’s initial analysis of the costs and benefits of IFRS 10

1 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users from implementing IFRS 10, both in year one and in subsequent years. The results of EFRAG’s initial assessment can be summarised as follows:

(a) Costs – EFRAG’s initial assessment was that all preparers would incur additional costs to implement the requirements in IFRS 10, and for some preparers (particularly companies in the banking industry and insurance industry), the initial costs of implementation and conducting the required analysis would be significant, with ongoing costs being less significant and decreasing over time. Furthermore, EFRAG’s initial assessment was that IFRS 10 is unlikely to result in significant costs for users.

(b) Benefits – EFRAG’s assessment was that preparers and users are likely to benefit from IFRS 10. In particular in areas where current IFRSs was silent or contained limited guidance, the new requirements should enhance consistency of application and increase comparability for users, in a significant way.

2 EFRAG published its initial assessment and supporting analysis on 9 February 2012. It invited comments on the material by 11 March 2012. In response, EFRAG received 24 comment letters. Nine respondents agreed with EFRAG’s assessment of the benefits of implementing IFRS 10 and the associated costs involved for users and preparers. Eleven respondents did not comment specifically on EFRAG’s initial assessment of the costs and benefits of implementing IFRS 10 in the EU, but supported EFRAG’s recommendation that IFRS 10 be adopted for use in Europe. Four respondents did not agree with EFRAG’s assessment of the benefits of implementing IFRS 10 and/or the associated costs or did not comment on this specific assessment.

EFRAG’s final analysis of the costs and benefits of IFRS 10

3 Based on its initial analysis and stakeholders’ views on that analysis, EFRAG’s detailed final analysis of the costs and benefits of IFRS 10 is presented below.

Cost for preparers

4 The significance of the costs to preparers of implementing IFRS 10 will depend on various factors such as the number of investees, the complexity of the ownership structures of the investees with which the preparer is involved, and the preparer’s involvement in structured entities.

One-off costs
Reading and understanding IFRS 10

5 Preparers will incur one-off costs to familiarise themselves with the new requirements and to train their employees accordingly. Those costs could also include consultations with other parties (e.g. peers and auditors) in order to
establish a common understanding and consistent application of the requirements, especially in terms of new terminology used in the standard (e.g. ‘relevant activities’, ‘significant’, ‘protection rights’).

6 For certain types of transactions, the implications of implementing IFRS 10 are relatively easy to understand. However, for other types of transactions – that require assessing control in situations involving less than the majority of voting rights including agency/principal relationships and applying a principles-based model to complex structured entities – the changes resulting from IFRS 10 will have a significant effect on the assessment of control and result in more (or less) consolidation. In these cases preparers may need to use additional resources to read and understand the elements of IFRS 10.

7 Overall, EFRAG believes that there are not likely to be any significant costs involved for preparers or users in reading and understanding IFRS 10.

Ability to direct the investee’s relevant activities

8 EFRAG notes that the term ‘relevant activities’ is broader than ‘financial and operating policies’ in existing IAS 27. Preparers will need to identify the relevant activities of their investees that significantly affect the investee’s returns, and judgement will be required in doing so.

9 The initial identification of the relevant activities of entities will be straightforward in some cases. However, when entities are involved in complex ownership structures or structured entities, the assessment can be complex and involve certain costs. These cases include situations where the relevant activities of an investee are split between multiple investors. Other cases may include situations when an entity has an interest in a structured entity and the relevant activities are set out in agreements between other investors, but where the entity does not have access (or has limited access) to that information. These more difficult situations are likely to impact banks and insurers, and have little or no impact on other preparers.

10 Some banks and insurers that engage in complex ownership structures and hold interests in many structured entities will initially need to identify the relevant activities for each type of arrangement that they are involved in. For some of those preparers, the total initial costs might be significant.

11 The term ‘relevant activities’ indicates a broader range of activities that goes beyond the term ‘financial and operating policies’; however, IFRS 10 does not provide a clear dividing line between those two approaches and neither does it define some of the terms used in the standard. For example, ‘significant’ and ‘substantive’ are not defined. As a result, preparers will need to exercise judgement and their own definitions that are consistent with the underlying principles on control, which in some cases might be difficult and time consuming, and result in preparers incurring costs.

12 To the extent that preparers need to consolidate additional entities as a result of the broader focus on which activities need to be considered in the control assessment, they will incur additional costs to set up financial systems and procedures in order to consolidate those investees. Those costs will depend on the size, complexity and number of the investees; and involve costs of issuing internal guidelines and preparing reporting packages. The complexity will vary and will depend to what extent the challenges identified in paragraph 9 affect the underlying investees.
De facto control

13 EFRAG understands that the assessment of de facto control may require a detailed review of the relevant facts and circumstances that might give an entity ability to control an investee. In some cases, the assessment will be straightforward and consideration of facts and circumstances will not entail significant judgement.

14 However, in other cases, the assessment might be challenging particularly when other shareholders are widely dispersed and have entered into agreements without the involvement of the entity making the assessment. EFRAG has learned that the main challenge will arise from obtaining the information required to assess control in situations where an entity might not legally control an entity. This challenge will generally arise when determining whether the rights held by others are substantive for the purpose of assessing control.

15 In particular, those preparers that currently do not consolidate on the basis of de facto control will need to obtain new information the first time when they make the assessments. Therefore, in some cases they will and incur additional costs. The explicit requirement that entities need to consolidate based on an ‘ability to control’, even though an entity holds less than the majority of voting rights, will mean a change in the scope of consolidation for some entities.

16 To the extent that preparers need to consolidate additional interests in entities on the basis of de facto control, they will incur certain additional costs to set up systems and procedures to consolidate those interests. Those costs will depend on the size and complexity of the investee, and may in individual cases be significant. EFRAG believes that to some extent the costs of interpreting and consequently implementing the requirements will be alleviated by the application guidance and the examples provided in IFRS 10, which should help with developing a common interpretation of the analysis required.

Potential voting rights

17 Similar to existing IFRSs requirements, the existence of potential voting rights must be considered in assessing control which requires preparers to collect information about the existence, terms and potential impact of the ‘ability to control’ another entity based on potential voting rights. Therefore, EFRAG does not expect preparers to incur significant initial costs to collect the required information.

18 However, IFRS 10 includes new requirements on whether or not potential voting rights are considered to give rise to control, and specifically requires determining whether the rights are substantive or not. Existing guidance does not focus on ‘substantive’ rights. Therefore, preparers will incur certain costs in reassessing the impact of existing potential voting rights when they implement IFRS 10. Overall, EFRAG does not believe that the costs of this reassessment when first implementing IFRS 10 will be significant.

19 To the extent that preparers will no longer need to consolidate certain investees, the one-off costs of this change are not expected to be significant. In situations where additional investees need to be consolidated, the costs will depend on the size and complexity of the investee. These costs would include costs of issuing internal guidelines and preparing reporting packages.

20 Overall, EFRAG believes that these requirements will not have a significant impact on the work preparers undertake to assess the effect of potential voting rights.
Agent/principal relationships

21 IFRS 10 provides guidance in relation to areas involving less than the majority of voting rights and whether an entity acts as an agent or principal when exercising decision-making authority over an investee. Current IFRSs provide limited guidance in this area. If the requirements in a standard are not clear or there is no guidance, preparers will often turn to independent advice and engage with their auditors to resolve uncertainty on how to account for a particular type of transaction. These costs would decrease if the requirements on agent/principal relationships are clearer.

22 IFRS 10 requires an entity to consider various factors when assessing control when it has decision-making rights but holds less than the majority of the voting rights. The absence of guidance in existing IFRSs will mean that currently entities might apply different accounting practices, and will need to conduct a one-off assessment to implement the new requirements. This assessment might lead to consolidation of previously unconsolidated entities and vice versa. A preparer may incur costs to determine whether it is an agent or a principal as a result of:

(a) collecting and evaluating the information about the scope of its decision-making authority, rights held by other parties, remuneration to which it is entitled and its exposure to variability of returns;

(b) conducting the analysis; and

(c) if it acts as a principal, consolidating the investee.

23 EFRAG understands that for many preparers that are banks or insurers holding interests in mutual funds, investment funds and similar entities, it might not be obvious whether the link between the power granted in the decision-making process and the returns generated indicates that they act as an agent or as a principal. Preparers will need to collect the information required to make the assessment and conduct an analysis based on various factors set out in the standard. In some cases, this might be a challenging and costly exercise.

24 For some of those preparers, particularly those that hold interests in a large number of different types of investees and/or complex structures, the total initial costs are likely to be significant. The costs are higher if an entity needs to consolidate previously unconsolidated funds.

Consolidation of structured entities

25 Additional one-off costs may be incurred by preparers to the extent that the requirement to apply a uniform basis for consolidation in IFRS 10, results in consolidation of additional structured entities.

26 Similar to the assessment of one-off costs for agent/principal relationships, the level of costs incurred will depend on the complexity of the structure of the underlying entities and the number of investees that need to be analysed. Banks and insurers are likely to be the most affected by this new requirement.

27 The change introduced by IFRS 10 in respect to the accounting for structured entities will not always result in more consolidation. In some cases, structured entities will no longer be consolidated, and therefore reduce costs for these preparers.
Transition requirements

28 IFRS 10 is required to be applied retrospectively. EFRAG notes that in some cases it can be difficult for preparers to obtain all the information about facts and circumstances, including the related financial data for prior periods. Collation of information would be more challenging when mergers and acquisitions have taken place in the past, in which case applying acquisition accounting under IFRSs might be challenging as reliable information may not always be available. Due to these factors and because of others, information for full retrospective application might not be readily available.

29 EFRAG notes that the transition requirements in IFRS 10 contain various relief provisions that reduce the cost of initial application of IFRS 10. In particular, no restatements are required regarding entities that remain consolidated and regarding entities that remain unconsolidated. Furthermore, where restatement is impracticable (as defined in IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors), IFRS 10 provides relief when an entity needs to consolidate an investee that was previously not consolidated. A similar relief is available in respect of investees that are no longer required to be consolidated under IFRS 10.

30 EFRAG believes that the reliefs mentioned above will reduce the initial costs for preparers of applying IFRS 10 although for some other preparers the costs to restate prior periods will be high.

Ongoing costs

31 As explained below, the magnitude of the ongoing costs will vary from preparer to preparer and is likely to affect preparer entities that have a large number of structured entities and investees with complex ownership structures. Similar to one-off costs, preparers operating in the insurance and banking industries are most likely to be affected by the new requirements.

Ability to direct the investee’s relevant activities

32 On an ongoing basis, preparers will need to monitor any changes in relevant activities of the entities in which they hold an interest. However, the relevant activities of investees are generally not expected to change often and therefore unlikely to result in significant costs to preparers.

33 In addition, preparers will need to assess the relevant activities of new interests in investees. EFRAG notes that once preparers have applied the new requirements and analysed their investees, the costs of applying the notion of relevant activities subsequently will diminish over time.

Power without a majority of voting rights of an investee (de facto control)

34 The assessment of de facto control may require, on an ongoing basis, judgement and a detailed review of the relevant facts and circumstances. However, over time preparers will develop internal guidelines necessary to collect information that is necessary to assess de facto control. Such guidelines will help preparers to address challenging situations regarding de facto control that require a high degree of judgement.

35 While preparers would incur certain costs in making these assessments, it is unlikely that there will be many business combinations on the basis of de facto control in any particular reporting period. Therefore, ongoing costs are unlikely to be significant to preparers.

Potential voting rights
36 Under current IAS 27, preparers are already required to collect information about, and assess the impact of, potential voting rights on an ongoing basis. In addition, EFRAG notes that the ongoing costs relate mainly to those arising from new potential voting rights and the reassessment of change in facts and circumstances regarding existing potential voting rights. Overall, the ongoing cost to implement this requirement is unlikely to be significant.

Agent/principal relationships

37 IFRS 10 provides new guidance on agent/principal relationships. The new guidance would mean that preparers need to incur costs to monitor their existing relationships with investees to determine whether their role as an agent or a principal remains unchanged. In EFRAG’s view, these costs should decrease over time and are unlikely to be significant as entities will develop internal guidelines to apply the requirement in a consistent manner.

38 Preparers will also incur ongoing costs from new relationships with investees. However, even for preparers in the financial services industry and insurance industry, the number of new agent/principal relationships that arise each year, is likely to be relatively small compared to the total number of such investees that they are involved with. However, entities that engage in high volumes of agent/principal relationships will need to undertake additional work in assessing whether they control the underlying funds in each relationship and should consolidate those funds based on the outcome of their assessment.

Consolidation of structured entities

39 Additional ongoing costs may be incurred by preparers that are involved in many structured entities because a preparer would need to assess whether it acts as a principal or agent in a structured entity. There would be perceived costs if their assessment would result in the consolidation of additional structured entities. Similar to the assessment of ongoing costs for agent/principal relationships, the level of costs incurred will depend on the complexity of the underlying structures and the number of investees that need to be monitored each year.

Costs for users

40 EFRAG has carried out an assessment of the cost implications for users resulting from IFRS 10.

41 Users will need to understand why the numbers in the financial statements are different and what this means when performing their analysis. They will also need to amend their models. However, these costs are unlikely to be significant.

Conclusion on costs for preparers and users

42 Overall, EFRAG’s assessment is that all preparers will incur additional costs to implement the requirements in IFRS 10, and for some preparers (particularly companies operating in the financial industry and insurance industry), the initial costs of implementation and conducting the required analysis will be significant, with ongoing costs being less significant and decreasing over time.
**Benefits for preparers and users**

43 EFRAG has carried out an assessment of the benefits for users and preparers resulting from the IFRS 10.

**Preparers**

44 One of the reasons that the IASB developed IFRS 10, was to more clearly articulate the principle of control and establish a common control approach that can be applied to all investees. This would benefit preparers because they would be able to apply the requirements in a consistent manner across investees.

45 Overall, the main benefit from the new control model in IFRS 10 for preparers is expected to be the improvement in financial communication. This should result in increased credibility of the entity’s financial statements and improve the accessibility to capital markets.

46 Having a uniform basis of consolidation (based on control) will allow preparers to apply the same requirements to all investees (including structured entities) and therefore enhance comparability of information for users, which will benefit preparers. If a uniform basis of consolidation proves to result in more appropriate consolidation decisions over time, preparers will benefit from enhanced user confidence in the information presented in the financial statements, and benefit from a decrease in the cost of capital.

47 The additional guidance on de facto control, potential voting rights and agent/principal relationships is expected to reduce the existing divergence in practice, and benefit preparers.

**Users**

48 The main objective of IFRS 10 is to address a number of concerns expressed by users. These concerns, in particular, include divergence in the scope of consolidation (IAS 27 versus SIC-12) and lack of explicit guidance on situations involving less than majority voting rights including agent/principal relationships.

49 EFRAG acknowledges that there will be one-off costs for users. These costs particularly include time and resources to be spent to modify existing financial models to incorporate the new requirements of IFRS 10.

50 Users would have an appropriate understanding of the basis to consolidate or not to consolidate an investee because preparers will use a uniform control basis for consolidation, together with the requirement to conduct a thorough analysis of facts and circumstances that might lead to control.

51 It is likely that, overall, the usefulness of consolidated information will improve, given that consolidation will be based on a uniform basis that applies to all investees and is complemented by comprehensive application guidance to assist entities with the assessment of control. In particular, this would be the case, when entities do not have the majority of voting rights over the investee. The new requirements involving situations without the majority of voting rights (including de facto, agency/principal relationships) build on the existing control principles and extend these principles to all investees that an entity controls. Similarly, the development of a uniform control basis (based on control) that applies to structured entities, will enhance comparability of information as entities will conduct the control assessment for all their investees using the same requirements.
However, the uniform basis of consolidation will entail a higher degree of judgement and use of assumptions, which might impact comparability and diminish the usefulness of information. In this respect, IFRS 12 requires comprehensive disclosure about the use of judgements and assumptions made by management in reaching consolidation conclusions. This should help users in understanding the consolidation decisions reached by management, particularly in situations involving less than a majority of the voting rights or situations involving complex ownership structures.

Furthermore, the disclosures required by IFRS 12 with regard to consolidated and unconsolidated structured entities help users in making a comprehensive analysis of the investor’s involvement in such entities and understanding the risks and support obligations associated with those interests. EFRAG believes this will provide significant benefits for users.

Conclusion on benefits for preparers and users

Overall, EFRAG’s assessment is that preparers and users are likely to benefit from IFRS 10. In particular in areas where current IFRSs was silent or contained limited guidance, the new requirements should enhance consistency of application and increase comparability for users, in a significant way.

Conclusion

To summarise, EFRAG reached the following individual conclusions on each of the areas discussed above. The following assessment combines the effects of one-off and ongoing costs to preparers and users with the benefits expected from the new requirements in IFRS 10.

(a) Reading and understanding the new elements – No significant costs or benefits are likely.

(b) Transition requirements – The requirements are likely to result in some increased costs for preparers and users. However, the relief provisions provided will reduce the initial costs for preparers in applying IFRS 10, although for some preparers the costs will remain high.

(c) Ability to direct the investee’s relevant activities – The requirements will not necessarily broaden the scope of consolidation for preparers in a significant way and the level of judgement required will not be so significant that it will affect costs in a significant way. Overall, the costs and benefits will probably balance out.

(d) De facto control – The costs will depend on the size and complexity of the investee, and may in individual cases be significant, particularly for those entities that did not previously consolidate de facto controlled investees.

(e) Potential voting rights – No significant costs or benefits are likely.

(f) Agency/principal relationships – For some entities (particularly banks and insurers) the costs are likely to exceed the benefits in the first year of implementation. However, the costs to monitor existing relationships will unlikely to be significant as entities will develop internal guidelines to apply the requirements in a consistent manner.
EFRAG’s assessment is that de facto control, agency/relationships and structured entities are the main factors listed above which need to be assessed by EFRAG as part of its assessment of IFRS 10. EFRAG believes that the net benefits arising from the application of a uniform consolidation basis for structured entities and having clearer guidance on the accounting for transactions involving less than a majority of the voting rights (de facto control) and agency/principal relationships, exceed the net costs arising from implementing these new requirements for the first time and on an ongoing basis.

Therefore, EFRAG’s overall assessment is that, on balance, the benefits that are expected to arise from the implementation of IFRS 10 in the EU will exceed the costs expected to be incurred.

APPENDIX 2A – SUMMARY OF IFRS 11

Background

1 Entities will generally enter into a ‘joint arrangement’ when they decide to share control of one or more economic activities with one or more parties. Such arrangements are common in the oil and gas and construction industries, although they can also be found in other industries.

2 IAS 31 Interests in Joint Ventures (IAS 31) defines a joint venture as a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control.

3 Users of financial statements have criticised IAS 31 for permitting a choice of accounting policy for jointly controlled entities (the use of either proportionate consolidation or equity accounting). This was one of the main reasons why the IASB decided to change IAS 31.

4 The IASB also believed that the accounting requirements under IAS 31 depended too much on the form of the arrangement (i.e. the existence of a separate entity) which, combined with the choice of accounting treatment for jointly controlled entities, resulted in some arrangements giving parties similar rights and obligations to be accounted for differently and, conversely, arrangements that give the parties different rights and obligations but are accounted for similarly under existing IFRSs.

5 The IASB therefore decided to amend IAS 31 to address the concerns described above. In particular, IFRS 11 aims to establish a set of principles that determine the accounting for all joint arrangements.

6 The IASB ‘Joint ventures’ project was initiated as a part of the Memorandum of Understanding between the FASB and the IASB. One of its objectives was to achieve further convergence between IFRS and US GAAP.

What has changed?

7 IFRS 11 replaces the term ‘joint venture’ in IAS 31 with ‘joint arrangement’, which is defined as ‘an arrangement of which two or more parties have joint control.

8 IFRS 11 introduces the following new elements in accounting for joint arrangements:
Core principal for classification and accounting for interests in joint arrangements; Parties without joint control having an interest in a joint operation; and Accounting for interests in joint operations in separate financial statements.

Core principal for classification and accounting for interests in joint arrangements

9 The ‘core principle’ in IFRS 11 is that the classification and accounting for the interests in joint arrangements is based on the rights and obligations of the parties to a joint arrangement.

Classification: type of joint arrangements

10 IFRS 11 requires that the classification of a joint arrangement be based on whether the parties to the arrangement have ‘rights’ to assets and ‘obligations’ for liabilities of the underlying arrangement or, alternatively, only have rights to the net assets of the joint arrangement.

11 Following the ‘core principle’, IFRS 11 identifies two types of joint arrangements: a joint operation and a joint venture.

(a) In a joint operation, the parties have rights to the assets and obligations for the liabilities of the arrangement. The notion of ‘jointly controlled assets’ that existed in IAS 31 has been merged into one type of joint arrangement called ‘joint operation’.

(b) In contrast, in a joint venture, the parties to the arrangement have rights to the net assets of the arrangement.

12 The term ‘jointly controlled entity’ is not used in IFRS 11. Under IAS 31 the distinction between ‘jointly controlled entities’ and all other joint ventures (previously called jointly controlled assets/operations) was based on the existence of a legal entity. This is not the case in IFRS 11, which states that if the legal separation of rights to assets and obligations for liabilities is overcome by the legal form, contractual terms or other facts and circumstances, the arrangement is accounted for in the same way as arrangements in which there is no separate structure at all. Appendix B of IFRS 11 sets out the application requirements and specific tests for each of these. To summarise:

(a) Joint arrangements not structured through a separate vehicle: If a joint arrangement is not structured through a separate vehicle, IFRS 11 states that the parties to a joint arrangement have rights and obligations to the assets and liabilities of the arrangement and hence the arrangement must be classified as a joint operation. No further assessment is required.

(b) Joint arrangements structured through a separate vehicle: If a joint arrangement is structured through a separate vehicle this could be either a joint venture or a joint operation. In such a case the parties need to assess whether the legal form of the separate vehicle, the terms of the contractual arrangement and, when relevant, any other facts and circumstances give them: rights to the assets, and obligations for the liabilities (i.e. the arrangement is a joint operation) or rights to the net assets to the
arrangement (i.e. the arrangement is a joint venture). In other words, the existence of a separate vehicle is a necessary, but not sufficient, condition for a joint arrangement to be considered a joint venture.

In some cases, the parties to a joint arrangement are bound by a framework agreement that sets up the contractual terms for undertaking one or more activities, which might be undertaken through different joint arrangements to deal with specific activities that form part of the agreement. In such cases, the rights and obligations of the parties might differ with regard to the different joint arrangements. In such cases, each joint arrangement set up under the framework agreement should be assessed separately and classified either as a joint operation or a joint venture.

Accounting for joint arrangements

The method of accounting will depend on the type of joint arrangement. The focus is no longer on the legal structure of the joint arrangements, but rather on how rights and obligations are shared by the parties to the arrangement. A party to a joint operation recognises – in accordance with all applicable IFRSs – in its financial statements:

(a) its assets, including its share of any assets held jointly;
(b) its liabilities, including its share of any liabilities incurred jointly;
(c) its revenue from the sale of its share of the output of the joint operation;
(d) its share of revenue from the sale of the output by the joint operation; and
(e) its expenses, including its share of any expenses incurred jointly.

A joint venturer accounts for its interest in a joint venture using the equity method of accounting under IAS 28 (2011). The existing accounting option to apply proportional consolidation to jointly controlled entities in IAS 31 has been eliminated.

Parties that participate in a joint arrangement but which do not have joint control

Under existing IFRSs, a party to a joint venture (under IAS 31 the term ‘joint venture’ included all types of joint arrangements) that did not have joint control should account for its interest in the joint venture in accordance with IFRS 9 Financial Instruments (IFRS 9) or IAS 39 Financial Instruments: Recognition and Measurement (IAS 39) or under existing IAS 28 (if it had significant influence over the joint venture).

Under IFRS 11, parties to a joint operation which do not have joint control in the arrangement, are required to measure their interest in the arrangement in the same way as joint operators if they have rights over the assets and obligations for the liabilities of the arrangement (recognition of assets, liabilities, revenue and expenses). Parties to a joint operation that do not have joint control and neither rights to assets nor obligations for the liabilities, account for their interests in the joint operation in accordance with IFRSs applicable to their interests.

Under IFRS 11, parties to a joint venture that do not have joint control, will continue to account for their investment in accordance with IFRS 9/IAS 39, unless they have
significant influence over the joint venture, in which case they shall account for it in accordance with IAS 28 (2011).

Accounting for interests in joint operations in separate financial statements

19 Under existing IAS 27 Consolidated and Separate Financial Statements (IAS 27), all interests in jointly controlled entities are accounted for at cost or at fair value in accordance with IFRS 9 or IAS 39.

20 Under IFRS 11, interests in joint operations are accounted for in the separate financial statements in the same manner as they are accounted for in the consolidated financial statements. That is, a joint operator will recognise its assets, liabilities, revenues and expenses relating to the joint operation. This requirement has been extended to parties to a joint operation that do not have joint control, but have rights to the assets and obligations for the liabilities of the arrangement.

21 Joint ventures are accounted for either at cost or fair value in accordance with IFRS 9 or IAS 39 in the separate financial statements of the joint venturers.

Other changes

The scope exception in existing IAS 31

22 The scope exception in existing IAS 31 for venture capital organisations, mutual funds, unit trusts or similar entities, including investment-linked insurance funds, has been removed and characterised as a measurement exception. As a result, entities are required to provide the disclosures in IFRS 12 Disclosure of Interests in Other Entities (IFRS 12) for all interests in joint ventures, including those that are held by venture capital organisations or similar entities and measured at fair value.

SIC-13 Jointly Controlled Entities – Non Monetary Contributions by Venturers

23 The guidance in SIC-13 Jointly Controlled Entities – Non Monetary Contributions by Venturers has been incorporated into IAS 28 (2011) Investments in Associates and Joint Ventures (IAS 28 (2011)).

Disclosure requirements under IFRS 12 for joint arrangements

24 IFRS 12 requires extensive disclosures about an entity’s interests in joint arrangements in response to user needs and as a result of the new accounting model for joint arrangements in IFRS 11.

25 Among others, IFRS 12 requires an entity to disclose the nature of the activities of the joint arrangement and summarised financial information about each joint venture that is material to the entity.

26 In relation to individually immaterial joint ventures, an entity is required to provide aggregate information about the carrying amounts of those investments and limited aggregate information about profit and loss and comprehensive income.

27 IFRS 12 requires less information about interests in joint operations than about interests in joint ventures, mainly because IFRS 11 requires a joint operator to account for (and disclose information about) assets and liabilities, income and
expenses relating to its interest in a joint operation, in accordance with applicable IFRSs.

When does IFRS 11 become effective?

28 IFRS 11 is effective for annual periods beginning on or after 1 January 2013, with early application permitted provided IFRS 10 Consolidated Financial Statements (IFRS 10), IFRS 12, IAS 27 (2011) Separate Financial Statements (IAS 27 (2011)) and IAS 28 (2011) are adopted at the same time.

APPENDIX 2B – ANALYSIS OF THE COSTS AND BENEFITS OF IFRS 11

EFRAG’s initial analysis of the costs and benefits of IFRS 11

1 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users from implementing IFRS 11, both in year one and in subsequent years. The results of EFRAG’s initial assessment can be summarised as follows:

(a) Costs – EFRAG’s initial assessment was that:

(i) IFRS 11 is likely to result in incremental one-off costs for preparers, which for some preparers could be significant. Preparers that expect to be most affected are (1) those that have interests in joint operations structured through a separate vehicle, which were previously accounted for under the equity method, and (2) those that present only separate financial statements and have interests in joint operations structured through a separate vehicle;

(ii) The incremental ongoing costs will not be significant for most of preparers. However, the ongoing costs could be significant for some preparers; in particular those that have interests in numerous joint operations structured through a separate vehicle and that present only separate financial statements; and

(iii) IFRS 11 is unlikely to result in significant costs for users.

(b) Benefits – EFRAG’s initial assessment was that IFRS 11 will provide significant benefits for users and some benefits for preparers.

2 EFRAG published its initial assessment and supporting analysis on 9 February 2012. It invited comments on the material by 11 March 2012. In response, EFRAG received 21 comment letters. Nine respondents agreed with EFRAG’s assessment of the benefits of implementing IFRS 11 and the associated costs involved for users and preparers. Nine respondents did not comment specifically on EFRAG’s initial assessment of the costs and benefits of implementing IFRS 11 in the EU, but supported EFRAG’s recommendation that IFRS 11 be adopted for use in Europe. Three respondents did not agree with EFRAG’s assessment of the benefits of implementing IFRS 11 and/or the associated costs or did not comment on this specific assessment.

EFRAG’s final analysis of the costs and benefits of IFRS 11

3 Based on its initial analysis and stakeholders’ views on that analysis, EFRAG’s detailed final analysis of the costs and benefits of IFRS 11 is presented below.

Core principle for classification and accounting for interests in joint arrangements
Cost for preparers

4 EFRAG has carried out an assessment of the cost implications for preparers resulting from IFRS 11 in relation to the determining of the type of the joint arrangement and the change in method of accounting.

One-off costs incurred on transition

5 To proceed with the transition from IAS 31 to IFRS 11, it is expected that preparers will need to incur the following types of costs:

(a) reading and understanding of IFRS 11;
(b) analysis of arrangements and data collection; and
(c) systems and processes modifications.

6 These types of costs are discussed in details in the paragraphs that follow. The relief provided by IFRS 11 transitional requirements from retrospective reassessment of the data is also discussed.

Reading and understanding of IFRS 11

7 Preparers will incur one-off costs to get acquainted with the new requirements, understand their impact on the reporting processes and to train their employees accordingly. These costs would need to be incurred by all entities that are a party to a joint arrangement, regardless of whether they currently use the proportionate consolidation or equity method. EFRAG foresees some effort to read and understand the new requirements, with no significant costs for preparers.

8 In addition, preparers may need to incur some costs of communicating and explaining the changes in their financial statements to users. In EFRAG’s view, this cost will not be significant.

Analysis of arrangements and data collection

9 EFRAG notes that one of the most significant costs preparers will incur relates to the need to analyse and classify the joint arrangements as either a joint operation or a joint venture.

10 When a joint arrangement is structured through a separate vehicle, preparers will need to consider the legal form, contractual agreements and other facts and circumstances in order to classify the joint arrangement as a joint venture or joint operation. For some entities this assessment will be straightforward and the cost of assessment will be insignificant. However, for other preparers classification of their joint arrangements will require more effort and lead to higher costs. In some cases, it might not be clear whether the legal form of the joint arrangement or the contractual agreement confer separation between the vehicle and the parties to the arrangement. In these cases, preparers may need to seek legal advice and engage external advisors or consultants, which would lead to entities incurring additional costs.

11 In EFRAG’s view preparers that currently use proportionate consolidation may have access to all the data necessary to make the transition either to the equity accounting for their interests in joint ventures or to recognise assets, liabilities, revenue and expenses of their joint operations. However, in some cases entities may need to collect additional information about individual assets, liabilities, revenue and expenses of the joint operation to be able to recognise the appropriate
share (percentage of assets, liabilities, revenue and expenses) in the financial statements.

12 Entities that currently use the equity method and that will classify some of their interests in joint arrangements structured through separate vehicle as joint operations might need to get access to additional information to recognise their share of assets, liabilities, revenue and expenses of a joint operation. Where the contractual arrangements currently do not foresee the provision of such detailed information, entities may need to agree with other joint operators on a way to obtain the required data.

**Systems and processes modifications**

13 Preparers are likely to incur costs to adapt and in some cases modify their financial systems and internal processes in order to make the transition either from proportionate consolidation to the equity method or from the equity method to accounting for assets, liabilities, revenue and expenses. That will depend on the classification of their interests in joint arrangements under IFRS 11 and the method of accounting currently used.

14 Some preparers which currently use equity method, will classify their interests in IAS 31 jointly controlled entities as joint ventures. In this case, they will continue using equity method.

15 Other preparers which currently use equity method, will classify some of their interests in IAS 31 jointly controlled entities as joint operations, in which case they might need to change existing systems and processes.

16 Some preparers which currently use proportionate consolidation, will classify their interests in IAS 31 jointly controlled entities as joint ventures and they will need to change from proportionate consolidation to the equity method. If these companies continue to use proportionate consolidation in their management reporting, it is possible that they will need to enhance their systems.

17 Other preparers which currently use proportionate consolidation, will classify their interests in IAS 31 jointly controlled entities as joint operations and will not need to modify their systems significantly. However, in cases when – according to the arrangement – a different percentage of individual assets, liabilities, revenue and expenses will need to be recognised (e.g. because their share of output taken differs from their legal ownership share in the vehicle), enhancement of the financial system might be needed.

18 EFRAG’s assessment is that the one-off costs to modify and change systems and processes will be significant for some preparers, in particular those which currently use the equity method and will classify some IAS 31 jointly controlled entities as joint operations.

**Transition requirements**

19 Preparers would need to incur one-off costs of restating retrospectively joint arrangements (from proportionate consolidation to the equity method or from the equity method to accounting for assets and liabilities) for comparative periods.

20 EFRAG notes that the transitional provisions in IFRS 11 bring some relief in the following situations:

(a) In case of transition from proportionate consolidation to equity method entities will need to recognise their investments in joint ventures at the beginning of
the earliest period presented as an aggregate of the existing carrying amounts of assets and liabilities that the entity previously proportionally consolidated. No remeasurement or restatement of the previous accounting is required.

(b) In case of transition from equity method to recognition of assets and liabilities entities will need to derecognise their existing investment and recognise their share of assets and liabilities in a joint operation at the beginning of the earliest period presented. Entities do not need to remeasure the recognised assets and liabilities at the date of transition.

21 Overall, in EFRAG’s opinion the reliefs mentioned above will reduce the initial costs for preparers of applying IFRS 11.

Impact on the cost of capital for joint arrangements classified as joint ventures

22 The change in the accounting method from proportionate consolidation to the equity method will result in different information being reported in financial statements. For example, total assets and total revenue reported by entities will decrease on the face of financial statements. If analysis were not to modify their approach, that change would have impact on certain key financial ratios, which may then affect the cost of capital for those entities.

23 However, users will be provided with summarised financial information about each joint venture that is material to the entity and for all immaterial joint ventures in aggregate, as required by IFRS 12. This should enable users to conduct their analysis in a way they believe is most relevant and appropriate. Moreover, having financial data about all joint arrangements in the notes being disaggregated from assets, liabilities and revenue and expenses of joint venturers, is likely to be useful for users.

Ongoing costs

24 Preparers are expected to incur the following incremental recurring costs to implement IFRS 11:

(a) data collection; and

(b) analysis of arrangements.

25 These costs are discussed in the paragraphs that follow.

Data collection

26 In some cases, IFRS 11 will lead to costs savings in terms of data collection and processing, in particular when the entity will change from the proportionate consolidation to the equity method.

27 However, some preparers may decide to continue to use proportionate consolidation for their management reporting under IFRS 8. For those entities implementation of equity method will not bring savings.

28 EFRAG notes that under IFRS 12, entities will need to collect data to present summarised financial information on joint ventures that are considered material to the entity. As a result, the overall costs savings in changing from proportionate consolidation to the equity method are not expected to be significant.

29 For the entities that currently use the equity method and will classify some or all their interests in jointly controlled entities as joint operations, IFRS 11 may lead to
an increase in ongoing costs of data collecting and processing. For some entities this cost will be insignificant, however for others it could be more significant, and will depend on the number of joint operations, characteristics of the joint arrangement and accessibility of the financial data.

30 For some entities that currently use proportionate consolidation, the reclassification of some of their interests to joint operations could lead to some increase in the costs of collecting and processing data, in order to be able to capture the additional information on a transaction level.

Analysis of arrangements

31 Entities will need to monitor the changes in key clauses of their contractual arrangements, in order to verify the correct classification of their joint arrangements on an ongoing basis. However, the changes to contracts or shareholders agreements that would trigger reclassification are not expected to occur frequently.

Conclusion on costs for preparers

32 Overall, EFRAG’s assessment is that IFRS 11 is likely to result in incremental one-off costs for preparers, which for some preparers could be significant. Preparers which expect to be most impacted are those that have interests in joint operations structured through separate vehicle, which were previously accounted for under the equity method.

33 Overall, EFRAG’s assessment is that the ongoing costs will not be significant for most preparers.

Costs for users

34 EFRAG has carried out an assessment of the cost implications for users resulting from IFRS 11.

35 Users will need to understand the new requirements and analyse why the numbers in the financial statements are different in order to amend their models and compare year-to-year figures. However, this cost is expected to be reduced by the fact that on transition preparers are required to provide the comparative data for all periods presented in their financial statements. Moreover, entities are required to provide reconciliation between the interests in joint arrangements accounted under IAS 31 as equity investment or proportionate consolidation and the interest in joint arrangements accounted for using different method under IFRS 11. This should make the transition more understandable for users.

36 Users will lose some information reported on the face of the financial statements in relation to jointly controlled entities that are currently proportionally consolidated. However, the summarised financial information for each material interest in joint venture, and in aggregate for all immaterial joint ventures, will be provided in the notes to the financial statements. The expanded disclosures are expected to compensate partially for the loss of information on the face of the primary financial statements.

Conclusion on costs for users

37 Overall, EFRAG’s assessment is that the IFRS 11 is unlikely to result in significant costs for users.
Benefits for preparers and users

38 EFRAG has carried out an assessment of the benefits for users and preparers resulting from IFRS 11.

39 IFRS 11 eliminates the existing accounting option for jointly controlled entities, and provides guidance on the classification of joint arrangements created through a separate vehicle. As a result, it is expected that users and preparers will benefit from the increased comparability of the financial statements under IFRS 11.

40 Moreover, the principle in IFRS 11 is based on recognising rights to assets and obligations for liabilities that arise from parties’ involvement in a joint arrangement, and not on the legal form of the arrangement. IFRS 12 requires more comprehensive disclosure about key financial data and risks and debt obligations associated with joint ventures. Having a consistent principle, with comprehensive disclosure is likely to increase usefulness of information to users.

Conclusion on benefits for preparers and users

41 For the reasons explained above, EFRAG assessment is that preparers are likely to benefit from IFRS 11. Moreover, EFRAG’s assessment is that IFRS 11 will provide significant benefits for users.

Overall assessment about the costs and benefits of implementing the IFRS 11 core principle for classification and accounting

42 EFRAG’s assessment is that the overall benefits resulting from IFRS 11 are likely to outweigh costs associated with implementation of new requirements.

Parties without joint control having interests in joint operation

Cost for preparers

43 EFRAG has carried out an assessment of the cost implications for preparers resulting from the guidance in IFRS 11 on accounting by parties without joint control having interests in joint operation.

44 The parties to the joint operations that do not have joint control but have rights to assets and obligations for liabilities of the joint operations, will need to change their accounting from applying IFRS 9/IAS 39 (or IAS 28 in case of significant influence) to recognising assets and liabilities based on the contractual rights they have under the joint arrangement.

45 EFRAG acknowledges that those entities will need to incur some additional costs of reviewing the contracts and collecting the necessary data to change the current accounting practice. In EFRAG’s view, the costs involved are unlikely to be significant.

46 In EFRAG’s view, the ongoing costs involved are unlikely to be significant.

Costs for users

47 EFRAG has carried out an assessment of the cost implications for users resulting from the IFRS 11 guidance on accounting in the financial statements of parties without joint control having interests in joint operation.

48 EFRAG acknowledges that users will need to make some effort to understand the changes – in the financial statements of the parties that do not have joint control but
only rights to the assets and obligations for the liabilities of the joint operation – and to update their analyses. However, as the scope of this change is limited, in EFRAG believes that the cost for users will not be significant.

Benefits for preparers and users

49 EFRAG has carried out an assessment of the benefits for users and preparers resulting from the IFRS 11 guidance on accounting in the financial statements of parties without joint control having interests in joint operation.

50 In EFRAG’s view, preparers without joint control that have rights to the assets and obligations for the liabilities of a joint operation will benefit from the new accounting guidance in IFRS 11 as they will be able to reflect better the activities conducted in cooperation with the joint arrangement.

51 In EFRAG’s view, users are expected to benefit from the IFRS 11 guidance on parties without joint control having interests in joint arrangement, because they will be provided with useful and relevant information about the rights to the assets and obligations for the liabilities which the parties without joint control have in relation to their interest in joint arrangements.

Overall assessment about the costs and benefits of implementing the IFRS 11 guidance on parties without joint control having interests in joint operation

52 EFRAG’s assessment is that the overall benefits from the IFRS 11 guidance, on parties without control that have an interest in a joint operation, are likely to outweigh costs associated with implementation of the new requirements.

Accounting for interests in joint operations in separate financial statements

Cost for preparers

53 EFRAG has carried out an assessment of the cost implications for preparers resulting from IFRS 11 in relation to accounting in the separate financial statements.

54 IFRS 11 requires the same accounting for the interests in joint operations, which is the recognition of assets and liabilities, revenue and expenses in separate and consolidated financial statements of the joint operator. Some of the joint arrangements structured through a separate vehicle will be classified as joint operations under IFRS 11. Under IAS 31 they may have been classified as jointly controlled entities and accounted for at cost or at fair value according to existing IAS 27.

One-off costs

55 In EFRAG’s view, entities that prepare consolidated financial statements will not incur additional significant costs to apply the requirements in the separate financial statements.

56 However, EFRAG acknowledges that entities which prepare only separate financial statements may need to incur additional costs. As explained above in ‘consolidated financial statements’, costs will be incurred to determine classification of the joint arrangement, collecting of additional data (about the underlying assets and liabilities), and modification of systems and processes.
Those preparers may also need to incur additional costs to explain and communicate this change in their separate financial statements to users.

In addition, preparers for which the separate financial statements are the basis for the tax declarations may need to incur costs that result from the underlying tax implications.

One-off costs will also (similar to those discussed above) be incurred by parties to a joint operation that do not have joint control but have rights to assets and liabilities for obligations relating to the arrangement.

EFRAG’s assessment is that one-off costs of implementing IFRS 11 might be significant for some entities that prepare only separate financial statements and have interests in joint operations structured through separate vehicle. In addition, the eventual tax implications that result from assessing tax obligations based on different numbers will also result in some preparers incurring additional costs (it should be noted that there is an equal and opposite benefit to the tax authorities).

**Ongoing costs**

Similar to one-off costs, preparers that currently account for their interests in joint operations structured through separate vehicle at cost or at fair value in their separate financial statements will incur some additional ongoing costs of providing the information about their rights to the assets and obligations for the liabilities of the joint operations.

The additional ongoing costs may include costs of data collection and processing, additional reconciliations with tax declarations and higher audit fees.

EFRAG’s assessment is that the ongoing costs could be significant for some of the entities (that prepare only separate financial statements), in particular having interests in numerous joint operations structures through separate vehicle.

**Conclusion on costs for preparers**

Overall, EFRAG’s assessment is that the guidance in IFRS 11 on accounting for the interests in joint arrangements in the separate financial statements is likely to result in incremental one-off and ongoing costs for preparers, which prepare separate financial statements.

These costs could be significant for preparers that present only separate financial statements and have interests in a number of joint operations structured through separate vehicle. For other preparers the costs are expected to be insignificant.

**Costs for users**

EFRAG has carried out an assessment of the cost implications for users resulting from the IFRS 11 guidance on accounting in separate financial statements.

Users will need to incur some costs of understanding the changes arising from IFRS 11 on the separate financial statements of joint operators and other parties to the joint operations that have rights to the assets and obligations for the liabilities relating to the joint operation. However, similarly to the consolidated financial statements, this cost will be mitigated by the fact that that the entities are required to provide reconciliation between the investment derecognised (at cost or at fair value) and the assets and liabilities recognised.
Conclusion on costs for users

68 Overall, EFRAG’s assessment is that the guidance in IFRS 11 on accounting in separate financial statements is unlikely to result in significant costs for users.

Benefits for preparers and users

69 EFRAG has carried out an assessment of the benefits for users and preparers resulting from IFRS 11 in respect to separate financial statements.

70 Users will have access to the information about a joint operator’s assets, liabilities, revenue and expenses relating to its interests in a joint operation, directly from the separate financial statements. This level of detail is unlikely to be readily available in the consolidated accounts, given that they have different focus and require less disclosure of information for each individual joint operation. In EFRAG’s view it will allow users to better understand the rights and obligations of the joint operators that arise from the interests in joint operation. This would be important in particular for the financial statements of the entities which do not prepare consolidated financial statements.

71 Furthermore, the information about the joint operations would be the same in the separate and consolidated financial statements, which would enhance comparability.

Conclusion on benefits for preparers and users

72 EFRAG assessment is that users are likely to benefit from the requirements in IFRS 11 in respect to separate financial statements.

Overall assessment about the costs and benefits of IFRS 11 guidance on accounting in the separate financial statements

73 EFRAG’s assessment is that the overall benefits resulting from IFRS 11 guidance on accounting in separate financial statements are likely to outweigh costs associated with implementation of the new requirements.

Overall assessment about the costs and benefits of implementing IFRS 11 in the EU

74 To summarise, EFRAG reached the following individual conclusions on each of the areas discussed above. The following assessment combines the effects of one-off and ongoing costs to preparers and users with the benefits expected from the new requirements in IFRS 11:

(a) Core principle for classification and accounting for interests in joint arrangements – The requirements are likely to result in increased costs for preparers and for some preparers the one-off costs could be significant. However, the benefits for users of the increased comparability and relevance of financial reporting are expected to outweigh the costs of implementation.

(b) Parties without joint control having interests in joint operations – The requirement is unlikely to result in significant costs for preparers and users, and therefore the benefits of a more faithful representation of rights and
obligations of parties to a joint operation that do not have joint control, are likely to outweigh the costs of implementation.

(c) Accounting for interests in joint operation in separate financial statements – The requirement is likely to result in increased costs for preparers. These costs could be significant for those preparers that have interest in numerous joint operations structured through separate vehicle and which prepare only separate financial statements. However, the benefits for users of a more faithful representation of rights and obligations of joint operators in their separate financial statements are likely to outweigh the costs.

75 On balance, EFRAG’s assessment is that the overall benefits resulting from IFRS 11 are likely to outweigh costs associated with implementation of new requirements.

APPENDIX 3A – SUMMARY OF IFRS 12

Background

1 Users of financial statements have consistently requested improvements to the disclosure of information provided by an entity (the investor) in relation to its interests in other entities (investees). The global financial crisis has highlighted a lack of transparency about the risks to which an entity is exposed from its involvement with structured entities (special purpose entities) and the need for better information about an entity’s interests in structured entities, including those that are not consolidated.

2 In addition, users have requested further information about non-controlling interests (NCI) in consolidated entities to help them understand the profit or loss and cash flows attributable to the shareholders of the parent entity and those attributable to the NCI.

3 The development of IFRS 10 Consolidated Financial Statements (IFRS 10) and IFRS 11 Joint Arrangements (IFRS 11) has shifted the focus to a more principles-based control model and replaced the choice of accounting policy in existing IAS 31 Interests in Joint Venturers (IAS 31) with a principle that focuses on the rights and obligations of the parties to a joint arrangement, rather than on its legal form. The new requirements require management to make certain assumptions and to exercise judgement in the assessments made and conclusions reached, which creates a need for additional disclosure to support users’ analysis.

4 Users have also indicated that the information provided in the notes is sometimes fragmented and not easy to find, which makes the information less understandable and less comparable between entities.

Objective of IFRS 12

5 IFRS 12 Disclosure of Interests in Other Entities (IFRS 12) was developed to address the concerns of users about the information on interests in other entities. The standard focuses only on information provided in the consolidated financial statements.
The objective of IFRS 12 is to set out a single source of guidance for all disclosure requirements for an entity’s interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities.

The standard establishes principles-based disclosure objectives and specifies the minimum information an entity must provide to meet those objectives. IFRS 12 emphasises that information should not be obscured by excessive detail and should be presented in a structured and understandable way.

IFRS 12 requires an entity to disclose information that helps users of financial information understand and 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.

What has changed?

Set out below is a description of the new elements and additional disclosure requirements introduced by IFRS 12:

(a) Unconsolidated structured entities;
(b) Significant judgements and assumptions;
(c) Interests in subsidiaries with material non-controlling interests;
(d) Consolidated structured entities;
(e) Interests in joint arrangements and associates; and
(f) Venture capital organisations, mutual funds or unit trusts and similar entities including investment-linked insurance funds that have an interest in a joint venture or associate.

Although the standard requires more granular information in some areas (with a focus on materiality), it does permit information with similar characteristics to be aggregated. The primary objective of IFRS 12 is to provide information to users in a structured and meaningful way.

Unconsolidated structured entities

IFRS 12 introduces disclosures about unconsolidated structured entities that were not required previously under IAS 27 Consolidated and Separate Financial Statements (IAS 27). The objective is to increase transparency about investees that are not consolidated.

IFRS 12 defines a structured entity as ‘an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity’.

IFRS 12 requires an entity to disclose qualitative and quantitative (summarised information) about the nature of its interest in unconsolidated structured entities and the risks to which an entity is exposed from that interest, including:

(a) nature, purpose, size and activities of the structured entity;
(b) how the structured entity is financed;

(c) the carrying amounts of the assets and liabilities relating to its interests in unconsolidated structured entity and how they compare to the maximum exposure to loss from that interest;

(d) the type and amount of the support provided to the structured entity without a contractual obligation to do so, and reasons for that; and

(e) current intention to provide support to the structured entity.

14 When an entity has no contractual involvement with the structured entity at the end of the reporting period but was a sponsor of that structured entity, it must disclose income received from the structured entity during the reporting period and all assets transferred to structured entities during the reporting period.

Significant judgments and assumptions

15 The introduction of a uniform consolidation model in IFRS 10 and the classification of a joint arrangement in IFRS 11 have resulted in the need for further disclosures to enable users to understand the significant judgements and assumptions made by management when deciding how an entity should account for its involvement with another entity.

16 The disclosures in IFRS 12 are intended to supplement the general disclosure requirements in IAS 1 Presentation of Financial Statements with more specific requirements relating to an entity’s decision about whether it controls, jointly controls or exercises significance influence over another entity.

17 An entity must disclose qualitative information about significant judgements and assumptions it has made in determining the nature of the relationship with the other entity (whether it has control, joint control or significant influence) and the type of joint arrangement it is involved with (joint operation or joint venture).

Interests in subsidiaries with material non-controlling interests

18 Some of the disclosures in existing IAS 27 have been carried forward to IFRS 12 without significant changes.

19 However, IFRS 12 requires (1) new disclosures in relation to subsidiaries with non-controlling interests (NCI) that are material to the entity and (2) extends the disclosure requirements about significant restrictions (on the parent’s ability to access or use the assets and settle the liabilities of its subsidiaries).

Interests in subsidiaries with non-controlling interests

20 IFRS 12 requires an entity to disclose – for each non-controlling interest that is material to the entity – the following information:

(a) the name of the subsidiary and its place of business;

(b) the proportion of ownership interests held by NCI and the proportion of voting rights (if different);

(c) the profit or loss allocated to NCI;
(d) accumulated NCI at the end of the reporting period;

(e) dividends paid to NCI; and

(f) summarised financial information about the subsidiary.

Some information about NCI is already required under IAS 1, such as total NCI within equity, profit and loss including total comprehensive income for the period attributable to NCI and a reconciliation between the opening and closing balance for NCI for the period. In response to user needs, IFRS 12 expands the disclosure requirements in relation to NCI.

The standard requires disclosures of summarised financial information to be presented for each subsidiary with material NCI, such as current assets, non-current assets, current liabilities, non-current liabilities, revenue, profit or loss, and total comprehensive income. This information is based on the amounts before consolidation eliminations.

**Significant restrictions on an entity's ability to access or use assets, and settle liabilities**

Existing IAS 27 already requires disclosures about the nature and extent of any significant restrictions on an entity's ability to transfer funds to its parent.

IFRS 12 expands the existing requirements about a parent’s ability to access or use the assets and settle the liabilities of its subsidiaries (including statutory, contractual and regulatory restrictions and the nature of protective rights of NCI on the entities ability to access or use assets and settle liabilities of the group).

The standard also requires disclosure of the carrying amounts in the consolidated financial statements of the assets and liabilities to which these restrictions apply.

**Consolidated structured entities**

Involvement in structured entities can expose an entity to risks that are different to those that typically arise from investing in other subsidiaries, due to factors such as the restricted activities of the structured entity, insufficient equity to fund losses or its design and intended purpose.

IFRS 12 requires disclosures about the risks associated with an entity’s involvement with consolidated structured entities when it could be required to provide financial support to them. To summarise, an entity must disclose:

(a) any contractual arrangements to provide support to consolidated structured entities, including the circumstances that could expose the reporting entity to loss;

(b) the type, amount and the reasons of any support provided to the consolidated structured entity during the reporting period without obligation to do so;

(c) the situation when provision of support to the previously unconsolidated structured entity resulted in obtaining control over that entity; and

(d) any current intention to provide support to a consolidated structured entity.
Interests in joint arrangements and associates

28 IFRS 12 extends the disclosure requirements in relation to an entity’s interests in joint arrangements and associates in response to user needs, and as a result of the new classification and accounting requirements for joint arrangements in IFRS 11.

29 For each joint venture and associate that is material to the reporting entity, an entity must disclose the following qualitative and quantitative information:

(a) name, place of business, nature of activities, and proportion of ownership;
(b) measurement method (equity method or fair value);
(c) summarised financial information; and
(d) fair value of an investment accounted for using equity method, if there is a quoted market price for the investment.

30 The required summarised financial information in (c) above, consists of different items included in the statement of financial position and the statement of comprehensive income of the individual joint venture and associate, and some additional information for joint ventures that are material to the reporting entity.

31 In relation to individually immaterial joint ventures and associates, an entity is required to provide aggregate information about the carrying amounts of those investments and limited aggregate information about profit and loss and comprehensive income.

32 IFRS 12 also aligns most of the disclosures for joint ventures and associates.

33 IFRS 12 requires less information about interests in joint operations than about interests in joint ventures, mainly because IFRS 11 requires a joint operator to account for assets and liabilities, income and expenses relating to its interest in a joint operation, in accordance with applicable IFRSs.

Venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds that have an interest in a joint venture or associate

34 IFRS 12 requires the same disclosures to be provided in respect to all associates and joint ventures, including those held by the venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds and measured at fair value. This is a change from existing IAS 28 Investments in Associates (IAS 28) and IAS 31, which require only specific limited disclosures when an entity is a venture capital organisation or a similar entity.

35 This requirement is consistent with the IASB’s decision to remove the scope exclusion in the amended IAS 28 Investments in Associates and Joint Ventures (IAS 28 (2011)) and IAS 31 when it was replaced by IFRS 11.

When does IFRS 12 become effective?

36 IFRS 12 becomes effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. An entity is encouraged to provide information required by IFRS 12 early, without being compelled to comply with all the requirements of IFRS 12 or to apply IFRS 10, IFRS 11, IAS 27 Separate Financial Statements (IAS 27 (2011)) and IAS 28 (2011) at the same time.
APPENDIX 3B – ANALYSIS OF THE COSTS AND BENEFITS OF IFRS 12

EFRAG’s initial analysis of the costs and benefits of IFRS 12

1 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users from implementing IFRS 12, both in year one and in subsequent years. The results of EFRAG’s initial assessment can be summarised as follows:

(a) *Costs* – To summarise, EFRAG’s assessment was that:

(i) some preparers are likely to incur significant one-off costs from implementing IFRS 12, in particular when they have numerous interests in other entities and when getting access to data is difficult;

(ii) the ongoing costs of providing the disclosures are likely to be insignificant in most cases, once preparers are acquainted with the new requirements and have adapted their systems and processes to meet the requirements and collected data for the first time; and

(iii) IFRS 12 is likely to result in significant one-off costs for users (particularly in those cases where detailed changes to their models are needed) and in cost savings on an ongoing basis.

(b) *Benefits* – To summarise, EFRAG’s initial assessment was that preparers were likely to benefit from IFRS 12 as the new disclosures are expected to improve the communication with users. Furthermore, EFRAG’s initial assessment was that IFRS 12 will bring significant long-term benefits to users.

2 EFRAG published its initial assessment and supporting analysis on 9 February 2012. It invited comments on the material by 11 March 2012. In response, EFRAG received 23 comment letters. Eight respondents agreed with EFRAG’s assessment of the benefits of implementing IFRS 12 and the associated costs involved for users and preparers. Eleven respondents did not comment specifically on EFRAG’s initial assessment of the costs and benefits of implementing IFRS 12 in the EU, but supported EFRAG’s recommendation that IFRS 12 be adopted for use in Europe. Three respondents did not agree with EFRAG’s initial assessment of the costs and benefits of implementing IFRS 12. One respondent did not comment on this specific assessment.

EFRAG’s final analysis of the costs and benefits of IFRS 12

3 Based on its analysis and stakeholders’ views on that analysis, EFRAG’s detailed final analysis of the costs and benefits of IFRS 12 is presented below.

*Cost for preparers*

4 The significance of the costs to preparers of implementing IFRS 12 will depend largely on the volume of investees including joint ventures and associates and
whether they are considered to be structured entities (special purpose entities) and involve complex ownership structures and contractual terms.

**One-off costs**

Reading and understanding IFRS 12

5 Preparers will incur one-off costs to read and understand the new requirements and to train their employees accordingly.

6 EFRAG notes that although IFRS 12 already includes a number of definitions of the terms used in the standard, some terms have not been defined (for example, a ‘sponsorship’, and ‘size’ of a structured entity). EFRAG believes that the lack of guidance on some undefined terms may cause some preparers to incur additional one-off costs.

**Aggregation of data**

7 IFRS 12 emphasises that information should not be obscured by excessive detail and should be presented in a structured and understandable way. The objective is to provide information to users in a meaningful way, in which items with similar characteristics are aggregated and vice versa.

8 EFRAG acknowledges that aggregating data in a meaningful and understandable way will not always be an easy task and it will require time and effort to aggregate the information. The overall difficulty will depend on the number of investees under consideration, the complexity of the structures and arrangements that an entity is involved with, and whether they have similar characteristics. The effort could be significant when applying IFRS 12 for the first time.

9 EFRAG observes that IFRS 12 provides guidance on how an entity should aggregate the data and clarifies that materiality is a key point of focus. The focus on ‘materiality’ is expected to bring relief to preparers in respect of developing a consistent and understandable pattern of aggregation policies for items that have similar characteristics. Materiality will also play an important role for preparers in determining which disclosures need to be aggregated and presented in the financial statements. The relief provided through aggregation should reduce the burden of providing the required disclosures.

10 Overall, EFRAG’s assessment is that the costs of developing aggregation policies that are relevant to their business model and consistent with the standard’s objectives should not be significant.

**Collecting of information, systems and processes modifications**

11 The new and more comprehensive disclosure requirements in IFRS 12 may require preparers to adjust or change current systems and reporting processes, to obtain the respective information. The related costs are discussed below.

**Unconsolidated structured entities**

12 EFRAG understands that one of the main costs of implementing IFRS 12 relates to the requirements about unconsolidated structured entities. These are new requirements that will result in initial costs of adjusting and changing financial systems and existing processes to produce the information the first time. For example, preparers may need to modify their systems in order to be able to track its transactions with structured entities. Furthermore, entities will incur analysis costs to review their interests in other entities, and conclude on whether they satisfy the definition of a ‘structured entity’ under IFRS 12. For some preparers these costs will be significant.
13 However, EFRAG notes that some of the required information is likely to be already collected for purposes other than the financial statements (for example, risk management purposes, regulatory requirements and investors’ relations). In some cases, the information might need to be converged with IFRS, which will result in costs for preparers. In other cases, a preparer may have limited access to the information, in particular when the structured entity is managed by other parties.

14 EFRAG’s assessment is that one-off costs of modifying systems and processes to collect and process the required information about unconsolidated structured entities are expected to be significant for some entities. Preparers in the insurance and banking industry having numerous interests in structured entities are likely to be affected most.

Subsidiaries with material non-controlling interests

15 In EFRAG’s view, the information necessary to meet the disclosure requirements about interests in subsidiaries with material NCI, which are currently consolidated, should be mostly available and it is unlikely to result in significant year-one costs for preparers.

16 However, in respect to the structured entities which will be consolidated for the first time under IFRS 10, collecting of information for the disclosure purposes might require more effort and result in additional costs. This is expected to be the case for some companies with interests in funds that were not consolidated under current standards, but that will be consolidated under IFRS 10 as a result of the new requirements on de-facto control and agent-principal relationships.

Interests in joint arrangements and associates

17 Some preparers may need to establish new processes and enhance their systems to be able to collect and process the summarised financial information required for interests in joint ventures and associates considered to be material to the reporting entity. EFRAG’s assessment is that these costs are not expected to be significant for most preparers, because in number of cases this data is already collected either to apply the equity method or proportionate consolidation under existing IFRSs, or for management reporting purposes (or both).

18 However, those costs may be significant for some venture capital and similar organisations, as the disclosure requirements are new and the respective data might have been collected before. For preparers that use the equity method to account for jointly controlled entities (IFRS 11 joint ventures) and for associates, the required IFRS data may not be readily available and they will incur some initial costs to implement this requirement.

Disclosure about significant judgements and assumptions

19 The introduction of a uniform principles-based consolidation model in IFRS 10 and the classification of joint arrangements in IFRS 11 have resulted in an increase in the level of judgement and assumptions applied when determining control, joint control and classification of a joint arrangement. For most preparers, this cost is likely to be insignificant. However, for preparers involved in more complex relationships with investees the requirement may entail some significant costs to set up reporting systems to produce the required information.

Transition requirements

20 IFRS 12 shall be applied for annual periods beginning on or after 1 January 2013, with earlier application being permitted. As there are no specific transition
requirements set out in IFRS 12, IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors applies and retrospective application is required.

21 EFRAG’s assessment is that in relation to the disclosure requirements about interests in consolidated subsidiaries, and interests in joint ventures and associates, the transition itself will not result in significant incremental costs to preparers. However, some preparers may find it challenging to apply some of the disclosure requirements retrospectively, in particular:

(a) The disclosures for unconsolidated structured entities will require an entity to identify whether, before applying IFRS 12, it had (has) interests in entities that meet the definition of structured entities.

(b) The disclosures for interest in subsidiaries’ with material non-controlling interests that are currently not consolidated (for example investment funds).

(c) The disclosures required by venture capital organisations, mutual funds, unit trusts and similar entities that have interests in a joint ventures or associates measured at fair value are mainly new requirements as these entities provide only limited disclosures under existing IAS 28 and IAS 31.

Ongoing costs

22 Similar to EFRAG’s assessment on one-off costs of implementing IFRS 12, the significance of ongoing costs will depend on the volume of investees, and the nature and complexity of an investee. EFRAG notes that due to the new and expanded disclosure requirements entities will incur additional recurring costs to collect and process the data.

23 EFRAG’s assessment of ongoing costs is discussed below.

Unconsolidated structured entities

24 EFRAG notes that some information required by IFRS 12 is already being collected for risk management purposes and compliance with regulatory requirements. However, EFRAG acknowledges that the data gathered for other purposes might not be in the format needed to satisfy IFRS 12 disclosure requirements, and result in ongoing costs to preparing at each reporting period.

25 However, the main difficulty in providing the disclosures on unconsolidated structured entities is the scope of the requirements and the potential difficulty in obtaining some of the information. Moreover, for all new transactions preparers will need to perform the assessment on whether they represent an interest in a structured entity.

26 EFRAG observes that the disclosures about interests in unconsolidated structured entities are quite extensive, and preparers might be required to invest time and effort to aggregate the data in a meaningful way.

27 The requirement to provide disclosures about unconsolidated structured entities is expected to affect mostly large financial institutions, particularly banks and insurance companies. In EFRAG’s view, the ongoing costs are likely to be higher for these preparers. Overall, EFRAG believes that over time, ongoing costs will decrease as preparers conform and automate their reporting systems to more easily produce the required information.
Significant judgements and assumptions

28 As explained above in ‘one-off’ costs, compiling disclosures about the significant judgement and assumptions is largely a one-off exercise. However, EFRAG acknowledges that the preparers will need to update the disclosure when the facts and circumstances change and for new investments.

29 EFRAG’s assessment is that ongoing costs of updating the disclosure about significant judgements and assumptions will not be significant.

Subsidiaries with material non-controlling interests (NCI)

30 EFRAG thinks that the information required by IFRS 12 about subsidiaries with material NCI is already collected for consolidation purposes, and can be easily reproduced from the available financial data. EFRAG notes that preparers having interests in numerous subsidiaries with material NCI – that were previously not consolidated – will need to make some additional effort to aggregate the information. Overall, EFRAG’s assessment is that the ongoing costs of aggregating the data and providing this disclosure are not expected to be significant for most preparers.

Consolidated structured entities

31 Preparers with interests in consolidated structured entities would need to review their contracts with structured investees to establish whether they have contractual arrangements that would require them to provide financial support to those entities. Some preparers may find this requirement challenging particularly if they have interests in numerous consolidated structured entities which they need to ‘maintain’, and also if they regularly invest in such structures.

32 EFRAG notes that some of the information is already collected for risk management purposes, regulatory requirements and communication with investors and does not expect the cost to gather and process the data on an ongoing basis to be significant.

Interests in joint arrangements and associates

33 EFRAG notes that in some cases the requirement to disclose summarised financial information for every material joint venture and associate will to need to be collected solely for the purpose of providing the disclosure under IFRS 12. In EFRAG’s view, while some companies already collect all (most) of this information (and their cost to report it would be low), other companies will incur additional ongoing costs of gathering and processing the information.

34 EFRAG understands that an operational difficulty, and an increase in costs, might arise when:

(a) The information available is not based on IFRS.

(b) Information will need to be audited (when previously it was not because it was not required for the IFRS consolidated accounts).

(c) In some jurisdictions, it may be difficult to access the information, because under local legislation, investors may not be allowed to disclose data about the investees that is not yet published.
(d) The requirement to provide a reconciliation of the data in the summarised financial information (of the joint venture or associate) to the carrying amount of the investment.

*Venture capital organisations, mutual funds, unit trusts and similar entities that have an interest in a joint venture or associate*

35 In EFRAG’s view, the ongoing costs to collect and process the data to implement the disclosure requirements are likely to be higher for venture capital organisations or similar entities that have material interests in numerous joint ventures and associates. However, in EFRAG’s view the number of preparers affected will be relatively limited.

**Costs for users**

36 EFRAG has carried out an assessment of the cost implications for users resulting from implementing IFRS 12.

37 Users will need to understand why the numbers in the financial statements are different and what this means when performing their analysis. Considering the significance of the change and the increase in the information provided in the notes, in some cases detailed changes to the models will be needed, and therefore the one-off costs are expected to be significant for users.

38 However, users are expected to benefit from the significant ongoing cost savings, because they will not need to undertake alternative procedures to collect relevant information that was previously not made available in the financial statements.

39 The ongoing costs of analysing the additional disclosure are not expected to be significant for users, as the entities are required to aggregate the data and provide it in the meaningful way. However, if entities do not aggregate the data in a meaningful way, users may need to spend more time and effort to search for relevant information and this will lead to higher ongoing costs for them. In such cases, the ongoing costs will be higher for entities that have interests in many unconsolidated structured entities.

**Benefits for preparers and users**

40 EFRAG has carried out an assessment of the benefits for users and preparers resulting from implementing IFRS 12.

**Preparers**

41 EFRAG notes that the new disclosures about an entity’s involvement with unconsolidated structured entities and the expanded disclosure about the nature and extent of risks associated with an entity’s interests in other entities, will improve financial reporting. Hence, it will enhance communication and user confidence which is likely to lead to a decrease in the cost of capital.

**Users**

42 IFRS 12 has been developed primarily to address concerns expressed by users who have indicated their dissatisfaction with the lack of information for unconsolidated structured entities, fragmented information and lack of transparency about NCI (how cash flows will be distributed to the shareholders of parent and which part is attributable to non-controlling interests) and requested additional information about interests in associates and jointly controlled entities.
In EFRAG’s view, the more comprehensive disclosures will help users to understand the nature and extent of risks associated with an entity’s interests in other entities. Furthermore, EFRAG notes that the information should be easier to find as it will be presented in the notes to the financial statements, even if some of the information is already presented outside the financial statements on a voluntary basis. This will enhance relevance and understandability of information. Comparability will also be enhanced by harmonising the way information is presented. Under IFRS 12 all entities will be required to provide the same disclosures for the same types of investees they are involved with.

To summarise:

(a) Disclosure of an entity’s interests in unconsolidated structured entities will allow users to assess and understand the nature and extent of risks to which an entity is exposed and the extent to which its financial and investment activities are dependent on the transactions with the structured entities.

(b) Disclosure of significant judgements and assumptions will enable users to understand significant judgements and assumptions made by an entity when deciding how to recognise and account for its involvement with another entity.

(c) Disclosure of an entity’s interests in subsidiaries with material NCI will provide users with information about a group’s composition and will enable them to assess the impact of NCI on the group (for example restrictions on transfer of assets and funds and minority protection rights) and cash flow distributions to the ultimate shareholders.

(d) Disclosure of an entity’s interests in consolidated structured entities provides users with information about how the entity makes use of the resources and whether some of resources are allocated to provide financial support to consolidated structured entities.

(e) Disclosure of an entity’s interests in joint arrangements and associates will provide users with an understanding of the relationship an investor has with joint arrangements and associates and the extent of the activity carried out through joint arrangements. The expanded disclosure will inform users about the investee’s debt position, profitability for each material joint venture and associate. The same information will be disclosed for all material joint ventures and associates, which is likely to improve comparability and consistency in the financial reporting and therefore facilitate user analysis.

Overall conclusion

EFRAG’s assessment is that IFRS 12 is likely to result in one-off and ongoing costs for preparers. The one-off costs are likely to be significant for some preparers, mainly those with interests in numerous structured entities, joint ventures and associates, and particularly when getting access to the required information is difficult.

The ongoing costs of providing the disclosures are unlikely to be significant in most cases, once preparers are acquainted with the new requirements and have adopted their systems and processes to implement the requirements.
EFRAG’s assessment is that the IFRS 12 is likely to result in significant one-off costs for users (particularly in those cases where detailed changes to their models are needed) and in cost savings on an ongoing basis.

EFRAG’s assessment is that preparers are likely to benefit from implementing IFRS 12, as the standard requires the provision of more robust disclosures about nature and extent of risks an entity is exposed to, and as such, improve financial reporting and communication with users.

EFRAG’s assessment is that IFRS 12 will bring significant long term benefits to users.

Taken together, EFRAG’s assessment is that the overall benefits of enhanced financial information resulting from IFRS 12 are likely to outweigh the costs involved.

APPENDIX 4A – SUMMARY OF IAS 27 (2011)
Background

1 Some of the changes in IAS 27 (2011) result from the development of IFRS 10 Consolidated Financial Statements (IFRS 10) and, as a consequence, the guidance on consolidation has been moved from the existing IAS 27 Consolidated and Separate Financial Statements (IAS 27) to IFRS 10.

2 Other amendments result from the development of IFRS 11 Joint Arrangements (IFRS 11), which addresses the accounting for joint arrangements:

(a) Joint ventures that are to be accounted for under the equity method; and

(b) Joint operations for which an entity recognises the assets, liabilities, revenue and expenses relating to its interest in a joint operation in accordance with applicable IFRSs.

3 Currently, entities that prepare separate financial statements under IFRSs, account for investments in jointly controlled entities (which could be classified under IFRS 11 as joint ventures or as joint operations) either at cost or in accordance with IAS 39 Financial Instruments: Recognition and Measurement (i.e. the reference to IFRS 9 Financial Instruments should be read as a reference to IAS 39).

What has changed?

4 Most of the existing requirements to account for investments in subsidiaries, joint ventures (as defined in existing IAS 31 Interests in Joint Ventures (IAS 31)) and associates in the separate financial statements prepared under IFRSs have been carried forward to IAS 27 (2011). Only a limited number of minor clarifications have been added which are described below:

(a) Terms and definitions: The definitions and terms used in IAS 27 (2011) have been made consistent with the terminology used in IFRS 10, IFRS 11, IFRS 12 Disclosure of Interests in Other Entities (IFRS 12) and IAS 28 (2011) Investments in Associates and Joint Ventures (IAS 28 (2011)).

(b) Relocation of requirements: Except for (c) below, the requirements applicable to separate financial statements have been moved from existing IAS 28 Investments in Associates and IAS 31 to IAS 27 (2011).
Accounting for joint operations: The accounting requirements in the separate financial statements (of the joint operators and of the parties without joint control) relating to interests in joint operations structured through a separate vehicle have been moved to IFRS 11. This means that interests in joint operations will be accounted for in the separate financial statements in the same way as in the consolidated financial statements. EFRAG’s initial assessments of IFRS 11, including this amendment, are discussed in a separate document.

IFRSs applicable for separate financial statements: The standard clarifies that an entity that prepares separate financial statements under IFRSs, must apply all relevant IFRSs.

Disclosure: To achieve consistency with the requirements in IFRS 12, an entity is required to disclose the principal place of business of the entity (and country of incorporation if different) of a parent and of all significant investments in subsidiaries, joint ventures and associates.

When does IAS 27 (2011) become effective?

IAS 27 (2011) becomes effective for the annual periods beginning on or after 1 January 2013. Earlier application is permitted, but only if an entity applies IAS 27 (2011) together with IFRS 10, IFRS 11, IFRS 12 and IAS 28 (2011).

EFRAG’s initial analysis of the costs and benefits of IAS 27 (2011)

1 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users from implementing IAS 27 (2011), both in year one and in subsequent years. The results of EFRAG’s initial assessment can be summarised as follows:

(a) Costs – EFRAG’s initial assessment was that IAS 27 (2011) will not result in any significant costs for users and preparers.

(b) Benefits – EFRAG’s initial assessment was that IAS 27 (2011) will not result in any significant benefits for users and preparers.

2 EFRAG published its initial assessment and supporting analysis on 9 February 2012. It invited comments on the material by 11 March 2012. In response, EFRAG received 21 comment letters. Nine respondents agreed with EFRAG’s assessment of the benefits of implementing IAS 27 (2011) and the associated costs involved for users and preparers. Eleven respondents did not comment specifically on EFRAG’s initial assessment of the costs and benefits of implementing IAS 27 (2011) in the EU, but supported EFRAG’s recommendation that IAS 27 (2011) be adopted for use in Europe. One respondent did not comment on this specific assessment.

EFRAG’s final analysis of the costs and benefits of IAS 27 (2011)

3 Based on its initial analysis and stakeholders’ views on that analysis, EFRAG’s detailed final analysis of the costs and benefits of IAS 27 (2011) is presented below.

Approach adopted for EFRAG’s cost and benefit assessments of IAS 27 (2011)
The approach adopted to conduct EFRAG’s assessments on the costs and benefits of IAS 27 (2011) is similar to the approach EFRAG undertook in its technical assessments of IAS 27 (2011). EFRAG focused on the changes (‘amendments’) to existing IAS 27 that are likely to result in additional costs and additional benefits to preparers and users.

EFRAG notes that the following amendments to existing IAS 27 are mainly minor consequential amendments or clarifications of existing IFRSs:

(a) Terms and definitions: The definition and terms used have been made consistent with the terminology used in IFRS 10, IFRS 11, IFRS 12 and IAS 28(2011).

(b) Relocation of requirements: Except for the accounting for joint arrangements classified as joint operations under IFRS 11, the requirements applicable to separate financial statements have been moved from existing IFRSs to IAS 27 (2011).

(c) IFRSs applicable for separate financial statements: The standard clarifies that an entity that prepares separate financial statements under IFRSs, must apply all relevant IFRSs.

(d) Disclosure: To achieve consistency with the requirements in IFRS 12, an entity is required to disclose the principal place of business of the entity (and country of incorporation if different) of a parent and of all significant investments in subsidiaries, joint ventures and associates.

In EFRAG’s view, these four amendments to IAS 27 are straightforward – they clarify or correct existing IFRS in minor ways – and do not raise significant concerns about costs and benefits to preparers and users. For this reason, they are not discussed specifically in this Appendix.

In EFRAG’s view, the only significant amendment to existing IAS 27, relates to the accounting for joint arrangements classified as joint operations under IFRS 11. EFRAG initial assessments on IFRS 11, including this amendment, are discussed in a separate document.

Conclusion

EFRAG’s overall assessment is that IAS 27 (2011) will not involve any significant change in costs or benefits for preparers or users (excluding the amendment relating to the accounting for joint operations in the separate financial statements of a joint operator, which is assessed as part of EFRAG’s assessment overall assessment on IFRS 11).

APPENDIX 5A—SUMMARY OF IAS 28 (2011)

Background

Existing IAS 28 Investments in Associates (IAS 28) provides guidance on the accounting for associates and the application of the equity method.
2 The changes to existing IAS 28 result from the IASB’s project on IFRS 11 *Joint Arrangements* (IFRS 11), which replaces the existing IAS 31 *Interests in Joint Ventures* (IAS 31).

3 Under IFRS 11, joint arrangements are classified either as joint operations or joint ventures and joint ventures are required to be accounted for using the equity method. The IASB decided to incorporate the accounting for joint ventures in IAS 28 (2011) given that the equity method is required for both investments in associates and joint ventures.

### The issue

4 The *majority* of changes to IAS 28 result from the incorporation of the accounting for joint arrangements classified as "joint ventures" under IFRS 11, into IAS 28 (2011).

5 It was not the IASB’s intention to reconsider the fundamental approach to the equity method established by IAS 28 and related Interpretations. Therefore, the assessment of significant influence and the approach underlying the equity method of accounting have been carried forward from existing IAS 28.

### What has changed?

6 The title of IAS 28 has been changed to reflect that it addresses the application of the equity method with regard to associates and joint ventures.

7 IAS 28 (2011) introduces a number of small amendments to the existing IAS 28, which are summarised below:

   (a) Potential voting rights: The additional guidance on potential voting rights when assessing significant influence or joint control has been moved from *Guidance on implementing IAS 27 Consolidated and Separate Financial Statements, IAS 28 and IAS 31* to IAS 28 (2011). The guidance requires an entity to take into account the effect of potential voting rights that currently give the entity access to the returns associated with an ownership interests. The guidance has *not* been amended to reflect the new guidance on potential voting rights in IFRS 10 *Consolidated Financial Statements* (IFRS 10), because the IASB did not reconsider the definition of significant influence when it amended IAS 28 and concluded that it would not be appropriate to change one element of significant influence in isolation.

   (b) Classification as held for sale: IAS 28 (2011) clarifies that an entity must apply the requirements in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* to a portion of an investment in an associate or a joint venture that meets the criteria to be classified as held for sale.

   (c) Partial use of fair value option extended to a portion of an associate: The use of the fair value measurement option in existing IAS 28 is extended to a portion of an investment in an associate if that portion is held indirectly through a venture capital organisation or a similar entity. Existing IAS 28 is silent in this respect and different accounting practices have emerged. The guidance on partial use of fair value option does not apply to interests in joint ventures, because the IASB thought that such events would be unlikely in practice.

   (d) Incorporation of SIC-13 *Jointly Controlled Entities–Non-Monetary Contributions by Venturers*: SIC-13 provides guidance on non-monetary
contributions to a jointly controlled entity being made in exchange for an equity interest in the jointly controlled entity, and limits a venturer to recognise in profit or loss only the portion of the gain or loss attributable to the equity interests of the other venturers. The guidance in SIC-13 has been substantially carried forward to IAS 28 (2011) and applies also to interests in associates.

8 IAS 28 (2011) also introduces the following two more significant amendments to accounting and disclosure requirements:

(a) Changes in interests held when an associate becomes a joint venture or vice versa:

A change was introduced in the accounting with respect to scenarios where an investment in an associate becomes an investment in a joint venture, or vice versa. Currently such changes trigger a remeasurement. IAS 28 (2011) eliminates the requirement to remeasure the retained interest, because the IASB noted that the composition of the group is unaffected, when an interest in a joint venture becomes an associate or vice versa. In such cases, both investments (i.e. the joint venture and the associate) continue to be measured using the equity method. Considering that there is neither a change in the group boundaries nor a change in the measurement requirements, the IASB concluded that losing joint control and retaining significant influence is not an event that triggers remeasurement.

(b) Disclosures in IFRS 12 Disclosure of Interests in Other Entities (IFRS 12) – apply to all interests within the scope of IAS 28:

The scope exception in existing IAS 28 for investments held in venture capital organisations and similar entities has been removed and characterised as a measurement exception. As a result, entities are required to provide the disclosures in IFRS 12 for all interests in joint ventures and associates, including those that are held by venture capital organisations or similar entities and measured at fair value.

When does IAS 28 (2011) become effective?

9 IAS 28 (2011) becomes effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. Early adopters would need to disclose that fact and apply IFRS 10, IFRS 11, IFRS 12 and IAS 27 (2011) Separate Financial Statements at the same time.

APPENDIX 5B – ANALYSIS OF THE COSTS AND BENEFITS OF IAS 28 (2011)
EFRAG’s initial analysis of the costs and benefits of IAS 28 (2011)

1 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users from implementing IAS 28 (2011), both in year one and in subsequent years. The results of EFRAG’s initial assessment can be summarised as follows:

(a) Costs – EFRAG’s initial assessment was that, for preparers, IAS 28 (2011) would involve a decrease in costs. For users, costs are unlikely to be significantly affected by IAS 28 (2011).
(b) **Benefits** – EFRAG’s initial assessment was that IAS 28 (2011) does not affect benefits for preparers in any significant way, and the users are likely to benefit from IAS 28 (2011), as the information resulting from them will assist users in their analysis.

2 EFRAG published its initial assessment and supporting analysis on 9 February 2012. It invited comments on the material by 11 March 2012. In response, EFRAG received 21 comment letters. Eight respondents agreed with EFRAG’s assessment of the benefits of implementing IAS 28 (2011) and the associated costs involved for users and preparers. Eleven respondents did not comment specifically on EFRAG’s initial assessment of the costs and benefits of implementing the IAS 28 (2011) in the EU, but supported EFRAG’s recommendation that IAS 28 (2011) be adopted for use in Europe. Two respondents did not agree with EFRAG’s assessment of the benefits of implementing IFRS 11 and/or the associated costs or did not comment on this specific assessment.

**EFRAG’s final analysis of the costs and benefits of IAS 28 (2011)**

3 Based on its initial analysis and stakeholders’ views on that analysis, EFRAG’s detailed final analysis of the costs and benefits of IAS 28 (2011) is presented below.

**Approach adopted for EFRAG’s cost and benefit assessments of IAS 28 (2011)**

4 The approach adopted to conduct EFRAG’s assessments on the costs and benefits of IAS 28 (2011) is similar to the approach EFRAG undertook in its technical assessments of IAS 28 (2011). Essentially, EFRAG focused on the changes that are likely to result in additional costs and additional benefits to preparers and users.

5 EFRAG notes that the following small changes resulting from IAS 28 (2011) are primarily clarifications of existing IFRSs or confirm existing practices in the absence of specific guidance in IFRSs:

   (a) Potential voting rights;

   (b) Classification as held for sale;

   (c) Partial use of fair value option extended to a portion of an associate;

   (d) Application of IFRS 5; and

   (e) Incorporation of SIC-13 into IAS 28.

6 In EFRAG’s view, the first four amendments to IAS 28 are straightforward – they clarify or correct existing IFRS in minor ways – and do not raise any significant new concerns about costs and benefits. For this reason, they are not discussed specifically in this Appendix.

7 The amendment regarding the incorporation of SIC-13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers* into IAS 28, it was not the IASB’s intention to reconsider the fundamental approach to the equity method established by IAS 28 and related Interpretations. Therefore, the assessment of significant influence and the approach underlying the equity method of accounting have been carried forward from existing IAS 28. As a consequence, the amendment is not discussed specifically in this Appendix.
The amendment relating to disclosure is assessed as part of EFRAG’s assessments on IFRS 12.

IAS 28 (2011) introduces a change in accounting with respect to scenarios where an investment in an associate becomes an investment in a joint venture, or vice versa, and eliminates the requirement to remeasure the retained interest. This amendment is discussed in the paragraphs below.

**Cost for preparers and users**

EFRAG has carried out an assessment of the cost implications for preparers and users resulting from IAS 28 (2011).

EFRAG’s overall assessment is that IAS 28 (2011) will result in a decrease in costs to preparers, primarily because an entity does not have to remeasure an investment at fair value, when it changes its interest in the investment from a joint venture to an associate and vice versa. Costs to users are unlikely to be significantly affected by IAS 28 (2011).

**Benefits for preparers and users**

EFRAG has carried out an assessment of the benefits for preparers and users resulting from IAS 28 (2011).

EFRAG’s assessment is that benefits for preparers are unlikely to be significantly affected by IAS 28 (2011).

Overall, EFRAG’s assessment is that users are likely to benefit from IAS 28 (2011) as the information resulting from it will generally remove inconsistencies in accounting and therefore increase comparability between entities and will enhance their analysis.

**Conclusion**

EFRAG’s overall assessment is that overall the benefits to be derived from IAS 28 (2011) (excluding the amendment relating to disclosure, which is assessed as part of EFRAG’s initial assessments on IFRS 12) are likely to outweigh any incremental costs associated with them.

30 March 2012

Françoise Flores  
EFRAG Chairman
Mr Jonathan Faull  
Director General  
European Commission  
Directorate General for the Internal Market  
1049 Brussels  

30 March 2012  

Dear Mr Faull  

_Adoption of IFRS 10 Consolidated Financial Statements (IFRS 10), IFRS 11 Joint Arrangements (IFRS 11), IFRS 12 Disclosure of Interests in Other Entities (IFRS 12), IAS 27 Separate Financial Statements (IAS 27 (2011)) and IAS 28 Investments in Associates and Joint Ventures (IAS 28 (2011))._  

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards we are pleased to provide our opinion on IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Interests in Other Entities, IAS 27 Separate Financial Statements (2011) and IAS 28 Investments in Associates and Joint Ventures (2011), referred to as (‘the Standards’). IFRS 11 and IFRS 10 were separately issued as Exposure Drafts in September 2007 and December 2008, respectively, both of which proposed to make amendments to IAS 27 and IAS 28. EFRAG commented on those Exposure Drafts. The IASB issued the Standards on 12 May 2011.  

The objective of IFRS 10 is to provide a single consolidation model that identifies control as the basis for consolidation for all types of entities. IFRS 10 replaces IAS 27 Consolidated and Separate Financial Statements and SIC-12 Consolidation—Special Purpose Entities. IFRS 11 establishes principles for the financial reporting by parties to a joint arrangement, and replaces IAS 31 Interests in Joint Ventures and SIC-13 Jointly Controlled Entities—Non-monetary Contributions by Venturers. IFRS 12 combines, enhances and replaces the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities. As a consequence of these new IFRSs, the IASB also issued the amended IAS 27 (2011) and IAS 28 (2011).  

The Standards are effective for annual periods beginning on or after 1 January 2013, with earlier application permitted. Except for IFRS 12, if an entity applies one of the Standards earlier, it shall disclose that fact and apply the other Standards at the same time. An entity is encouraged to provide information required by IFRS 12 earlier than the annual periods beginning on or after 1 January 2013, and is permitted to provide some of the disclosures required by IFRS 12 without complying with all of its requirements and without applying IFRS 10, IFRS 11, IAS 27 (2011) and IAS 28 (2011) at the same time.  

EFRAG decided that it would assess each of the Standards separately. Therefore, EFRAG published a separate invitation to comment on its draft endorsement advice and effect study report on each of these five standards. To support its assessment, EFRAG carried
out field-tests with European constituents before issuing an invitation to comment on its initial assessments. In finalising its endorsement advice and the content of this letter, EFRAG took the comments received in response to the invitations to comment into account. EFRAG’s evaluation is based on input from standard setters, market participants and other interested parties, and its discussions of technical matters are open to the public.

EFRAG’s assessment is that it supports the adoption of the Standards and has concluded that they meet the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards in that they:

- meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

For the reasons given above, EFRAG believes that it is in the European interest to adopt the Standards. Notwithstanding the positive recommendation that the Standards meet the endorsement criteria, EFRAG does not support the effective date of 1 January 2013 for the following reasons:

(a) Constituents raised concerns about the effective dates of the Standards shortly after the Standards were published. From the final wording of the Standards, it had become clear to them that developing a common understanding of how the principles should be applied, would require more effort and time than they had originally expected. These constituents observed that the Standards were only published in May 2011, rather than in the beginning of 2011 as had been originally expected. The concerns expressed relate specifically to the implementation of IFRS 10, IFRS 11 and in some cases the related disclosures in IFRS 12.

(b) A further concern of EFRAG is that the IASB is currently consulting on two exposure drafts that will amend the requirements of IFRS 10 and are expected to be incorporated into the Standard prior to its effective date. In particular, the Exposure Draft Investment Entities, issued by the IASB in August 2011, has the potential to change consolidation decisions and might lead to unnecessary cost and uncertainty for constituents. The Exposure Draft proposes an exception from consolidation for companies that fulfil the definition of an investment entity in accordance with specific criteria. It also requires a parent of an investment entity that is not itself an investment entity to consolidate all of its controlled entities including those it holds through subsidiaries that are investment entities. However, the corresponding FASB exposure draft proposes that such parent entities retain the fair value accounting applied by their subsidiaries that are investment entities. In its exposure draft, the IASB has asked its constituents whether or not they agree with the proposed requirements. Some constituents (mainly banks and insurance companies) have raised the concern with EFRAG that they might be required to start consolidation of certain investments under the current requirements of IFRS 10, but might need to adopt investment entity accounting (i.e. fair value through profit and loss
accounting) once the Exposure Draft on investment entity accounting is issued as an amendment to IFRS 10.

(c) With regard to IFRS 11, some constituents have raised concerns with EFRAG that they will need to collect additional information about assets, liabilities, revenue and expenses of the joint arrangements classified as joint operations. They believe that gathering this information will be challenging, particularly if those joint operations were previously classified as jointly controlled entities under IAS 31 and were accounted for under the equity method, when the existing contractual arrangements currently do not foresee the provision of such detailed information to the joint operator.

(d) EFRAG has conducted field-tests of the requirements of IFRS 10, IFRS 11 and IFRS 12 in recent months. These field-tests confirm the concerns listed under (a), (b) and (c) above. In these field-tests some participants noted that they have concerns that the mandatory effective date of 1 January 2013 would not allow them sufficient time to implement the new requirements set out in IFRS 10 and IFRS 11, which includes developing a common understanding of the Standards and making the required assessments, which in some cases require significant judgement. The issues regarding IFRS 10 are concentrated in the banking industry and insurance industry, where some companies are required to present more than one comparative period in their financial statements.

In December 2011, EFRAG requested the IASB to defer the mandatory effective dates of the Standards, which was considered by the IASB in a public meeting held in January 2012. Although the IASB acknowledged the concerns raised by EFRAG and by some European constituents, it decided to retain the mandatory effective date of 1 January 2013 of the Standards. In reaching this conclusion, the IASB gave particular weight to the fact that the Standards, particularly IFRS 12, are part of the response to the financial crisis and address matters raised by the G20 and the Financial Stability Board.

Nevertheless, EFRAG recommends the mandatory effective date of the Standards to be 1 January 2014 with early adoption permitted. Finally, given the interaction between the Standards, EFRAG believes that the mandatory effective date should be the same for all the Standards.

On behalf of EFRAG, I should be happy to discuss our advice with you, other officials of the EU Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely,

Françoise Flores
EFRAG Chairman
APPENDICES – BASIS FOR CONCLUSIONS

The following appendices set out the basis for the conclusions reached, and for the recommendation made, by EFRAG on IFRS 10, IFRS 11, IFRS 12, IAS 27 and IAS 28. Appendix 1B notes two dissenting opinions on the endorsement of IFRS 10 and Appendix 2B notes four dissenting opinions on the endorsement of IFRS 11.

APPENDIX 1A – BASIS FOR CONCLUSIONS: IFRS 10

EFRAG’S TECHNICAL ASSESSMENT OF IFRS 10 AGAINST THE ENDORSEMENT CRITERIA

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on IFRS 10 Consolidated Financial Statements (IFRS 10).

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG’s capacity of contributing to the IASB’s due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS in the European Union and European Economic Area.

In the latter capacity, EFRAG’s role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the technical criteria for the European endorsement, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG’s thinking may evolve.

Does the accounting that results from the application of IFRS 10 meet the technical criteria for EU endorsement?

1 EFRAG has considered whether IFRS 10 meets the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002, in other words that IFRS 10:

(g) is not contrary to the principle of ‘true and fair view’ set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

(h) meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG also considered, based only on evidence brought to its attention by constituents, whether it would be not conducive to the European public good to adopt IFRS 10.

Approach adopted for the technical evaluation of IFRS 10

2 EFRAG observed that some requirements in the existing consolidation model are carried forward from existing IFRSs without a significant change and therefore do not
need to be assessed in relation to the endorsement criteria. In performing its overall assessment, EFRAG focused on the impact of the new requirements introduced by IFRS 10 that involves a significant change to the current consolidation requirements.

3 IFRS 10 introduces new elements that affect the following areas when assessing control:

(a) Ability to direct the investee’s relevant activities.
(b) De facto control.
(c) Potential voting rights.
(d) Agent/principal relationships.
(e) Consolidation of structured entities.

4 EFRAG overall assessments of IFRS 10 are discussed below.

5 In order to get evidence to support its overall assessment of IFRS 10, EFRAG considered the effect analysis published by the IASB, held meetings with the various groups of constituents and conducted field-testing activities. The results of the various consultations have been reflected in this overall assessment of IFRS 10.

Relevance

6 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.

7 EFRAG considered whether IFRS 10 would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

8 In EFRAG’s view, the relevance of information is affected by each of the five areas mentioned in paragraph 3, each of which is assessed separately below.

Ability to direct the investee’s relevant activities

9 IFRS 10 introduces the concept of ‘relevant activities’ and requires an entity to identify the relevant activities of an investee when assessing control of the investee. Relevant activities are defined by the standard as those activities of an investee that significantly affect its returns and can exist, even if those activities occur only when particular circumstances arise.

10 IFRS 10 takes a broad view about what activities of the investee should be considered, and indicates that ‘operating and financing’ activities can sometimes be considered to be relevant activities that significantly affect returns, but that is not the only factor.

11 EFRAG agrees that in order for an entity to be able to apply a uniform control model to a wider range of investees, it is necessary and appropriate to broaden the focus on the
activities of the investee that significantly affect its returns and which an investor can direct (or has the ability to do so).

12 EFRAG notes that the reference to ‘relevant activities’ that significantly affect the returns of the investee, aims to provide guidance on which activities of an investee should be considered when assessing control. The term ‘relevant activities’ requires a more comprehensive analysis of an entity’s relationship with an investee and understanding of the way it engages with other investors in the activities of the investee, and assists entities to identify which investees they control.

13 In EFRAG’s view, identifying the relevant activities of an investee will be straightforward in some cases; however in other cases it will not, particularly when an entity is involved with structured entities or in cases in which several investors separately have the ability to direct different relevant activities. EFRAG considered the following situations in which determining ‘relevant activities’ might be challenging:

(a) The involvement of ‘multiple’ investors which split the responsibility for specific operations or activities of the investee among themselves. In such cases, determining which relevant activities significantly affect the returns of the investee might be challenging.

(b) When an entity is set up with predetermined activities (e.g. an ‘autopilot’ entity), the design of the entity is an important factor to evaluate power. In the banking and insurance industry it is common practice for an entity to be set up with predetermined activities, for example to securitise receivables, with all activities and responsibilities laid out in the set up agreement. Using an example of a simple securitisation vehicle, the only activity that can affect returns is the management of the receivables on default.

(c) If the terms and conditions of the contractual agreements between investors determine the possible range of business activities of an investee at inception, it might be difficult to identify what should be considered as relevant activities and how to evaluate whether the features of the involvement provide the investor with rights that are sufficient to give it power.

14 In the above cases, it is not always obvious which activities could significantly affect the returns of the investee and will require judgement which might, if applied incorrectly, have a negative impact on the relevance of information provided. Some constituents believe that the level of judgement might be high in some cases, and that the requirement to focus on relevant activities when assessing control represents one of key challenges introduced by IFRS 10.

15 Particularly, in the case of investees that involve entity structures set up for tax, regulatory and similar purposes, or involve investees that are created with a predetermined purpose, relevant activities might occur only when particular circumstances arise or an event has taken place. These constituents argue that although the term ‘relevant activities’ is broader than ‘financial and operating policies’. In their view, IFRS 10 does not provide a clear dividing line between those two concepts. Due to the broader focus, and a lack of a clear definition of the terms used, judgement is required to apply the concept of relevant activities appropriately in light of the specific business operations of an investee, which may affect relevance of the information produced.

16 EFRAG agrees that in the cases described above, identifying which activities should be considered relevant activities that affect the returns significantly in the assessment of
control can be challenging. The challenges will particularly arise when entities are still trying to understand which activities should be considered as part of their assessment in the first year of application.

17 EFRAG also notes that, in cases where the evaluation is subjective, the disclosure required by IFRS 12 about assumptions and judgement used to determine ‘relevant activities’ should be helpful to explain decisions reached in those more challenging scenarios and thereby will either enhance relevance of information or limit the loss of relevance that might result from applying inappropriate judgement.

**De facto control**

18 IFRS 10 introduces a uniform control principle, and reduces the reliance on ‘bright lines’ that, strictly applied, would, require control to be based on an absolute majority of the voting rights. Rather the standard focuses on an ‘ability to control’ model and provides application guidance on factors to be considered to determine de facto control.

19 EFRAG notes that the issue of de facto control is not a new one and has been implicitly embedded in existing IFRSs. The IASB has in previous debates recognised the existence of de facto control in the existing consolidation model. Companies that already consolidated subsidiaries under existing IAS 27 based on de facto control will not be affected by IFRS 10. However, those companies that did not do so, will be required to do so under IFRS 10.

20 Explicitly extending the ‘ability to control’ approach to situations where an entity controls an investee with less than the majority of voting rights, requires a degree of judgement because it requires an entity to consider all relevant facts and circumstances that can lead to control. In some cases, particularly situations involving more ‘conventional’ investees without complex transactions and simple shareholder structures, the assessment is likely to be a straightforward one.

21 In other cases, EFRAG acknowledges that it might be challenging to make the assessment, in particular:

(a) Determining whether other shareholders are widely dispersed and understanding whether they would be able to form a blocking interest.

(b) Determining whether there is a possibility of agreements between other shareholders.

(c) Access to information and gathering evidence on whether rights held by other investors (through agreements between them) are substantive and obtaining information on ownership structures of other investors.

(d) Assessing what are substantive rights – for example would financial covenants contain substantive rights and therefore lead to de facto control.

(e) Assessing whether rights held by others are only protective in nature and whether or not they impact the control assessment.

22 EFRAG notes that similar situations as those described above may arise when an investor assesses control in agent/principal relationships, which is discussed later in this appendix.
EFRAG believes that in some cases, where other shareholders are dispersed, it would seem reasonable to conclude that they would not be able to form a blocking interest, without having to conduct a very detailed analysis to assess whether the entity has de facto control.

Other constituents disagree that the application guidance will be helpful in all cases, particularly when it is difficult to obtain the necessary information about ownership by other investors and existing agreements between them. This information is necessary to assess the impact these will have on another entity’s control rights. EFRAG has learned that some banks and insurers will have difficulties in monitoring and collecting such information, because these entities are not always the ‘record keeper’ of certain investment products and do not have the legal rights to access the records for monitoring the ownership structure. In situations where agreements between other shareholders are concluded without the involvement of the entity, it could be challenging to obtain the information about those agreements and the rights they convey to others. For non-publicly traded companies, the necessary shareholder information is not publicly available. Furthermore, in some jurisdictions disclosure of such information might not be legally permitted (e.g. limited partnerships).

EFRAG acknowledges that IFRS 10 requires an entity to consider additional facts and circumstances, making the decision about whether control exists difficult and complex in some cases. Even though IFRS 10 provides guidance it might still be difficult to assess the situation described in the paragraphs above, and IFRS 10 does not go ‘far enough’ to address these more complex situations and provide ‘real-life’ illustrative examples of complex cases.

EFRAG notes that if inappropriate judgements are made when conducting the assessment and considering facts and circumstances, the information obtained might be incomplete or misrepresent the rights of other investors, and lose its predictive value. This will have a negative effect on relevance. However, the guidance in IFRS 10 (which includes a range of factors to access control – such as voting rights and potential voting rights held by the investor, along with other facts and circumstances), should provide a helpful starting point to allow an entity to assess and consequently draw a conclusion about whether it controls an investee. Preparers that were applying the de facto control notion under the current IFRS guidelines have not reported fundamental issues in applying the de facto guidance in IFRS 10.

EFRAG further notes that consideration of facts of circumstances is already required in existing IFRSs and that the use of judgement is inherent in a principles-based environment. In EFRAG’s view, an alternative to a principles-based control model would be a ‘bright-line’ control approach that is based on a threshold of at least half the voting rights of an investee. EFRAG notes that the existing control model in IAS 27 is already based on an ‘ability’ model and this model has proved to work appropriately in practice.

Potential voting rights

The existence of potential voting rights must be considered in assessing control under IFRS 10, which requires an entity to consider all the rights that it and other investors hold, including the purpose and design of the rights, when assessing control. IFRS 10 shifts the focus from the ‘exercise date’ in existing IAS 28 to the economic characteristics of potential voting rights, which inherently requires the use of judgement.
In general, EFRAG acknowledges that operational difficulties may arise to assess whether the rights are substantive or not, which may affect the relevance of information. In some cases, this assessment might be complex, particularly when differentiating between substantive and protective rights of the investors. EFRAG notes that the assessment should be supported by an analysis of the purpose and design of the instrument giving rise to potential voting rights. The assessment also considers regarding investor’s relationship with the investee. This includes an assessment of the terms and conditions of such rights as well as the apparent expectations, motives and reasons for agreeing them, which should assist in appropriate assessment of the rights conveyed by the underlying instruments.

Some constituents argue that IFRS 10 and IAS 28 are interrelated and cannot be considered on a stand-alone basis. Given this interrelationship, there is a need for a consistent use of definitions in prescribing the principles underlying the consolidation or non-consolidation of entities in which a reporting entity has an interest.

Some constituents also argue that by only changing the definition of potential voting rights in IFRS 10 and not in IAS 28, the IASB has created an inconsistency between these standards. Absent a consistent definition of terms, they believe there is a risk that the resulting financial statements may not meet the relevance criterion, because relevant information might be omitted or irrelevant information might distort otherwise relevant information.

While EFRAG generally supports consistency of definitions, it notes that IFRS 10 and IAS 28 apply to different types of investments and these differences in definitions do not cause inconsistencies in the accounting for the same class of holdings. Furthermore, EFRAG notes that the IASB did not reconsider the equity method of accounting, including the impact of potential voting rights when assessing significant influence, when it developed IFRS 10.

Overall, EFRAG believes that the requirement to focus on economic characteristics will enhance relevance of information.

Agent/principal relationships

Existing IFRS literature does not contain requirements or guidance to assess whether a decision maker is an agent or a principal. IFRS 10 provides criteria and guidance for an entity to evaluate whether a decision maker is using its power as a principal or as an agent. These criteria would affect the assessment of whether an entity is a principal and, if so, whether the entity should consolidate the investee being evaluated.

EFRAG believes that some of the aspects about the requirements to assess control of an investee in an agent/principal relationship are covered in the discussion above about de facto control. However, EFRAG considered other arguments which are relevant specifically to situations involving agent/relationships, which are discussed below.

As a general principle, when assessing control under IFRS 10, only substantive rights held by the entity and other shareholders are considered. Similar to the control assessment regarding de facto control, if an entity holds less than the majority of the voting rights, it is required to consider both substantive rights that it holds and substantive rights held by others. IFRS 10 requires an entity to consider a range of factors (that include substantive rights, and other facts and circumstances) when assessing whether a decision maker is acting as an agent or a principal, including whether any single party holds substantive rights to remove the decision maker without
cause. The existence of a single party with substantive rights to remove the decision maker alone would be sufficient to conclude that the decision maker is an agent. In the absence of unilateral removal rights involving various parties, an entity must consider a range of other factors including:

(a) the scope of authority entrusted to the decision maker;
(b) the rights held by other parties;
(c) remuneration; and
(d) its rights and its exposure to variability of returns from the investee.

37 EFRAG understands that the need to apply judgement in assessing control in a situation involving agent/principal relationships poses a significant challenge in practice.

(a) EFRAG has learned that determining which rights are substantive, and specifically understanding the combined effect of variability of returns from an investment fund and ownership interest in the fund, can be very subjective and difficult to determine. In many cases, the assessment of whether ‘removal rights’ are substantive or not involves significant judgement because if there are removal rights, they are normally not held by one party alone or a relatively small group of investors.

(b) Furthermore, EFRAG has learned that some constituents believe that assessing ‘exposure to variability of returns’ is highly judgemental and believe that it is often difficult to determine whether an entity acts as an agent or as a principal. They believe that IFRS 10 does not contain clear guidance on which factors a fund manager has to consider in the determination of the ‘exposure to variability of returns’. These constituents also argue that IFRS 10 lacks clear guidance on how to proceed in more complex cases when rights to remove the fund manager held by more than one party should influence the control decision, in particular when information on the dispersion of rights held by other parties is missing.

38 EFRAG notes that a counterargument to the concerns expressed above in paragraph 37, is that the requirement to consider a broad range of factors and circumstances that focus on control and economic interest, rather than on majority of rewards and benefits, offers a principles-based approach to consolidation. As noted in the discussion about ‘relevance’ of de facto control approach, the consideration of facts of circumstances is already required in existing IFRSs and that it is inherent in a principles-based environment the use of judgement.

39 EFRAG acknowledges that similar to the concern described in assessing de facto control, gathering information from a widely dispersed group of investors is not always an easy task as the entity does not always have access to the ownership records of other investors and does not have access to agreements between them. EFRAG agrees that lack of important information might lead to incorrect consolidation decisions and thus diminish the relevance of information produced. Overall, EFRAG believes that, despite the need to apply judgement, over time entities will be able to gather the required information which might not be currently readily available.

40 Consolidation of investment funds (including mutual and other types of investment funds) will require some preparers to include some funds on a line by line basis in the income statement and statement of financial position instead of accounting for the fund
in some other way – at either fair value or the equity method. It could be argued that line by line consolidation, fair value accounting and equity accounting offer different perspectives of how investees affect an investor’s financial performance and position, and that all three perspectives provide useful information for some investment funds. As a general principle, EFRAG believes that it is conceptually the correct principle to apply the control principle to all investees that an investor controls and will therefore lead to appropriate financial reporting.

EFRAG notes that some constituents argue that applying the guidance in IFRS 10 on agent/principal relationships to investment funds (or to some funds) does not lead to meaningful financial information. These constituents argue that the characteristics of some funds are such that it is doubtful that the control model in IFRS 10 is always appropriate and produces relevant information. EFRAG understands that the following concerns have been raised:

(a) The application of the new control model results in the consolidation of financial assets that ‘belong’ to third parties (the policyholders) and that do not result in risks and rewards for the entity (generally an asset or a fund manager). In many cases, an entity might control an investment fund under IFRS 10, yet hold substantially less than the majority of the interest in the fund (e.g. 30 per cent), in which case it will need to present a 70 per cent non-controlling interest, either in equity or as a liability (in the case of an open-ended fund with puttable units). This is consequence of replacing the “risks and rewards” model in existing IFRSs with a uniform control approach for all investees. These constituents argue that the issue becomes more challenging in funds with puttable units where the investor has no control over its percentage holding in the fund, which might question whether the decision maker has power over risks and rewards associated with the fund. Therefore, some constituents are of the view that such funds should not be consolidated.

(b) Some constituents have raised concerns about consolidation of mutual funds in which fund managers operate under strict regulatory provision. The strict regulatory requirements limit the decision-making authority of fund managers regardless of their holding in the fund. In such cases, these constituents question the power of the fund manager over the fund. Therefore, they argue that such funds should not be consolidated as the fund manager does not ‘actually’ have control over the fund. Furthermore, they argue that the IASB has not appropriately defined agency relationships in IFRS 10. In particular, the need to consider the level of interest that a fund manager holds in an investment fund should not be a deciding factor in assessing whether such fund should be consolidated. This is especially the case when a fund manager is subject to strict regulation and must operate according to narrowly defined operating and financing policies, to ensure that the entity is operated in the best interests of all investors.

(c) When an entity acquires its own shares in a fund that it needs to consolidate under IFRS 10, current IFRSs require own shares to be eliminated against equity on consolidation, and some constituents (particularly banks and insurers) have expressed concern with the impact this might have on the reporting entity’s equity. A related concern was expressed regarding the consolidation of mutual funds that hold bonds issued by the group.

(d) A further concern is that existing hedge accounting relationships might be broken, because the item that was hedged may no longer exist as a result of changes in the scope of consolidation (e.g. issued bonds might now be eliminated upon
consolidation and no longer qualify as hedged items). This could distort information on funding and liquidity reported by the reporting entity.

42 The concerns in paragraph 41 are mainly expressed by banks and insurers with involvement in particular funds. In their view, those funds should not be assessed for control under IFRS 10.

43 Despite the challenges of implementing IFRS 10 for agency relationships, EFRAG supports in principle a single model to assess control with reduced reliance on ‘bright lines’ and believes that IFRS 10 offers a robust solution to address at least some of the concerns users expressed about lack of transparency and omission of relevant information.

44 The application of a uniform consolidation principle based on ability to control (which incorporates risks and rewards but requires power over those risks and rewards to have control) and applies to all investees could help prevent non-consolidation when control exists, because there are situations in which an entity can control an investee even though it does not have the majority of the voting rights and does not have other contractual rights relating to the activities of the investee. In principle, this should lead to appropriate financial reporting. EFRAG notes that jurisdictions have different legal and regulatory environments relating to the protection of shareholders and investors, which often determine or influence the rights held by shareholders and therefore affect whether or not an entity controls an investee. Therefore, drawing a line at 50 per cent in terms of voting power and the key to determining control, might lead to inappropriate consolidation decisions and diminish the relevance of the information.

45 Overall, EFRAG believes that a control model based on a uniform set of principles together with comprehensive application guidance and examples to illustrate the principles will result in relevant financial reporting.

Consolidation of structured entities

46 As noted earlier, IFRS 10 applies to all investees, including structured entities as defined in IFRSs. IFRS 10 builds on the requirements and concepts in IAS 27 with regard to the concept of control and sets out a consolidation model that applies to all investees including entities that are accounted for under SIC-12. In doing so, IFRS 10 provides additional context, explanations and application guidance on how to assess control, without changing the fundamental concept of control on which IAS 27 is based.

47 Under IFRS 10, assessment of control may not be the same compared to IAS 27 and SIC-12; in some cases ‘more’ entities might be consolidated and in other cases ‘fewer’ entities might be consolidated. This is primarily because, when assessing the existence of control, there is a reduced focus on a ‘majority of risks and rewards’, as required in SIC-12; rather IFRS 10 sets out a single control model that applies to all investees based on an ‘ability to control’.

48 EFRAG acknowledges that challenges may arise to determine which investees are structured entities, and it can be difficult to determine whether an investor has power over investees that do not require substantive continuous decision-making.

49 In some cases, it could be argued that the application of a single control model (based on the ability of an entity to use its power over an investee to affect the amount of the investor’s returns), may result in some true ‘autopilots’ remaining unconsolidated, because there are no decisions to be taken by its investors.
Similar to the arguments discussed above on de facto control and agent/principal relationships, EFRAG believes that a uniform principles-based approach to consolidation will over time help entities assess which investees they control, and reduce inappropriate deconsolidation decisions or off-balance sheet treatment. In particular, these situations would include when an entity has the power to direct an investee’s relevant activities, even though it is not exposed to the majority of risks and rewards of the investee. In other cases, the uniform approach would reduce inappropriate consolidation decisions when an entity is exposed to the majority of risks and rewards but has no control over an investee.

EFRAG notes that IFRS 12 requires comprehensive disclosure about unconsolidated structured entities. EFRAG understands that users welcome information on structured entities that are not consolidated, to ensure that they have sufficient information to understand an entity’s involvement with those unconsolidated entities, including exposure to risk and understanding the nature of risk and the impacts on the reporting entity’s performance.

Overall, EFRAG believes that the requirement in IFRS 10 to consider the ability to control on the basis of a range of facts and circumstances regarding an investee, would include assessing the risks and rewards of the investee. In EFRAG’s view, this would provide relevant information.

Conclusion

EFRAG acknowledges that in some cases identifying relevant activities of an investee and performing the control assessment where an entity holds less than the majority of voting rights, can be challenging and involve considerable judgement. EFRAG notes that IFRS 12 requires disclosures about the significant judgements and assessments made by entities, which should help users understand the underlying decisions taken by management and therefore enhance relevance.

The guidance in IFRS 10, serves as an appropriate starting point that helps entities in determining which investees they control. For more challenging cases, the guidance provides direction for entities to make an assessment based on facts and circumstances.

On balance, EFRAG’s overall assessment is that the requirements in IFRS 10 on relevant activities, de facto control, potential voting rights, agent/principal relationships and consolidation of structured entities would result in the provision of relevant information, and therefore satisfy the relevance criterion.

Reliability

EFRAG also considered the reliability of the information that will be provided by applying the new elements. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.

In EFRAG’s view, the reliability of information is affected by each of the five areas mentioned in paragraph 3, which are assessed separately below.
Ability to direct the investee’s relevant activities

For most investees it will be clear that one party or body has decision-making authority to direct the activities of an investee that significantly affect the investee’s returns. In these cases, identifying relevant activities will be a straightforward exercise.

However, EFRAG notes that in some other cases it is possible that more than one party has decision making authority over different activities of an investee and that each activity may significantly affect the investee’s returns. Examples include structured arrangements such as multiple seller conduits, multi seller securitisations, and investors for which the assets are managed by one party and the funding is managed by another. In these cases, identifying the relevant activities requires judgement and might affect the reliability of information.

Overall, EFRAG understands that the introduction of the concept of relevant activities will not have a significant impact on the way control is assessed and as a result does not believe reliability of information will be affected in a significant way.

EFRAG notes that IFRS 12 requires investors, as part of their control assessment, to disclose the assumptions made in determining relevant activities that significantly affect an investee. This would faithfully represent management’s reasoning in making its assessment of control especially in cases where an investor is involved in investees with complex ownership structures.

De facto control

EFRAG notes that the assessment of ‘de facto control’ requires consideration of all facts and circumstances, for example, determining the exact point and about when other investors are sufficiently dispersed. In some cases, it will be challenging for some investors to determine the date when they obtain de facto control. Nevertheless, EFRAG believes that in order to faithfully represent the activities of a group of companies, the consolidated information would need to be based on the substance of the arrangements and the careful exercise of judgement is inherent in such a principles-based approach.

In addition, IFRS 12 requires disclosure in respect to the judgement exercised and assumptions used to determine control, when an entity owns less than half of the voting rights. In EFRAG’s view, these disclosures provide information that reduces the degree of uncertainty introduced by the use of judgement in the assessment of de facto control.

Potential voting rights

EFRAG acknowledges that, in some cases, determining whether potential voting rights are substantive or not may be challenging. In particular, the assessment of control requires an analysis of various factors including the purpose and design of the instruments that provide potential voting rights and any other involvement that an entity has with the investee. This includes an assessment of the terms and conditions of such rights as well as an entity’s motives and reasons for agreeing to them.

EFRAG notes that some difficulty in performing this analysis might arise in cases of ‘deadlock’ clauses between the investors inherent in some of these instruments. In such cases, there may be a negative impact on reliability of information if the primary (dominant) investor has limited access to information to appropriately perform its evaluation of control. This might occur because, even though an entity might have the
‘ability’ to control an investee, it might not have legal rights to control under local laws, and might need to undertake additional procedures to gather information to meet its reporting obligations.

67 On balance, EFRAG does not expect such cases to have a significant impact on reliability of information, because if an entity simply cannot obtain information about the rights of other shareholders and the agreements entered into by other parties, it might be that the entity does not in fact have the ‘ability’ to control the underlying investee.

Agent/principal relationships

68 IFRS 10 provides criteria and guidance for an entity to evaluate whether a decision maker is using its power as a principal or an agent. As noted earlier in the discussion about ‘relevance’, entities need to consider a range of factors, when making this evaluation. In some cases, obtaining the information needed for the assessment of control might be challenging and involve significant judgement to analyse the information, and raise concerns about reliability.

69 In particular, EFRAG believes that the following situations are likely be the most challenging when assessing control in an agent/principal scenario:

(a) Determining whether (and which) rights are substantive (particularly in the absence of unilateral removal rights).

(b) Obtaining information on ownership structures and monitoring how the interests of other investors will change over time. In particular, it would include situations when a preparer is involved in complex ownership structures or (and) many structured entities.

(c) Determining at what point the exposure and variability of an investor’s returns change from insignificant to significant.

(d) Determining whether the investor’s remuneration is commensurate with that of other service providers.

70 EFRAG notes that making judgements is inherent in a principles-based environment and that the level of judgment required by IFRS 10 should not so exceptional in nature that it would be impracticable to apply IFRS 10. In fact, in this particular case the guidance in IFRS 10 explains what type of evidence to look for when assessing the existence of control, and sets of a range of factors an entity should consider, without specifying whether a single factor in isolation will lead to conclusive evidence of control. The weighting of factors will depend of the relevant facts and circumstances that are appropriate to the entity conducting the assessment.

71 Furthermore, the disclosures required by IFRS 12 will assist users in understanding the assumptions made by management and the degree of judgement exercised to apply the requirements and reach a conclusion on control in situations involving agency/principal relationships.

Consolidation of structured entities

72 IFRS 10 includes application guidance followed by examples to assist preparers to apply the requirements in IFRS 10 for consolidation of structured entities. The examples illustrate that some investees may not be consolidated under IFRS 10, whereas they were consolidated under current IAS 27. This may be the case when an
investor receives the majority of risks and rewards but does not have the ability (power) to affect the returns of the investee.

EFRAG notes that the revised control definition may be difficult to apply in some cases and might require a significant amount of judgement in order to assess whether an investor has control over a structured entity. For example, assessing control over structured entities when there is a change in the business purpose (from ongoing activity to termination).

However, as previously mentioned, like other IFRSs, IFRS 10 involves judgement and requires careful analysis of facts and circumstances. This is likely to ensure a more rigorous analysis of an entity’s involvement with another entity and consideration of facts and circumstances associated with the purpose and design of a structured entity.

Conclusion

For the above reasons explained above, EFRAG’s overall assessment is that the requirements in IFRS 10 on relevant activities, de facto control, potential voting rights, agent/principal relationships and consolidation of structured entities satisfy the reliability criterion.

Comparability

The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

EFRAG has considered whether the changes introduced by IFRS 10 result in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

EFRAG has noted that comparability of information about the areas mentioned in paragraph 3 is determined more by the provision of a general objective and overall application of the control model in IFRS 10. For this reason, EFRAG decided to assess comparability of IFRS 10 in its entirety.

Uniform control model for all investees including situations of de facto control, agent/principal relationships and structured entities

When determining control of an investee under IFRS 10, entities will apply a uniform ‘ability’ to control model to all investees. IFRS 10 considers the rights held by an entity, as well as the rights held by other investors, when assessing control, which, in principle, will be applied in a similar way when other investors hold potential voting rights, kick-out rights or similar rights, and therefore enhance comparability of information.

Application of judgement and assumptions
In EFRAG’s view, the main concern regarding comparability arises from the degree of judgement required by IFRS 10 in some areas, particularly when the evaluation requires various factors to be considered and those factors might contain uncertainty or the information to support them might be difficult to obtain.

In general, EFRAG acknowledges that in some cases the guidance and examples provided in IFRS 10 might be interpreted in different ways which may lead to inconsistency and diverse application within group entities. In particular, to assess de facto control and assess control in agent/principal relationships (which involves determining substantive rights, rights of other parties and other challenging assessments), IFRS 10 might not provide detailed answers in the form of specific guidance and examples.

EFRAG notes that in a principles-based control model, the use of judgement is an inherent factor, and the disadvantage of applying principles instead of rules, is that there might be divergence in practice. As noted earlier in the discussion about ‘relevance’ and ‘reliability’, EFRAG believes that the level of judgment required by IFRS 10 is not so exceptional in nature that it would be impracticable to apply the standard in a consistent manner.

Furthermore, EFRAG understands that the issue of consistent application is most prominent upon initial application, as entities will become more familiar with the guidance and the assessments that they are required to make.

IFRS 10 requires entities to consider a broad range of facts and circumstances in determining control. It provides application guidance and examples on how to apply the new requirements that articulate the principles in a simple way without making the fact patterns overly complex. This is helpful to ensure that entities apply the control model and the requirements in a similar way and, therefore, lead to comparable information between investees.

In some cases, IFRS 10 does not provide a definition of the terms used (e.g. sponsored entity). EFRAG believes that relevant terms in an IFRS should be defined to avoid divergent interpretations in practice. However, on balance EFRAG notes that it is not possible to define every term that is necessary in applying IFRS 10. Therefore, the existence of undefined terms should not raise significant concerns about comparability, because management would have enough knowledge to interpret the terminology in a consistent manner or use other IFRS literature for interpretation where necessary.

Taken together, the requirements in IFRS 10 and the enhanced disclosures in the new IFRS 12 is likely to result in consistent application of the requirements in IFRS 10 and improve comparability of information amongst entities over time.
Conclusion

87 For the above reasons, EFRAG’s overall assessment is that the requirements in IFRS 10 on relevant activities, de facto control, potential voting rights, agency/principal relationships and structured entities satisfy the comparability criterion.

Understandability

88 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.

89 Although there are a number of aspects to the notion of ‘understandability’, EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.

90 As a result, EFRAG believes that the main additional issue it needs to consider, in assessing whether the information resulting from the application of IFRS 10 and in particular whether the information about the areas mentioned in paragraph 3 is understandable, is whether that information will be unduly complex.

91 EFRAG acknowledges the argument that the increase in application guidance and clarifications provided by IFRS 10 will be useful to allow entities to assess better the cases in which ‘de facto’ control exists, and IFRS 12 will also assist with relevance of information by requiring an entity to disclose the assumptions and judgement used in determining ‘de facto control’. Therefore, the guidance and disclosure would make the financial information understandable by users.

92 IFRS 10 does not alter the fundamental nature of the consolidated financial information. Therefore EFRAG does not expect any new issues about understandability to arise.

Conclusion

93 For the above reasons explained above, EFRAG’s overall assessment is that the requirements in IFRS 10 on relevant activities, de facto control, potential voting rights, agency/principal relationships and structured entities satisfy the understandability criterion.

True and Fair

94 EFRAG has concluded that the information resulting from the application of IFRS 10 would not be contrary to the true and fair view principle.
EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt IFRS 10.

Conclusion

For the reasons set out above, EFRAG's overall assessment is that IFRS 10 meets the technical criteria for EU endorsement and EFRAG should therefore recommend its endorsement.

With regards to the mandatory effective date of IFRS 10, please refer to Appendix 6.

APPENDIX 1B – DISSENTING OPINIONS: IFRS 10

Nicklas Grip and Gabi Ebbers (EFRAG TEG members) dissent from the endorsement of IFRS 10, for the reasons explained below.

Dissenting opinion of Nicklas Grip

The IASB changed the definition of potential voting rights in IFRS 10 such that it is no longer aligned with the definition of potential voting rights in IAS 28.

The definition of agency relationships as interpreted in the application guidance to IFRS 10.

Nicklas Grip considers that IFRS 10 and IAS 28 are part of a package of interrelated standards and cannot be considered on a stand-alone basis. Given this interrelationship, he believes that there is a need for a consistent use of definitions in prescribing the principles underlying the consolidation or non-consolidation of entities in which a reporting entity has an interest.

The definitions determine the boundaries between cases in which a reporting entity concludes it should (1) not consolidate (i.e. when it has a pure ownership interest without control or significant influence), (2) apply one-line consolidation (i.e. when it applies the equity method on the grounds that it has significant influence) and (3) consolidate (i.e. when it has control).

Nicklas Grip believes that, by only changing the definition of potential voting right in IFRS 10 and not in IAS 28, the IASB has created an inconsistency in the chain of definitions. Absent a consistent definition of terms between IFRS 10 and IAS 28, he believes there is a risk that the consolidated financial statements may not meet the relevance criterion, because relevant information might be omitted or irrelevant information may distort otherwise relevant information. Therefore he believes that IFRS 10 may also fail the reliability criteria since the degree of control that an entity have over different entities may not be faithfully represented in the consolidated financial statements. In particular, he is concerned about the potential risk that the difference in the definition of potential voting rights may in theory create a situation in which IFRS 10
requires consolidation, even when a reporting entity would not be considered to have significant influence as defined in IAS 28.

Nicklas Grip does not recommend the endorsement of IFRS 10, because the above case clearly illustrates that the relevance criterion will possibly not be met. 

The definition of agency relationships as interpreted in the application guidance to IFRS 10

Nicklas Grip considers that the IASB has not appropriately defined agency relationships in IFRS 10. In particular, the definition is too broad and results in the consolidation of not just those SPEs that are worthwhile, but also in the consolidation of holdings in traditional mutual funds and similar transactions in which there exist neither economic or legal rights nor market risks. According to Nicklas Grip, the definitions combined with the application guidance will in those circumstances result in financial reporting that does not faithfully represent the economic substance of the holdings in the investees in the statement of financial position and in the income statement.

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Nicklas Grip understands that this issue is of concern to the financial services industry and more specifically life insurance companies and a significant proportion of universal banks and investment banks. He believes that this issue on its own would warrant a reconsideration of the requirements of IFRS 10 before its effective date.

This issue appears most starkly in the case of a reporting entity that manages a mutual fund that is strictly governed by law or regulation to ensure that the fund is operated in the best interests of all investors; the law requires the reporting entity to have holdings in the mutual fund that exactly correspond to the amount of the liability of the customers (e.g. policyholders in a life insurance agreement); and the holdings of those mutual funds are protected if the reporting entity were to be liquidated. Although the reporting entity, in its capacity as fund manager, has some discretion both in choosing the type of fund, and in making investment decisions, it does so within narrow parameters that have been determined and are governed by regulation.

Nicklas Grip considers that the fund manager is subject to strict regulation that restricts its decision-making authority to narrowly defined operating and financing policies, and make decisions on behalf of the investors/customers. Irrespective of its direct investment, the fund manager cannot use its decision-making powers 'so as to benefit itself' due to regulatory oversight. Hence, the fact that the fund manager holds direct interests in such a mutual fund on its own account, it does not provide it with the power to manage the fund for its own benefit.

Nicklas Grip, therefore, believes that regardless of the ownership interest (e.g. whether it holds 0%, 40% or 80% or not), such a mutual fund should not be consolidated. Given that IFRS 10 would require consolidation of the funds in such cases, he does not believe the standard meets the relevance criterion. In addition, he considers that the standard would not meet the reliability criterion as there is a lack of faithful representation in the statement of financial position and the income statement.

Finally, Nicklas Grip believes that the conclusion that IFRS 10 should not be recommended for endorsement is also supported by the following:

(a) In the case of open-ended investments funds that are required to redeem shares/units that are offered by its investors, the fund manager would not have any form of control over its ownership percentage. Consequently, those shares/units not owned by the fund manager would be classified as a liability that would change constantly as investors enter and leave the fund. That means the fund manager would be required to capture the percentage of its ownership
interest continuously to be able to prepare its financial statements in accordance with the requirements of IFRS 10.

(b) In the case of a mutual fund that hold shares in the reporting entity (e.g. index funds that include the reporting entity in the index), the reporting entity would be required to eliminate those ‘treasury shares’ on consolidation, even if the reporting entity has no market risk regarding its interests in the mutual fund (e.g. the share/units are used in unit-linked investment products). This results in an imbalance between mutual funds’ assets and liabilities as those treasury shares would need to be eliminated on consolidation.

Dissenting opinion of Gabi Ebbers

13 Gabi Ebbers dissents from the endorsement of IFRS 10 for the following reasons:

14 Gabi Ebbers believes that contrary to the IASB’s objective to clarify and provide guidance on existing consolidation requirements, IFRS 10 is highly complex and unclear to implement in practice and requires significantly more judgement compared to IAS 27 and SIC 12. The principles based approach in IFRS 10 removes “bright lines” and requires the application on a case by case basis considering numerous factors and broad terms. The practical examples provided in IFRS 10 lack a definite understanding of the control concept, which implies the risk of different interpretation in financial reporting practice. Contrary to its aim, IFRS 10 is not suited to improve relevance and comparability in financial reporting. In the asset management industry, instead, it would lead to inappropriate consolidation of a potentially large number of investment funds and thereby inappropriately grossing up balance sheets of companies.

In particular:

Clear rationale for distinguishing between an agent and a principal is missing in IFRS 10

15 The distinction of agent and principal under IFRS 10, whilst useful in considering other types of investments, is not appropriate to deciding whether consolidation is required for investment funds. Such a distinction presumes that the level of holdings of the fund manager in investment funds is decisive for consolidation. Consolidation requires the inclusion of all of the funds’ assets, even if third party investors can always redeem their interests in the investment funds at any time. Thus, the inclusion of funds’ assets not effectively controlled by the fund manager would not represent the economic reality and would reduce the relevance of consolidated financial statements because of a significantly grossed up balance sheet and the consolidation of non-controlling interest. This would lead to non-decision useful information for capital markets.

16 The criterion “exposure to variability of returns” (paragraphs B71 and B72 of the application guidance in IFRS 10) is highly judgemental and not practicable to distinguish between a fund manager and a principal. IFRS 10 does not contain clear guidance which factors a fund manager has to consider in the determination of the “exposure to variability of returns”. Different fee structures, a large variety of transactions and fee splits across different jurisdictions, performance guarantees and fluctuations in the markets complicate the assessment of “exposure to variability of returns” and require a continuous assessment as returns for a fund manager usually vary disproportionally higher than investors’ return.

17 IFRS 10 lacks clear guidance on how to proceed when rights to remove the fund manager held by more than one party should influence the control decision, in particular when information on the dispersion of rights held by other parties is missing.
and when it cannot be assessed whether those rights are "substantive" (paragraph B65 of the application guidance in IFRS 10).

**IFRS 10 implementation is highly complex**

18. Companies need to review all investments directly or indirectly held to assess if the ultimate parent has the ability to exercise control on a case by case basis. In particular for financial institutions holding a large amount of investment funds, the implementation of IFRS 10 is expected to be very complex and costly.

19. In the asset management business there is typically involvement with a large number of products with different agents to monitor information. Data collection will be challenging, as the fund manager is not the record keeper of certain investment products and there are no legal rights to access the records for monitoring the ownership structure. There are no mandatory notifications to the fund manager in place once the ownership structure in an investee changes. Information about ownership held by other investors and possible agreements between other shareholders might be impossible to obtain.

**Parts of IFRS 10 are still under consideration and might reverse a consolidation decision**

20. The IASB’s Exposure Draft Investment Entities, which is currently under consultation, proposes an exemption from consolidation for investment entities in accordance with specific criteria. Any resulting amendments are expected to be included in IFRS 10 prior to its effective date of application. These amendments to IFRS 10 cause considerable uncertainty and raise the concern that companies might be required to start consolidation of certain investment funds under the current version of IFRS 10, but may have to change to fair value through profit or loss accounting once the amendments as a result of the Exposure Draft Investment Entities are incorporated in IFRS 10.

**In summary**

21. Gabi Ebbers supports the IASB’s objective to develop a principle based control model as a basis for consolidation, however believes that the above described conceptual flaws in IFRS 10 must be corrected to ensure that the IASB achieves its original intentions.

**APPENDIX 2A – BASIS FOR CONCLUSIONS: IFRS 11**

**EFRAG’S TECHNICAL ASSESSMENT OF IFRS 11 AGAINST THE ENDORSEMENT CRITERIA**

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on IFRS 11 Joint Arrangements (IFRS 11).

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG’s capacity of contributing to the IASB’s due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS in the European Union and European Economic Area.

In the latter capacity, EFRAG’s role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the technical criteria for the European endorsement, as currently defined. These are explicit criteria which have been designed specifically
for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG’s thinking may evolve.

Does the accounting that results from the application of IFRS 11 meet the technical criteria for EU endorsement?

1 EFRAG has considered whether IFRS 11 meets the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002, in other words that IFRS 11:

(i) is not contrary to the principle of ‘true and fair view’ set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

(j) meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG also considered, based only on evidence brought to its attention by constituents, whether it would be not conducive to the European public good to adopt IFRS 11.

Approach adopted for the technical evaluation of IFRS 11

2 In performing its overall assessment, EFRAG focused on the impact of the new following elements introduced by IFRS 11:

(a) Core principle for classification and accounting for interests in joint arrangements;

(b) Parties without joint control having an interest in a joint operation; and

(c) Accounting for interests in joint operations in separate financial statements.

Each of these elements has been assessed separately in this Appendix.

3 The scope exception in existing IAS 31 for venture capital organisation, mutual funds, unit trusts or similar entities, including investment-linked insurance funds, has been moved to IAS 28 (2011) and characterised as a measurement exception. The main effect of this change is that it triggers a requirement for additional disclosure under IFRS 12. EFRAG’s overall assessment of IFRS 12 is discussed in Appendix 3.

4 The accounting guidance in SIC-13 on non-monetary contributions has been incorporated into IAS 28 (2011) and now also applies to associates. This amendment to IAS 28 is further discussed in Appendix 5. In that document EFRAG assessed that this amendment is straightforward and does not raise any new concerns.

5 The new disclosure requirements of IFRS 12 on interests in joint arrangement are discussed and assessed in Appendix 3.

6 To obtain evidence to support its overall assessment of IFRS 11, EFRAG considered the effect analysis published by the IASB, held meetings with the various groups of constituents and conducted field-testing activities. The results of the various consultations have been reflected in this overall assessment of IFRS 11.
Core principle for classification and accounting for interests in joint arrangements

Relevance

7 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.

8 EFRAG considered whether IFRS 11 would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

9 EFRAG notes that accounting for interest in joint operations not structured through separate vehicle is consistent with existing IFRSs and does not raise any concerns about relevance.

10 EFRAG notes that based on the ‘core principle’, IFRS 11 requires parties to joint arrangements which have rights to the assets and obligations for the liabilities to the joint arrangement, to recognise those assets and liabilities in their financial statements.

11 In practice, the accounting outcome for joint arrangements classified as joint operations, will be similar to proportionate consolidation under existing IFRSs for consolidated financial statements (unless a party’s ownership interest in the joint operation differs from its share of assets, liabilities, revenue and expenses). However, the rationale under IFRS 11 is that an entity has rights to assets and obligations for liabilities, which is not something that is required to exist to qualify for proportionate consolidation under IAS 31. For this reason, some argue that proportionate consolidation does not produce relevant information because in their view there is no basis for combining jointly controlled assets and liabilities with those ‘fully’ consolidated (and controlled) by an entity. Supporters of this view contend that a party to a joint arrangement that does not control its share of the assets and liabilities of the joint arrangement, should not report those items in its statements of financial position because they do not meet the definition of an asset or liability, respectively.

12 The concern described above would be addressed if the focus in classifying a joint arrangement was on the ‘rights to assets and obligations for the liabilities’ a party has relating to its involvement in the arrangement. IFRS 11 does that, and states that rights and obligations conferred on the parties can arise in various ways: from a legal perspective, from contractual agreements between the parties to the arrangements or from other facts and circumstances.

13 EFRAG notes that under IFRS 11, an entity would recognise assets and liabilities relating to its interests in the joint operation, if they meet the IFRSs recognition criteria for assets and liabilities. In particular, when the legal form of a joint arrangement does not grant a separation between the parties and the separate vehicle, the parties have rights to the assets of the joint arrangement and are liable for its obligations. In EFRAG’s view the accounting required under IFRS 11 will reflect this lack of ‘separation’ in an appropriate manner and therefore provides relevant information. Also in cases when the contractual arrangement between the parties reverse the separation between the parties and a joint arrangement and give the parties direct rights to the assets and the parties agree to take over the liabilities of this joint arrangement, recognition of these assets and liabilities in the financial statements of the parties would be appropriate and should bring relevant information to users.

14 Under IFRS 11, an entity would be considered to have rights to assets also if the purpose of the joint arrangement is to provide the parties with all output being produced
by the assets. In such cases, the economic benefits generated by those assets flow entirely (or substantially) to the parties that jointly control the arrangement and therefore the parties are required to recognise those assets in their financial statements. A similar argument could be used for the liabilities of a joint arrangement, if the liabilities it incurs, are in substance, satisfied by the parties either through a contractual agreement or by the cash flows received from the parties through their purchases of the output. In both cases, the indication is that the parties have an obligation for the liabilities of the arrangement, which they should recognise. In EFRAG’s view, in such cases the substance of the joint arrangement overrides its legal form. In such cases parties have in essence set up a joint arrangement with the intention to have access to the assets and not in order to receive a profit from the investment.

15 However, some constituents argue that applying the ‘core principle’ might result in an entity recognising liabilities for which it does not have an obligation. According to these constituents when a joint arrangement has been structured through a separate vehicle, and the legal form grants a separation between the parties and this feature has not been reversed by a contractual agreement, it should not be concluded that the parties have rights to assets and obligations for liabilities based solely on the other facts and circumstances (e.g. whether the parties purchase the output of the arrangement or not). In the fact pattern described in the above paragraph, the parties are not severally liable for the obligations of the joint arrangement from a legal perspective and in case of liquidation of a separate entity their potential loss is limited to their share in the net assets.

16 Furthermore, these constituents argue that the parties do not have direct rights to the assets of the arrangement as they do not control the assets. Accordingly, the differentiating feature between a joint operation and a joint venture should not be whether the parties purchase the output from the joint arrangement. The outcome should be the same irrespective of whether the parties purchase all the output from a joint arrangement or from an independent supplier.

17 EFRAG notes that IFRS 11 requires recognition of the share of assets, liabilities, revenue and expenses based on the contractual rights of the parties and which could in some cases be different from the share of assets, liabilities, revenue and expenses recognised based on the ownership interest in a joint arrangement. In EFRAG’s opinion the information based on those contractual rights and obligations would have more predictive value.

18 EFRAG notes that based on the ‘core principle’ in IFRS 11, if parties to a joint arrangement have neither rights to assets nor obligations for the liabilities, they recognise their interest in the joint venture in accordance with the equity method under IAS 28 (2011), as this reflects the fact that the parties have only rights to the net assets of the joint arrangement. The parties are not liable for the obligations of the joint venture and should therefore not recognise these as liabilities. They also do not have direct rights to the specific assets of the joint arrangement.

19 EFRAG notes that IFRS 11 eliminates proportionate consolidation, which means that the parties to joint arrangements will not be able to recognise a share of assets and liabilities, revenue and expenses of the joint arrangement in their financial statements unless they have rights to the assets and obligations for the liabilities. Under IFRS 11 those rights and obligations can be conferred to the parties by legal form of an arrangement, through contractual agreements or as a result of other fact and circumstances indicating that in substance the parties have rights to the assets and obligations for the liabilities.
20 Some constituents argue that the ‘core principle’ should not focus solely on ‘rights and obligations’, rather on the fact to which extend the activity of the joint arrangement is linked to the business of the parties.

21 EFRAG considered whether there are cases when relevant information will be omitted because the loss of proportionate consolidation would no longer allow entities (parties to a joint arrangement) to report performance and underlying revenue and expenses of the activities in the joint arrangement in a way that provides relevant information to users.

22 EFRAG notes that in many cases activities undertaken through the joint arrangement are closely related to the business and operating activities of the parties and the parties are highly involved in the activities of the arrangement which is consequently considered as an ‘extension’ of the activities of these parties. For example, when parties agree that part of their production activity should be outsourced to a joint arrangement. In such cases, the joint arrangement is often structured such that it would meet the definition of a joint operation, in which case the parties to the arrangement would need to recognise their share of assets, liabilities, revenue and expenses based on the contractual rights. This accounting would provide – unless a party’s ownership interest in the joint operation differs from its share of assets, liabilities, revenue and expenses – in practice similar information as proportionate consolidation would have under IAS 31, as it provides information about the scale of the operations managed by, and the risks borne by, the parties undertaking the joint activity.

23 EFRAG notes that in some cases a joint arrangement may not meet the criteria to be classified as a joint operation, for example, because the arrangement has been structured so that the output it produces is sold to a third party rather than to the parties to the arrangement. In these cases the legal form of a joint arrangement that confers separation between the parties and the separate vehicle might have been chosen because of legal constraints in the jurisdiction in which it operates, or for tax purposes. In those cases joint venturers will be precluded from recognising their share of the joint arrangements’ assets, liabilities, revenue and expenses in their financial statements. This would cause a loss of useful information in the statement of financial position and the income statement of the parties to the joint arrangement.

24 Furthermore, EFRAG understands that applying the equity method to joint ventures will in some cases be inconsistent with management reporting under IFRS 8 Segment Reporting and the way in which management views its business operations and makes strategic and operating decisions.

25 EFRAG notes a potential concern expressed by users about the equity method being applied to interests in joint ventures is the lack of information it provides about the performance of a joint venture and its debt. Therefore, users have stressed the importance and relevance of the additional disclosure about interest in joint ventures and the risks associated with those interests. In EFRAG’s view, a key element to consider are the enhanced disclosure requirements in IFRS 12 for all joint arrangements, particularly those accounted for using the equity method.

26 Under IFRS 12 much of the information about the assets, liabilities and performance of the joint venture will be presented separately for each joint venture considered material to the reporting entity. Furthermore, in relation to individually immaterial joint ventures, limited aggregate information will be provided about an entity’s share in the joint ventures’ profit and loss and other comprehensive income. Moreover, EFRAG notes that the summarised financial information for each joint venture will be disaggregated from the assets, liabilities, revenues and expenses of the parties as presented on the
face of the financial statements. EFRAG understands that disaggregation of information on joint ventures is considered useful for users in their analysis.

27 EFRAG notes that the accounting in IFRS 11 is complemented by the disclosure of interests in joint arrangements under IFRS 12; the potential loss of information on the face of the financial statements will be, at least partially, compensated for by the information provided in the notes to the financial statements.

Conclusion

28 Overall, EFRAG agrees with the ‘core principle’ in IFRS 11, which requires an entity to recognise its interests in a joint arrangement based on its rights and obligations. In EFRAG’s view, it is appropriate to recognise assets and liabilities in the financial statements of the parties if they have direct rights to the assets and are liable for the obligations, as this results in relevant information to users.

29 EFRAG also agrees that in some cases other facts and circumstances might indicate that the recognition of assets and liabilities in the financial statements of the parties would be more relevant than equity accounting. That could be the case when parties set up a joint arrangement with a sole purpose of receiving the whole output of this joint arrangement, that is being produced according to their specifications. In this case the joint arrangement’s only source of cash flow to settle its liabilities comes from the parties of the joint arrangement. In EFRAG’s view, recognition of assets, liabilities, revenue and expenses relating to this joint arrangement in the financial statements of the parties reflects the economic substance of the joint arrangement.

30 However, as explained above, EFRAG acknowledges that there will be situations in which IFRS 11 requires application of the equity method to joint arrangements despite the fact that they might be a key element of an entity’s core business. In such situations, relevant information might be omitted from the face of the primary financial statements. In EFRAG’s view, this loss of relevance will be partially compensated by the detailed disclosure about interest in joint arrangements required by IFRS 12.

31 Taken together, EFRAG’s overall assessment is that IFRS 11, in relation to the ‘core principle’ for classification and accounting for interests in joint operation, meets the relevance criterion.

Reliability

32 EFRAG also considered the reliability of the information that will be provided by applying IFRS 11. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

33 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.

Classification

34 IFRS 11 requires an entity to consider a number of factors when assessing classification of joint arrangements: their legal form, contractual agreements, and when relevant, other facts and circumstances.

35 EFRAG believes that a classification principle based on indicative factors such as legal form of the vehicle, contractual agreements, and where necessary the purpose and design of the arrangement, will help an entity to make a comprehensive assessment
about why it is involved with the joint arrangement. This approach is, therefore, likely to help entities make the right assessment and thus provide reliable information.

36 EFRAG notes that determining the type of joint arrangement structured through a separate vehicle requires a degree of judgement. (IFRS 11 does not provide 'bright lines' for the classification of a joint arrangement).

37 In particular, this is the case when the legal form of the separate vehicle ensures the separation between the parties and the joint arrangement, and the contractual agreement does not explicitly provide the parties with the rights and the obligations, the entities should consider other facts and circumstances to conclude on the classification.

38 Although, the standard assumes that the contractual arrangements will include terms that make reference to the assets, liabilities, revenue and expenses to which each joint operator is entitled, it stresses that in some cases it is necessary to refer back to the purpose of the joint arrangement (for example, whether the purpose is to provide the parties with an output).

39 IFRS 11 provides guidance on the facts and circumstances that should lead to classifying the separate entity as a joint operation. However, EFRAG acknowledges in some cases the guidance may require a considerable degree of judgement particularly in complex fact patterns. EFRAG notes that IFRS 12 requires an entity to disclose the significant judgements and assumptions made in determining the type of joint arrangement. In EFRAG’s view, the disclosures required by IFRS 12 will provide useful information to users that help them understand the assessments made by the entity, which should mitigate concerns about the impact of significant judgement on the reliability of information.

Accounting for joint operations and joint ventures

40 IFRS 11 requires the parties to a joint operation to recognise their assets and liabilities, revenues and expenses based on the contractual agreements, and to account for them in accordance with all applicable IFRSs. In EFRAG’s view, this should lead to the provision of reliable information as it only broadens the application of existing standards.

41 EFRAG notes that in some cases the contract may not state clearly the percentage of assets to which a party to a joint operation has rights (the same for liabilities, revenue and expenses). This may happen when the classification to the joint operation is based solely on the fact that the parties purchase the output of the joint arrangements and the percentage purchased may either vary from the ownership percentage and vary from year to year. In these cases, management would need to apply judgement to determine the appropriate share of assets, liabilities, revenue and expenses that should be recognised in the financial statement, which may raise a concern about reliability of information.

42 IFRS 11 requires a party to a joint venture to recognise their interests as an investment and account for their interests applying the equity method under IAS 28 (2011). In EFRAG’s view, applying the equity method should not raise concerns about reliability.

Conclusion

43 EFRAG’s overall assessment is that IFRS 11, in relation to the ‘core principle’ for classification and accounting for interests in joint operation, satisfies the reliability criterion.
Comparability

44 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

45 EFRAG has considered whether IFRS 11 results in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

Classification

46 As noted earlier, IFRS 11 requires the parties to classify their interests in joint arrangements as joint operations or joint ventures based on the assessment of their rights and obligations in relation to the joint arrangements. In performing the classification, the parties should consider the legal form of an arrangement, contractual terms and other facts and circumstances. Therefore, in EFRAG's view, IFRS 11 would lead to the provision of comparable information, by ensuring that like arrangements are being accounted for similarly, while dissimilar transactions would not be accounted for as if they were similar.

47 EFRAG notes that in some cases, contractual agreements establish that parties to a joint arrangement have different rights to assets and obligations for liabilities. Under IFRS 11, this fact pattern would need to be considered when determining the classification of the joint arrangement for each of the parties concerned. On this basis, EFRAG believes that comparability of information will be preserved because the joint arrangements will be classified based on the parties' rights and obligations. In reaching this conclusion, EFRAG also notes that paragraph BC35 of IFRS 11 states 'that the unit of account of a joint arrangement is the activity that two or more parties have agreed to control jointly, and that a party should assess its rights to the assets, and obligations for the liabilities, relating to that activity'. Furthermore, paragraph 18 of IFRS 11 provides guidance when entities are bound by a framework agreement that sets up different joint arrangements to undertake different activities and which can result in the parties having different rights and obligations. In such cases, each joint arrangement set up under the framework agreement would be assessed separately and classified either as a joint operation or a joint venture.

48 Some constituents argue that IFRS 11 does not provide clear guidance to address situations in which a joint arrangement that is structured through separate vehicle undertakes more than one activity. In such cases, the rights and obligations of the parties might differ with regard to the different activities undertaken by the joint arrangement. For the reasons noted in paragraph 47 above, EFRAG believes that the guidance in IFRS 11 is sufficient to enable consistent application in situations when two separate activities coexist in one separate vehicle.

49 EFRAG observes that the classification of joint arrangements structured through a separate vehicle requires judgement which in some cases may lead to a different classification of similar joint arrangements, and have a negative impact on comparability. In EFRAG's view, it is likely that entities require time to apply the requirements in a consistent manner, and that full comparability will only be achieved over time between entities.
EFRAG notes that IFRS 12 requires the entities to disclose the significant judgements and assumptions applied when determining the type of joint arrangements, which should be helpful to address at least some of the concerns expressed above about comparability.

Accounting for joint operations and joint ventures

IFRS 11 requires all interests in joint ventures to be accounted for using the equity method, and does not allow a choice of accounting policy for those interests.

Furthermore, IFRS 11 develops a single accounting method for all interests in joint operations; that is, recognition of assets, liabilities, revenue and expenses in the financial statement of the joint operator in accordance with applicable IFRSs.

In EFRAG’s view, the elimination of accounting options together with the requirement applicable for all joint arrangements, that the interests in the joint arrangements should be recognised based on the parties rights and obligations will enhance comparability of information.

EFRAG observes that IFRS 11 does not provide specific guidance about how a party to a joint operation should recognise its share of assets and liabilities when the parties to a joint arrangement have ownership interests that are different to the percentage of output acquired (or the right to reserve capacity) – on the basis of ownership interest or on the basis of percentage of output acquired. IFRS 11 assumes that the contractual arrangements will include terms that make reference to the share of assets, liabilities, revenue and expenses to which each joint operator is entitled to and requires the joint operators to refer to the contracts. EFRAG understands that some constituents perceive this as a lack of specific guidance in IFRS 11 that could lead to diversity in practice, and reduce comparability. However, in most cases, parties to a joint arrangement are likely to agree on their rights and obligations in the contractual terms of their joint arrangement and entities will be able to consistently reflect these in the accounting.

Conclusion

EFRAG’s overall assessment is that IFRS 11, in relation to the ‘core principle’ for classification and accounting for interests in joint operation, satisfies the comparability criterion.

Understandability

The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.

Although there are a number of aspects to the notion of ‘understandability’, EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.

As a result, EFRAG believes that the main additional issue it needs to consider, in assessing whether the information resulting from the application of IFRS 11 is understandable, is whether that information will be unduly complex.

EFRAG notes that IFRS 11 requires joint operators to recognise and account for their assets, liabilities, revenue and expenses in accordance with all applicable IFRSs. Furthermore, the joint venturers should apply the equity method to their interests in
joint ventures. In EFRAG’s view, the requirements in IFRS 11 do not raise significant concerns about complexity of information.

Moreover, the requirement of IFRS 12 to disclose significant judgements and assumptions made in determining the type of joint arrangement ensure that the information produced under IFRS 11 is understandable to users, as it will enable them to better understand the financial information provided in case of more complex arrangements, particularly when the classification assessment is based on other facts and circumstances and structure of the joint arrangement is complex.

**Conclusion**

EFRAG’s overall assessment is that IFRS 11 in relation to the ‘core principle’ for classification and accounting for interests in joint operation satisfies the understandability criterion.

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**Parties without joint control having an interest in a joint operation**

Under IFRS 11, parties to a joint operation that do not have joint control in the arrangement, are required to recognise their interest in the arrangement in the same way as joint operators, provided that they have rights over the assets and obligations for the liabilities of the arrangement (recognition of assets, liabilities, revenue and expenses). Parties to a joint operation that do not have joint control and neither rights to assets nor obligations for the liabilities, account for their interests in the joint operation in accordance with IFRSs applicable to their interests.

**Relevance**

Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.

EFRAG considered whether IFRS 11 would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

EFRAG considered whether the fact that some parties to joint operation do not have joint control of the arrangement should prevent them from recognising assets to which they have rights or obligations for which they are not liable. EFRAG notes that parties to a joint operation might have an agreement that gives them access to their share of the assets and obligations for their share of liabilities. Also, such parties may receive their returns in the form of product produced by the arrangement.

EFRAG understands that the examples of such agreements are common in particular in the oil and gas industry. In EFRAG’s view, when parties without joint control have rights to assets and obligations for the liabilities of the joint operations, recognising those rights and obligations in their financial statements would provide relevant information.

**Conclusion**

EFRAG’s overall assessment is that IFRS 11, in relation to the recognition of interest in joint arrangements by parties without joint control, satisfies the relevance criterion.
Reliability

68 EFRAG also considered the reliability of the information that will be provided by applying IFRS 11. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

69 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.

70 IFRS 11 requires the parties to the joint arrangement that do not have joint control to recognise their interests in the joint operation according to their contractual rights and obligations. In EFRAG’s view, this should not create concerns about reliability.

Conclusion

71 EFRAG’s overall assessment is that IFRS 11, in relation to the recognition of interest in joint arrangements by parties without joint control, satisfies the reliability criterion.

Comparability

72 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

73 EFRAG has considered whether IFRS 11 results in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

74 In EFRAG’s view, IFRS 11 would lead to provision of comparable information in similar situations, by requiring the parties to a joint arrangement that do not have joint control to recognise always – regardless of the legal form – the assets to which they have rights and the liabilities for which they have an obligation.

Conclusion

75 EFRAG’s overall assessment is that IFRS 11, in relation to the recognition of interest in joint arrangements by parties without joint control, satisfies the comparability criterion.

Understandability

76 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.

77 Although there are a number of aspects to the notion of ‘understandability’, EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.

78 In EFRAG’s view, by requiring the parties to the joint operation without joint control but with rights to assets and obligations for liabilities to recognise those assets and
liabilities instead of a single line investment IFRS 11 enhances the understandability of the financial statements.

Conclusion

79 EFRAG’s overall assessment is that IFRS 11, in relation to the recognition of interest in joint arrangements by parties without joint control, satisfies the understandability criterion.

Accounting for interests in joint operations in the separate financial statements

80 Under existing IFRSs, interests in jointly controlled entities are accounted for at cost or at fair value under IFRS 9 or IAS 39.

81 Under IFRS 11, a joint operator will recognise its assets, liabilities, revenues and expenses relating to its interests in a joint operation. Therefore, interests in joint operations are accounted for in the separate financial statements in the same manner as they are accounted for in the consolidated financial statements. This requirement has been extended to parties to a joint operation which do not have joint control in the arrangement.

Relevance

82 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.

83 EFRAG considered whether IFRS 11 would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

84 As discussed above in respect to accounting for interests in joint arrangements in the consolidated financial statements, EFRAG’s overall assessment is that the accounting for joint operations under IFRS 11 reflects the underlying rights and obligations of the parties to a joint operation and therefore provides users with relevant information of an entity’s assets and liabilities, revenue and expenses that arise from its interest in the joint operation.

85 EFRAG notes that under IFRS 11, an investor (a joint operator or a party to joint operation which does not have joint control) only recognises assets and liabilities of a joint operation to the extent that it has rights to the assets and obligation for the liabilities, in which case the assets and liabilities must meet the recognition criteria from the investors’ perspective.

86 EFRAG notes that in some cases the legal form of a separate vehicle does not grant a separation between that vehicle and the parties to the arrangement. In those cases parties have direct rights to assets and are liable for the obligations of the joint arrangement. Therefore, in EFRAG’s view, it is appropriate to recognise those assets and liabilities in the separate financial statements of the entity.

87 EFRAG notes that if an entity concludes that it has rights to the assets of the joint arrangement and is liable for its obligations, that fact should be taken into account in preparing the consolidated as well as the separate financial statements. EFRAG also notes that, if an entity has contracts in place that give it rights to the assets of a subsidiary and is liable for its obligations, that fact should be taken into account in preparing the consolidated as well as the separate financial statements. In EFRAG’s
view, such rights and obligations should be accounted for in accordance with the IFRSs applicable to the particular assets, liabilities, revenues and expenses that they give rise to.

88 EFRAG notes that the accounting required by IFRS 11 is based on the economic substance of the contract, which overrides its legal form. EFRAG observes that application of the substance-over-form principle in IFRSs is not restricted to just the consolidated financial statements, but is also applicable to the separate financial statements.

89 For the reasons explained above, EFRAG's overall assessment is that IFRS 11 will enable users to have access to the relevant information about the rights and obligations of the parties to the joint operation directly in their separate financial statements. EFRAG believes that this information is relevant if a joint operation is structured through a legal entity. Moreover, this information could be particularly valuable for users in relation to those entities that do not have subsidiaries and are therefore not otherwise required to produce this information.

90 However, some constituents believe that in the case of entities that do prepare consolidated financial statements, such information might be redundant. These constituents also believe that the recognition of assets and liabilities of the joint operation structured through separate vehicle in the separate financial statements of the parties would be misleading and would not provide the relevant information. Moreover, they argue that investments in joint operations structured through an entity should be accounted for in accordance with existing IAS 27 which they believe requires that the assets and liabilities of joint operations to which the entity has rights should not be recognised in the separate financial statements.

Conclusion

91 Taken together, EFRAG's overall assessment is that IFRS 11, in relation to the information provided for the joint operations in separate financial statements, satisfies the relevance criterion because joint operators will recognise in their separate financial statements those assets and liabilities that meet the IFRS recognition criteria.

Reliability

92 EFRAG also considered the reliability of the information that will be provided by applying IFRS 11. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

93 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness. In EFRAG's view, IFRS 11 does not raise any significant issues concerning freedom from material error and bias.

94 IFRS 11 does not provide new requirements in terms of measurement; it simply prescribes the same recognition and measurement requirements for joint operations in the consolidated accounts and the separate accounts of the joint operator. It therefore does not raise significant concerns about reliability.

Conclusion

95 EFRAG’s overall assessment is that IFRS 11, in relation to the information provided for the joint arrangements in separate financial statements, satisfies the reliability criterion.
Comparability

96 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

97 EFRAG has considered whether IFRS 11 results in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

98 IFRS 11 ensures that, in the separate financial statements of the joint operator, joint operations structured through an entity are accounted for in the same way as those that are not structured through an entity. Furthermore, IFRS 11 requires other parties to a joint operation which do not have joint control but have rights to assets and obligations for the liabilities of the joint operation to recognise those assets and liabilities also in their separate financial statements.

99 In EFRAG’s view, IFRS 11 will result in economically similar transactions being accounted for in a similar way in the separate financial statements of the joint operators.

100 Some constituents believe that the recognition criteria for joint operations structured through a separate vehicle are inconsistent with the requirements that apply to the treatment of subsidiaries in the separate financial statements. As explained in paragraph 87 above, EFRAG believes that to the extent that an entity has rights to the assets of a subsidiary and is liable for its obligations, that fact should be taken into account in preparing the consolidated as well as the separate financial statements. In EFRAG’s view, such rights and obligations should be accounted for in accordance with the IFRSs applicable to the particular assets, liabilities, revenues and expenses that they give rise to.

Moreover, some constituents believe that IFRS 11 is not clear on how a joint operator should account in its separate financial statements for subsidiaries held by a joint operation. EFRAG observes that IFRS 11 requires joint operators to recognise and account for its assets, liabilities, revenue and expenses relating to its interests in a joint operation in accordance with applicable IFRSs. Therefore, provided that the interest held by a joint operation meets the definition of a subsidiary it should be accounted for in accordance with IAS 27 (2011) in the separate financial statements of the joint operators.

Conclusion

102 On balance, EFRAG’s overall assessment is that IFRS 11, in relation to the information provided for the joint arrangements in separate financial statements, satisfies the comparability criterion.

Understandability

103 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.
Although there are a number of aspects to the notion of ‘understandability’, EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.

As a result, EFRAG believes that the main additional issue it needs to consider, in assessing whether the information resulting from the application of IFRS 11 is understandable, is whether that information will be unduly complex.

In EFRAG’s view, the requirements of IFRS 11 do not introduce any new complexities in the separate financial statements that may impair understandability.

Some constituents argue that the inconsistency between the requirements for subsidiaries and joint operations structured through separate vehicle, could also affect the understandability of financial statements. However, for the reasons explained in paragraph 100, EFRAG believes that IFRS 11 would in fact improve understandability in most cases as comparability is improved.

Conclusion

EFRAG’s overall assessment is that IFRS 11, in relation to the information provided for the joint arrangements in separate financial statements, satisfies the understandability criterion.

True and Fair

Overall, EFRAG has concluded that the information resulting from the application of IFRS 11 would not be contrary to the true and fair view principle.

European public good

EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt IFRS 11.

Conclusion

For the reasons set out above, EFRAG’s overall assessment is that IFRS 11 satisfies the technical criteria for EU endorsement and EFRAG should therefore recommend its endorsement.

With regards to the mandatory effective date of IFRS 11, please refer to Appendix 6.
APPENDIX 2B – DISSENTING OPINIONS: IFRS 11

1 Araceli Mora, Nicolas De Paillerets, Carsten Zielke and Andrea Toselli (EFRAG TEG members) dissent from recommending the endorsement of IFRS 11 Joint Arrangements.

Elimination of proportionate consolidation


3 Araceli Mora, Nicolas De Paillerets and Carsten Zielke disagree with the elimination of proportionate consolidation for the reasons explained below.

4 The view of Araceli Mora and Nicolas De Paillerets is based on previous empirical research studies that investigate the relative information content of the equity method compared to proportionate consolidation as a means to explain market risk and bond ratings. They observe that the findings from these studies are consistent with the view that financial statements prepared using proportional consolidation (1) provide a better basis to predict shareholder returns on equity and (2) are more risk relevant for explaining price volatility of market prices than financial statements prepared using the equity method.

5 Although there is some evidence that indicates that the application of the equity method could be more relevant to explain bond ratings, most of the findings analysed by Araceli Mora and Nicolas De Paillerets conclude that proportionate consolidation is, in all cases, more relevant for creditors.

6 For the above reasons, Araceli Mora and Nicolas De Paillerets believe that the elimination of proportionate consolidation for interests in joint arrangements classified as joint ventures will result in a loss of relevant information to users.

7 Carsten Zielke believes that proportionate consolidation reflects more appropriately the performance and the debt position of a joint arrangement that is classified as a joint venture under IFRS 11. The equity method provides limited information and does not provide users with sufficient insight for the purposes of performing a debt analysis of the operations that are jointly controlled, because the total statement of financial position is artificially reduced.

8 For the above reasons, Carsten Zielke believes that the elimination of proportionate consolidation for interests in joint arrangements classified as joint ventures will result in a loss of relevant information to users.

9 In addition, Nicolas De Paillerets believes that EFRAG’s basis for conclusions supporting its overall decision to recommend endorsement of IFRS 11 should, with respect to the European public good, have reflected the fact that often the development of European companies is substantially made through joint ventures in certain geographic areas. He is concerned that these companies may be inadequately assessed and valued by investors as their consolidated financial statements will not fully reflect their operations and underlying performance, and will lack key financial data required by investors.
Insufficient guidance in IFRS 11 for classification and accounting for interests in joint arrangement structured through separate legal entity

10 IFRS 11 lacks clear application guidance on the application of the criteria to determine whether a joint arrangement is a joint operation or a joint venture. Carsten Zielke is concerned that the lack of guidance in this area will result in different interpretations of IFRS 11 and create a lack of comparability of information.

11 IFRS 11 requires an investor in a joint arrangement structured through a separate vehicle to recognise either direct individual rights and obligations or the equity interest in the separate vehicle, depending on the joint arrangement being classified as a joint operation rather than a joint venture. This is true for both consolidated and separate financial statements.

12 The classification of an arrangement as joint operation rather than a joint venture may lead to dramatic differences in the purported information therefore such decision must, in Andrea Toselli’s view, be guided to limit the scope for similar arrangements being classified differently. He is convinced that IFRS 11 does not contain sufficiently clear guidance to ensure that such decision is made consistently.

13 In addition, the wording in the standard does not provide sufficiently clear guidance in respect to which, in a joint operation, the rights and obligations are to be measured and presented: either based on the extent of interest held in the separate vehicle (resembling proportionate consolidation) or based on the actual exposure to individual assets and liabilities conveyed by the arrangement (as the main principle seems to suggest). Certain joint arrangements could also present a mix of exposure in the vehicle’s equity as well as direct exposure to specific assets/liabilities. The treatment to be followed in these cases is even more unclear.

14 The lack of guidance in IFRS 11 would force preparers to apply an extraordinary level of judgement to the extent of impairing the reliability criterion. Andrea Toselli believes that this would inevitably generate diversity in practice and hence the comparability criterion would also be undermined.

Accounting for interests in joint operations structured through a separate vehicle in separate financial statements

15 Nicolas De Paillerets and Andrea Toselli disagree with new accounting requirements in IFRS 11 with regard to the accounting for interests in joint operations structured through separate vehicle in separate financial statements. Their reasons are explained below.

16 Andrea Toselli observes that the specific reference to the application of IFRS 11 to separate financial statements, the views presented in paragraphs 11-14 above hold true. In addition, in those cases where a preparer would conclude that the assets and liabilities of a joint operation are to be presented on the basis of the interest held in the separate vehicle (a sort of proportionate consolidation), the information would not be relevant as it would not report the actual exposure and rights of the entity. It would in fact be a simulation of an overall position not necessarily in place.

17 On the other hand a preparer who believes that a joint operation is to be presented based on the actual involvement of the entity in the individual assets and liabilities of the arrangement reaches the same accounting already in place based on current standards (as per certain types of consortiums). IFRS 11 is, in Andrea Toselli’s view, a step back from what currently in IAS 27.
As a consequence of this lack of clarity and considering the current use of separate financial statements in the EU, Andrea Toselli believes that also the understandability criterion is not satisfied.

IFRS 11 requires a joint operator, in its separate financial statements, to account for its interest in a joint operation structured through a separate legal entity, in the same manner as in the consolidated financial statements, regardless of the existence of the separate legal entity. Nicolas De Paillerets disagrees with this requirement, as he believes that IFRS 11 will:

(a) result in inconsistency with the accounting for interests in subsidiaries under IAS 27 (2011) at cost or fair value. IAS 27 (2011) does not consider whether the parent controls the assets or has an obligation for the liabilities of the subsidiary. Even if the parent had such control (or obligation), it would recognise the equity investment under IAS 27 (2011) at cost or fair value. Nicolas De Paillerets struggles to understand why such a distinction is relevant only in circumstances when parties share joint control. For that reason, he believes that extending the recognition principle in IFRS 11 to separate financial statements could give rise to comparability issues since economic similar situations could be accounted for differently; and

(b) lead to situations when assets and liabilities would be directly (even if only pro-rata) recognised in the annual accounts of an entity, irrespective of the existence of direct ownership rights or control by the entity over the individual assets or liabilities of the joint operation. In the view of Nicolas De Paillerets, this could conflict with the legal frameworks that define the purposes of annual accounts in the EU member states requiring or permitting the use of IFRSs in annual accounts, as further explained hereunder.

Under IFRSs, separate financial statements are those presented by a parent (i.e. an investor with control of subsidiary) or an investor with joint control of, or significant influence over, an investee, in which the investments are accounted for at cost or in accordance with IFRS 9/IAS 39. Separate financial statements are presented in addition to consolidated financial statements or in addition to financial statements in which associates or joint ventures are accounted for using the equity method, unless an entity is exempted from consolidation or from applying equity accounting for associates or joint ventures. Hence, unless an entity has neither an investee nor a subsidiary, separate financial statements are never presented without consolidated financial statements. This reflects the definition of an entity under IFRSs.

European regulations do not refer to separate financial statements, but to ‘annual accounts’ and differentiates them from consolidated accounts. The Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards leaves to Member States the option to permit or require companies to prepare their annual accounts in conformity with IFRSs as endorsed by the European Union. Annual accounts are also commonly described as company-only accounts, stand-alone accounts or statutory accounts.

In their Basis for Conclusions to IFRS 11, ‘the IASB [had] acknowledged that the requirement for joint operations to be accounted for in the same way in the entity's consolidated financial statements as in the entity's separate financial statements might lead to additional costs to entities in jurisdictions in which separate financial statements are required to be reported in accordance to IFRSs. This is because those requirements might cause entities to perform additional manual procedures such as reconciliations between the statutory accounts and the tax returns, and might require
an entity to provide additional explanations of the impact of the changes to, for example, its creditors. Except for these costs [...], the costs of accounting for joint arrangements once the entities have determined their classification will remain unchanged as a result of the IFRS.’

23 Nicolas De Paillerets believes that the IASB’s assessment, as described above, does not recognise the diversity of the legal frameworks that define the purposes of statutory accounts in the European Union, and that this matter is not within the remit of the IASB. Therefore, this EFRAG TEG member is of the view that an additional assessment by the European Union and the Member States would be necessary to determine whether the European public good criterion is met when applying the requirements of IFRS 11 to annual accounts.

APPENDIX 3 – BASIS FOR CONCLUSIONS: IFRS 12

EFRAG’S TECHNICAL ASSESSMENT OF IFRS 12 AGAINST THE ENDORSEMENT CRITERIA

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on IFRS 12 Disclosure of Interests in Other Entities (IFRS 12).

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG’s capacity of contributing to the IASB’s due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS in the European Union and European Economic Area.

In the latter capacity, EFRAG’s role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the technical criteria for the European endorsement, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG’s thinking may evolve.

Does the accounting that results from the application of IFRS 12 meet the technical criteria for EU endorsement?

1 EFRAG has considered whether IFRS 12 meets the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002, in other words that IFRS 12:

(a) is not contrary to the principle of ‘true and fair view’ set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

(b) meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG also considered, based only on evidence brought to its attention by constituents, whether it would be not conducive to the European public good to adopt IFRS 12.
Approach adopted for the technical evaluation of IFRS 12

2 EFRAG observes that some disclosures have been carried forward from existing IFRSs without a significant change and therefore do not need to be assessed in relation to the endorsement criteria.

3 IFRS 12 extends the disclosure requirements about significant restrictions on a parent’s ability to access or use the assets and settle the liabilities of its subsidiaries. EFRAG notes that these requirements are not new, because existing IAS 27 already requires similar disclosures. In EFRAG’s view, this change should not significantly impact the quality of information provided and has therefore not been assessed in this appendix.

4 In performing its overall analysis, EFRAG focused on the impact of the requirements introduced by IFRS 12 that involve new elements to existing disclosure requirements. IFRS 12 impacts the following areas:

(a) unconsolidated structured entities;
(b) significant judgements and assumptions;
(c) interest in subsidiaries with material non-controlling interests;
(d) consolidated structured entities;
(e) interests in joint arrangements and associates; and
(f) venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds that have an interest in a joint venture or associate.

5 EFRAG’s overall assessments of the disclosure requirements listed above are discussed in the paragraphs that follow.

6 EFRAG notes that although IFRS 12 requires more extensive and voluminous disclosure about interest in other entities, it requires entities to aggregate or disaggregate the disclosure such that useful information is not obscured. Furthermore, IFRS 12 puts an emphasis on the disclosure of material and significant items. EFRAG has conducted its overall assessment on the basis that entities will be able to aggregate information reasonably. However, EFRAG acknowledges that in some cases entities might face difficulties to aggregate data in a consistent and understandable manner, in particular when they hold numerous interests in other entities that are not homogeneous. EFRAG’s overall assessment is that if the disclosures are not aggregated in a reasonable manner and presented in a meaningful way, this would impact the relevance and understandability of financial reporting.

7 To get evidence to support its overall assessment of IFRS 12, EFRAG considered the effect analysis published by the IASB, held meetings with the various groups of constituents and conducted field-testing activities. The results of the various consultations have been reflected in this overall assessment of IFRS 12.

Relevance

8 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.
EFRAG considered whether IFRS 12 would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

In EFRAG’s view, the difference in the nature and risks that arise from interests in different types of investees is reflected in the disclosure requirements. Therefore, EFRAG has assessed relevance of information provided under IFRS 12, by conducting a separate assessment of the new requirements.

**Unconsolidated structured entities**

The relationships between a parent entity and its investees that are considered structured entities cover a wide spectrum. IFRS 10 provides new guidance on consolidation of structured entities. If an entity has the majority of voting rights or exposure to risks and rewards but does not have the ability to control (the power to direct the relevant activities of the investee) it should not consolidate an investee under IFRS 10.

IFRS 12 provides a definition of a structured entity and requires an entity to disclose qualitative and quantitative information about the nature of its interest in unconsolidated structured entities which exposes an entity to risks. EFRAG notes that these new disclosure requirements were developed by the IASB to address users’ needs, particularly in light of the global financial crisis in 2008/09.

EFRAG notes that an entity’s involvement in transactions with a structured entity can, due to the special nature and designed purpose of the entity, expose that entity to different types of risks. EFRAG understands that users welcome a framework for disclosing information on structured entities that are not consolidated, to ensure that they have sufficient information to understand an entity’s involvement with those unconsolidated entities, including exposure to guarantees and commitments, potential losses and the impact on the entity’s performance.

EFRAG has considered whether the disclosures for unconsolidated structured entities are too far reaching and will obscure the actual risks. Some constituents have expressed concern that the broad definition of unconsolidated structured entities will encompass many interests that are insignificant to the reporting entity and the disclosures in IFRS 12 will result in a mix of relevant and irrelevant information. EFRAG also observes that IFRS 12 provides guidance on how an entity should aggregate the data and that it clarifies that materiality is a key point of focus. The focus on ‘materiality’ is expected to help preparers to develop a consistent and understandable pattern of aggregation policies for items that have similar characteristics.

EFRAG also considered the disclosures an entity is required to provide when it has no interests in a structured entity at the end of reporting period, but may still be required to support the structured entity. In EFRAG’s view, the information is useful to users because, as a sponsor of that structured entity, the entity can remain exposed to risk including reputational or litigation risk and commitments for ongoing support.

Finally, EFRAG considered to what extent the disclosures required by IFRS 12 on interests in unconsolidated structured entities overlap with the disclosures already required by IFRS 7 *Financial Instruments: Disclosures* and whether the disclosure requirements should be limited to those unconsolidated structured entities where the entity is the sponsor. Some constituents have informed EFRAG that the disclosure requirements should be limited to structured entities where the reporting entity is sponsor, and guidance on materiality should be added to explain that such individually
immaterial interests in unconsolidated structured entities should not be disclosed, not even in aggregated form.

17 EFRAG notes that IFRS 12 focuses on the nature of and risks associated with an entity’s interest in another entity, rather than on the specific risks arising from financial instruments, which is the focus of IFRS 7. Therefore, it could be argued that the IFRS 12 disclosures complement the disclosures required by IFRS 7, rather than duplicate them.

18 EFRAG notes that this requirement was developed in IFRS 12 specifically to address user concerns about information on off-balance sheet entities, and should result in a significant increase in transparency and useful information to users.

Significant judgements and assumptions

19 The assessment of whether an entity controls, jointly controls or significantly influences another entity requires a degree of judgement that would generally depend on factors such as complexity of the transaction and ownership structure of the underlying investee.

20 EFRAG notes that the main objective of this disclosure requirement is to develop a principle that requires an entity to disclose information about all significant judgements and assumptions made in determining the nature of its interest in another entity and the type (classification) of joint arrangement in which it has an interest.

21 EFRAG observes that IFRS 10 introduces a uniform consolidation principle and removes some of the existing ‘bright lines’. Therefore, more judgement will be required to assess control when an entity holds less than the majority of voting rights – for example when determining de facto control or whether an investment fund manager is acting as an agent or as a principal, to evaluate whether a fund manager controls the underlying fund. The level of judgement will be significant, particularly when the ownership structure of the investee is complex and involves investors that are widely dispersed. In these cases, the information about the facts and circumstances and the level of judgement and assumptions made to determine control over an investee, will be relevant for users to understand the consolidation decisions taken by entities.

22 IFRS 12 also requires disclosures about significant judgements and assumptions in determining whether a joint arrangement under IFRS 11 is a joint operation or a joint venture. This assessment requires management to exercise a degree of judgement and consider all facts and circumstances to determine the classification of a joint arrangement, particularly when it is structured through a separate entity. In EFRAG’s view, it will be relevant for users to understand in which situations significant judgement has been exercised and the factors that support the classification decision.

23 EFRAG notes that IAS 1 Presentation of Financial Statements already requires disclosure about significant judgements and assumptions made in applying the entity’s accounting policies that have a significant effect on the amounts recognised in the financial statements. However, EFRAG’s assessment is that the disclosure requirements in IFRS 12 are more focused on a principle about how an entity determines the nature of its interest in another entity or joint arrangement. Therefore, EFRAG considers that providing information about assumptions and judgement exercised that supports an entity’s assessment will be relevant to users.

Subsidiaries with material non-controlling interests

24 IFRS 12 requires new disclosures in relation to subsidiaries with non-controlling interests (NCI) that are material to the entity. This requirement aims to address user
concerns about the lack of information about NCI in relation to cash flows attributable to the shareholders of the parent entity and those attributable to the NCI.

25 In EFRAG’s view, the information will enable users to understand the composition of a group and how profits will be distributed among shareholders. Furthermore, the information will help users to identify the subsidiaries that hold debt, to assess the financial situation of a particular entity structure within the group and the ability to generate cash and to fund its commitments.

26 For the reasons explained above, EFRAG’s overall assessment is that the expanded disclosures will be relevant to users and help address concerns about the lack of useful information in this area.

Consolidated structured entities

27 IFRS 12 requires additional disclosures about consolidated structured entities that are not required for other non-structured subsidiaries. In particular, IFRS 12 requires an entity to disclose whether it is required, either through a contractual agreement or a special relationship (e.g. the entity being a sponsor), to provide support to a structured consolidated entity. EFRAG’s overall assessment is that this disclosure should be relevant for users in order to assess the risks associated with the interest in that entity, and the level of support provided by an entity to structured entities.

28 Furthermore, EFRAG notes that this requirement refers to the provision of support by a parent or a subsidiary of the group to the consolidated structured entity. Those transactions are eliminated in the consolidated financial statements.

Interests in joint arrangements and associates

29 IFRS 12 requires additional disclosure about an entity’s interests in joint arrangements (particularly joint ventures) and associates. The requirements focus mainly on joint ventures and associates that are material to the reporting entity, and require less detailed information for individually immaterial investments. The requirement aims to address concerns expressed by users about a lack of information regarding the nature and extent of risks associated with associates and joint ventures as well as the potential loss of information due to the elimination of proportionate consolidation for joint arrangements classified as joint ventures under IFRS 11.

30 EFRAG understands that users want a more comprehensive breakdown of current assets and current and non-current liabilities (in particular, cash and certain financial liabilities) to help them understand the asset and debt position of joint ventures. Furthermore, users highlighted the need for more comprehensive information about amounts reported in statement of comprehensive income that would help them when valuing an entity’s investment in a joint venture that is accounted for under the equity method. The summarised financial information should be based on IFRSs and reconciled to the carrying amount of the investment in the reporting entity’s financial statements. In EFRAG’s view, the summarised financial information required for each joint venture and associate that is material to the reporting entity will address some of these needs, and enhance the relevance of information provided to users. In EFRAG’s view, the aggregation of information provided for individually immaterial associates and joint ventures that are accounted for under the equity method will alleviate concerns about excessive and too granular information.

31 EFRAG notes that the summarised financial information required by IFRS 12 for each material associate is less detailed than for each material joint venture. In EFRAG’s view, significant influence is different from joint control. EFRAG’s overall assessment is that the additional information required for interests in joint ventures is appropriate.
because a joint venturer is generally more involved in the operations of a joint venture, and thus the level of information required by users is likely to be different.

32 IFRS 12 requires only limited disclosure in relation to interests in joint arrangements classified as joint operations, because in those cases the joint operator recognises assets, liabilities, revenue and expense that arise from its interest in the joint operation in accordance with all applicable IFRSs and provides all the disclosures required by IFRSs. It is therefore not necessary to require further information in IFRS 12 in relation to joint operations.

Venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds that have an interest in a joint venture or associate

33 IFRS 12 requires the same information to be provided for interests in joint ventures and associates held by venture capital and similar organisations even, if these investees are accounted for at fair value in accordance with IAS 39 Financial Instruments: Recognition and Measurement.

34 EFRAG considers that the summarised financial information for each material joint venture and associate will help users to obtain information that supports the fair value of the underlying investment.

Conclusion

35 For the reasons explained above, EFRAG’s overall assessment is that IFRS 12 would result in the provision of relevant information, and therefore satisfies the relevance criterion.

Reliability

36 EFRAG also considered the reliability of the information that will be provided by applying IFRS 12. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

37 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness. In EFRAG’s view, IFRS 12 does not raise any significant issues concerning freedom from material error and bias.

38 For the purpose of assessing reliability of information provided under IFRS 12, EFRAG has analysed separately the new disclosure requirements for all types of entities. Similar to its assessment on ‘relevance’, EFRAG’s overall assessment is that the difference in the nature and risks for interests in different types of entities is reflected in the disclosure requirements and, therefore warrants separate assessment.

Unconsolidated structured entities

39 The disclosure requirements about interests in unconsolidated structured entities required by IFRS 12 are new. An entity with an interest in a structured entity will often have the information (or some of the information) required in IFRS 12, if it is used for its internal risk management purposes or for compliance with regulatory reporting.

40 However, EFRAG understands that some entities will not have all the information readily available to comply with all the requirements in IFRS 12 regarding unconsolidated structured entities, particularly when they are managed by other parties unrelated to the entity. In these cases, new processes or contractual agreements might
need to be established to ensure the entity has access to the required information on a
timely basis. Once entities have the processes in place, the initial concerns about
reliability should diminish.

41 EFRAG notes that the disclosures required when the reporting entity has no interest in
a structured entity at the reporting date are limited, and refer mainly to the events that
have taken place in the reporting period (for example, income received from the
structured entity and carrying amount (at the time of transfer) of all assets transferred
to the structured entity). Therefore, in EFRAG’s view, providing these disclosures
should not cause significant issues with regard to the availability and reliability of
information.

42 EFRAG is concerned that the disclosure requirement about the ‘current intention’ to
provide financial support to an unconsolidated structured entity is forward-looking
information that might raise a reliability concern. However, this type of information is
already required by IFRSs. For example IAS 37 Provisions, Contingent Liabilities and
Contingent Assets already requires disclosure of information about uncertain future
events (e.g. contingent liabilities) and the requirements in IFRS 12 should not be so
exceptional that they would raise additional concerns about reliability.

Significant judgements and assumptions

43 EFRAG notes that information about significant judgements and assumptions made in
assessing control and significant influence, are already required under existing IFRSs,
including IAS 1 Presentation of Financial Statements. Therefore, this requirement does
not impose significant additional concerns with reliability.

Subsidiaries with material NCI

44 In EFRAG’s view, entities should have all or most of the information available in
respect of subsidiaries with material NCI in preparing its consolidated financial
statements. Therefore, the new requirement does not raise significant reliability
concerns.

Consolidated structured entities

45 IFRS 12 requires disclosures that did not exist previously. Entities that are obliged to
provide financial support to consolidated structured entities, with or without having an
obligation to do so, will be required to provide information in this respect. EFRAG notes
that a similar type of forward-looking disclosure is already required in other IFRSs, for
example IAS 37 requires an entity to provide information on contingent liabilities and
provide estimates of its financial effects.

46 Therefore, EFRAG’s overall assessment is that the disclosure requirements regarding
the nature of risks associated with an entity’s interests in consolidated structured
entities should not cause significant issues with reliability of information.

Interests in joint arrangements and associates

47 IFRS 12 requires an entity to provide qualitative information and summarised financial
information for each joint venture and associate that is material to the reporting entity.

48 In EFRAG’s view, the qualitative information (name, place of business, activities)
should be readily available, and would not lead to significant reliability concerns.

49 For joint ventures and associates accounted for under the equity method, the
summarised financial information required by IFRS 12 should be based on the joint
venture’s or associate’s IFRS financial statements and adjusted for group entries made
at consolidation level. In addition, the standard requires the summarised financial
information to be reconciled to the carrying amount of the investment in the reporting entity’s financial statements.

50 For individually immaterial associates and joint ventures that are accounted for under the equity method, the information requirements are less detailed and an entity is required to provide aggregate information about the carrying amounts of those investments and limited aggregate information about profit and loss and comprehensive income.

51 EFRAG understands that in some cases, entities will need to perform additional procedures and perhaps change the reporting structures to gather the required IFRS data for investments in joint ventures and associates. However, in EFRAG’s view, entities should have most of the required information and the requirements should not pose a significant reliability concern.

Venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds that have an interest in a joint venture or associate

52 IFRS 12 requires venture capital and similar entities that have interests in associates and joint ventures – that they measure at fair value and that are material to them – to provide the same type of information as required for other interests in associates and joint ventures.

53 However, for associates and joint ventures measured at fair value, the reporting entity is not required to present summarised financial information based on IFRS numbers if those numbers are not available (or difficult to obtain) and is permitted to use another basis that it needs to disclose. Therefore, this requirement should not raise significant reliability concerns.

Conclusion

54 Overall, EFRAG’s overall assessment is that the disclosures required by IFRS 12 satisfy the reliability criterion.

Comparability

55 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

56 EFRAG has considered whether IFRS 12 results in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

57 EFRAG notes that the comparability of information provided by the disclosure requirement under IFRS12 is determined more by the provision of a general objective and aggregation guidance rather than specific disclosure requirements. For this reason, EFRAG decided to assess whether or not IFRS 12 meets the comparability criterion for the standard in its entirety.

58 The application guidance in IFRS 12 should help with consistent interpretation and application of the disclosure requirements. The standard prescribes a list of mandatory disclosures in some areas, and provides examples of additional disclosures.
EFRAG notes that some terms remain undefined in IFRS 12 (for example, ‘sponsor’, ‘financial support’, ‘size of a structured entity’) which could result in inconsistent interpretations of the underlying terms and affect comparability of information. However, in EFRAG’s view, the objectives of IFRS 12 was clearly laid out in the standard, and through discussions with group entities and peers, entities will be able to develop definitions that are consistent with IFRS 12’s objectives and mitigate potential loss of comparability within and between entities in the initial year(s) of implementation, while getting familiar with the requirements.

As discussed earlier, some of the existing disclosure requirements are new, for example existing IFRSs do not require disclosure about an entity’s involvement in unconsolidated structured entities. The lack of guidance has led to divergence in practice and inconsistencies in the information provided in the notes to the financial statements in relation to risks associated with those entities. In EFRAG’s view, the new set of disclosure about interests in unconsolidated structured entities should improve the comparability of information between entities.

IFRS 12 requires similar disclosures for interests in all joint ventures and associates that are material to the reporting entity, regardless of whether they are held by venture capital and similar organisations or by other investors. This is a change from existing IFRSs, which require only limited disclosures when an entity is a venture capital organisation or a similar entity. The objective of IFRS 12 is to set out a single source of guidance for all disclosure requirements for an entity’s interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. In EFRAG’s view, the disclosures in IFRS 12 have been developed as a package, which should promote consistency and coherence of the requirements thereby comparability of financial reporting.

Conclusion

EFRAG’s overall assessment is that IFRS 12 satisfies the comparability criterion.

Understandability

The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.

Although there are a number of aspects to the notion of ‘understandability’, EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.

EFRAG has noted that the understandability of information provided under IFRS 12 is determined more by the provision of a general objective and aggregation guidance rather than by specific disclosure requirements. For that reason, EFRAG decided to assess the understandability criterion of IFRS 12 in its entirety.

As mentioned under ‘comparability’, one of the objectives of IFRS 12 is to integrate in one standard all disclosure requirements for interests a reporting entity has in other entities, including unconsolidated structured entities.

EFRAG notes that IFRS 12 sets out a clear objective for all disclosures required, which is to enable users to evaluate the nature of and risks associated with its interests in
other entities, and to assess the effects of those interests the financial position, financial performance and cash flows.

68 IFRS 12 requires an entity to consider the level of detail necessary to satisfy the disclosure objective and to aggregate or disaggregate disclosures, so that useful information is not obscured by either inclusion of voluminous insignificant detail or the aggregation of items that have different characteristics. IFRS 12 provides examples of aggregation criteria and requires the entity to disclose how it has aggregated the information.

69 EFRAG observes that IFRS 12 requires more comprehensive disclosures in some areas (e.g. interests in unconsolidated structured entities, summarised financial information about interests in subsidiaries with material NCI, material joint ventures and material associates). In EFRAG’s view, as already explained in paragraph 7 above, if the new voluminous disclosures are not aggregated in a reasonable manner, and provided in a meaningful way, this could impact understandability of financial reporting. It could be the case, when an entity has numerous investments that are not homogeneous, in which case it cannot aggregate the information.

Conclusion

70 For the above reasons, EFRAG’s overall assessment is that IFRS 12 satisfies the understandability criterion.

True and Fair

71 EFRAG has concluded that the information resulting from the application of IFRS 12 would not be contrary to the true and fair view principle.

European public good

72 EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt IFRS 12.

Conclusion

73 For the reasons set out above, EFRAG’s overall assessment is that IFRS 12 meets the technical criteria for EU endorsement and EFRAG should therefore recommend its endorsement.

APPENDIX 4 – BASIS FOR CONCLUSIONS: IAS 27

EFRAG’S TECHNICAL ASSESSMENT OF IAS 27 AGAINST THE ENDORESEMENT CRITERIA

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on IAS 27 Separate Financial Statements (IAS 27 (2011)).

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG’s capacity of contributing to the IASB’s due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS in the European Union and European Economic Area.

In the latter capacity, EFRAG’s role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the technical criteria for the European
endorsement, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG’s thinking may evolve.

Does the accounting that results from the application of IAS 27 (2011) meet the technical criteria for EU endorsement?

1. EFRAG has considered whether IAS 27 (2011) meets the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002, in other words that IAS 27 (2011):
   (a) is not contrary to the principle of ‘true and fair view’ set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and
   (b) meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG also considered, based only on evidence brought to its attention by constituents, whether it would be not conducive to the European public good to adopt IAS 27 (2011).

Approach adopted for the technical evaluation of IAS 27 (2011)

2. EFRAG notes that the following changes to existing IAS 27 are mainly minor consequential amendments or clarifications of existing IFRSs:
   (a) Terms and definitions;
   (b) Relocation of requirements;
   (c) IFRSs applicable for separate financial statements; and
   (d) Disclosure.

3. In EFRAG’s view, these four amendments are straightforward – they clarify or correct existing IFRSs in minor ways – and do not raise significant concerns. For this reason, they are not discussed specifically in this Appendix.

4. The more fundamental amendment to existing IAS 27 relates to the accounting for joint arrangements structured through a separate vehicle and classified as joint operations under IFRS 11. EFRAG overall assessments of IFRS 11, including this amendment, are discussed in a separate document.

5. For the above reasons, EFRAG’s overall assessment is that IAS 27 (2011) satisfies the criteria of relevance, reliability, comparability and understandability.

True and Fair

6. EFRAG has concluded that the information resulting from the application of IAS 27 (2011) would not be contrary to the true and fair view principle.
European public good

7 EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt IAS 27 (2011).

Conclusion

8 For the reasons set out above, EFRAG’s overall assessment is that IAS 27 (2011) satisfies the technical criteria for EU endorsement and EFRAG should therefore recommend its endorsement.

APPENDIX 5 – BASIS FOR CONCLUSIONS: IAS 28

EFRAG’S TECHNICAL ASSESSMENT OF IAS 28 AGAINST THE ENDORSEMENT CRITERIA

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on IAS 28 Investments in Associates and Joint Ventures (IAS 28 (2011)).

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG’s capacity of contributing to the IASB’s due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS in the European Union and European Economic Area.

In the latter capacity, EFRAG’s role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the technical criteria for the European endorsement, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG’s thinking may evolve.

Does the accounting that results from the application of IAS 28 (2011) meet the technical criteria for EU endorsement?

1 EFRAG has considered whether IAS 28 (2011) meets the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002, in other words that IAS 28 (2011):

(a) is not contrary to the principle of ‘true and fair view’ set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

(b) meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG also considered, based only on evidence brought to its attention by constituents, whether it would be not conducive to the European public good to adopt IAS 28 (2011).
Approach adopted for the technical assessment of IAS 28 (2011)

2 EFRAG notes that the following small changes resulting from IAS 28 (2011) are primarily clarifications of existing IFRSs or confirm existing practices in the absence of specific guidance in IFRSs:

(a) Potential voting rights;
(b) Classification as held for sale;
(c) Partial use of fair value option extended to a portion of an associate;
(d) Application of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*; and
(e) Incorporation of SIC-13 into IAS 28.

3 In EFRAG’s view, amendments (a) to (d) above are straightforward – they clarify or correct existing IFRS in minor ways – and do not raise any significant new concerns. For this reason, they are not discussed specifically in this Appendix.

4 Regarding the incorporation of SIC-13 *Jointly Controlled Entities–Non-Monetary Contributions by Venturers* into IAS 28, EFRAG notes that it was not the IASB’s intention to reconsider the fundamental approach to the equity method established by IAS 28 and related Interpretations, and this approach has been carried forward from existing IAS 28. As a consequence, EFRAG has not reconsidered “unchanged” accounting to IAS 28 and related Interpretations and therefore this amendment is not discussed specifically in this Appendix.

5 IAS 28 (2011) also requires that entities provide the disclosures in IFRS 12 for all investments in joint ventures and associates, including those that are held by venture capital organisations or similar entities and measured at fair value. The main effect of this change is that it triggers a requirement for additional disclosure under IFRS 12, but does not change the way these interests are measured or the entities that fall within its scope. EFRAG’s overall assessments on IFRS 12, including this amendment, are discussed in a separate document.

6 Finally, IAS 28 (2011) introduces a change in accounting with respect to scenarios where an investment in an associate becomes an investment in a joint venture, or vice versa, and eliminates the requirement to remeasure the retained interest. This amendment is discussed in the paragraphs that follow.

Changes in interests held when an associate becomes a joint venture or vice versa

Relevance

7 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.

8 EFRAG considered whether this amendment would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

9 The amendment eliminates the requirement to remeasure a retained interest when an entity changes its interest in an investment from an associate to a joint venture, or vice
versa. In such cases, both interests will be measured using the equity method ‘before’ and ‘after’ the change. It follows that there is neither a change in the “group boundaries” nor a change in the measurement requirements, and therefore information will be relevant to users without remeasurement.

10 For the reasons stated above, EFRAG’s overall assessment is that this amendment meets the relevance criterion.

Reliability

11 EFRAG also considered the reliability of the information that will be provided by applying this amendment. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

12 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness. EFRAG notes that this amendment does not involve significant judgement and would therefore not raise any significant issues with regard to reliability of information.

13 EFRAG’s overall assessment is that this amendment satisfies the reliability criterion.

Comparability

14 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

15 EFRAG has considered whether the amendment results in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

16 This amendment applies to situations that involve an entity losing joint control of a joint venture and retaining significant influence in the underlying investment (an associate) and vice versa, and requires no remeasurement in such cases.

17 The purpose of this amendment is to address the accounting when an entity changes its interest in an associate to a joint venture or vice versa. EFRAG acknowledges that, in such cases, the investor-investee relationship and the nature of the interest changes. However, EFRAG notes that in both cases the underlying interests will continue to be accounted for using the equity method. In such cases the information would be more comparable from year to year as nothing has changed as it would not be necessary to remeasure the investment.

18 For this reason, EFRAG’s overall assessment is that this amendment satisfies the comparability criterion.

Understandability

19 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.
Although there are a number of aspects to the notion of ‘understandability’, EFRAG notes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.

As a result, EFRAG is of the view that the main additional issue it needs to consider, in assessing whether the information resulting from the application of the amendment is understandable, is whether that information will be unduly complex.

In EFRAG’s view, the amendment does not introduce any new complexities that may impair understandability. Therefore, EFRAG’s overall assessment is that this amendment satisfies the understandability criterion.

**True and Fair**

EFRAG has concluded that the information resulting from the application of IAS 28 (2011) would not be contrary to the true and fair view principle.

**European public good**

EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt IAS 28 (2011).

**Conclusion**

For the reasons set out above, EFRAG’s overall assessment is that IAS 28 (2011) satisfies the technical criteria for EU endorsement and EFRAG should therefore recommend its endorsement.

EFRAG notes that the amendment relating to disclosure is assessed as part of EFRAG’s overall.

**APPENDIX 6 – BASIS FOR CONCLUSIONS: DEFERRAL OF THE MANDATORY EFFECTIVE DATE**

1 IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Interests in Other Entities, IAS 27 Separate Financial Statements (2011) and IAS 28 Investments in Associates and Joint Ventures (2011), referred to as (‘the Standards’) are effective for annual periods beginning on or after 1 January 2013, with earlier application permitted. Except for IFRS 12, if an entity applies one of the Standards earlier, it shall disclose that fact and apply the other Standards at the same time. An entity is encouraged to provide the information required by IFRS 12 earlier than annual periods beginning on or after 1 January 2013, and is permitted to provide some of the disclosures without complying with all of the requirements of IFRS 12 and without applying the other four Standards.

**Approach adopted for the technical evaluation of the effective dates of the Standards**

2 The European Commission Regulation (EC) No 1606/2002, requires that a Standard or an Interpretation:

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1. meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

3. EFRAG believes that to produce financial reporting that meets the EU regulation endorsement criteria, financial reporting standards must not only provide for sensible accounting requirements, but also ensure that those requirements can be implemented as intended. Therefore, EFRAG considered as part of its assessment against the endorsement criteria whether the effective date of the Standards was set accordingly. Specifically, when assessing whether the Standards met the technical criteria for endorsement, EFRAG considered the evidence received from constituents that indicated that a mandatory effective date of 1 January 2013 for the Standards would result in a quality of implementation such that one or more endorsement criteria would not be met.

4. Some constituents raised a number of significant practical concerns in respect to the mandatory effective date of 1 January 2013. In particular, these constituents noted that the mandatory effective date of 1 January 2013 would not allow them sufficient time to implement the new requirements set out in IFRS 10 and IFRS 11 in a manner that would produce reliable information. These constituents indicated that they needed more time to develop a common understanding of IFRS 10 and IFRS 11 and prepare for their implementation, particularly when the requirements and necessary assessments involve significant judgement.

5. EFRAG notes that deferring the adoption of the Standards, raises concerns about loss of comparability of information, particularly when permanent differences arise as a result of differences in the start date of application of IFRS 10 and IFRS 11. However, EFRAG believes that permanent differences would only arise in limited circumstances, as explained below. EFRAG also acknowledges that deferring the mandatory effective date would affect comparability as some entities would adopt early and others would not. EFRAG believes, however, that first and foremost, the conditions for preparation of reliable financial reporting must be met, as a lack of reliability may result in the true and fair view principle not being met.

6. For the reasons mentioned in paragraph 4 above, which are further explained in the letter to the European Commission, EFRAG concluded that the mandatory effective date of 1 January 2013 in IFRS 10 and IFRS 11, would not allow meeting the reliability criterion, for all entities. In EFRAG’s view, a deferral of the mandatory effective date to 1 January 2014, while permitting early adoption, would allow those constituents that experience the concerns noted above to ensure that their financial statements are prepared reliably, and EFRAG concluded that IFRS 10 and IFRS 11 meet the endorsement criteria. However, those constituents that do not experience the concerns noted above should not be prevented from complying with the original mandatory effective date of 1 January 2013.

7. Therefore, notwithstanding EFRAG’s positive recommendation that the Standards meet the endorsement criteria, EFRAG does not support the mandatory effective date of 1 January 2013, and recommends the mandatory effective date of the Commission Regulation amending Regulation (EC) No 1725/2003 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards to the Standards to be 1 January 2014 with early adoption permitted. The letter to the European Commission sets out EFRAG’s findings on the concerns raised with an effective date of 1 January 2013 for the Standards.
Temporary and permanent differences resulting from a deferred effective date

8 EFRAG acknowledges that a difference in adoption dates can create both temporary and permanent differences in financial reporting between IFRS as issued by the IASB and IFRS as endorsed by the EU. The temporary difference in 2013, as a result of the application of different standards, would disappear in 2014. However, to the extent that companies are permitted to apply the Standards prospectively – as a result of transitional reliefs in those Standards – any differences in the start date of application might give rise to permanent differences that would not disappear in 2014.

9 EFRAG believes that such permanent differences would only arise in limited circumstances and they could be minimised by avoiding reliance on the transitional reliefs. Companies that need to comply with IFRS as issued by the IASB, such as those with a listing in the US, would avoid permanent differences altogether as they would adopt the Standards in 2013.

Investment entities ED

10 The Exposure Draft Investment Entities, issued by the IASB in August 2011, proposes an exception from consolidation for companies that meet the definition of an investment entity. In EFRAG’s view, the Exposure Draft may result in a change in the scope of consolidation compared to the requirements in IFRS 10, which may lead to unnecessary cost and uncertainty for constituents. EFRAG notes that the IASB, when consulting on the proposals in the Exposure Draft, specifically asked constituents whether or not they believed that a parent entity should retain the fair value accounting applied by their subsidiaries that are investment entities. In EFRAG’s view, some companies (mainly banks and insurers) might be required to start consolidation of certain investments under the current requirements of IFRS 10, but might need to adopt investment entity accounting (i.e. fair value through profit and loss accounting) once a standard on investment entities is completed. EFRAG believes that the IASB should have finalised its decisions on the Exposure Draft, before requiring the mandatory adoption of IFRS 10.

One effective date for the Standards

11 Given the interaction between the Standards, EFRAG believes that the mandatory effective date should be the same for all the Standards.