FEEDBACK REPORT ON THE EUROPEAN OUTREACH EVENT ON EFRAG PROACTIVE DISCUSSION PAPERS

EFRAG

OIC – ORGANISMO ITALIANO DI CONTABILITA'

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DISCLAIMER

This feedback report has been prepared by EFRAG secretariat for the convenience of European constituents. The content of this report has not been subject to review or discussion by the EFRAG Technical Expert Group although it has been jointly approved for publication by representatives of EFRAG and the OIC attending the event.

Panel

- *Massimo Tezzon – OIC General Secretary*
- *Andrea Toselli – EFRAG TEG Member*
- *Mario Abela – EFRAG Research Director*
- *Alberto Giussani –Vice President of OIC Technical Committee*
- *Andrea Angelino – ENEL Group Administrative Director*
- *Chiara del Prete – Unicredit Head of Accounting Principles and Disclosure*
- *Lorenzo Pini Prato – PwC Partner*
- *Enrico Laghi – Full Professor of Business Economics*
- *Tommaso Fabi – OIC Technical Director*
- *Alessandro Sura – OIC Director of Research*
- *Giorgio Alessio Acunzo – EFRAG Project Manager*
- *Leonardo Piombino (observer) – IASB staff*

Executive summary

Objective

EFRAG's Discussion Papers issued as part of its proactive projects.

In October and in December 2011, EFRAG issued two Discussion Papers, 'Accounting for Business Combination under Common Control' and 'Improving the Financial Reporting of Income Tax'. These publications have been issued together with the Italian standard setter Organismo Italiano di Contabilita' (OIC) and the UK Accounting Standards Board (ASB) respectively.

The accounting for Business Combination under Common Control.

The Discussion Paper on accounting for Business Combinations under Common Control represents a first step in responding to the diversity that exists in practice. It principally aims to set out the arguments and provide analysis to stimulate discussion and debate and, therefore, includes a comprehensive analysis of the issues drawing on the relevant IFRS literature. In addition, it notes that there is no 'ideal' approach but draws out three different views of looking at the problem, highlighting some of the strengths and weaknesses of each.

Improving the Financial Reporting of Income Taxes.

The Discussion Paper on income tax represents the first step to gain input on whether IAS 12 should be improved or whether there should be a fundamental rethink and a new approach has to be pursued. Several commentators argued that IAS 12 is a difficult standard to understand and apply, and users do not find the information reported on useful. Income tax represents one of the most significant single costs to most businesses and the accounting for it remains relevant.

EFRAG, together with National Standard Setters, is engaged in organising outreach events to collect constituents' views on the topics.

EFRAG and the National Standard Setters involved in these proactive projects are keen to gather views from constituents and obtain input in order to understand what practitioners and others think about the topics.

This feedback statement summarises the comments made at the outreach event held in Milan on 15 March 2012, arranged in co-operation with the Italian Standard Setter the OIC – Organismo Italiano di Contabilita' and with PricewaterhouseCoopers SpA (Italy).

It is expected that the input from this event (and similar events being held in other countries) will be beneficial to EFRAG, the National Standard Setters involved and the future work of the IASB.

Next Step.

This feedback report is intended to be read together with EFRAG's Discussion Papers, which detail the arguments discussed at these outreach events.

EFRAG has deliberately not taken a position in either Discussion Papers. Given the objective of both Discussion Papers, EFRAG has attempted to provide a comprehensive analysis of the issues and the clear intention is for constituents to consider the arguments set out and provide their views. The nature of comments received will form the basis for EFRAG's re-deliberation of the issues that fall in the scope of the project. It will be at that stage that a decision will be taken about what further steps need to be taken before putting forward views to the IASB.

EFRAG proactive activities.

It is important to set these projects within the broader context of EFRAG's Proactive Work. EFRAG aims to influence future standard-setting developments by engaging with European constituents and providing timely and effective input to early phases of IASB's work. This proactive work is done in partnership with National Standard Setters in Europe to ensure resources are used efficiently and to promote stronger coordination at European level.

There are four strategic aims that underpin proactive work:

- Engaging with European constituents to ensure we understand their issues and how financial reporting affects them;
- Influencing the development of global financial reporting standards;
- Providing thought leadership in developing the principles and practices that underpin financial reporting; and
- Promoting solutions that improve the quality of information, are practical, and enhance transparency and accountability.

More detailed information about our proactive work and current projects is available on the EFRAG website (www.efrag.org).

Methodology

The Outreach event was conducted by presenting the main topics analysed within the Discussion Papers to the audience made up of preparers, users and practitioners.

Participants were requested to express their views in response to the questions included in the Discussion Papers.

The EFRAG secretariat prepared this feedback statement for release on the EFRAG website.

Level of participation

The tables below show the number of participants by nature and by industry:

Nature	Number
Users	48
Preparers	56
National Standard Setters	10
Total	114

Industry	Number
Accountants	35
Banking & Insurance	19
Services	16
Telecommunications	7
Utilities	7
University	6
Others	24
Total	114

Opening and Introduction

The OIC General Secretary welcomed participants to the Outreach event aimed at collecting constituents' view on EFRAG proactive discussion papers on 'Accounting for Business Combination under Common Control' ('the BCUCC DP') and 'Improving the Financial Reporting of Income Tax' ('the IT DP').

The OIC General Secretary introduced the Outreach event giving key messages for future developments.

Given their ownership structures, Italian companies are significantly affected by BCUCC transactions.

He expressed OIC's view about the importance of dealing with the accounting for BCUCC. Such transactions regularly occur in Italy due to the existence of several highly concentrated and vertically structured groups. In addition, the choice made by the Italian legislature to require listed companies and certain other entities to apply International Financial Reporting Standards ('IFRS') for their separate financial statements, had led to the OIC starting a discussion on this topic with EFRAG and issuing the DP. The intention was to stimulate the debate at the European level and, ultimately, at the International Accounting Standard Board ('the IASB').

The Italian Auditing Association (ASSIREVI) had produced relevant guidance ('the Italian guidance') in accounting for BCUCC. It is noted that issuing national guidance is not suitable in order to achieve the consistent application in jurisdiction applying IFRSs.

In this context, the OIC, as a national standard setter, decided that it was needed to promote proactively the development of a project on this subject.

Furthermore, he recognised that it was no longer possible to issue any sort of document at a local level without an international debate being present. Issuing documents at a local level also carries the risk of introducing differences in practice, undermining the consistent application of IFRSs.

As National Standard Setter the OIC is determined to participate in the international accounting debate.

The cooperation with EFRAG in drafting the BCUCC DP represented therefore the evidence of the turning point for the OIC. It has formally become part of the international accounting debate and, together with EFRAG and the other European National Standard Setters, is tracing the path to let Europe speak with a single voice to the IASB.

The factual evidence of such influence should be that the tentative Agenda of the IASB includes a project on accounting for BCUCC.

The project scope has been limited to the consolidated accounts. Further developments may occur if the accounting for BCUCC transactions was

On the BCUCC DP specifically, he stressed the importance of having carved out from the project, the analysis of the impacts that BCUCC transactions have on the separate financial statements. He noted that at an early stage, participants in the project doubted whether the current set of IFRS and the Conceptual Framework provided sufficient guidance in general, with reference to separate *extended to separate financial statements.*

financial statements. Therefore, the document requests to constituents to give input on whether the project on BCUCC should deal with these transactions at separate financial statement level. This could lead IASB to consider this issue in its project and, more generally, to consider also the role of separate financial statements.

The accounting for Income Taxes similarly represents a widespread issue.

The General Secretary also stressed the importance of the DP on income taxes, as multiple constituents have called for improved guidance and stated that the OIC was proud of having contributed to it.

EFRAG Proactive Activities

The Vice President of the OIC Technical Committee introduced the topic of the role of EFRAG proactive activities. He explained that EFRAG received pressure from European constituents (users, preparers, regulators and National Standard Setters) to influence the international standard setting process before reaching the stage of endorsement advice.

EFRAG aims to represent the European accounting voice.

The 27 countries which make up the European Union, represent a rare instance of countries that apply IFRSs without adapting them to their local specificities. Therefore, the European view should be taken into account and influence the IASB before it issues final determinations.

At the same time, he believed that the role of EFRAG enhanced the European view at the IASB level, while other big economies – both developed and developing – are also demanding a more active role in the international standard-setting process.

EFRAG's proactive activities are aimed at stimulating and influencing the accounting debate.

He underlined that EFRAG proactive projects are aimed at gathering constituents' views at a national level, to identify specific issues and to evaluate their impact within Europe. Furthermore, EFRAG proactive activities enhance financial reporting not only within Europe but across the world of IFRS preparers.

EFRAG Research Director continued, describing the proactive projects currently ongoing, and underlined that EFRAG proactive activities are aimed at influencing the international accounting debate. In particular, it is too late to wait until endorsement to influence the content of IFRS – efforts need to begin upstream.

As discussed in the paper 'Considering the Effects of Accounting Standards', which is to be finalised shortly, what EFRAG and the other National Standard Setters are trying to achieve is to make the IASB consider the impacts of accounting standards before issuing them. A metaphor for this is drug trials to evaluate the efficacy of a drug prior to regulatory approval. Whilst standard setting was not as scientific, the same burden of proof in terms of evidence of the intended outcome should apply.

The proactive projects 'Business Combinations Under Common Control' and 'Improving the Financial Reporting of Income Taxes' were to be discussed at the outreach event.

Another project is on the 'Disclosure Framework', which is considering how to improve the quality of information disclosed in the notes to the financial statements.

The project is accordingly aimed at defining a framework of principles to be used by standard setters and preparers in applying requirements. This project involves the UK ASB, the French ANC and co-operation with the US FASB who have a similar project underway.

Other on-going projects are:

- The role of the business model in financial reporting;
- Separate financial statements;
- How capital providers use financial statements.

The project on 'The Role of the Business Model in Financial Reporting' stems from the introduction of the Business Model in IFRS 9 in deciding how to classify and accordingly measure financial instruments, and a more general trend to refer to the business model in IFRS literature. The main question is what a business model is and how financial reporting should allow companies to disclose and reflect these. Historically, this has been reflected in the way companies account for transactions in their income statements, which actually disclose how companies achieve their financial and economic goals. Currently, with the statements of comprehensive income, it is difficult to identify an entity's past performance.

The project on 'Separate Financial Statements' is of relevance as the current set of IFRS is mainly focused on consolidated financial reporting: preparers have often struggled with applying the IFRS on the separate financial statements.

In 'How Capital Providers Use Financial Statements', the main topic EFRAG would like to investigate is what capital providers do with financial information. Understanding this better should enhance the analysis of accounting issues for the users of financial reporting.

Future projects of the EFRAG proactive team will depend on the IASB agenda. But what is certain is that further resources will be invested on the disclosure framework, on investigating what performance reporting is and what should be the proper relationship between elements in the statement of comprehensive income, on the conceptual distinction between debt and equity, and, finally, on what should drive the basis of measurement.

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The TEG member asked whether EFRAG proactive activities were influencing the IASB's current and future activities.

EFRAG Research Director replied that the impact is significantly increasing, with particular reference to the work carried on the Disclosure Framework and on the accounting for BCUCC.

In addition, the fact that EFRAG had started to work jointly with the FASB has generated interest from the IASB side to understand, on a regular basis, the status of EFRAG proactive projects. Moreover, the IASB is intending to leverage from the work EFRAG had produced so far, recognising EFRAG's efforts.

Accounting for Business Combinations Under Common Control

Andrea Toselli – EFRAG TEG Member

He introduced the main topics dealt with in the discussion paper, which represented three years of hard work from the project group.

One of the valuable characteristics of the BCUCC DP is that it had been drafted by a project group including people from diverse countries and professional backgrounds.

The setting up of the project.

The project stems from the lack of specific guidance on BCUCC transactions within IFRS 3 Business Combinations (and previously within IAS 22 Business Combinations) which are scoped out from the standards. As BCUCC are scoped out, the standards do not forbid applying the treatment required for business combinations to BCUCC transactions and, hence, the debate arises on the opportunity to do it.

The separate financial statements issue.

Defining the scope of the project represented the most critical issue of the entire project. Early stage discussions identified that the separate financial statements issue is not shared around Europe. Many countries still allow or require individual accounts to be prepared under local accounting principles.

The 'mirror accounting' issue.

The decision to deal only with consolidated financial statements of the transferee also represented a matter of choice. The prevailing view was that accounting for the sale of the business in the consolidated financial statements of the transferor would have to comply with other relevant standards.

Similarities and differences with other generally accepted set of accounting standards.

The analysis of similarities and differences with other set of GAAPs has also represented a key step in setting up the project. For example, under US GAAP, the accounting for BCUCC is treated as a transfer of net assets.

Purposes of transactions.

The project team spent significant time and resources analysing the effects on stakeholders. When cash consideration is transferred, an investor may question the effect on the return on investments, especially in terms of cash flows and risks.

The 'reporting entity' issue.

Finally, consideration had been paid to the fact that the entity which purchases the business is controlled by the ultimate parent, which has the control not only on its relevant activities but also on the process that leads to the preparation of the financial statements.

He emphasised that all the project members agreed that the users' needs should be considered throughout the analysis while, at the same time, deciding to exclude from the analysis any local legal requirements.

The project identified two fundamentally opposite views for accounting for such transactions:

- An acquirer can always be identified and, hence, the acquisition basis within IFRS 3 could always be used;
- Transactions can be seen as a mere transfer not affecting cash flows or risks and should, therefore, be accounted for on a predecessor accounting basis.

The methodology followed to investigate the issue.

In order to perform a rigorous analysis of the issue, the hierarchy within IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors was followed in order to ensure consistency with the Conceptual Framework and existing IFRS literature.

Even the terminology used in the DP was deliberately determined in order not to influence the debate. Therefore, the term 'transferee' is used instead of 'acquirer' (which is derived from IFRS 3) while, at the same time, using a definition of 'business' derived from IFRS 3.

The main question.

The project was set up on the main question of whether the step-up accounting set out in IFRS 3 best depicts the economics of such transactions when occurring between parties under common control, rather than merely being related.

The views identified.

The working group identified three different views and these are set out in the DP:

a) View 1: IFRS 3 should always apply whenever an acquirer can be identified;

b) View 2: Step-up accounting should never be applied, as these transactions are completely different from those covered by IFRS 3 and the selection of an accounting treatment is dependent upon who the users and their information needs are (the so called 'predecessor basis of accounting' or 'the fresh start accounting');

c) View 3: Facts and circumstances should be evaluated in order to understand on occurrence which of View 1 or View 2 best depicts the economics of the particular transaction and gives relevant information.

The transaction price might influence the accounting treatment.

View 3 is broadly similar to the Italian guidance as it leads to an analysis of the individual transaction aimed to assess what is the most appropriate treatment for the specific transaction based on specific facts and circumstances.

He noted that View 1 was not applicable in situations when the transaction was undertaken at a price not reflective of the current value of the assets transferred.

Constituents' responses to the questions set out in the DP will influence both the finalisation of the DP and future debate on the topic.

Views and experience of panel members

Chiara Del Prete – Unicredit Head of Accounting Principles and Disclosure

UniCredit experienced, in the period 2005 – 2007, a path of external growth with several business combinations, followed by a reorganisation phase. For example, in 2010, all the Italian banks were combined and merged into the Holding Company for internal reorganisation purposes.

Given that there is no specific treatment for BCUCC under IFRS, the representation of these transactions in the separate financial statements of the entities involved, has been determined from time to time, on the basis of developing standards and interpretations.

Considering the peculiar economic nature of most these transactions, the prevailing approach adopted is the predecessor basis of accounting, i.e.:

- the carrying amount existing in the financial statements of the transferor has been assumed for initial recognition in the financial statements of the transferee of the net asset transferred; and
- the difference between transfer price and carrying amount of the net asset transferred has been recognised in an equity reserve by both the transferor and the transferee.

This accounting treatment was in particular preferred when, considering the economics of the specific BCUCC transaction and under the perspective of the transferee, applying IFRS 3 would not have resulted in more relevant information. The following economic characteristics normally would prevail in these types of BCUCC:

- The transactions do not change the ultimate controlling entity. In other words, the operating and financial policies are determined by the same ultimate parent company before and after the transaction.
- The goal of the transaction is not to create additional synergies, but rather to give the ultimate parent the opportunity to fully achieve the synergies embedded in the existing goodwill, initially recognised when the transferred entity was originally acquired.
- Assets and liabilities continue to be managed on the basis of the transferor's carrying value. Accordingly, the transferor is not able to exploit any additional goodwill that may have to be recognised following the BCUCC.
- Transfer price is not directly derived from the market, as the transferee and transferor are related parties, and:
    i. the price is not formed in a negotiation process and, hence, a continuity concept prevails.
    ii. in the absence of a price formed in negotiation between third parties, the transfer price is in practice typically supported by an independent expert valuation in order to duly consider creditors' and minorities' interests and for tax implication (particularly for cross-border transactions), also taking into account legal requirements.
    iii. the presence of this expert valuation mitigates eventual concerns about the reliability of the transaction price.
- From the perspective of the users of the transferee's financial statements, due to the factors above, predecessor basis of accounting is deemed more representative of the economic substance.
- The excess of the transfer price over the carrying value of net assets transferred represented, from an entity's perspective, a reallocation of resources by the ultimate parent between different legal entities. Accordingly, such excess does not represent a realised profit for the transferor and it does not meet the criteria for recognition as an asset in the balance sheet of the transferee (the fact pattern does not encompass the sale of a subsidiary).
- On the contrary, if the difference is negative it may provide evidence of a possible impairment of the transferred business, to be assessed according to IAS 36 and, in

presence of the conditions set in this standard, recognised by the transferor before the transfer.

However, a rather different concept prevails if the transferor is not fully owned by the ultimate parent but minorities are significant. In this case, the recognition of a profit/loss might also provide useful information to the users of the transferor's financial statements. In this case, if the predecessor basis of accounting is applied, appropriate complementary disclosure should be requested by the relevant standard, in order to properly inform all interested users.

As a preparer, she expressed her concerns on the costs related to holding several sets of accounting data and the related operational risks:

1. Running a parallel accounting system with two different values is excessively onerous, as the transferee is required to report to the parent company based on the former carrying value and to report in its separate financial statements, on the basis of fair value at the BCUCC date.
2. In addition if the transferred business is itself a separate legal entity, a third level might be required and the reporting for the financial statements of the transferred legal entity would be based on the historical cost, which is different than those that have arisen in the first business combination (purchase accounting for the acquisition done by the parent company).

Andrea Angelino – ENEL Group Administrative Director

In recent years, ENEL undertook several transactions identifiable as BCUCC, mainly with the aim of reorganising the structure of the group. They followed mainly the Italian guidance to evaluate the economic substance of the transaction (view 3 in the DP).

Hence, the analysis of any impact on the cash flows before and after the transaction represented the main aspect to evaluate, in order to derive the most appropriate accounting treatment.

He emphasised that several BCUCC within the ENEL Group had been accounted for using the predecessor basis of accounting, from the consolidated financial statements point of view, as no likely impact on future cash flows had been identified.

In some other situations, the approach resulted in accounting treatment consistent with View 1 in the DP. ENEL, in fact, experienced situations where, only few months after the purchase of a business from a third party, the same business had been contributed to other companies within the group. In such situation, using book value was considered the most appropriate treatment as this fairly represented the fair values measured in the recent

Business Combinations accounting.

Notwithstanding, he expressed the view that, sometimes, reorganising the legal boundaries of entities within the group might result in significantly enhancing and improving future cash flows of the combined entities and, hence, the accounting treatment, which, in his view, best represented the substance of the BCUCC was the one in IFRS 3.

He presented a summary of the reorganisation of ENEL reinsurance branches in the Netherlands and he stressed that, in his opinion, the entity that resulted from the BCUCC really represented something different and bigger, compared to the previous separate entities, which participated to the BCUCC and, hence, the application of IFRS 3 guidance resulted in a fair representation of the transaction. He also noted the importance of considering all other implications stemming from the BCUCC transaction, such as tax implications – even if they could not represent the drivers of the accounting treatment – as they may influence the choice of treatment if view 3 is taken.

Lorenzo Pini Prato – PwC Partner

He expressed his view that from a user perspective, it was only partially clear how entities were currently dealing with such transactions due to a limited disclosure; no specific requirements are mandatory in that area. In addition, some groups had not even developed accounting policies specifically related to BCUCC transactions.

There is also the risk that within the same group similar transactions had been accounted for in a non-consistent way. He thought that it would have been beneficial for the analysis to consider how groups were currently dealing with the significant amount of BCUCC transactions which had recently occurred.

He supported the use of the Italian guidance but thought that further enhancements might flow from an analysis of existing non-IFRS accounting literature and in particular from US GAAP and benchmarking.

Trying to identify several subcategories (e.g. the object of the transactions) could further positively contribute to the debate.

He also noted that additional inputs to enhance the debate on BCUCC could derive from the analysis of the impact of evolving accounting key concepts, as the new notion of control introduced by IFRS 10 Consolidated Financial Statements and of fair value measurement consistent with IFRS 13 guidelines. Some additional input can be derived from practical analysis, for example, from specific issues related to funds, structured entities and similar entities within the financial industry. In addition, he thought that consideration should also be paid to the circumstance where these transactions occur between related parties and, therefore, the concept of fair value results significantly challenged under that perspective.

He also noted that even if the predecessor basis of accounting is used in practice, several ways of applying it can be identified and, hence, the divergence in practice has not been removed.

In addition, he believed that there might be further not yet investigated issues stemming from, for example, civil law, tax legislation and regulatory requirements which would relate to the separate financial statements. As already pointed out by some speakers, the accounting treatment of BCUCC in the separate financial statements represents "a problem within the problem".

Enrico Laghi – Full Professor of Business Economics

Prof Laghi noted that the methods of growth followed by UniCredit and ENLI have clearly influenced the accounting representation of the BCUCC transactions they presented.

Groups that have grown externally have already acquired assets and liabilities measured at fair value and recognised any goodwill and intangible assets. Any subsequent reorganisation within the group was presumably aimed at reallocating resources according to the Groups' needs.

On the contrary, Groups which have grown internally (e.g. internal reorganisation) usually are recognised at historical value and, hence, it might be the case where a business is still profitable in terms of profits and cash flows but has negative book value.

He therefore supports View 3 in the DP on BCUCC as it gives the opportunity to identify which is the most appropriate accounting treatment, depending on the facts and circumstances. Nevertheless, he believes that the DP should go further in its analysis and identify some business indicators that would reduce divergence in practice and reduce structuring opportunities.

The economic substance, which is the main driver to be considered while applying the Italian guidance, should be further developed, for example the differences between distributing economic resources within a group and between segments within a group.

Any impacts on minorities also have to be investigated as it might be a case where the BCUCC transactions occur at a different level of the pyramid when several listed companies are spread over the vertical line.

An additional example which came from the practice is the litigation, which quite often arises when a joint venture is created within a group and, subsequently, the venturers decide to re-acquire what they contributed. Using the predecessor basis of accounting in this situation does not represent the economics of the transactions.

He expressed his view that one of the more valuable elements of the DP was the attempt to identify users' needs and, accordingly, to identify the most appropriate corresponding accounting practice.

Moreover, he believed that the real issue depended on the impacts on the separate financial statements of the entity. The main question to be answered is which entity should be considered the reporting entity. Is it the legal entities directly involved in the BCUCC or is it the ultimate parent company?

He believed that this issue required an extension of the scope of the DP, also considering all local regulatory and civil requirements along with accompanying complications.

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A user wondered if, instead of having invested so much effort in drafting the DP, it would not have been more useful to derive guidance from the Italian guidance or to refer to the existing guidance in IAS 16 *Property, Plant and Equipment* and in IAS 38 *Intangible Assets* on the exchange of assets.

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The EFRAG TEG member replied that, considering that the Italian guidance has been developed by a panel of Italian auditors, no due process has thus been followed to involve other constituents. In addition, the document encompasses other topics, such as issues related to the so-called 'mirror accounting' and the accounting treatment of BCUCC transactions within the separate financial statements. On the other hand, the DP on the BCUCC is the result of a three year debate which involved people from different professional backgrounds and interests and, hence, might fairly represent a shared basis for discussion.

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The Technical Director of the OIC noted that, whilst the guidance issued in Italy by the association of auditors looks at the economic substance of the transaction, the approach developed within the DP resulted from a more rigorous analysis, which stems from the Conceptual Framework and from financial statements users' needs. Therefore, it is improper to analogise the view 3 with the guidance issued in Italy by the association of auditors and thus, the DP represents a step ahead in the discussion on accounting for BCUCC.

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The OIC Director of Research expressed his view that the Italian document was difficult to apply and, in his personal experience, led entities to reduce their net assets even in circumstances when the price paid fairly represented, in their opinion, the substance of the transaction.

Moreover, he reminded the group that the guidance on the exchange of assets should be applied only in circumstances where the nature of the exchanged assets is the same; accordingly, in a BCUCC transaction where the nature of the assets exchanged is dissimilar, such guidance would not have been used.

Improving Financial Reporting on Income Taxes

The EFRAG Research Director introduced the project which was started four years earlier. The IASB had a similar but smaller project to make IAS 12 consistent with the relevant USGAAP standard. But it did not succeed in achieving its original objectives.

The DP in particular is divided into two section; within the first one, constituents are required to express their view on whether they believe that IAS 12 should be improved generally; several areas of improvement are provided to stimulate the debate thereon. If they believe that the standard is burdensome and does not appropriately produce relevant financial information, the second section of the paper provides a different theoretical approach, which could be followed in accounting for income taxes.

What is important is that the reporting of income tax expenses should be intelligible and comprehensible, especially given their significance in the context of an entity's performance.

Input from users is that they would like to understand the sustainable future tax rate for an entity, in order to properly model performance. This would require improvements structured around clear disclosure and reconciliations between tax paid and tax reported.

Some consideration is also given to measurement issues as, for instance, constituents ask themselves why deferred tax liabilities are not discounted, given the guidance in IFRS on long term liabilities.

Finally, constituents require a clear guidance on recognition and measurement of uncertain tax positions which currently are scoped in IAS 12 without a clear and articulated guidance thereon.

The second part of the DP explores the different opportunities that could be used to build a renewed standard on income taxes based on the following potential approaches:

- Temporary Differences (the IAS 12 approach)
- Flow Through
- Valuation Adjustments
- Partial Allocations
- Accruals

The Temporary difference approach aligns accounting with tax values. Nevertheless, some may argue that recognising deferred tax on temporary difference is not in compliance with the recognition criteria set in the Conceptual Framework on assets and liabilities.

The quantity of questions submitted to the IFRS Interpretations Committee and amendments introduced through the Annual Improvements projects demonstrate the difficulty that preparers and practitioners have in applying the current standard.

Moreover, some struggle with the definition of income taxes as in some countries, several taxes have been introduced that have not been clearly placed within the definition set in IAS 12.

The Flow Through approach requires supplementary disclosures to provide some understanding of future tax implications. Tax expense is measured in accordance with the tax return. The problem with this approach is that it requires the same level of work as temporary differences and therefore does not resolve the issue of burden.

The Valuation adjustment approach is considered by academics to be the purest as it tries to identify, within assets and liabilities, the economic consequences deriving from the assets and liabilities per se and the economic consequences from the tax regime.

Under the Partial allocation approach, deferred tax accounting is to be applied only to some sorts of temporary differences on a pragmatic basis. Some complain that this approach is not useful in evaluating cash flows.

Finally, the Accruals approach requires starting from the tax liabilities and then considering the tax differences which impact on its calculation. It is similar to the current approach followed in IAS 12 but it implies that fewer temporary differences should be recognised - only those foreseen will influence the tax liability. It is a principle-based approach, which places itself near current IAS 12 guidance but is easier to apply.

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The Technical Director of the OIC queried IASB's approach to improving the accounting for income taxes.

The EFRAG Research Director replied that in his opinion the IASB would not have soon dealt with Income Taxes. Within the public consultation the IASB had on its proposed agenda, income taxes had not come out as a problem to address.

Closing

The OIC General Secretary highlighted that the OIC is following two projects: the proactive project in Separate Financial Statements and another project on the impairment of goodwill, which is going to be presented at the forthcoming international meeting in Kuala Lumpur.

He wanted to re-emphasise the importance of the proactive project on the Separate Financial Statements. He believed that all the input to be collected during similar outreach events might even result in constituents calling for a revision, not only of the European Regulation on the implementation of IFRS in Europe, but also to the whole set of IFRS. If this were the case, the IASB should admit that it is not practicable to resolve all the existing and future issues on the application of IFRSs to the separate financial statements.

Moreover, it should be finally accepted that the separate financial statements are a relevant instrument within financial reporting and play an important role in several jurisdictions for tax matters, civil law purposes, etc.

In this regard, for example in Italy, there is a law (the so-called 'Milleproroghe') which, in the light of the IFRSs impact on the financial statements, permits to introduce some mechanisms in order to be consistent with the local set of rules governing the preparation of financial statements (e.g. profit distribution).

Furthermore, he recognised that there are other relevant transactions which have not yet been dealt with, within the IFRS. The OIC is working to fill the gap and to further stimulate the debate around Europe and at the IASB.