

EFRAG STAFF PAPER FOR PUBLIC MEETING

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Final endorsement advice on the Amendments to IAS 27
Equity Method in Separate Financial Statements

Note to EFRAG Board Members

- 1 On 12 August 2014, the IASB published *Equity Method in Separate Financial Statements* (Amendments to IAS 27). The Amendments allow entities to account for their investments in subsidiaries, joint ventures and associates under the equity method in their separate financial statements in addition to the existing options in IAS 27 to account for such investments either at cost or at fair value. An entity will, however, have to apply the same accounting treatment for each 'category' of investments (associate, joint venture or subsidiary).
- 2 The Amendments are applicable retrospectively for annual periods beginning on or after 1 January 2016 with early adoption permitted.

EFRAG TEG discussion and advice to the EFRAG Board

- 3 On 23 October 2014, EFRAG published its draft endorsement advice and effects study report on *Equity Method in Separate Financial Statements* (Amendments to IAS 27). EFRAG's initial assessment was that:
 - (a) the Amendments met the criteria of understandability, relevance, reliability, and comparability. EFRAG emphasised that, although the introduction of an additional accounting option may impact comparability, there was a trade-off with relevance, as the Amendments would result in some entities providing information that was more decision-useful to users of separate financial statements;
 - (b) the Amendments would not result in significant increased costs for most preparers and users, particularly when considering that the use of the equity method is optional in the separate financial statements prepared under IFRS; and
 - (c) the Amendments would not result in significant benefits for all preparers, i.e., it was likely to be neutral for many preparers.

Feedback received on EFRAG's draft Endorsement Advice

- 4 At the date EFRAG TEG finalised its advice to EFRAG Board, six comments letters [ASCG; anonymous German preparer; ICAEW; UK FRC; AAT; EASB] had been received in response to its Draft Endorsement Advice. Two additional letters [ICAC, OIC] were received after EFRAG TEG finalised its advice to the Board. A list of respondents, in each category, is provided in Appendix 2.
- 5 All respondents (including the ones that provided input after the EFRAG TEG meeting) agreed with EFRAG's initial assessment that the Amendments meet the technical criteria for endorsement.
- 6 One respondent [AAT] commented that the equity method was particularly relevant when the investor and its investees carry out the same activities and the investees operate as "divisions" of one overall activity.
- 7 The five respondents that provided comments on EFRAG's assessment of the benefits of implementing the Amendments and the associated costs involved for users and preparers [German Company; ICAEW; UK FRC; AAT; EASB] agreed with that assessment.
- 8 Finally, six respondents [ASCG; anonymous German preparer; ICAEW; UK FRC; AAT; EASB] agreed with EFRAG's initial assessment that there is not a reason to believe that it is not conducive to the European public good to adopt the Amendments. Other respondents did not specifically address the question in their response.
- 9 One respondent [OIC], while supporting the endorsement advice, emphasised that the introduction of the equity method further stressed the need to conceptually define the role and objectives of separate financial statements and the challenges that arise in practice to those who prepare and use them as identified in the discussion paper on separate financial statements, recently published by EFRAG and its partners.
- 10 To address that concern EFRAG Secretariat has prepared a draft letter to the chairman of the IASB which is presented in agenda paper 12.04.

EFRAG TEG advice to the EFRAG Board

- 11 Considering the feedback received, EFRAG TEG maintains its initial assessment that the Amendments:
 - (a) are not contrary to the principle of 'true and fair view' set out in Article 4(3) of Council Directive 2013/34/EU; and
 - (b) 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.
- 12 EFRAG TEG is not aware of any reason to believe that it is not conducive to the European public good to adopt the Amendments.
- 13 Therefore, EFRAG TEG advises the Board to approve the final endorsement advice that recommends the endorsement of the Amendments. All members of EFRAG TEG present at the December meeting supported this recommendation, except for one EFRAG TEG member who expressed a dissenting opinion. This view is described in Appendix 1 of this paper.

EFRAG staff recommendations

- 14 EFRAG staff recommend that EFRAG Board approve a positive endorsement advice to the European Commission. The basis for this view is:
 - (a) this is a straightforward and generally welcomed amendment to IAS 27; and

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- (b) there is no issue that needs further investigation from the perspective of the European public good.
- 15 EFRAG staff recommend that the additional concern, which is beyond the scope of EFRAG's endorsement advice to the European Commission, be raised with the IASB and include a draft letter for the consideration of EFRAG Board.

Questions for EFRAG Board members

- 16 Do EFRAG Board members approve the Letter to the European Commission included in agenda paper 12.02?
- 17 Do EFRAG Board members approve the draft letter to the IASB Chairman in agenda paper 12.03?

Agenda Papers

- 18 In addition to this cover note, agenda papers for this session are:
- (a) Agenda paper 12.02 – Letter to the EC
 - (b) Agenda paper 12.03 – Draft letter to the IASB chairman.

Appendix 1: EFRAG TEG member' Dissenting opinions

- 1 Araceli Mora dissents from recommending the endorsement of the Amendments.

THE MOTIVATION FOR THE AMENDMENT

- 2 Araceli Mora believes that the motivation for the amendment can have undesirable unintended consequences.
- 3 Araceli Mora notes that in paragraph BC10B of the Amendments to the Basis for Conclusions on *IAS 27 Separate Financial Statements* the IASB explains that the only reason for the Amendment is to facilitate convergence between local GAAP and IFRS in those jurisdictions where local GAAP is required for separate financial statements and such local GAAP requires the use of the equity method to account for investments in subsidiaries, joint ventures and associates.
- 4 Araceli Mora believes that the motivation behind the amendments is wrong and emphasises that the same rationale could be applied to many other issues, as most countries have local GAAP for separate financial statements. It is understandable that preparers, and even local enforcers, will prefer to have the same valuation method in both separate and consolidated financial statements (implicitly assuming that Equity Method is not a consolidation method as we are considering separate financial statements). However, there might be additional cases where they would prefer to further align the accounting policies of separate and consolidated financial statements and/or to further integrate local GAAP into IFRS.
- 5 Aligning local GAAP and IFRS and/or aligning the accounting policies of separate and consolidated financial statements can reduce costs of preparing and supervising financial reports. However, in her view, this reasoning can have unintended consequences on the development of new standards or future amendments if the IASB wants to be consistent.

IMPACT ON RELEVANCE

- 6 Araceli Mora also believes that there is a loss of relevance in the primary financial statements as a consequence of the Amendments.
- 7 As mentioned in paragraph 4 of appendix 2 of the draft endorsement advice, in order to evaluate the impact on relevance, EFRAG considered whether the Amendments would result in the provision of relevant information or whether it results in the omission of relevant information.
- 8 In fact, Araceli Mora does not deny that the use of equity method in separate financial statements will provide relevant information to users. However, she also believes that this information is redundant, as such information is already provided in consolidated financial statements. Araceli Mora also notes that when the IASB decided to remove the option to use the equity method in separate financial statements in 2003, it provided this very same argument.
- 9 In addition, allowing the use of the equity method in separate financial statements may omit very relevant information from the primary financial statements. If preparers opt to use the equity method in separate financial statements, information provided under the "cost method" or the "fair value method" would be lost. In her view, disclosures will never be considered a complete substitute for recognition and measurement, as it is argued many times.

IMPACT ON COMPARABILITY

- 10 Araceli Mora thinks there is a clear loss of comparability as a consequence of the Amendments.
- 11 As stated in paragraph 15 of the appendix 2 of the draft endorsement advice, “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”.
- 12 Araceli Mora is in general not in favour of permitting options in the accounting treatments for the same given transaction or event, (unless there is a strong reason supporting the option) as it reduces the comparability of financial information among entities. In fact, Araceli Mora highlights that this amendment is against one of the IASB’s objectives referred in paragraph 12 of the Preface to IFRS, where it states that the IASB intends not to permit choices in accounting treatment.
- 13 The Amendments will only increase consistency in the accounting policies applied in separate and related consolidated financial statements. Araceli Mora thinks that this is not the definition of comparability, and this increase in consistency between separate and consolidated financial statements may not be necessary and not even desirable.
- 14 Finally, Araceli Mora notes that in the recently published Discussion Paper on Separate Financial Statements it is argued that different uses and users of separate financial statements could justify the uses of different accounting policies.

Appendix 2: List of respondents to our Draft Endorsement Advice

- 1 At the date EFRAG TEG finalised its advice to EFRAG Board, six comments letters had been received:
 - (a) Accounting Standards Committee of Germany (ASCG);
 - (b) German Listed Company, included in the ASCG letter (from the DAX30);
 - (c) Institute of Chartered Accountants in England and Wales (ICAEW);
 - (d) Financial Reporting Council (UK FRC);
 - (e) Association of Accounting Technicians (AAT);
 - (f) Estonian Accounting Standards Board (EASB)

- 2 After EFRAG TEG finalised its advice of the Board, two additional comment letters were received:
 - (a) Instituto de Contabilidad y Auditoria de Cuentas (ICAC) ;
 - (b) Organismo Italiano di Contabilita (OIC)