IFRS® Foundation

Post-implementation review IFRS 10, IFRS 11 and IFRS 12

Agenda

Introduction to the post-implementation review

IFRS 10

IFRS 11

IFRS 12

Introduction to the post-implementation review

Post-implementation reviews

What is a post-implementation review	• The International Accounting Standards Board (Board) undertakes a post-implementation review of a new IFRS Standard or major amendment after it has been implemented internationally for more than two years • A post-implementation review is a part of the Board's due process and helps to assess the effect of new requirements on investors, preparers and auditors
Outcome of a post-implementation review	• The Board can add a standard-setting project to its agenda, consider one or more matters further as part of its research programme, or both. The Board could also decide to take no action.

Timeline of this post-implementation review

We are here (between Q4 2020 and Q2 2021)

Phase 1	Q4 2020	Q2 2021	H2 2021	TBA
Assess and select matters for further investigation	Publish Request for Information	Comment period ends (10th May)	IASB deliberates on feedback and other evidence	IASB decision and project summary

IFRS

Post-Implementation Review of IFRS 10/11/12 – EFRAG's Project

EEA Workshop – 26 March 2021

EFRAG
European Financial Reporting Advisory Group

EFRAG’s Project

EFRAG’s process

Preparatory phase

- Collect information through working groups, CFSS, EFRAG TEG, EFRAG Board, FIWG, User Panel
- Nov 2019 – Dec 2020

Consultation phase

- Jan 21 - Apr 21 - publication of survey for users and preparers
- Outreach activities – webinars, workshops, interviews

Provide input to IASB

- Collected information shared with IASB
- Stress particular European issues

IFRS 10 *Consolidated Financial Statements*

IFRS 10 control assessment

Definition of control	An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee
Does an investor control its investee?	The IASB is asking for further information on: • identifying relevant activities • rights that give an investor power • control without a majority of the voting rights • agency relationship • non-contractual agency relationship

Control and investment decisions

Premise

- IFRS 10 control assessment is holistic and based on all facts and circumstances.
- Control based on quantitative thresholds may lead entities to hold interests just below or above the threshold to achieve a desired outcome. Prior research shows concentration of shareholding around 50%.

Question

- Is there evidence on changes in the concentration of shareholdings around the 50% threshold or other thresholds following implementation of IFRS 10?

Identifying an investment entity

Feedback

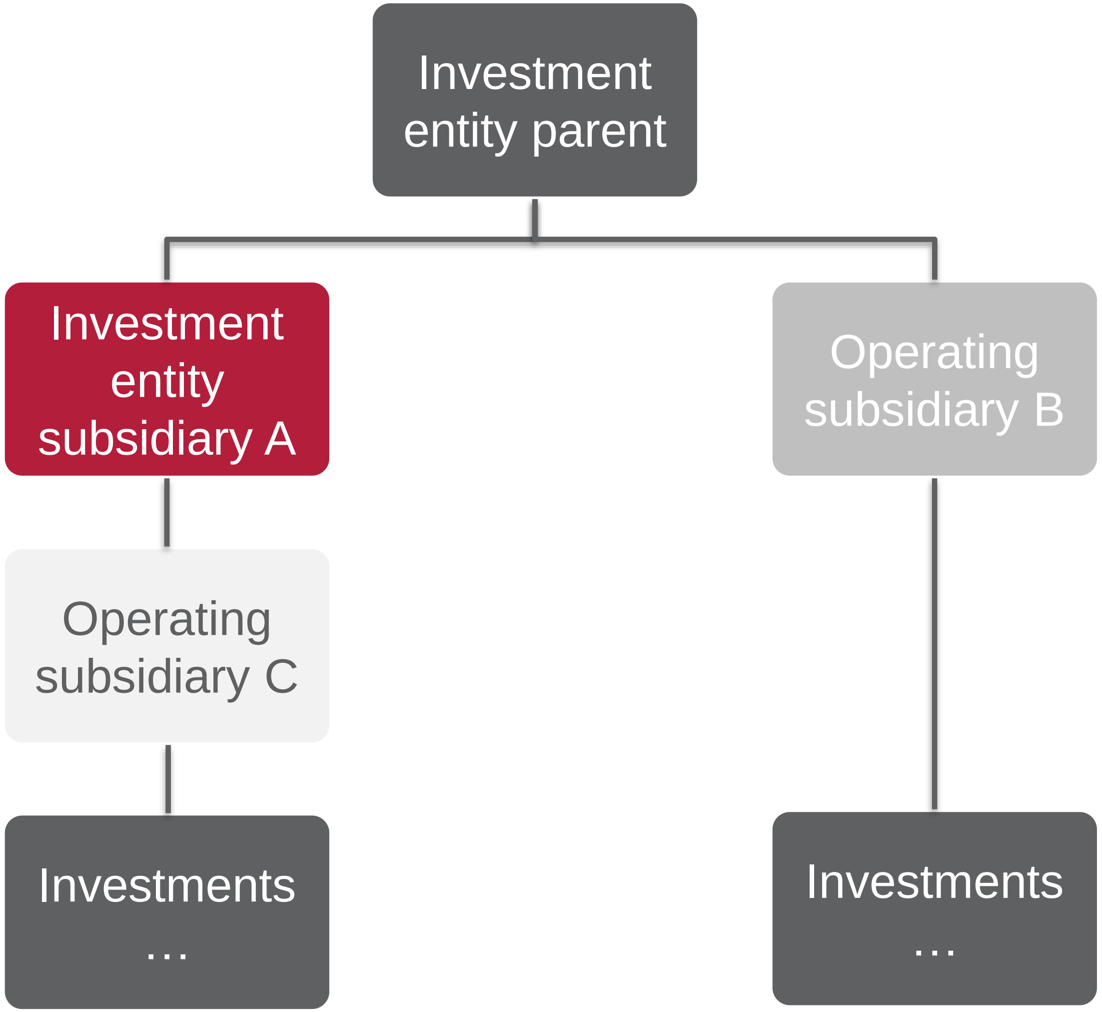
Definition of an investment entity—stakeholders asked for clarification

Criteria		Characteristics	
	• business purpose • exit strategy • fair value measurement		• more than one investment • more than one investor • investors that are not related parties of the entity • ownership interests in the form of equity or similar interests

Accounting for a subsidiary of an investment entity that is also an investment entity

Feedback

Measuring at fair value an investment in a subsidiary which is an investment entity itself (rather than consolidating the assets and liabilities of the subsidiary) results in loss of information



Investment entities

Premise

- There is a wide range of structures (venture capital organisations, investment funds, private equity, sovereign funds) that invest for capital appreciation, investment income or both.
- Measuring an investment entity's investments, including its investments in subsidiaries, at fair value provides relevant information.

Question

- Is there evidence about groups of entities for which fair value provides relevant information, including investments in subsidiaries?

Summary of findings from the academic literature review

- Mixed evidence on whether implementation of IFRS 10 resulted in significant changes in the assessment of control:
  - applying IFRS 10 concept of control (see slide 7) resulted in a change to the number of subsidiaries consolidated (Gluzova, 2015)
  - minor changes were observed in assets, liabilities and profit or loss in the year of implementation relative to the previous year (Lopes and Lopes, 2019)
  - only empirical evidence on the effects of IFRS 10 (Bugeja, Loyeung and Nelson, 2019)
    - no effect on value relevance of earnings and book values
    - entities consolidated fewer non-majority-owned subsidiaries after implementing IFRS 10
    - after implementing IFRS 10, entities that reported a decrease in the number of subsidiaries earned lower consolidated profits
    - no evidence of an association between the number of subsidiaries and leverage, auditor type, CEO ownership and profitability after the implementation of IFRS 10

What have we already heard on IFRS 10

- Assessment of control
  - Determining which rights are protective
  - Assessment of power over investee in de-facto control (particularly, when the ownership changes)
  - Principle vs agent assessment (SPE in fund management)
  - There is lack of definition of returns (e.g., how to consider reimbursables)

- Investment entities
  - General support for IE accounting
  - Request for more information on group financing and leveraging, which is lost in fair valuation

- Practical guidance on consolidation techniques
  - Accounting for cross ownership in groups with financial investments (e.g., pensions)
  - Consolidating different types of investments

Protective rights = rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate

What have we already heard on IFRS 10

- Integral and non-integral investments
  - This notion could be brought into the group accounting and applied to subsidiaries; i.e., a non-integral subsidiary would not need to be consolidated

- IFRS 10 lacks the overarching principle which would explain the reason for consolidated financial statements

- Providing a proof that nobody requested presenting consolidated financial statements in a sub-group, seems challenging

Protective rights = rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate

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

SSE EXECUTIVE EDUCATION

Virtual Research Workshop,
March 26, 2021

Niclas Hellman, Stockholm School of Economics

IFRS 10 – ACADEMIC COMMENTARY

IFRS 10 (AASB 10) may change which entities are within a group. These changes were made by the IASB, in part, in response to the financial crisis, when there was heavy criticism of accounting rules that permitted certain entities to remain off-balance sheet (Ernst and Young, 2011, p. 1).

- To avoid consolidation of entities may have significant impact on accounting numbers. We saw this during the GFC and in the Enron case.

- IFRS 10 is principle-based in a way that should prevent companies from not consolidated entities that they control. If successful, we should not perhaps observe any new accounting scandals due to firms not consolidating de facto controlled entities.

IFRS 10 – ACADEMIC COMMENTARY

ACCOUNTING & FINANCE

The impact of IFRS 10 on consolidated financial reporting

Anna Bedford, Martin Bugeja, Nelson Ma

‘We first consider the implications of IFRS 10 on consolidation practices and find that IFRS 10 adoption resulted in firms reporting significantly fewer subsidiaries, with this result concentrated in the first year of adoption.’

‘…we consider the incidence of non-majority consolidation (i.e., subsidiaries at or below 50 percent) and find evidence of a decrease in the consolidation of non-majority-owned subsidiaries after IFRS 10 adoption, with this effect again strongest in the first year of IFRS 10 adoption.’

This is somewhat surprising – wouldn’t the entities permitted to be off-balance during the GFC be consolidated under IFRS 10?

IFRS 10 – ACADEMIC COMMENTARY

ACCOUNTING & FINANCE

The impact of IFRS 10 on consolidated financial reporting

Anna Bedford, Martin Bugeja, Nelson Ma

The next set of tests examines the consequences of changes in consolidation practices from IFRS 10. First, our results suggest that, inconsistent with the consolidation of loss-making subsidiaries, there is no effect on firm profitability for firms reporting an increase in subsidiaries after the standard is adopted.

Second, our findings show that the value relevance of equity, but not income, increases after IFRS 10 adoption…When partitioning firms based on the directional change in subsidiaries, we document a significant decline in the value relevance of net income after IFRS 10 adoption for firms which consolidate fewer subsidiaries.

The results are somewhat difficult to interpret…

IFRS 10 – ACADEMIC COMMENTARY

. The standard provides further guidance should it not be clear whether there is a controlling influence. In light of the new standard, an analysis of shareholder agreements was carried out. For some joint ventures, the assessment is that SCA has a controlling influence in accordance with IFRS 10.

13 Joint ventures and associates

SEKm	2014	2013	2012
Joint ventures			
Opening carrying amount	837	771	8
Investments	129	10	3
Net increase in joint ventures for the year[1)]	–165	–49	58
Remeasurement effect upon changes in holdings	–	46	–
Reclassifications from subsidiaries to joint ventures	–	37	737
Reclassifications from joint ventures to associates	–719	–	–
Translation differences	40	22	–35
Value at December 31	**122**	**837**	**771**
Associates			
Opening carrying amount	183	1,486	871
Investments	–	1	654
Increase through acquisition	–	58	1
Company divestments	–	–13	–
Net increase in associates for the year[1)]	101	104	65
Reclassifications from associates to subsidiaries	–72	–1,454	–88
Reclassifications due to changes in the acquisition balance sheet	–11	–	–
Reclassifications from joint ventures to associates	719	–	–
Translation differences	46	1	–17
Value at December 31	**966**	**183**	**1,486**
Value at December 31, joint ventures and associates	**1,088**	**1,020**	**2,257**

- As many changes occurred simultaneously, and the changes are interrelated, it would seem useful for research to evaluate both sides of each change (e.g., if fewer subsidiaries, what are the new classifications of the previous subsidiaries?).

SSE EXECUTIVE EDUCATION

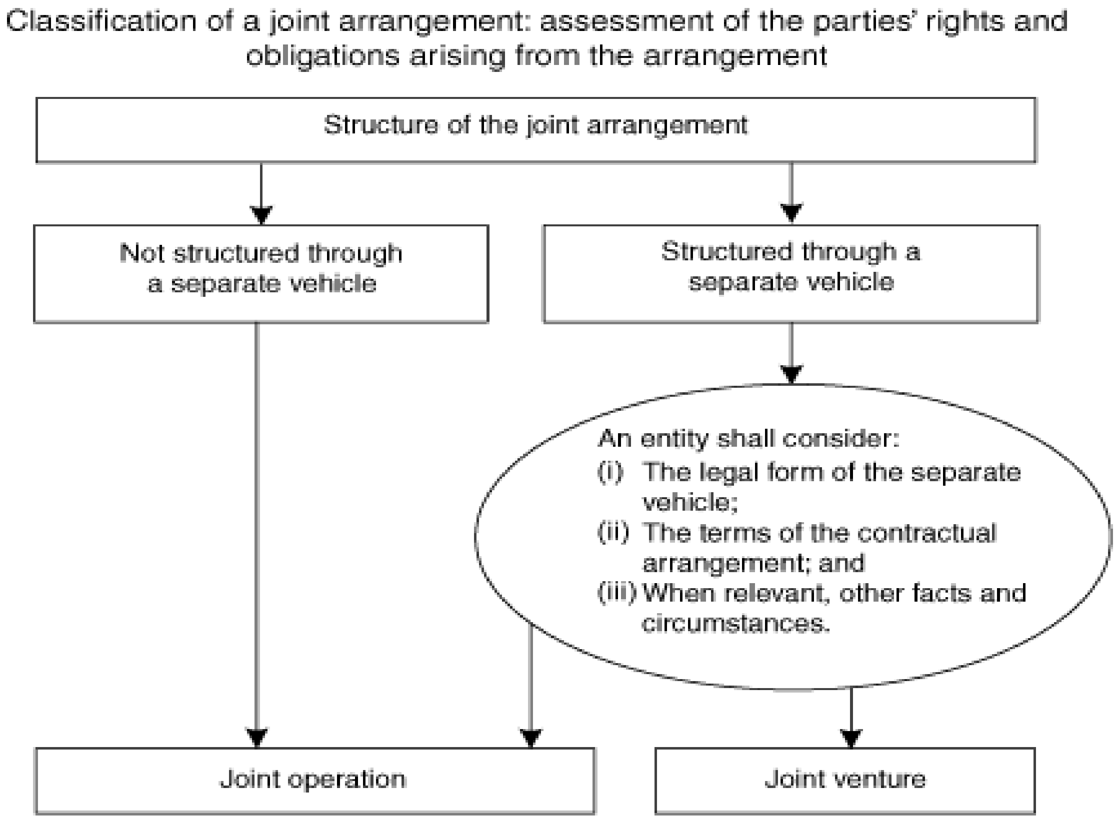
SCA annual report 2014

IFRS 11 *Joint Arrangements*

Classifying joint arrangements

Feedback

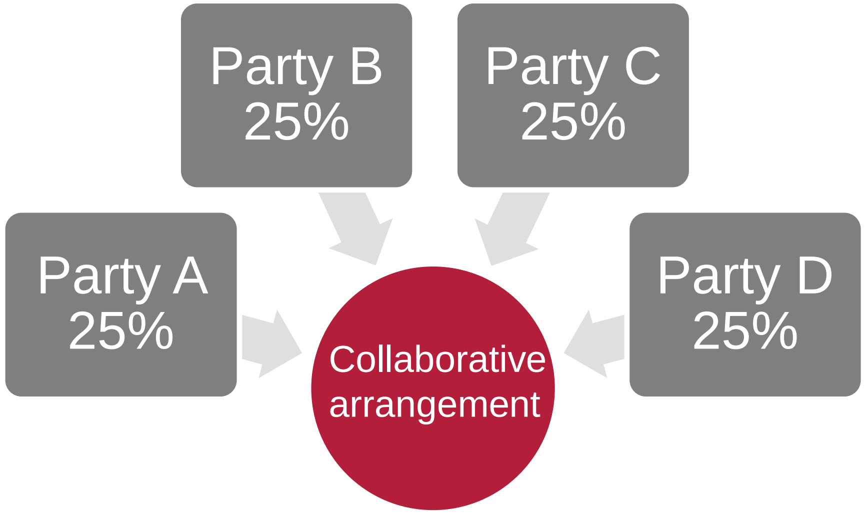
Classifying joint arrangements in some situations requires significant judgement



Collaborative arrangements outside the scope of IFRS 11

Feedback

IFRS Standards do not provide sufficient requirements for all types of collaborative arrangements, such as arrangements in which two or more parties manage activities together but do not have joint control



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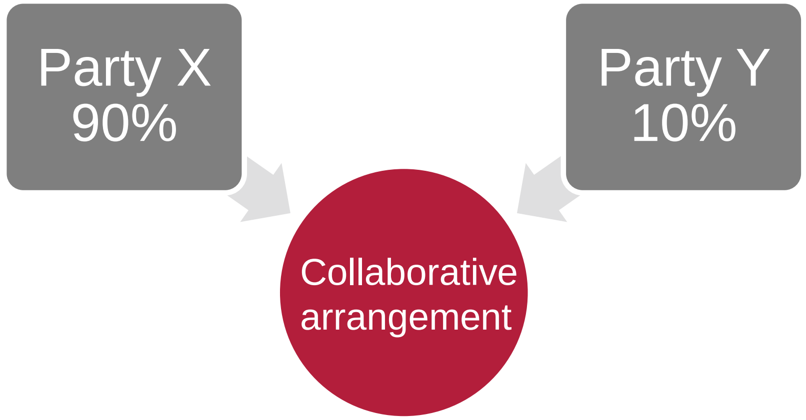

Joint arrangements

Premise

- In addition to joint arrangements that are jointly controlled, a wide range of arrangements exists in which two or more parties manage activities.

Question

- Is there evidence on the use of arrangements in which two or more parties manage activities?

Summary of findings from the academic literature review

- Mixed evidence on whether IFRS 11 improved relevance and comparability in accounting for joint arrangements:
  - eliminating the accounting policy option for proportionate consolidation is associated with significant financial statement changes (Lopes and Lopes, 2019)
  - some evidence that the equity method is more informative (So, Wong, Zhang and Zhang, 2018)
  - analysts' information environment is not affected by entities exercising the accounting policy option in favour of either proportionate consolidation or the equity method (Inchausti, Sanchez and Fuentes, 2017)
  - comparability of financial statements, measured by the extent to which accounting amounts map into economic outputs, has increased for some clusters of countries and decreased for others (Sarquis et al, 2019)

What have we already heard on IFRS 11?

- A re-iterated request to reconsider proportional consolidation
  - To provide the coverage of fixed obligations
  - To reduce the level of forecasting errors for analysts
- Requested guidance on accounting and disclosures:
  - collaborative arrangements and risk sharing arrangements (arrangements without joint control or a corporate wrapper)
- Joint operation accounting in separate financial statements
  - A request to treat the investments in the same way as investments in subsidiaries, JVs etc., ie. to eliminate accounting for assets/liabilities.

Collaborative arrangement: a contractual arrangement that involves a joint operating activity. These arrangements involve two (or more) parties that: i) are active participants in the activity; and ii) are exposed to significant risks and rewards depending on the commercial success of the activity.

IFRS 11 – ACADEMIC COMMENTARY

CONSOLIDATED INCOME STATEMENT		
Years ended December 31, SEK million	Notes	2010
Net sales	C3, C4	203,348
Cost of sales		–129,094
Gross income		74,254
Gross margin (%)		36.5%
Research and development expenses		–31,558
Selling and administrative expenses		–27,072
Operating expenses		–58,630
Other operating income and expenses	C6	2,003
Operating income before shares in earnings of joint ventures and associated companies		17,627
Operating margin before shares in earnings of joint ventures and associated companies (%)		8.7%
Share in earnings of joint ventures and associated companies	C12	–1,172
Operating income		16,455
Financial income	C7	1,047
Financial expenses	C7	–1,719
Income after financial items		15,783
Taxes	C8	–4,548
Net income		11,235

Includes the JV SonyEricsson

Source: Ericsson's annual report 2010

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IFRS 11 – ACADEMIC COMMENTARY

Use of the proportionate consolidation method for SonyEricsson (50%) instead of the equity method

	Equity method **2010**	Take out the profit share	Add 50% of SE's P&L	PCM **2010**
Net sales	203 348		28 323	231 671
Operating income before profit shares in ACs & JVs	**17 627**		716	**18 343**
Profit shares in associated companies & JVs	-1 172	-405		-1 577
Operating income	**16 455**			**16 766**
Financial income	1 047		81	1 128
Earnings Before Interest Expenses	**17 502**			**17 894**
PROFIT MARGIN	**8.61%**			**7.72%**
ASSET TURNOVER	**0.737**			**0.802**
ROA	6.35%			6.20%

Both methods represent a challenge for analysts and investors.

The equity method creates both margin and capital turnover distortion

IFRS 11 – ACADEMIC COMMENTARY

Sarquis et al. (2020): ‘We measured the comparability of accounting information between several possible combinations of clusters that used different accounting practices…We found an increase in comparability after the adoption of IFRS 11 in 4 out of 10 clusters comparisons, but also found a decrease in comparability for other 4 clusters comparisons. The results from the last two comparisons are strongly sensible to the comparability metric that was used…Taken together, these results indicate that the elimination of accounting choice does not necessarily improve comparability.’

Inchausti et al. (2017): Analysts’ information environment is not affected by entities’ choices of either the equity method or the proportionate consolidation method.

IFRS 11 – ACADEMIC COMMENTARY

Gavana et al. (2020): ‘Our findings demonstrate that companies that preferred proportionate consolidation before adopting IFRS 11 and were then required to change to the equity method suffered a decrease in the value relevance of total liabilities and, with lower statistical significance, of total assets. Conversely, companies that used the equity method before IFRS 11 came into force do not show any significant effect on the value relevance of their total assets and liabilities.’

Research results are inconclusive. Two suggestions:

1. It is challenging to incorporate joint arrangements (JA) in DCF models – when do JA’s cash flows come under the control of the JA partner? It would be interesting to learn more about how analysts and investors incorporate JA investments in their cash flow forecasts and the role of the IFRS Standards in this context.

2. Research on how firms apply IFRS 10, IFRS 11, IFRS 12 and IAS 31 might benefit from studying the effects of the standards as a package on a firm-by-firm basis.

IFRS 12 *Disclosure of Interests in Other Entities*

IFRS 12

Feedback

Only a few stakeholders commented on IFRS 12 requirements and feedback was mixed—some stakeholders called for additional disclosures while others argued that the disclosure requirements are excessive.

Effects of IFRS 12 requirements

Premise

- IFRS 12 enables users to evaluate the nature of the risks and effects of those risks from an entity's interests in other entities
- Improved information is expected to lead to more efficient capital allocation because of a better assessment of risk

Question

- Is there research on the effects (eg cost of capital or value relevance) of IFRS 12?

Disclosure—joint ventures and associates (equity accounted investments)

Requirements	The disclosure of the nature, extent and financial effects of an entity's interests in joint arrangements and associates: • summarised financial information of material joint ventures and associates; and • aggregated financial information of individually immaterial joint ventures and associates

Disclosure—joint ventures and associates (equity accounted investments)

Material joint ventures and associates

US$ million	Associate A	Associate B	Total material associates	Joint venture C	Joint venture D	Total material joint ventures
Non-current assets	2,399	4,589	**6,988**	4,905	5,712	**10,617**
Current assets	630	1,276	**1,906**	1,306	7,363	**8,669**
Non-current liabilities	(768)	(1,170)	**(1,938)**	(1,207)	(3,855)	**(5,062)**
Current liabilities	(57)	(486)	**(543)**	(794)	(5,389)	**(6,183)**
The above assets and liabilities include the following:						
Cash and cash equivalents	157	55	**212**	163	184	**347**
Current financial liabilities[1]	(21)	(53)	**(74)**	(15)	(2,770)	**(2,785)**
Non-current financial liabilities[1]	(15)	(146)	**(161)**	(95)	(3,450)	**(3,545)**
Net assets 31 December 2019	**2,204**	**4,209**	**6,413**	**4,210**	**3,831**	**8,041**
Group's ownership interest	33.3%	33.8%		44.0%	49.9%	
Acquisition fair value and other adjustments	409	1,872	**2,281**	1,116	1,246	**2,362**
Carrying value	1,143	3,295	**4,438**	2,968	3,158	**6,126**

Disclosure—joint ventures and associates (equity accounted investments)

Material joint ventures and associates (continued)

US$ million	Associate A	Associate B	**Total material associates**	Joint venture C	Joint venture D	**Total material joint ventures**
Revenue	1,483	3,038	**4,521**	3,147	25,057	**28,204**
(Loss)/income for the year	(1,440)	892	**(548)**	945	(29)	**916**
Other comprehensive loss	–	–	**–**	(23)	(3)	**(26)**
Total comprehensive (loss)/income	(1,440)	892	**(548)**	922	(32)	**890**
Group's share of dividends paid	66	243	**309**	467	–	**467**
The above (loss)/income for the year includes the following:						
Depreciation and amortisation	(565)	(811)	**(1,376)**	(640)	(524)	**(1,164)**
Interest income[1]	–	15	**15**	35	28	**63**
Interest expense[2]	(12)	(3)	**(15)**	(25)	(202)	**(227)**
Impairment, net of tax[3]	(1,305)	–	**(1,305)**	–	–	**–**
Income tax credit/(expense)	46	(489)	**(443)**	(437)	(40)	**(477)**

Disclosure—joint ventures and associates (equity accounted investments)

Individually not material joint ventures and associates

Aggregate information of associates that are not individually material:

US$ million	2019
The Group's share of (loss)/income	(110)
The Group's share of other comprehensive loss	(25)
The Group's share of total comprehensive loss	(135)
Aggregate carrying value of the Group's interests	2,420

Findings—segment information(voluntary disclosure)

Segment information—associates and joint ventures

	The Company and its subsidiaries		Associates and joint ventures			
	Revenue *	Results	Share of revenue	Share of results	Combined revenue *	Consolidated results
Property sales						
Hong Kong	36,268	15,965	605	368	36,873	16,333
Mainland China	3,497	1,667	862	367	4,359	2,034
Singapore	–	–	32	10	32	10
	39,765	17,632	1,499	745	41,264	18,377
Property rental						
Hong Kong	15,914	11,898	3,095	2,558	19,009	14,456
Mainland China	3,995	3,211	622	451	4,617	3,662
Singapore	–	–	588	447	588	447
	19,909	15,109	4,305	3,456	24,214	18,565

* In the context of this example, the term "results" refers to net profit or loss.

Information on joint ventures

Premise

- IFRS 11 requires an investor to classify joint arrangements based on the investor's rights and obligations.
- IFRS 12 requires disclosure of summarised financial information for each joint venture that is material to the entity, providing information on the profitability and indebtedness of the joint venture.

Question

- Is there research on disclosures on joint ventures in the notes and segment information?

Summary of findings from the academic literature review

- Limited evidence related to IFRS 12:
    - the level of compliance with disclosure requirements in IFRS 12 is relatively low (Sarquis, Santos, Lourenco and Braunbeck, 2019; Ašenbrenerová, 2016)

What have we already heard regarding IFRS 12 disclosures?

Generally, IFRS 12 provides useful information

Several requests to provide more information, for instance:

- Non-controlling interest
  - No information on the NCI effects on the group as a whole
  - Information needed on revenues, cash flows, assets, liabilities, and other performance measures split per particular NCI
  - Cash flow statements do not present information split between the majority owned and NCI
  - Proportionate EBITDA - as a good example of voluntary disclosure to present information on NCI

- Unconsolidated structured entities
  - Request for more information

What have we already heard regarding IFRS 12 disclosures?

- Request for disclosures on:
  - the factors used and their weight for judgments needed to classify an investment as a subsidiary, associate, or joint venture
  - economic compulsion
  - risks and cash flows at a more granular level

What have we already heard on interactions with other IFRS Standards?

- IFRS 16 *Leases* vs IFRS 11
  - Accounting for lease liabilities in the context of joint operations
  - Presenting information by operators on leased field assets in extractive industries (e.g., oilfields)
- IFRS 5 *Discontinued Operations*
  - When a subsidiary, joint venture, or associate moves into discontinued operations, the information about the operations is lost.

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IFRS 12 – ACADEMIC COMMENTARY

- I am not aware of any research on market effects of IFRS 12 disclosures.
- Disclosures on joint ventures in the notes are reported on in the article by Gavana et al. (2020):

'…since the equity method does not allow the co-venturer's share of joint venture assets and liabilities to be shown on the statement of financial position, we investigate whether the value relevance of the disclosure of such amounts in the notes increases for companies required to change to the equity method.'

'…we expect the switch to the equity method to increase the value relevance of the disclosure of co-venturers' share of joint venture assets and liabilities. This is because market participants will be able to obtain, from the notes, the information that the equity method keeps off the statement of financial position and use it to predict more accurately the co-venturer's future cash flows.'

'…we do not find any significant increase of value relevance of the disclosure of the co-venturer's share of joint venture assets and liabilities.'

'Our results suggest that investors have a low propensity to consult the information provided in the notes and base their decisions mainly on the amounts reported on the face of the financial statements.'

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Gavana, G., Gottardo, P., Moisello, A. M. (2020). Did the switch to IFRS 11 for joint ventures affect the value relevance of consolidated financial statements? Evidence from France and Italy. *Journal of International Accounting, Auditing and Taxation*, 38 (2020), 1–15.

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