

Review of IFRS 12 *Disclosure of Interests in Other Entities*

Objective

To review IFRS 12 *Disclosure of Interests in Other Entities* to consider whether the concerns raised by the Board in response to the disclosure requirements in ED 9 *Joint Arrangements* and ED 10 *Consolidated Financial Statements* have been appropriately addressed. In addition, staff have reviewed the disclosures in IFRS 12 to identify whether there are any outstanding issues of concern.

Interests in Unconsolidated Structured Entities

Issues raised in the AASB's submission on ED 10 (see agenda paper 8.2.2)

The Board expressed concern regarding the growing level of disclosure in financial statements. It acknowledged that some disclosures may be warranted to enhance transparency but did not support the following disclosures proposed in ED 10:

- (a) para B32(c) – the basis for assessing that the reporting entity does not control a structured entity from which it receives returns that are potentially significant to the structured entity;
- (b) para B34 – the accounting consequences (i.e. summarised financial information) in relation to entities that the reporting entity does not control (including, but not limited to, structured entities) despite being the dominant shareholder with voting rights; and
- (c) para 48(d) – the nature of, and risks associated with, the reporting entity's involvement with structured entities that the reporting entity does not control.

The Board stated that these proposed disclosures are particularly onerous and duplicate disclosures required by IFRS 7. The Board expressed concern that the additional disclosure is a substitute for what may be perceived as an unsatisfactory consolidation framework.

In regard to non-controlled structured entities, the Board stated that it would be useful to know whether the reporting entity provided financial support to such entities during the year, and:

- (a) whether the support remains outstanding at the reporting date;
- (b) when the support is expected to be repaid; and
- (c) the financial risk, if any, to which the reporting entity is exposed by providing the financial support.

Furthermore, the Board expressed concern that management may seek to consolidate structured entities that are not controlled in order to avoid having to make the onerous disclosures proposed in the ED. The Board therefore thought that the IASB should review the appropriateness of the proposed disclosures about non-controlled structured entities.

In response to the IASB's question in ED 10 regarding the availability of the information to the reporting entity to satisfy the disclosure requirements, the Board considered that there would be a number of impediments to a reporting entity obtaining the information required

from unconsolidated structured entities, such as legal restrictions and entities not being compliant with IFRSs or not having adequate reporting systems (see page 12 of the submission for the Board's detailed description of the perceived impediments).

The Board acknowledged that per paragraph B39 of ED 10 the disclosures would not be required if it is impracticable to provide them. However, the Board stated that impracticability is a high threshold and that the reporting entity would then be required to explain why it is impracticable and how it manages its exposure to the risk from its involvement with unconsolidated structured entities.

The requirements in IFRS 12

IFRS 12 (para's 7-9) requires the reporting entity to disclose significant judgements and assumptions made in determining that it has control of another entity, and also in certain cases that it does not have control of another entity, e.g. when it holds more than half the voting rights. However, the disclosure of aggregate information to assist users in evaluating the accounting consequences, as proposed in paragraph B34 of ED 10, has been removed.

The disclosures proposed in paragraphs 48(d) and B38-B47 of ED 10 in relation to unconsolidated structured entities have also been retained in IFRS 12 – see paragraphs 24-31 and B26. The disclosures relate to the nature of, and risks associated with, structured entities not controlled by the reporting entity. The term 'structured entity' is defined in Appendix A of IFRS 12.

Basis for Conclusions

The IASB has stated in the Basis for Conclusions (paragraph BC62) that the disclosure concerning interests in unconsolidated structured entities was in response to requests from users of financial statements, regulators and others to improve the disclosure requirements for 'off balance sheet' activities. The IASB concluded (para BC63) that users would benefit from information about the risks to which the entity is exposed from an interest in such entities and the information is relevant in assessing the amount, timing and uncertainty of the entity's future cash flows. The Basis for Conclusions (paragraphs BC65-BC68) further states that there was general support for improved disclosures but differing views were expressed with regard to the nature and amount of information that should be disclosed. Concern was expressed that the disclosures duplicated IFRS 7 requirements whilst other respondents stated, consistent with the concerns expressed by the AASB, that they suspected the disclosures were acting as a 'safety net' in relation to structured entities that might fail the consolidation criteria.

The IASB has stated (para BC70) the disclosures were proposed to provide a timely response to particular information needs identified during the global financial crisis and more specifically in response to users' and regulators' concerns about the lack of disclosure relating to investment and securitisation activities that an entity conducts through structured entities and their need for specific risk disclosures for an entity's interest in unconsolidated structured entities.

The IASB responded (para's BC72-BC74) to the concern regarding the duplication of IFRS 7 requirements by stating the difference between the disclosures requirements is how the requirements describe an entity's risk exposure and whilst IFRS 7 requires qualitative and quantitative disclosures about the various risks associated with financial instruments, IFRS 12 requires an entity to disclose its exposure to risk from its interest in a structured entity. The

IASB believes that information from both perspectives assists users in analysing an entity's exposure to risk. The IASB acknowledged the disclosures may overlap to some extent but stated that they complement each other.

In addition, the IASB stated (para BC75) that users of financial statements in the US who had been using the disclosures required by US GAAP confirmed that the new disclosures would provide information that was not previously available, but which they regard as important for a thorough understanding of an entity's exposure to risk.

Staff views

Staff consider that the disclosure requirements in IFRS 12 (para's 7-9) concerning the assumptions and judgements made in assessing control of entities, with the removal of the additional disclosures previously proposed in ED 10 paragraph B34, are reasonable and should be retained.

Although the disclosures in IFRS 12 paragraphs 26-31 concerning interests in unconsolidated structured entities are far more detailed than those recommended by the Board, they are reasonable disclosures that should provide sufficient detail to address the concerns raised by the users of financial statements and regulators. The disclosures address the revenue, assets, liabilities, financial support and exposure to loss that an entity is exposed to from having an interest in an unconsolidated structured entity. However, staff are of the opinion that the additional disclosures in paragraphs B25-B26 – about the nature of risks from interests in unconsolidated structured entities – appear to be excessive. To some extent this view is mitigated by remembering that all of the disclosure requirements are subject to materiality.

In addition, given the more limited nature-of-risk disclosures required in relation to interests in consolidated structured entities (see paragraphs 14-17), staff believe the concern expressed by the Board in its submission remains a valid concern – that the management of a reporting entity, after assessing the disclosures required, may decide to consolidate such entities to avoid the otherwise potentially onerous disclosures.

Regarding access to information of unconsolidated structured entities, the IASB does not appear to address this issue in the Basis for Conclusions and staff have noted that the impracticability proviso in paragraph B39 in ED 10 has not been included in IFRS 12, except in relation to summarised financial information for joint ventures or associates (see paragraph B15(b)). However, IFRS 12 does include the following paragraph (paragraph 4), which was also included in ED 10:

An entity shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the requirements in this IFRS. It shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics (see paragraphs B2–B6).

Although this paragraph may serve to address some of the concerns regarding the level of disclosure required, it does not address the Board's concern regarding the ability to access the information in the first place.

Interests in Joint Arrangements and Associates

Issues raised in the AASB's submission on ED 9 (see agenda paper 8.3.2)

The Board considered that requiring the additional disclosure of summarised financial information for each material joint venture is not warranted and that if such additional information is deemed necessary in the notes, then the requirements of the Standard should be re-examined. The Board further stated that the accounting method should largely reflect the information needed by users and that significant disclosures should not be needed. The Board had reservations about the removal of the proportionate consolidation method of accounting for interests in joint ventures.

The requirements in IFRS 12

IFRS 12 (paragraph B12(b)) specifies detailed requirements for the disclosure of summarised financial information for each joint venture and associate that is material to the reporting entity. The disclosures are more extensive than proposed in ED 9, such as profit or loss from continuing operations and discontinued operations, and other comprehensive income and total comprehensive income.

Furthermore, for each joint venture that is material to the reporting entity, in addition to the summarised financial information required by paragraph B12(b), paragraph B13 requires the reporting entity to disclose further detailed information that breaks down the requirements of paragraph B12, for example cash and cash equivalents included in paragraph B12(b)(i) and current financial liabilities (excluding trade and other payables and provisions) included in paragraph B12(b)(iii).

The Standard (paragraph B14) further states that the disclosures required by paragraphs B12 and B13 shall be the amounts included in the IFRS financial statements of the joint venture or associate, and not the entity's share of those amounts. Paragraph B14 states that the amounts shall be adjusted to reflect adjustments made by the entity when using the equity method and requires the entity to provide a reconciliation of the summarised financial information to the carrying amount of its interest in the joint venture or associate.

Hence rather than reducing, it appears that the disclosure requirements in IFRS 12 have in fact increased through the due process.

Basis for Conclusions

The IASB stated in the Basis for Conclusions (paragraph BC47) that the aggregated financial information currently required under IAS 28 and IAS 31 has been expanded in response to financial statement users' requests.

The Basis for Conclusions (para BC48) notes that some respondents did express concerns about confidentiality when providing summarised financial information on an individual basis for some joint ventures that were established to implement a single project. In addition, in response to the proposed elimination of proportionate consolidation, some respondents expressed concern that this would result in a loss of information and requested more detailed disclosures and stated that there was a need for a detailed breakdown of current assets and current and non-current liabilities (in particular, cash and financial liabilities excluding trade payables and provisions), which would help users understand the net debt position of joint ventures. Furthermore, the IASB stated that respondents felt there was a need for a more

detailed breakdown of amounts presented in the statement of comprehensive income (such as depreciation and amortisation) that would help when valuing an entity's investment in a joint venture.

Furthermore, in response to recommendations from some users, the IASB decided (paragraphs BC50-BC51) that summarised financial information should also be provided for each material associate, but with fewer line item disclosures required for each material associate than for each material joint venture. This decision was based on the view that an entity is generally more involved with joint ventures than with associates: the different nature of the relationship between a joint venturer and its joint ventures from that between an investor and its associates warrants a different level of detail in the summarised financial information.

The IASB stated (para BC49) that it decided to depart from the original proposal in the ED requiring an entity to present summarised financial information for each material joint venture or associate on the basis of its proportionate interest on the grounds that it would be confusing to present the entity's share of the assets, liabilities and revenue of a joint venture or associate when the entity has neither rights to, nor obligations for, the assets and liabilities of the joint venture or associate. Hence, the IASB concluded that an entity should present the summarised financial information for each material joint venture or associate on a '100 per cent' basis, and reconcile that to the carrying amount of its interest in the joint venture or associate.

Staff views

Based on a review of IFRS 12, it is clear there has been a significant increase in the disclosures required concerning an investment in a joint venture and an associate. Staff appreciate that the IASB has responded to requests from users and note that with the removal of proportionate consolidation there may be a need for detailed disclosure of information for joint ventures.

However, staff believe the disclosures, especially those required in paragraph B14, requiring adjustments and reconciliations, may prove to be quite onerous for a reporting entity. IFRS 12 (paragraph B15) appears to allow the summarised financial information to be on the basis of the joint venture's or associate's financial statements even if those statements are not prepared under IFRS, however this may result in the users of the financial statements having difficulties in interpreting the information (financial statements based on IFRS, joint venture or associate information based on non-IFRS).

Interests in Subsidiaries

Based on the review of the final Standard against ED 10, staff have identified that most of the proposed disclosures have been retained in the final Standard and that there are several additional disclosures.

Non-controlling interests and summarised financial information

The ED proposed the disclosure of summarised information for subsidiaries whose activities are directed through voting rights and the reporting entity holds less than half the voting rights.

However, the disclosure requirement in IFRS 12 (paragraph B10) has been amended to require summarised financial information for each subsidiary that has non-controlling interests that are material to the reporting entity (i.e. the group). In addition, the disclosure requirements are greater, requiring the disclosure of current and non-current assets and liabilities versus total assets and liabilities. Furthermore, it is explicitly stated in paragraph B11 that these amounts are required to be the amounts before inter-company eliminations.

Basis for Conclusions

The IASB states in the Basis for Conclusions (paragraphs BC24-BC25) that the requirement to disclose specific information for each subsidiary with material non-controlling interests, including summarised financial information, was in response to users advising the IASB that, as part of their analysis of financial statements, they need to identify profit or loss and cash flows attributable to the shareholders of the parent and those attributable to non-controlling interests. The IASB noted that IAS 1 provides some of the information, but users requested additional information, such as the non-controlling interests' share of net assets of subsidiaries, to enable them to make better estimates of future profit or loss and cash flows attributable to the ordinary shareholders of the parent and provide comparable information for different entities.

In addition, although users requested information about all subsidiaries that are material to the group, the IASB decided (para BC28) to limit the requirement to only those subsidiaries with material non-controlling interests, deciding that the disclosure for subsidiaries with immaterial non-controlling interests would prove to be onerous to prepare without any significant benefit.

The IASB further stated (para BC29) that they did not believe the disclosure would be particularly onerous to prepare because the information should be available to the entity in preparing the consolidated financial statements.

Staff views

Staff appreciate that users may need this information, and that the disclosures currently required by IAS 1 may not appropriately address all their needs. In addition, although in many instances users could access the information they require from the separate financial statements of the subsidiary, there may be subsidiaries that are not required to prepare or publish separate financial statements, and therefore this information would not be readily available to users. As the disclosures are only required for subsidiaries with non-controlling interests that are material to the group, this reduces the disclosure burden on an entity because a group is unlikely to have many subsidiaries with non-controlling interests that are material to the group.

Staff however are concerned that this disclosure is required to be based on the subsidiaries' amounts before inter-company eliminations (paragraph B11), since the consolidated financial information is of course after eliminations. Therefore, the summarised financial information may not compare readily with the consolidated figures, and the parent entity may need to obtain additional information from affected subsidiaries beyond the usual consolidation package. This adds to the reporting burden.

Consolidated Structured Entities

The requirements in IFRS 12

IFRS 12 (paragraphs 14-17) includes disclosures about the nature of risks associated with an entity's interests in consolidated structured entities. The disclosures include:

- the terms of any contractual arrangements that could require the parent or its subsidiaries to provide financial support to a consolidated structured entity;
- details of financial or other support provided by a parent or any of its subsidiaries to the consolidated structured without having a contractual obligation to do so. The disclosure shall include the type and amount of support provided and the reasons for providing the support;
- an explanation of the relevant factors in reaching the decision to provide financial or other support, without having a contractual obligation to do so, to a previously unconsolidated structured entity and that provision of support resulted in the entity controlling the structured entity;
- any current intentions to provide financial or other support to a consolidated structured entity, including intentions to assist the structured entity in obtaining financial support.

Basis for Conclusions

The IASB stated in the Basis for Conclusions (paragraph BC34) that, on considering that an entity can be exposed to risks from both consolidated and unconsolidated structured entities, it decided to require an entity to disclose the terms of the contractual arrangements that could require it to provide financial support to a consolidated structured entity, and the risk exposure from non-contractual obligations to provide support to both consolidated and unconsolidated structured entities.

Staff views

As noted above, the disclosures concerning consolidated structured entities are reasonable and unlikely to be onerous to an entity.