

Issues paper

Scope exclusions in AASB 10 and AASB 128

Purpose

- 1 To consider whether to amend the scope exclusion in AASB 10 *Consolidated Financial Statements* and/or the exemption from applying the equity method in AASB 128 *Investments in Associates and Joint Ventures* for an Australian group that has a foreign parent that prepares consolidated financial statements.
- 2 This paper is organised as follows:
 - (a) Background (paragraphs 3–11)
 - (b) AASB staff analysis (paragraphs 12–22)
 - (i) Results of targeted outreach
 - (ii) Consideration of ED 250
 - (c) AASB staff recommendation (paragraphs 23–24)

Background

- 3 In 2004, when Australia adopted IFRS as ‘Australian equivalents to IFRSs’ (now known as Australian Accounting Standards), the Board approved a number of differences between IFRSs and Australian Accounting Standards.
- 4 One of these differences was to amend the IFRS scope exclusion for IAS 27 *Consolidated and Separate Financial Statements* to remove paragraph 10 exempting particular entities from presenting consolidated financial statements. These amendments were made on the basis that the application of the Standards is a matter for national standard setters, and the reporting entity notion had previously been the determinant of the application of Australian standards. The Board (at that time) was particularly concerned about leaving certain reporting entities outside the scope of consolidation requirements that applied prior to Australia adopting IFRS.
- 5 The Board also amended the exclusions provided in AASB 128 (2007) *Investments in Associates* and AASB 131 *Interests in Joint Ventures* which permitted entities not to apply the equity method of accounting (or proportionate consolidation) when the ultimate Australian or any intermediate parent of the associate (or venturer) produces consolidated financial statements available for public use that comply with IFRSs (para. 13(c)(iv)). The practical impact of these amendments was that there may be Australian reporting entities that were required apply the equity method (or proportionate consolidation) that would have been exempted from doing so if the Board had adopted IFRS without change.
- 6 In July 2006 the Board reconsidered Australian additions to, and deletions from, IFRSs. The Board agreed to reintroduce paragraph 10 of IAS 27 into AASB 127.

However, the Board also noted concerns that this might lead to consolidated financial statements of an Australian group that is a reporting entity not being prepared when it has a foreign parent that prepares consolidated financial statements at the global level that comply with IFRSs.¹

- 7 At its September 2006 meeting, the Board further noted that if paragraph 10 were included in AASB 127 unamended, it would mean that the ultimate Australian group with a foreign parent would be covered by AASB 127 only when that parent does not report under IFRSs and that it seems inappropriate for the reporting obligations of an ultimate Australian group to depend on the type of reporting done by its foreign parent.²
- 8 The Board subsequently issued ED 151 *Australian Additions to, and Deletions from, IFRSs*, which included a proposal to add paragraph 10 and paragraph Aus 10.1. The proposals were ultimately approved and issued by the Board as Amending Standard 2007-4 *Amendments to Australian Accounting Standards arising from ED 151 and Other Amendments*.
- 9 In August 2011 the Board issued AASB 10 *Consolidated Financial Statements* and AASB 128 (2011) *Investments in Associates and Joint Ventures* as part of the suite of Standards revising accounting requirements for consolidation, joint ventures and off balance sheet arrangements.
- 10 In issuing AASB 10 the Board carried forward the requirements in AASB 127 paragraph Aus10.1, without amendment, as paragraph Aus4.2³. The Board did not specifically redeliberate the requirements of the paragraph.
- 11 In issuing AASB 128 (2011) the Board adopted the IFRS wording in IAS 28 (2011) paragraph 17(d) without amendment. That is, the Board did not carry forward the, related, Australian-specific requirement in AASB 128 (2007) (paragraph 13(c)(iv)) that entities are not required to apply the equity method of accounting (or proportionate consolidation) when the ultimate Australian or any intermediate parent of the associate (or venturer) produces consolidated financial statements available for public use that comply with IFRSs. This issue was not specifically discussed by the Board at the time, nor was it specifically highlighted to the Board as a change from the previous requirements in AASB 128 (2007).

AASB staff analysis

- 12 AASB staff note that, for the scope exclusion to apply, AASB 10 paragraph 4(a)(iv) requires the ultimate or intermediate parent entity financial statements to be available for public use. AASB staff acknowledge that, when the Board last deliberated the consolidation exemption for the ultimate Australian group with a foreign parent in

¹ AASB Minutes July 2006 Agenda Item 6 *Australian Additions to, and deletions from, IFRSs Separate Financial Statements and Scope of AASB 127*

² AASB Minutes September 2006 Agenda Item 8 *Australian Additions to, and deletions from, IFRSs Separate Financial Statements and Scope of AASB 127*

³ Refer to the Appendix of this Agenda Paper for text of paragraphs 4–Aus4.2

2007, the availability of financial statements for foreign entities could have been limited. However, in the current environment, AASB staff are of the view that users of financial statements would be able to readily access the consolidated financial statements of an ultimate or intermediate parent entity that meets all the other conditions of paragraph 4(a).

- 13 AASB staff considered whether there is a specific domestic or regulatory reason (in accordance with paragraph 21 of AASB Policies and Processes⁴) to limit the scope exclusion. AASB staff are not aware of any specific domestic or regulatory issue in Australia that would require AASB 10 paragraph Aus4.2 to be retained other than the matters previously raised in Board meetings in 2006.

Results of targeted outreach

- 14 AASB staff have conducted targeted outreach to large accounting firms, regulators, and participants of the Melbourne Emerging Accounting and Auditing Issues Group. The results of the outreach were mixed.
- 15 A number of respondents were of the view that the issue is regulatory in nature and/or a public policy issue (as opposed to being a standard-setting issue). However, these respondents had differing views as to how the AASB should proceed to address the issue. Some respondents supported the view that paragraph Aus4.2 should be deleted from AASB 10, and that regulators should address any reporting requirements they deemed appropriate. Other respondents, although acknowledging it is a regulatory issue, were concerned with a potential information gap, recommended that paragraph Aus4.2 be retained and that the AASB discusses the issue further with regulators before making any change.
- 16 Some respondents noted that removing Aus4.2 may have an unintended impact on the ultimate Australian parent from a Corporation Act perspective. That is, entities that are required to prepare consolidated financial reports are not currently required to prepare full parent entity financial statements and notes. If Aus4.2 is removed, the ultimate Australian parent may voluntarily provide consolidated financial statements, but would also be required to present full parent entity information.
- 17 Many respondents supported the view that paragraph Aus4.2 should be deleted from AASB 10. The key reasons provided for this view included:
- (a) the issue is a regulatory issue, and therefore should be addressed by the relevant regulator(s);
 - (b) there is no Australian-specific reason for differing from the requirements of IFRSs in this regard – particularly as the Australian parent would be required to disclose where the consolidated financial statements are available;
- 18 Some respondents were of the view that paragraph Aus4.2 should be retained, and that the wording in AASB 128 (2011) paragraph 17(d) be amended to be consistent with the requirements of Aus4.2. The key reasons provided for this view included:

⁴ http://www.aasb.gov.au/admin/file/content102/c3/Policy_Statement_03-11.pdf (accessed 30 July 2014)

- (a) Australian entities remain fully IFRS compliant whether or not Aus4.2 is retained;
 - (b) the original concerns identified by the AASB that a reporting entity's reporting obligations in Australia should not depend on the type of reporting done by its foreign parent have not changed. That is, it would be inappropriate for the reporting obligations of an ultimate Australian group to be dependent on the financial reporting undertaken by a foreign parent;
 - (c) the Australian financial reporting framework should ensure that Australian operations report on an appropriate basis as it is reasonable to expect that there will be users who are dependent on these general purpose financial statements;
 - (d) it may be difficult for Australian users to know whether foreign jurisdiction consolidated financial statements would be readily accessible and how to access the reports – particularly if the foreign entity is not listed;
 - (e) the information provided in the foreign group financial statements is not the information that is of interest in the Australian users;
 - (f) the financial reports may not be in English.
- 19 Some respondents noted that this issue overlaps with the current debate about the future of special purpose financial statements and the reporting entity concept and recommended that the issue be taken up as part of a broader consideration of the nature and purpose of financial reporting in Australia.
- 20 A number of respondents recommended that the AASB undertake further outreach on this issue. One respondent recommended the AASB conducts further research to understand the impact of removing paragraph Aus4.2 on the range of potential users of financial reports.

Consideration of proposals in ED 250

21 In June 2014 the IASB issued ED/2014/2 *Investment Entities: Applying the Consolidation Exemption* (issued by the AASB as ED 250 of the same name). One of the proposals is to amend IFRS 10 to confirm that the exemption from preparing consolidated financial statements set out in paragraph 4(a) of IFRS 10 continues to be available to a parent entity that is a subsidiary of an investment entity that measures subsidiaries at fair value in accordance with paragraph 31 of IFRS 10 (for further detail on this issue refer to Agenda Papers 8.1 and 8.2 of this meeting). The proposed revised paragraph would read as follows:

4 An entity that is a parent shall present consolidated financial statements. ~~This IFRS applies to all entities~~, except as follows:

- (a) a parent need not present consolidated financial statements if it meets all the following conditions:

- (i) ...

- ...

- (iv) its ultimate or any intermediate parent produces ~~consolidated~~ financial statements that are available for public use and comply with IFRSs, including the requirements of this IFRS to consolidate subsidiaries or measure them at fair value.

- 22 If the proposals in ED 250 proceed, the limitation in paragraph Aus4.2 on the exclusion from the requirements of AASB 10, in its current form, would be inconsistent with the investment entity exception in AASB 10. Therefore, if the Board decides to retain paragraph Aus4.2 and the proposals in ED 250 are finalised, the Board would need to consider amending the paragraph to maintain consistency within AASB 10.

AASB staff recommendation

- 23 Based on the above analysis and feedback received from the targeted outreach, AASB staff recommend that the AASB undertakes further outreach on this issue to further understand and address the concerns raised. In particular, concerns relating to whether this is a standard-setting issue or a broader regulatory issue.

Question 1 to Board members

Does the Board agree with the staff's recommendation in paragraph 23 above to conduct further outreach on this issue?

- 24 AASB staff also recommend retaining the wording in AASB 128 (2011) paragraph 17(d) without amendment, at least until work is progressed in relation to AASB 10 paragraph Aus4.2.

Question 2 to Board members

Does the Board agree with the staff's recommendation in paragraph 24 above?

Appendix – Extract from AASB 10 *Consolidated Financial Statements*

- 4 An entity that is a parent shall present consolidated financial statements. This Standard applies to all entities, except as follows:
- (a) a parent need not present consolidated financial statements if it meets all the following conditions:
 - (i) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;
 - (ii) its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);
 - (iii) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and
 - (iv) its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with International Financial Reporting Standards (IFRSs).
 - (b) post-employment benefit plans or other long-term employee benefit plans to which AASB 119 *Employee Benefits* applies.
- Aus4.1 Notwithstanding paragraph 4(a)(iv), a parent that meets the criteria in paragraphs 4(a)(i), 4(a)(ii) and 4(a)(iii) need not present consolidated financial statements if its ultimate or any intermediate parent produces consolidated financial statements available for public use and:
- (a) the parent and its ultimate or intermediate parent are:
 - (i) both not-for-profit entities complying with Australian Accounting Standards; or
 - (ii) both entities complying with Australian Accounting Standards – Reduced Disclosure Requirements; or
 - (b) the parent is an entity complying with Australian Accounting Standards – Reduced Disclosure Requirements and its ultimate or intermediate parent is a not-for-profit entity complying with Australian Accounting Standards.
- Aus4.2 Notwithstanding paragraphs 4 and Aus4.1, the ultimate Australian parent shall present consolidated financial statements that consolidate its investments in subsidiaries in accordance with this Standard when either the parent or the group is a reporting entity or both the parent and the group are reporting entities.