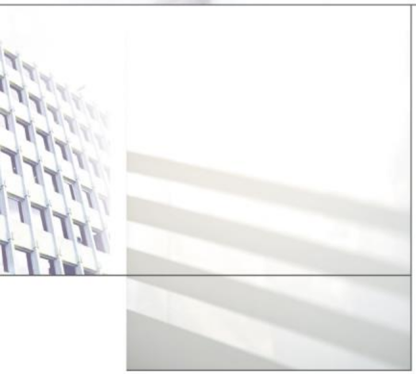
AP1A

CMAC Meeting

27 February 2015



EFRAG

European Financial Reporting Advisory Group

Separate Financial Statements

Discussion Paper

Why a project on separate financial statements?

Objective of the Discussion Paper (DP)

The IAS Regulation published in 2002 has enabled companies to prepare their annual accounts in conformity with IFRS. Since its adoption, a number of practical concerns have arisen in Europe in the application of IFRS to separate financial statements.

In addition, the Italian Standard Setter (OIC) and EFRAG's DP on *Accounting for Business Combinations under Common Control (BCUCC)* highlighted the need for further work on the application of IFRS to separate financial statements.

The DP *Separate Financial Statements* aims to address these concerns by considering how financial statements, other than consolidated financial statements, are used in Europe for economic decision making, and analysing the technical financial reporting issues that arise when preparing such financial statements under IFRS.

Finally, the DP proposes solutions to the issues identified and suggestions on how to consider them in the future.

Introduction

Chapter 1 starts by providing the objective of the DP and then sets the framework of separate financial statements in Europe

In particular, it:

- **defines a common terminology to be used throughout the DP**
- **highlights the legal role of separate financial statements in Europe**
- **describes the European legislative framework on financial reporting**
- **describes the current IFRS guidance on separate financial statements**
- **considers both the view of a group and the view of a legal entity**

Definition of Separate Financial Statements

The first hurdle to be cleared relates to definitions.

There is often a misunderstanding of terms such as ‘annual accounts’, ‘separate financial statements’ and ‘individual financial statements’.

In accordance with paragraph 4 of IAS 27 *Separate Financial Statements* (2011)

“Separate financial statements are those presented by a parent or an investor with joint control of, or significant influence over, an investee, in which the investments are accounted for at cost or in accordance with IFRS 9”

In Europe, Member States have the option to permit or require companies (listed and non-listed) to prepare annual accounts in conformity with IFRS. Although it is an option, the majority of the countries permit or require the use of IFRS in the annual accounts.

The use of financial statements of an individual entity

In Chapter 2 the DP focuses on identifying the users of financial statements presented by an individual entity, their information needs and how such financial statements are used in Europe for economic decision-making

In chapter 2 we have identified a wide range of users of financial statements of an individual entity: equity investors, debt providers, trade creditors, tax authorities, regulatory authorities, bidders, employees and other interested parties that have or intend to have transactions with the entity.

Nonetheless, we have also noted that the relevance and level of use of such financial statements depends significantly on the type of user. For example, some users only look for very specific information (e.g. distributable dividends), while others examine financial statements more comprehensively (e.g. assess credit worthiness).

In addition, we have highlighted in this chapter that debt providers and legal/regulatory authorities have been identified as primary users of these financial statements.

The use of financial statements of a legal entity (cont.)

Question to CMAC members

Q1. As a user, do you support these conclusions?

Q2. From your experience, how do users use, and for what purposes, separate financial statements?

Defining and addressing the financial reporting areas related to separate financial statements

Chapter 3 considers whether there is a need for the IASB to specifically address the accounting in separate financial statements and whether there is a need to amend certain IFRS requirements

This chapter starts with a discussion on the accounting policies to be applied in separate and consolidated financial statements. In particular, whether the accounting policies to be applied to either set of financial statements should be related.

Subsequently, this chapter considers a number of financial reporting issues identified by those applying and using separate financial statements under IFRS.

Those areas have been discussed in a number of meetings, namely with users, preparers, academics, National Standard Setters and professional associations and are summarised in the following slides.

Defining and addressing the financial reporting areas related to separate financial statements (cont.)

The main financial reporting areas outlined in this chapter are the following:

- **Measurement of investments in separate financial statements:** how to account for transaction costs and contingent consideration in separate financial statements
- **Disclosures under separate financial statements:** the question is whether the disclosure requirements under current IFRS are sufficient from a user perspective or whether IFRS should require additional disclosures about dividends available to shareholders, taking into account any restrictions that might apply
- **Clarification of the current terminology under IFRS:** this relates to the feedback received from users, preparers, academics and public authorities that the IASB should clarify the purpose of separate financial statements and individual financial statements (as referred in IFRS), and the specific requirements applicable to each other.

Defining and addressing the financial reporting areas related to separate financial statements (cont.)

The main financial reporting areas outlined in this chapter are the following:

- **General concerns regarding common control transactions:** common control transactions may have a significant impact on the separate financial statements of an entity. This is because of the effects of non-arm´s length intragroup transactions and the fact that intragroup transactions and outstanding balances are not eliminated in the separate financial statements of an entity. To address this issue we present a number of different measurement bases that could be used for initial measurement of an investment acquired in a common control transaction: (i) transaction cost approach; (ii) fair value approach, and (iii) carrying amount approach.

- **The accounting treatment of business combinations under common control in separate financial statements:** the DP considers the issue of how to account for business combinations under common control in the separate financial statements of the acquirer. In addition, it considers how some corporate restructurings, such as legal mergers, should be accounted for.

Defining and addressing the financial reporting areas related to separate financial statements (cont.)

Question to CMAC members

Q3. What are your main practical concerns related to separate financial statements? What could be done, in terms of accounting and disclosures, to solve those concerns?

Q4. Do you read the information presented in separate financial statements together with the information presented in consolidated financial statements? If so, do you consider that there should be a certain symmetry in the accounting principles applied in separate and consolidated financial statements?

Key messages from the discussion paper

Our analysis in chapters 2 and 3 lead us to conclude that it is important to:

- **Clarify the objective of separate financial statements**
- **Develop guidance on how to account for transaction costs and contingent consideration in separate financial statements**
- **Hold a comprehensive debate on common control transactions as the method of accounting for such transactions may impair the usefulness of separate financial statements**
- **Consider the accounting for business combinations under common control in the acquirer's separate financial statements, including legal mergers**
- **Strengthen the disclosures on distributions to equity holders**
- **Consider whether every new standard or amendment creates difficulties or implementation issues to those who prepare and use separate financial statements; and whether it should be applied to separate financial statements**

Key messages from the discussion paper (cont.)

Question to CMAC members

Q5. As a user, do you support these conclusions?

Q6. What is the most important action that must be taken to improve the usefulness of separate financial statements?