CRUF
CORPORATE REPORTING USERS' FORUM

10 May 2021

IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD

Dear Sir/Madam,

Request for Information: Post- implementation review of IFRS Standards for group accounting - IFRS 10, 11 and 12

The Corporate Reporting Users' Forum (CRUF) welcomes the opportunity to provide the IASB with our comments.

The CRUF was established in December 2005 and we have been holding regular meetings since. CRUF Japan has prepared this comment letter based on discussions in CRUF meetings and has reflected input from other CRUFs globally. As always, we do not seek to reach a consensus within the CRUF but to reflect a broad spectrum of users' views. We have highlighted any contrasting views in our response. Our comments are based on our professional experience.

Responses to the questions raised in the consultation that relate to the issues that concern CRUF participants are set out below.

Question 5 (a)(iii)

In transactions, events or circumstances that result in a loss of control, does remeasuring the retained interest at fair value provide relevant information? If not, please explain why not, and describe the relevant transactions, events or circumstances.

We think that the accounting treatment of remeasuring the retained interest in the event of a loss of control at fair value and booking the change in valuation from remeasurement in the income statement should be revised. This is because when the retained interest is an investment accounted for in accordance with IFRS 9 and the OCI option for the retained interest is selected, companies end up booking revaluation gains/losses in the income statement that are not useful to users of financial statements because it results in a different view of financial performance for the same underlying economics.

The current accounting treatment emphasizes the change in ownership objective from investment in a subsidiary to general investment, and treats the retained interest upon loss of control as though the company had reacquired the retained interest. Under the OCI option, changes in fair value from remeasurement upon loss of control are booked to the income statement, but subsequent changes in fair value are booked to OCI.

In reality though, the company is merely continuing to hold the retained interest after the loss of control. Investments in subsidiaries are typically predicated on long-term ownership, and we believe that if a company selects the OCI option for the retained interest, an interpretation that it is continuing to own the interest for the long term in spite of the loss of control is closer to the reality of the situation. By contrast, it is unthinkable in practice that a company would sell its entire interest and reacquire the retained interest due to a change in the purpose of ownership. We see no need to construct a fictitious reacquisition, and we view the revaluation gains/losses incurred from this fictitious transaction as having little utility. We also see risk of arbitrary manipulation of earnings by using superficial structures to book these kinds of revaluation gains/losses that do not involve any cash in/outflows.

Consequently, we propose that the retained interest in the event of a loss of control should be retained at book value rather than re-measured. In addition, in cases where the OCI option is not selected for the retained interest, all changes in fair value for the retained interest in the accounting period when the loss of control occurred are booked to net income, so the outcomes of the accounting treatments in the current standard and our proposal are the same.

Question 9 (c)

What additional information that is not required by IFRS 12, if any, would be useful to meet the objective of IFRS 12? If there is such information, why and how would it be used? Please provide suggestions on how such information could be disclosed.

The main concern of users of financial statements with regard to the scope of consolidation is that material assets and/or liabilities could be left out based on management accounting policies or practical judgments; in other words, there is risk that the scope of consolidation is not sufficiently comprehensive.

Accordingly, we propose requiring additional disclosure regarding 1) thresholds for materiality used when determining the scope of consolidation and 2) the names of the main non-consolidated subsidiary companies, on top of the current requirements. In terms of thresholds for determining materiality, we propose disclosing ratios of combined totals for non-consolidated subsidiary companies to items in the consolidated financial statements (sales, total assets).

We also see scope for management arbitrariness in selecting which subsidiaries meet the criteria for disclosure of summarized financial information as consolidated subsidiaries with non-controlling shareholders. We therefore propose disclosing breakdowns of non-controlling interests and net income attributable to non-controlling interests by company. We think disclosure of breakdowns by company would ensure comprehensiveness.

In addition, in the event that a material consolidated subsidiary is removed from the scope of consolidation (and does not meet the definition of a discontinued operation in IFRS 5), we propose disclosing summarized financial information for that former consolidated subsidiary. At present, information disclosure regarding companies that are removed from the scope of consolidation is lacking in comparison with subsidiaries that are newly added to the scope of consolidation. We think appropriate information disclosures regarding the impact of companies being removed from consolidated accounts are also desirable for forecasting future earnings.

Next, for both associates and JVs we propose disclosing the breakdowns of equity-method investments and equity-method income/losses by company. In addition, in cases of listed associates, we propose additional disclosure of the breakdown of unrealized gains/losses at the term end by company.

Question10

Are there topics not addressed in this Request for Information, including those arising from the interaction of IFRS 10 and IFRS 11 and other IFRS Standards, that you consider to be relevant to this Post-implementation Review? If so, please explain the topic and why you think it should be addressed in the Post-implementation Review.

Fundamental review of IAS28 (*Investments in Associates and Joint Ventures*)

We also think discussions regarding fundamental reform of equity-method accounting are needed. This post-implementation review covers IFRS10 (*Consolidated Financial Statements*), IFRS11 (*Joint Arrangements*), and IFRS12 (*Disclosure of Interests in Other Entities), but not IAS28 (Investments in Associates and Joint Ventures*). We think a full discussion of whether equity-method accounting faithfully presents the actual condition of companies subject to it and provides useful information is a key prerequisite for considering the accounting treatments in IFRS11 and notes relating to associate companies in IFRS12.

While equity-method accounting has been in practical use for many years, we hear numerous practical issues and concerns. Accounting standards need a coherent core accounting philosophy to function, and we think revisions are needed on this basis. In addition, the scope of application is broad—from associate companies in which a 20% interest is held through joint ventures under IFRS11, and we have doubts as to whether the stripped-down accounting treatment faithfully reflects conditions at all the companies that it is applied to. The issue has long been avoided as a weighty theme, but we think discussions should not be put off. We think a rethink of the fundamentals of equity-method accounting is needed in combination with this post-implementation review.

Presentation of financial statements in cases where a parent company is not an investment entity but a consolidated subsidiary

In cases where a parent company is not an investment entity but a consolidated subsidiary is an investment entity and the parent owns consolidated sub-subsidiaries through the investment entity, the sub-subsidiary is valued at fair value under the investment entity but is consolidated in consolidated accounts, making financial information regarding the sub-subsidiary difficult to understand for users of financial statements.

In such cases, it may be more reflective of actual condition if the sub-subsidiaries held by the investment subsidiary are valued at fair value rather than consolidated.

On the other hand, in cases where the sub-subsidiary is viewed as an operating company of the consolidated group, we propose additional disclosure of 1) the differences between fair value of the sub-subsidiary and the book value of assets/liabilities in consolidated accounts, 2) fair value changes for the sub-subsidiary recognized by the investment entity, and 3) a summary of the P/L for the sub-subsidiary as recognized in consolidated accounts.

Revision of the accounting treatment for step acquisition gains/losses recognized when acquiring control under IFRS3

There were discussions relating to accounting treatment for step acquisition gains/losses in the event of acquisition of control under IFRS3 in conjunction with the accounting treatment in the event of loss of control (question 5-a-iii). Some of our members support the current treatment as useful, whereas there are others that call for revisions.

The argument of those calling for revisions is that the amount that an acquiring company invests to acquire another company is the cumulative amount spent to acquire its interest, so there is no need to revalue the interest that had already been acquired prior to acquisition of control as though the entire controlling interest had been acquired in one go. In one case, a listed company acquired an additional 2% of another listed company to lift its stake to 51% and make it a consolidated subsidiary. This resulted in booking of step acquisition gains and goodwill that significantly exceeded the amount invested to acquire the additional 2% interest. This accounting treatment is markedly divorced from actual movements of cash, and some members argued that it should be revised in conjunction with this post-implementation review.

Additional disclosure for non-listed non-controlling interests and equity method investments

Many equity investors value the enterprise, representing the consolidated subsidiaries, add the value of equity method investments and then subtract the non-controlling interests. To do this investors need estimates for the market value of non-controlling interests and the market value of equity method investments. The problem is that the book value of non-controlling interests and equity method investments, based on historic cost, is often materially higher or lower to the market value.

If subsidiaries are listed, then a market value is available. However, if subsidiaries are unlisted, then the limited disclosure makes it difficult to estimate a market value. This is particularly the case for loss making subsidiaries. At present it is very hard to value a loss-making subsidiary: is it a loss-making business with negligible value or is it a promising early stage business worth a considerable amount? Investors need additional disclosure for non-listed non-controlling interests and equity method investments where the difference between the market value and book value is material to the overall valuation for the group. The additional disclosure should be sufficient to estimate a market valuation.

About the Corporate Reporting Users' Forum (CRUF)

The CRUF was set up in 2005 by users of financial reports to be an open forum for learning about and responding to the many accounting and regulatory changes that affect corporate reporting. In particular, participants are keen to have a fuller input into the deliberations of accounting standard setters and regulators. CRUF participants include buy and sell-side analysts, credit ratings analysts, fund managers, investors and corporate governance professionals. Participants focus on equity and fixed income markets. The CRUF includes individuals with global or regional responsibilities and from around the world, including Australia, Canada, France, Germany, Hong Kong, India, Japan, New Zealand, South Africa, UK and USA.

The CRUF is a discussion forum. Different individuals take leadership in discussions on different topics and in the initial drafting of representations depending on their area of interest or expertise. In our meetings around the world, we seek to explore and understand the differences in opinions of participants. The CRUF does not seek to achieve consensus views, but instead we focus on why reasonable participants can have different positions. Furthermore, it would not be correct to assume that those individuals who do not participate in a given initiative disagree with that initiative. This response is a summary of the range of opinions discussed at the CRUF meetings held globally. Differences of opinion are noted where applicable.

Participants take part in CRUF discussions and joint representations as individuals, not as representatives of their employer or other organisations they are a member of or associated with. Accordingly, we sign this letter in our individual capacity as participants of the Corporate Reporting Users' Forum and not as representatives of our respective employer or other organisations. The participants in the CRUF that have specifically endorsed this response are listed below.

Signatures

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