Federation of European Accountants
Fédération des Experts comptables Européens

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Ref.: ACC/PFK/PGI/SRO

Dear Ms Flores,

Re: FEE comments on Separate Financial Statements Discussion Paper

FEE (the Federation of European Accountants, www.fee.be) is pleased to provide you below with our comments on the proactive Discussion Paper on Separate Financial Statements, produced by EFRAG in conjunction with ICAC, OIC and RJ.

FEE welcomes the initiative of these bodies in stimulating the discussion on the role of separate financial statements and highlighting key areas of potential divergence between them and consolidated financial statements prepared under IFRS.

Whilst we understand the reason for not broadening the discussion paper to also deal with individual financial statements, we do feel that there are issues in common with both separate financial statements and individual financial statements and this is an opportunity to address these issues. We feel that this would be beneficial, particularly within Europe where some jurisdictions have made use of the option to insist that all financial statements are prepared under IFRS.

FEE believes that, wherever possible, separate financial statements and consolidated financial statements should be prepared using the same accounting policies for entities within the same groups. However, we have identified circumstances where it may not be appropriate to align accounting policies for separate financial statements with those of consolidated financial statements. This is largely due to there being different users for the two types of financial statements, who make different uses of each.

For example, in respect of the treatment of acquisition-related costs, we do not believe that it would add to the usefulness of separate financial statements to require these to be expensed rather than treated as part of the initial investment. This in turn raises the question as to whether the issue is really a divergence in accounting policies between separate and consolidated financial statements or rather an issue of divergence between a few accounting standards and the majority of accounting standards.

Please refer to the appendix for our responses to the specific questions asked in the Discussion Paper.

For further information on this letter, please contact Paul Gisby, Manager, from the FEE Team, on +32 2 285 40 70 or via e-mail at paul.gisby@fee.be.

Yours sincerely,

Petr Kriz
President

Olivier Boutellis-Taft
Chief Executive

<u>Encl</u>.

Question 1 – Introduction

Q1.1 Do you believe that chapter 1 appropriately sets out the framework of separate financial statements in Europe? If not, what should be changed in chapter 1 and why? Please explain.

(1) FEE agrees that Chapter 1 appropriately sets out the framework of separate financial statements in Europe and the resultant definition of separate financial statements that is then used throughout the discussion paper.

(2) We do, however, believe that EFRAG could have expanded the scope of this paper to include within the discussion individual financial statements, both as prepared by subsidiary companies who do not themselves hold investments in other companies and by completely stand-alone companies.

(3) Many of the same arguments that can be used to justify increased alignment in accounting treatment between consolidated and separate financial statements could also be applied to the financial statements of subsidiaries that do not themselves hold investments but that are part of groups that are required to prepare financial statements under IFRS.

(4) Additionally, there are several EU Member States requiring or permitting that the financial statements of all companies be prepared under IFRS, irrespective of size and of whether they hold investments in other companies. Presumably, one of the reasons behind this decision is to prevent Member States that have limited resources from having to develop their own national GAAP from first principles, meaning that there is a probable shortage of guidance as to how the standards may be applied to entities beyond those required to use IFRSs by the 2002 EU IAS Regulation.

(5) We believe that if EFRAG were to expand the scope of this paper to include all entities preparing non-consolidated financial statements under IFRS it could assist the IASB in deciding whether there is a need to issue guidance on this matter.

(6) Whilst we understand the logistical advantages in restricting the scope of the paper to separate financial statements, expanding the scope to include individual financial statements would provide the opportunity to discuss other issues not yet addressed, such as those arising in applying *IFRS 2 – Share-based payment* (i.e. a share – based payment scheme where the parent entity grants shares or share options on its equity for goods or services acquired by another entity of the group) and *IAS 12 – Income taxes* (i.e. the treatment of the deferred tax asset/liability that occurs when a business combination takes place). These transactions have different impacts on the consolidated, separate and individual financial statements and broadening the scope of this discussion paper could provide an opportunity to discuss whether or not the divergence of treatments is appropriate.

Questions 2.1, 2.2 and 2.3 - The use of financial statements of a parent or an investor, regardless of whether they are prepared under IFRS or Local GAAP

Q2.1 Do you agree with the description provided in chapter 2 of the use of financial statements of a parent or an investor, regardless of whether they are prepared under IFRS or Local GAAP? Please explain.

(7) We will deal with this question in conjunction with question 2.2.

Q2.2 Considering the wide range of users of financial statements of a legal entity identified in the Discussion Paper, do you believe that paragraphs 2.13 to 2.17 accurately identify the primary users of separate financial statements? Please explain.

(8) We believe that the paper correctly identifies the users of separate financial statements. We also support that the paper's contention that it is the fact that is the entity itself contracts with third parties, and not the group as a whole, that makes separate financial statements important to these users. We feel that this work may be useful information for the IASB in its ongoing work on the conceptual framework and in developing standards in general.

(9) We also agree that, especially for the case of separate financial statements, an important use of financial statements is the assessment of credit worthiness. In general, financial statements are the primary, or even the sole, source of financial information about an entity available to parties who are not part of the central management or control of that entity. In that regard, we believe that the final sentence of para 2.14 would be better placed at the start of Chapter 2 rather than being included under considerations of the users of the financial statements, as is currently the case.

(10) We also agree that separate financial statements are frequently used by management in the course of making management decisions, even though they may not be the ideal means of doing so.

(11) We are not, however, convinced by the approach of separating the users into primary and secondary categories. We have two main reasons for this.

(12) First, we do not consider that there can be an absolute category of "primary" users. Who constitutes a primary user depends very much on the type of industry the business operates in, its individual circumstances, local law or regulations or even the prevailing economic conditions at the time.

(13) For example, a simple business model for a retailer may be primarily be funding by its suppliers, with very low levels of bank funding, and in this circumstance it would be nonsensical to describe the bank as being a primary user and a significant supplier as being a secondary user. Equally, we fail to see why a regulatory body should be regarded as a primary user but a taxation authority is not – both tend to have similar powers to request additional information and both would similarly use the separate financial statements as the starting point for their assessment.

(14) Second, even though the distinction is made in the paper it does not seem to follow through to any conclusion – i.e. we do not see how identifying the primary users of separate financial statements has then affected the proposals made in Chapter 3. We, therefore, suggest that it may be better to list the potential users with equal prominence and provide an indication of where their particular interest in separate financial statements may lie and how, if at all, it may affect the outcomes shown in Chapter 3. Indeed, we feel that if EFRAG considered it necessary to define the potential users and uses of the financial statements as a starting point for the paper, perhaps more emphasis could be made later in the paper as to how these users and uses may influence the decision as to whether the accounting policies adopted in separate and consolidated financial statements should be aligned.

Question 2.3 In your experience; are there any additional users of financial statements of a parent or an investor, regardless of whether they are prepared under IFRS or Local GAAP? If so, could you please identify the other users of such financial statements?

(15) We have not identified any additional users of financial statements but, in view of the points made above, would suggest that employees and equity providers are given the same prominence as the other categories.

Question 3.1 - Accounting policies to be applied in separate and consolidated financial statements

Question 3.1 In which cases, if any, do you believe that the accounting policies applied to either set of financial statements should differ? Please explain.

(16) FEE believes that, wherever possible, the accounting policies in separate financial statements should be consistent as possible with those in the consolidated financial statements.

(17) However, as will be discussed in further detail below, we are not convinced that complete convergence between the two is appropriate in every circumstance. That being said, we also consider that in most of the situations where we do believe that accounting policies should differ, this divergence is a result of inconsistencies between different standards rather than of the nature of the financial statements.

(18) As the scope of the paper is restricted to separate financial statements, we believe that the list of financial reporting areas covered, as detailed in para 3.3, is comprehensive and we have no additional areas to add.

Questions 3.2 and 3.3 - Accounting for transaction costs and contingent consideration

Question 3.2 Do you consider that acquisition-related costs should be expensed or should be part of the initial measurement of investments in subsidiaries, joint ventures or associates accounted for at cost in the separate financial statements? Please explain.

(19) As mentioned above, FEE's position is that there should be consistency wherever possible between the accounting policies in the consolidated and separate financial statements.

(20) However, whilst accepting the fact that acquiring a business is a fundamentally different proposition from acquiring a collection of assets, we do not believe that acquisition costs should be expensed in separate financial statements and should continue to be included in the carrying cost of the asset.

(21) We consider that separate financial statements are often used differently to consolidated financial statements and, consequently, that in certain circumstances different accounting policies may be required. In this circumstance, we believe that using fair value to account for acquisitions would not add to the usefulness of the separate financial statements for the users. Additionally, by adding acquisition costs to the cost of the shares, this keeps the accounting treatment consistent with other asset classes.

(22) This last point illustrates a reoccurring issue - that perhaps what we are considering here is not an issue of divergence between separate financial statements and consolidated financial standards but rather a divergence between a few accounting standards and the majority of accounting standards. Consequently, the real issue may not whether acquisition costs should be expensed in separate financial statements but rather whether it is appropriate to expense them in consolidated financial statements.

Question 3.3 Do you consider that contingent consideration should be accounted for in accordance with IFRS 3 or should be accounted for as part of the initial and subsequent measurement of investments in subsidiaries, joint ventures or associates accounted for at cost in the separate financial statements? Please explain.

(23) Consistent with our answer to question 3.2, FEE believes that, whilst we support maximum consistency in accounting policies between separate and consolidated financial statements, we do not believe that applying IFRS 3 rules on contingent consideration to separate financial statements would provide the majority of users with more meaningful information.

Questions 3.4, 3.5, 3.6 and 3.7 - Sale or contribution of equity investments between entities under common control

Question 3.4 Do you agree that the IASB needs to set out specific accounting requirements for the acquisition of investments from entities under common control in the separate financial statements? Please explain.

(24) We are not aware of whether this is an issue of such general concern as to require specific requirements for its accounting treatment to be set by the IASB. This could be an area for further research by EFRAG to determine whether there is a wide divergence in accounting treatment for these transactions and whether these divergences result in practical problems for the users of the financial statements.

Question 3.5 In your view, which of the approaches presented in paragraph 3.66 of the Discussion Paper provides more relevant information to users? Please explain.

(25) From a conceptual point of view, we believe that the fair value approach is the strongest approach and should provide the most meaningful information to users of the separate financial statements. It would, of course, also be consistent with the accounting policy in the consolidated financial statements.

(26) However, whilst FEE believes that fair value is the best approach, we also consider that, in certain circumstances, its application will lead to practical problems in valuation. By their very nature, related party transactions tend not to be at arms-length and we can envisage circumstances where it may not be practical to accurately calculate an open market value.

(27) In such circumstances, FEE's preferred approach would be to use the transaction cost approach with disclosures detailing the potential open market value and the difficulties in ascertaining an accurate arms-length value. This would be consistent with the approach in *IAS 24 – Related Party Disclosures*. This method could, however, lead to practical difficulties in dealing with the disclosures after year one and this is one of the reasons that we believe that fair value should be used whenever possible.

(28) We accept that approach 3 (carrying amount) may be the simplest for the preparers of the financial statements but FEE believes that this approach would provide the least meaningful information to users of the financial statements.

Question 3.6 If an entity applies the ‘fair value’ approach or ‘carrying amount’ approach (as described in paragraph 3.66 of the Discussion Paper), how should it account for any difference between the ‘transaction price’ and the amount of investment initially recognised at ‘fair value’ or ‘carrying amount’’? Please explain.

(29) Where the fair value approach is applied we believe that the difference should be recorded in equity.

(30) We believe that it may be appropriate to defer consideration of this issue until the IASB has clarified the role of the Other Comprehensive Income (OCI) in the course of completing its work on the Conceptual Framework.

Question 3.7 Do you think that the use of the fair value method (i.e. the application of IAS 39/ IFRS 9) is the most appropriate option to account for investments acquired by entities under common control? Please explain.

(31) As with the previous sections, we believe that fair value has the clearest conceptual basis for accounting for investments acquired by entities under common control. This is because we believe that it has the potential to provide the most useful information to users of separate financial statements.

(32) However, we can see this approach potentially having the same issues of valuation at arm’s-length as other assets acquired from entities under common control, but with the added complexity of making an open market valuation of an asset of which the entity only has partial control. This could lead to the question as to whether the investment should be valued on the basis of fair value to the group as a whole, and then apportioned between the entities that hold the investment, or valued in each owning entity on the basis of their individual holding in the investment – i.e. after applying discounts.

Question 3.8 - Business combinations and separate financial statements

Question 3.8 In your view, what is the most appropriate approach to account for a business combination between entities under common control in the separate financial statements? Please explain.

(33) As mentioned above, FEE believes that fair value is conceptually the best basis for accounting for such transactions under common control but we accept that it is not always possible to accurately measure fair value in such circumstances. Where it is not possible to accurately measure fair value then we would agree that the tentative view expressed in para 3.97 would be appropriate and that accounting treatment should be driven by the facts of each transaction.

Questions 3.9 and 3.10 - Legal Mergers

Question 3.9 Do you agree that both the approaches described in paragraph 3.109 (use of the carrying amounts in the consolidated financial statements) and paragraph 3.111.a) (use of the carrying amount in the separate financial statements of the acquiree) can provide decision-useful information to users of separate financial statements? Please explain.

(34) We will deal with this question in conjunction with 3.10 below.

Question Q3.10 In your view, which of the approaches described in paragraphs 3.110 – 3.113 provides, when applied in practice, more relevant information to users? Please explain.

(35) FEE believes that it will be difficult to come to a consensus as to the most appropriate accounting approach in this area, due, in part, to differing national legal requirements.

(36) We believe that there are situations where the treatment in para 3.113 a) and b) could be appropriate but we are not convinced that the treatment detailed in part c) is conceptually sound or would provide meaningful information for the users of the financial statements.

(37) In our opinion, treatment a) would be most appropriate where, as a result of the merger, the owning parties have the same interests as before the merger. Where, however, an element of reconstruction is also present so that effective ownership changes or there are changes to the assets or liabilities of the combined asset, then the fair value approach in option b) is more likely to better represent the underlying commercial reality of the merger and also to provide more meaningful information to the users.

(38) We believe that approaches a) and b) of para 3.113 would produce the most relevant information, depending on the exact nature of the merger. We do not believe that there would be a great deal of utility for users in option c) and we do not believe that this approach would produce more relevant information.

Questions 3.11 and 3.12 - Disclosures on distributions to Equity Holders in the separate financial statements

Question 3.11 Do you think that additional disclosures about distributable dividends are necessary in the separate financial statements? Please explain.

(39) FEE believes that additional information about distributable dividends could be useful to users of the separate financial statements but we are not convinced that the separate financial statements themselves are necessarily the best vehicle for providing this information.

(40) What constitutes distributable profits is often defined by national legislation so it may not be feasible to include additional information about distributable dividends through international accounting standards. Another possibility would be for such additional disclosure to be defined at national (or European) level and that the disclosure would take place in the management report.

Question 3.12 Do you think that all the cumulative amounts of gains or losses recognised in Other Comprehensive Income ('OCI') that will be reclassified (recycled) to profit or loss should be always presented in the statement of financial position as a separate component of equity? Please explain.

(41) FEE does not agree with this proposal. The IASB is currently working in defining the use of the OCI in the financial statements, and they are considering introducing a definition that explains that everything that is included in the OCI should be, at some point in time, being recycled in the profit or loss unless there is not a reliable basis to do so.

(42) Currently in the IFRS literature there are two instances where this occurs and one more where the standard suggests a special treatment (best practice). The two examples are: (a) the actuarial gains/losses arising from a defined benefit employee benefit scheme recognised in the OCI in accordance with *IAS 19 – Employee Benefits* and (b) the setting-off of the cash flow hedge reserve with the actual transaction when the transaction occurs.

(43) We also make reference to the IAS 16 – Property, Plant and Equipment proposed treatment for the revaluation reserve. The standard suggests that an amount equal to the difference to the annual depreciation charge due to the revaluation should be transferred directly to Retained Earnings (after any effects that arise from the application of IAS 12 – Income Taxes).

(44) As the presumption is that all items included in the OCI should be recycled, we do not believe that the inclusion of a separate line in equity will add significantly to the utility of the financial statements, particularly as the few exceptions to this general presumption are well known and should already be factored in by users of the financial statements. In any event, we believe that further consideration of this issue should be deferred until the IASB has further progressed in its work on the OCI.

Question 3.13 - Clarification of the current terminology under IFRS

Question 3.13 Do you agree with our tentative view as described in paragraph 3.139 above? Please explain.

(45) FEE believes that the IASB should clearly define the different types of financial statements and also clarify the objective of separate financial statements as suggested in EFRAG's tentative view.

(46) We also agree with EFRAG's tentative view that the IASB should consider the usefulness of the guidance provided in IAS 27 and explicitly allow that only one set of separate financial statements be produced where the entity does not have subsidiaries and where investments are accounted for under IAS 28.

Questions 3.14 and 3.15 - Other issues

Q3.14 Do you think there are any other significant issues regarding separate financial statements under IFRS which have not been addressed in this paper? Please explain.

(47) We have not identified any further issues.

Q3.15 Do you have any other comments related to separate financial statements?

(48) We have no further comments to make.