



Tel: +44 20 7893 3300
Fax: +44 20 7487 3686
@: abuchanan@bdoifra.com
www.bdointernational.com

BDO IFR Advisory Limited
Contact: Andrew Buchanan
55 Baker Street
London W1U 7EU
United Kingdom

International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London
E14 4HD

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Dear Sir

Post-implementation review Request for Information - IFRS 10, 11 and 12

We are pleased to comment on the above Request for Information (the RFI). Following consultation with the BDO network¹, this letter summarises views of member firms that provided comments on the RFI.

Our responses to the questions in the RFI are set out in the attached Appendix.

We hope that you will find our comments and observations helpful. If you would like to discuss any of them, please contact me at +44 (0)7875 311782 or by email at abuchanan@bdoifra.com.

Yours faithfully

Andrew Buchanan

Global Head of IFRS and Corporate Reporting

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Appendix

Information about the respondent

Question 1 - To understand whether groups of stakeholders share similar views, the Board would like to know:

- (a) your principal role in relation to financial reporting. Are you a user or a preparer of financial statements, an auditor, a regulator, a standard-setter or an academic? Do you represent a professional accounting body? If you are a user of financial statements, what kind of user are you, for example, are you a buy-side analyst, sell-side analyst, credit rating analyst, creditor or lender, or asset or portfolio manager?*
- (b) your principal jurisdiction and industry. For example, if you are a user of financial statements, which regions do you follow or invest in? Please state whether your responses to questions 2-10 are unrelated to your principal jurisdiction or industry.*

BDO is an international network of public accounting, tax and advisory firms which perform professional services under the name of BDO. BDO public accounting, tax and advisory firms provide professional services in 167 countries, with 91,054 people working out of 1,658 offices worldwide.

In preparing this comment letter, BDO consulted with numerous representatives from BDO firms worldwide.

IFRS 10 Consolidated Financial Statements

Question 2(a) - In your experience:

- (i) to what extent does applying paragraphs 10-14 and B11-B13 of IFRS 10 enable an investor to identify the relevant activities of an investee?*
- (ii) are there situations in which identifying the relevant activities of an investee poses a challenge, and how frequently do these situations arise? In these situations, what other factors are relevant to identifying the relevant activities?*

Applying the requirements of IFRS 10 generally enables investors to identify the relevant activities of an investee.

We have identified instances where the relevant activities of an investee might change over time, with this change being expected as at the inception of an investee. For example, an entity that will incur significant research and development expenses with the goal to commercialise intellectual property might have different relevant activities that differ during the development and commercialisation phases of its life cycle. However, in our experience, these instances are rare.

Question 2(b) - In your experience:

- (i) to what extent does applying paragraphs B26-B33 of IFRS 10 enable an investor to determine if rights are protective rights?*
- (ii) to what extent does applying paragraphs B22-B24 of IFRS 10 enable an investor to determine if rights (including potential voting rights) are, or have ceased to be, substantive?*

In our experience, the requirements of B26-B33 and B22-B24 are generally sufficient. In some instances, it may require significant judgement in order to determine whether rights are protective or substantive, however, we do not believe that IFRS 10 could be substantially improved in this area. Significant judgement is required in applying many of the requirements of IFRS.

Question 2(c) - In your experience:

- (i) to what extent does applying paragraphs B41-B46 of IFRS 10 to situations in which the other shareholdings are widely dispersed enable an investor that does not hold a majority of the voting rights to make an appropriate assessment of whether it has acquired (or lost) the practical ability to direct an investee's relevant activities?*
- (ii) how frequently does the situation in which an investor needs to make the assessment described in question 2(c)(i) arise?*
- (iii) is the cost of obtaining the information required to make the assessment significant?*

It is relatively common in certain industries for an investor to control an investee without holding a majority of the voting rights. We have observed that practice has developed in certain jurisdictions, often driven by the views of regulators, where the principles and guidance in B41-B46 are interpreted to create 'quasi-rules'. This may be a result of regulators attempting to increase consistency of application in their jurisdiction.

In our experience, clear disclosure of the judgements made in applying B41-B46 are crucial for a financial statement user to understand why an investor has concluded that they do or do not control an investee.

The cost of obtaining this information is not generally significant, however, the judgements required are difficult, particularly when different jurisdictions appear to conclude on similar fact patterns differently as a result of views expressed by regulators.

Question 3(a) - In your experience:

- (i) to what extent does applying the factors listed in paragraph B60 of IFRS 10 (and the application guidance in paragraphs B62-B72 of IFRS 10) enable an investor to determine whether a decision maker is a principal or an agent?*
- (ii) are there situations in which it is challenging to identify an agency relationship? If yes, please describe the challenges that arise in these situations.*
- (iii) how frequently do these situations arise?*

Similar to our response to question 2(c), determining whether a decision maker is acting as a principal or agent is very common, particularly in the investment manager industry. Common fact patterns are already included in IFRS 10 in examples 13-16, however, we have observed instances where practice has developed to interpret the numerical figures in these examples as 'quasi-rules' in certain jurisdictions.

The numerical exposure to variable returns that can be derived from these examples range from 22% to 37% of the profits of the fund. We have observed regulators and entities applying these numerical examples strictly, where any exposure below 22% for a fund manager (or other type of investor) is determined to be insufficient exposure to variable returns, whereas anything beyond 37% is determined to result in sufficient exposure to variable returns. The range between 22-37% is often considered to be a 'grey zone', which is open to judgement and the development of accounting policies.

While this issue arises frequently in numerous jurisdictions, we are uncertain whether IFRS 10 may be amended to reduce this issue. We have observed that numerical examples being introduced to IFRS standards where an area is highly judgemental often results in preparers interpreting the examples to convey requirements beyond those that exist within the body of the standard itself.

Question 3(b) - In your experience:

- (i) to what extent does applying paragraphs B73-B75 of IFRS 10 enable an investor to assess whether control exists because another party is acting as a de facto agent (ie in the absence of a contractual arrangement between the parties)?*
- (ii) how frequently does the situation in which an investor needs to make the assessment described in question 3(b)(i) arise?*
- (iii) please describe the situations that give rise to such a need.*

We have no specific observations relating to this question.

Question 4(a) - In your experience:

- (i) to what extent does applying the definition (paragraph 27 of IFRS 10) and the description of the typical characteristics of an investment entity (paragraph 28 of IFRS 10) lead to consistent outcomes? If you have found that inconsistent outcomes arise, please describe these outcomes and explain the situations in which they arise.*
- (ii) to what extent does the definition and the description of typical characteristics result in classification outcomes that, in your view, fail to represent the nature of the entity in a relevant or faithful manner? For example, do the definition and the description of typical characteristics include entities in (or exclude entities from) the category of investment entities that in your view should be excluded (or included)? Please provide the reasons for your answer.*

We observe that the IFRS Interpretations Committee issued agenda decisions in March 2014 and March 2017, which have significantly affected how IFRS 10.27-28 are interpreted in practice. These agenda decisions have reduced diversity in practice and clarified the requirements of IFRS 10 relating to determining whether an entity meets the definition of an investment entity or not.

While these agenda decisions are useful, we observe that they interpret fundamental requirements of IFRS 10, which suggests that they should be incorporated into IFRS 10. While preparers are required to apply IFRS standards, taking into account explanatory material in IFRS Interpretation Committee agenda decisions (as has been clarified by recent amendments to the Due Process Handbook), agenda decisions are not necessarily as visible or as accessible as IFRS standards themselves. We observe that agenda decisions are included in the annotated versions of IFRS standards, however, these editions are only published periodically and are only available for a fee.

Additionally, IFRS Interpretation Committee agenda decisions are only translated into other languages once bound volumes of IFRS standards are issued (e.g. the 'red' or 'blue' books). This creates a barrier to access for preparers who do not speak English or whose first language is not English, as they are unable to access IFRS Interpretations Committee agenda decisions until the next translated version of the bound volumes are published, and once they are, the translated agenda decisions are only available for a fee.

We encourage the IASB to incorporate the guidance contained in important agenda decisions into the standard itself where considered appropriate, as well as giving consideration to making agenda decisions available in other languages more promptly and with fewer barriers to access (e.g. fees to purchase bound volumes containing the agenda decisions).

Question 4(b) - In your experience:

- (i) are there situations in which requiring an investment entity to measure at fair value its investment in a subsidiary that is an investment entity itself results in a loss of information? If so, please provide details of the useful information that is missing and explain why you think that information is useful.*
- (ii) are there criteria, other than those in paragraph 32 of IFRS 10, that may be relevant to the scope of application of the consolidation exception for investment entities?*

Measuring a subsidiary that meets the definition of an investment entity may result in a loss of information in instances where the subsidiary is highly geared. For example, if Investment Entity Parent A measures its interest in Investment Entity Subsidiary B at fair value through profit or loss, and B has financed its investments in subsidiaries by issuing financial instruments that meet the definition of a liability, this information is not readily apparent. While IFRS 12 would require disclosure of information relating to B, A not being required to consolidate B could be considered to reduce the information value of A's consolidated financial statements, as a subsidiary that engages in similar activities to A is not consolidated.

Question 5(a) - In your experience:

- (i) how frequently do transactions, events or circumstances arise that:
 - (a) alter the relationship between an investor and an investee (for example, a change from being a parent to being a joint operator); and*
 - (b) are not addressed in IFRS Standards?**
- (ii) how do entities account for these transactions, events or circumstances that alter the relationship between an investor and an investee?*
- (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 frequently observe transactions in which the relationship between an investor and an investee changes, particularly during the current environment of significant corporate transactions and restructuring occurring worldwide. In most cases, IFRS standards address how these changes in relationship should be accounted for.

In November 2017, the IFRS Interpretations Committee issued an agenda decision - *Acquisition of a group of assets*. This agenda decision states that there are two possible ways of accounting for the acquisition of a group of assets that do not constitute a business. Therefore, diversity in practice exists in how entities account for these transactions.

This diversity has increased due to the recent amendments to IFRS 3, which amended the definition of a business and introduced an optional concentration test, which became effective for annual reporting periods beginning on or after 1 January 2020. These

amendments have increased the number of acquisitions that are accounted for as asset acquisitions rather than business combinations.

Due to the diversity in practice that exists and the increased prevalence of these transactions, we believe the IASB should address these requirements via standard setting.

Question 5(b) - In your experience:

- (i) how do entities account for transactions in which an investor acquires control of a subsidiary that does not constitute a business, as defined in IFRS 3? Does the investor recognise a non-controlling interest for equity not attributable to the parent?*
- (ii) how frequently do these transactions occur?*

Generally, we observe that entities recognise a non-controlling interest when they acquire control of a subsidiary, regardless of whether the subsidiary meets the definition of a business as we believe this is required by IFRS 10.22.

This is a common occurrence, as many significant assets may be placed inside of a corporate wrapper when there are multiple entities with an interest in that underlying asset (e.g. land, real estate, etc.).

IFRS 11 Joint Arrangements

Question 6 - In your experience:

- (a) how widespread are collaborative arrangements that do not meet the IFRS 11 definition of 'joint arrangement' because the parties to the arrangement do not have joint control? Please provide a description of the features of these collaborative arrangements, including whether they are structured through a separate legal vehicle.*
- (b) how do entities that apply IFRS Standards account for such collaborative arrangements? Is the accounting a faithful representation of the arrangement and why?*

We have no specific observations relating to this question.

Question 7 - In your experience:

- (a) how frequently does a party to a joint arrangement need to consider other facts and circumstances to determine the classification of the joint arrangement after having considered the legal form and the contractual arrangement?*
- (b) to what extent does applying paragraphs B29-B32 of IFRS 11 enable an investor to determine the classification of a joint arrangement based on 'other facts and circumstances'? Are there other factors that may be relevant to the classification that are not included in paragraphs B29-B32 of IFRS 11?*

It may be difficult to classify a joint arrangement as a joint venture or a joint operation because joint ventures and joint operations are both defined directly in IFRS 11 rather than by exclusion to one another. Said another way, certain joint arrangements may appear to

meet the definition of both a joint venture and a joint operation (or neither) because each has different criteria.

When an item must be classified in a binary way, many other IFRS standards introduce criteria which result in being able to determine whether those criteria are met, and if they are not, a 'residual' result occurs. For example:

- IFRS 9: financial assets must be assessed under the 'solely payments of principal and interest' (SPPI) test. If they fail, they must be classified as financial assets at fair value through profit or loss and if they pass, a business model test is performed.
- IFRS 16: from the perspective of lessors, leases are classified as finance or operating depending on whether the lease transfers substantially all the risks and rewards incidental to ownership of an underlying asset. Depending on whether this criterion is met, a lease is classified as either operating or finance.
- IAS 19: defined contribution plans are defined directly, and defined benefit plans are defined as post-employment benefit plans other than defined contribution plans.

Question 8 - In your experience:

- (a) to what extent does applying the requirements in IFRS 11 enable a joint operator to report its assets, liabilities, revenue and expenses in a relevant and faithful manner?*
- (b) are there situations in which a joint operator cannot so report? If so, please describe these situations and explain why the report fails to constitute a relevant and faithful representation of the joint operator's assets, liabilities, revenue and expenses.*

IFRS 11 generally results in a joint operator reporting its assets, liabilities, revenue and expenses in a relevant and faithful manner, however, in some instances, IFRS standards are unclear on how this should be reflected.

In March 2019, the IFRS Interpretations Committee issued an agenda decision - *Liabilities in relation to a Joint Operator's Interest in a Joint Operation*. While the agenda decision clarified how a joint operator should account for its obligations relating to a lease where another party is primarily responsible (i.e. the 'credit'), the agenda decision has not addressed how the joint operator accounts for the debit side of this entry. This has led to continued diversity in practice.

Please also see our response to question 10 below.

IFRS 12 Disclosure of Interests in Other Entities

Question 9 - In your experience:

- (a) to what extent do the IFRS 12 disclosure requirements assist an entity to meet the objective of IFRS 12, especially the new requirements introduced by IFRS 12 (for example the requirements for summarised information for each material joint venture or associate)?
- (b) do the IFRS 12 disclosure requirements help an entity determine the level of detail necessary to satisfy the objective of IFRS 12 so that useful information is not obscured by either the inclusion of a large amount of detail or the aggregation of items that have different characteristics?
- (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.
- (d) does IFRS 12 require information to be provided that is not useful to meet the objective of IFRS 12? If yes, please specify the information that you consider unnecessary, why it is unnecessary and what requirements in IFRS 12 give rise to the provision of this information.

We have no specific observations relating to this question.

Other Topics

Question 10 - 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.

Consistent with our response to question 4(a), we believe the IASB should consider whether at least some agenda decisions relating to IFRS 10, 11 and 12 should be changed into application guidance, which forms part of the standard. 22 agenda decisions have been published relating to IFRS 10, 11 and 12, which indicates that amount of interpretation is required in order to apply the standards.

For the reasons noted in our response to question 4(a), including ease of accessibility and issues related to translation, we believe incorporating these agenda decisions into the standard would increase the consistent application of the standards by preparers.

In some cases, agenda decisions did not include a conclusion on the appropriate accounting requirements because there was not sufficient clarity in the standard. For those agenda decisions, the IASB should consider standard setting to address the issues.