

Auditor's Report on Financial Statements – Reporting on Unconsolidated Financial Statements

Introduction

1. Many jurisdictions currently require entities to publish audited unconsolidated (parent only) financial statements as well as or, in certain restricted circumstances, instead of consolidated financial statements. These financial statements are required to provide shareholders and other stakeholders with a view of the financial position/results of operations of the legal entity as opposed to the economic entity.
2. Current reporting practices under local accounting and auditing standards varies. Some jurisdictions require parent only financial statements to be provided with consolidated financial statements. Auditors then issue an opinion that covers both the parent only and consolidated financial statements or they issue separate opinions on the parent only and consolidated financial statements. Other jurisdictions provide certain exemptions from the preparation of consolidated financial statements. When the exemption criteria are met, auditors then report on the parent only financial statements.
3. This agenda paper assumes that unconsolidated financial statements will continue to serve a useful purpose and it:
 - Explores how current practice under domestic standards will be impacted when entities adopt IFRSs and ISAs;
 - Highlights the issues that will need to be addressed to enable entities and auditors to continue local practices under IFRSs and ISAs;
 - Recommends an approach that might be adopted by IAASB in order to address these issues.

Action Required by the IAASB

Consider the issues identified by the Task Force with respect to the preparation of unconsolidated financial statements under IFRS.

Do you agree with the Task Force recommendations on page 3 regarding the approach that might be adopted by IAASB in order to address these issues?

How Adoption of IFRS and ISA will Impact Current Practice

- 4 As already noted, numerous jurisdictions require entities to prepare and publish audited parent only financial statements (e.g., Denmark, France, Germany, Hong Kong and Japan). Most of these jurisdictions currently issue these statements under local standards.
- 5 IAS 27, "Consolidated Financial Statements and Accounting for Investments in Subsidiaries," permits the preparation of parent only financial statements in very limited circumstances. IAS 27.8 states that a parent is exempt from providing consolidated financial statements when it is a:
 - Wholly owned subsidiary; or
 - Virtually wholly owned subsidiary and it obtains the approval of the owners of the minority interest.

IAS 27.8 also requires the parent that is exempt from providing consolidated financial statements to disclose the following:

- Reasons why consolidated financial statements have not been presented;
- Bases on which subsidiaries are accounted for in its separate financial statements; and
- Name and registered office of its parent that publishes consolidated financial statements.

- 6 While IAS 27 recognises that in many countries parent only financial statements are presented by a parent in order to meet legal or other requirements (IAS 27.31), it does not provide guidance as to how entities can address these requirements under IFRS.
- 7 Given the requirements of IAS 27, entities that currently issue unconsolidated financial statements under domestic standards will only technically be permitted to do so under IFRS in the restricted circumstances described above. The reporting implications for entities that do not meet the exemption criteria but that decide to issue parent only financial statements under IFRS in order to meet local requirements will therefore be very negative. By virtue of IAS 1 and the proposed IAPS on "Reporting on Compliance with IFRS," entities will not be able to describe these statements as complying with IFRS (except for the failure to apply the consolidation standards). If entities do describe these statements in this way, auditors will have no choice but to issue either a qualified or adverse opinion on such statements.
- 8 Currently, entities and their auditors are getting around this problem by issuing parent only financial statements under local standards and the consolidated statements under IFRS. However, this is viewed as a stopgap solution. In practice, auditors are increasingly being asked to provide opinions on parent only financial statements prepared in accordance with IFRS even when these statements do not meet the exemption criteria. The inability to issue a clean ISA opinion under IFRS on such statements, when they have been prepared in addition to consolidated financial statements to meet local requirements, seems illogical to both the entities and their auditors.

Issues That Will Need to be Addressed to Enable Entities and Auditors to Issue and Report on Parent Only Financial Statements

- 9 As noted in the introduction to this agenda paper, the major premise underlying the Task Force recommendations is that there is currently a need for parent only financial statements and that the need for such statements will continue.
- 10 Given this premise, the Task Force believes that, unless international standards better address the preparation and reporting on parent only financial statements, entities and auditors will continue to rely on local standards for such statements. This can therefore act as a significant impediment to full adoption of IFRS and ISA.
- 11 The Task Force also believes that while this issue has ISA reporting implications, it cannot be properly addressed without the involvement of the IASB. There is a need for the IASB to reconsider when it is appropriate for entities to prepare parent only financial statements and how such statements should be presented (e.g., supplementary to consolidated financial statements or on a standalone basis).

Task Force Recommendations

In view of the above, the Task Force recommends that the IAASB:

- (a) Discuss the need to revise IAS 27 with the IASB;
- (b) Recommend to the IASB that both Boards establish a joint working group that:
 - (i) Identifies the circumstances under which parent only financial statements are appropriate;
 - (ii) Identifies the areas in IAS 27 that need to be amended and clarified;
 - (iii) Develops the revisions for consideration by the IASB;
 - (iv) Considers the ISA reporting implications; and
 - (v) Develops recommendations as to how these reporting issues can be addressed by IAASB.

Given that the IASB is in the process of revising certain aspects of IAS 27 as part of its exposure draft on Improvements to International Accounting Standards (May 2002), the Task Force recommends that the discussions with IASB be initiated on an urgent basis. The proposed revisions to IAS 27 attempt to clarify when the exemption criteria in IAS 27.8 apply but they do not address the preparation of parent only financial statements in other circumstances.

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