

Package of five standards on consolidation, joint arrangements, associates and disclosures

Candy Fong
(7 March 2013)

Deloitte. *Our Responsibilities and Obligations*

德勤 All materials or explanations (not restricted to the following presentation slides) (collectively “Material”) have been and are prepared in general terms only. The Material is intended as a general guide and shall not be construed as any advice, opinion or recommendation given by Deloitte Touche Tohmatsu and/or its personnel (collectively “DTT”).

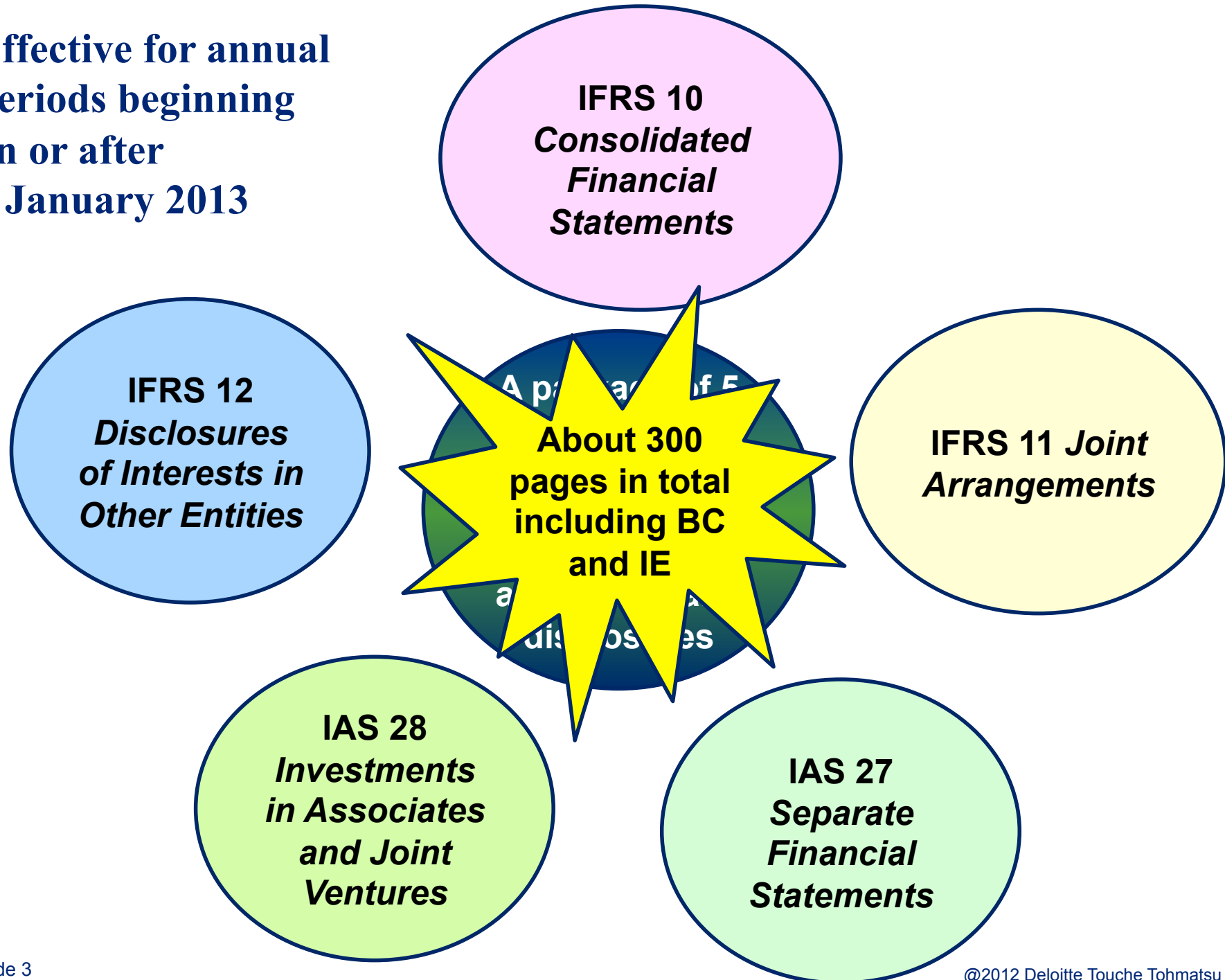
In addition, the Material is limited by the time available and by the information made available to us. You should not consider the Material as being comprehensive as we may not become aware of all facts or information. Accordingly, DTT is not in a position to and will not make any representation as to the accuracy, completeness or sufficiency of the Material for your purposes.

The application of the content of the Material to specific situations will depend on the particular situations involved. Professional advice should be sought before the application of the Material to any particular circumstances and the Materials shall not in any event substitute for such professional advice.

You will rely on the contents of the Material at your own risk. While all reasonable care has been taken in the preparation of the Material, all duties and liabilities (including without limitation, those arising from negligence or otherwise) to all parties including you are specifically disclaimed.



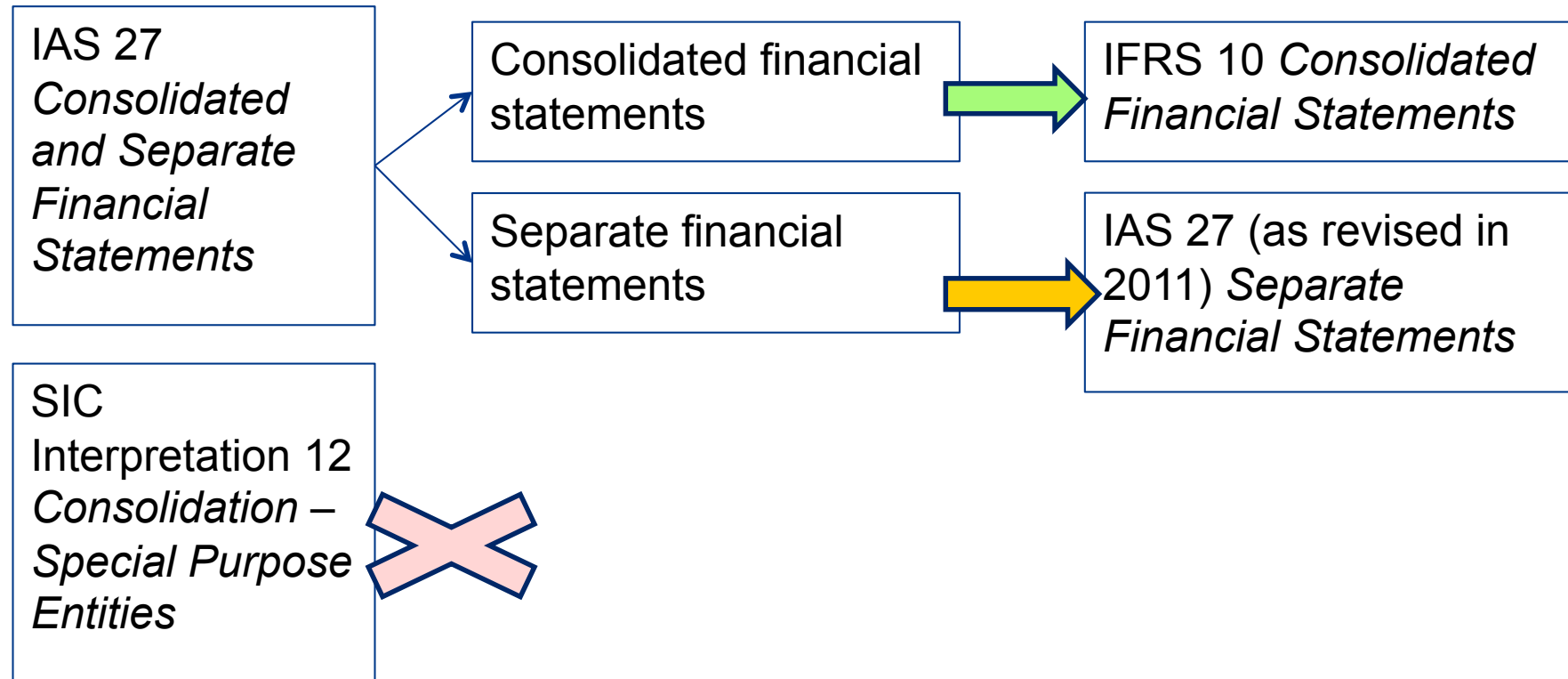
Effective for annual periods beginning on or after 1 January 2013



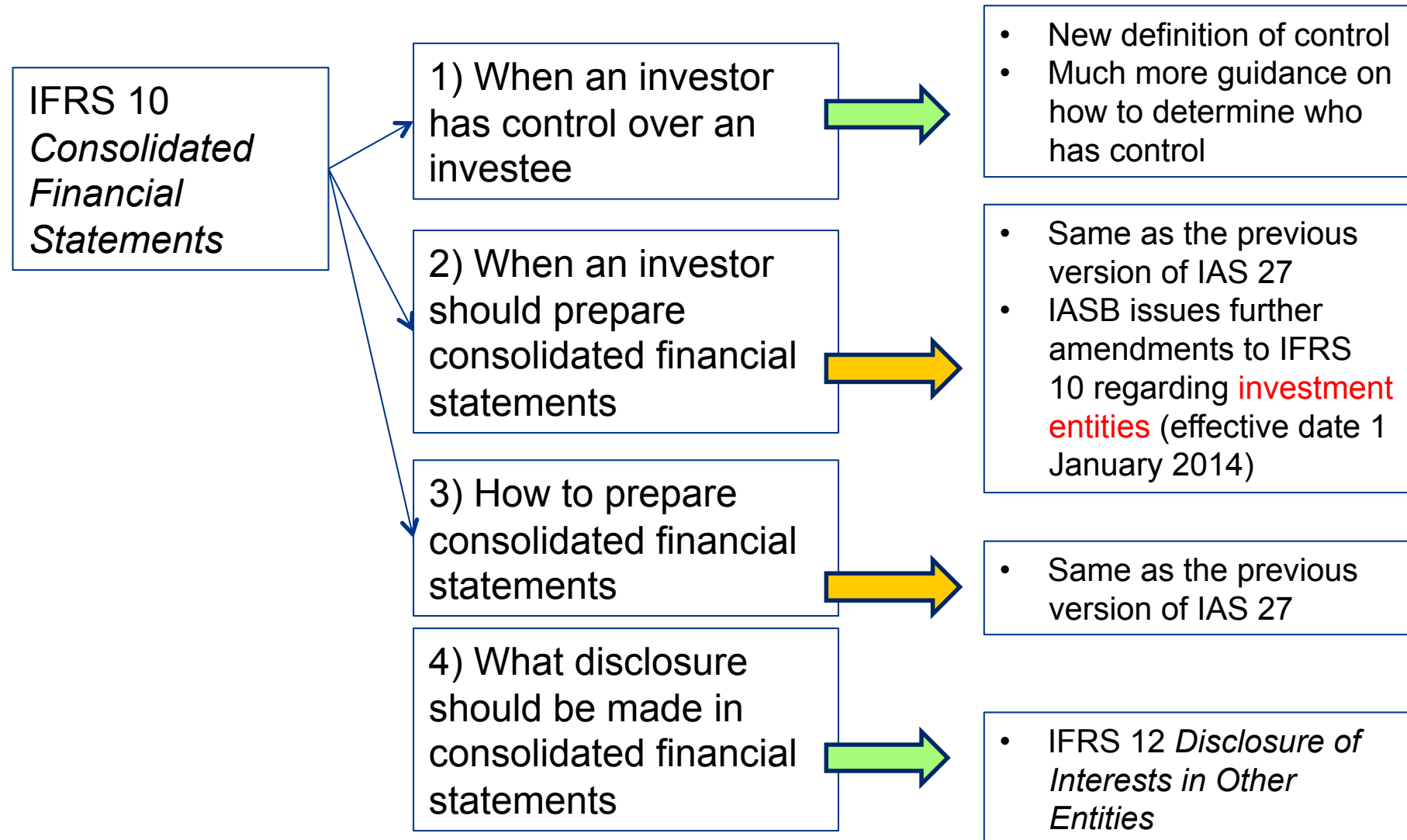
IFRS 10
*Consolidated
Financial Statements*



Roadmap of IFRS 10(1)



Roadmap of IFRS 10(2)



The previous version of IAS 27 defines control as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

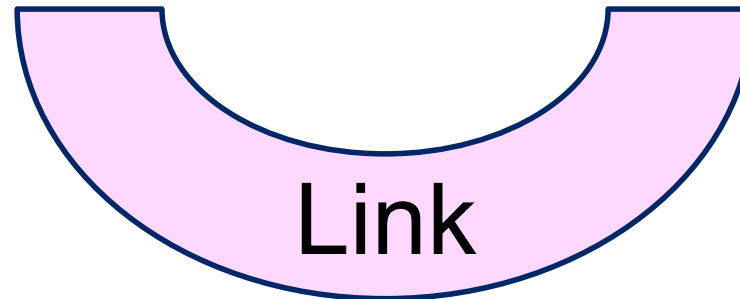
New
definition of
control under
IFRS 10

=

1) Power over
the investee

+

2) Exposure or
rights to
variable returns



3) Ability to use the power to affect
the investor's returns

Power over an investee

- An investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities of the investee.

Step 1: What are the relevant activities of an investee?

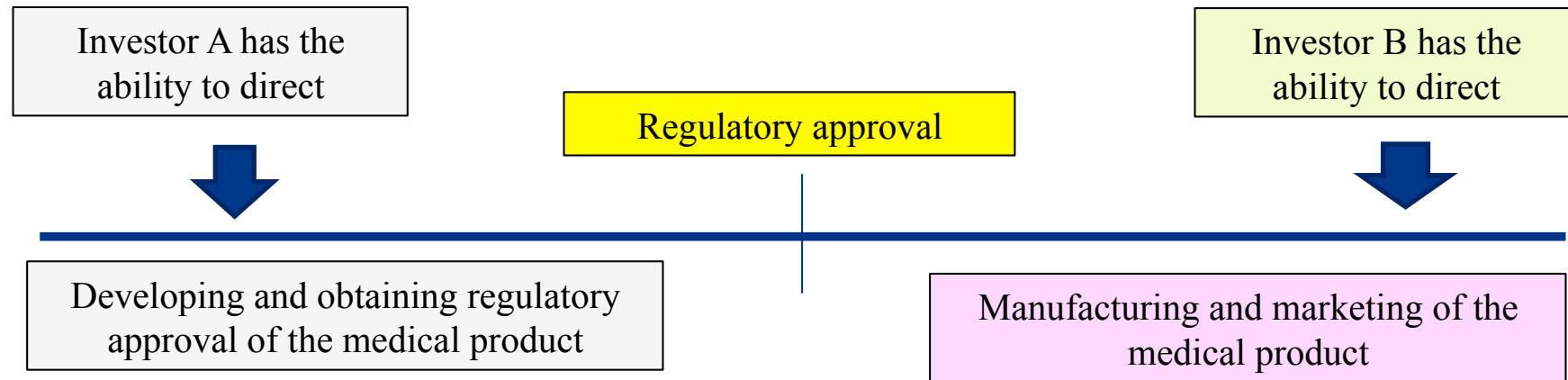
Step 2: How decisions about the relevant activities of the investee are made?

Step 3: Does the investor have rights that give it the current ability to direct the relevant activities?

Step 1: Identifying relevant activities of an investee

- Relevant activities of an investee are the activities of the investee that significantly affect the investee's returns
- IFRS 10 does not specify what the relevant activities are
- Examples of relevant activities in IFRS 10
 - Selling and purchasing of goods or services
 - Managing financial assets during their lives (including upon default)
 - Selecting, acquiring or disposing of assets
 - Researching and developing new products or processes
 - Determining a funding structure or obtaining funding

Example: Investors have ability to direct different relevant activities of an investee



- Who has power over the investee (Investor A or Investor B)?
- Relevant activities = activities that most significantly affect the returns of the investee has power
- A number of factors to be considered (e.g. factors that affect profit margin, revenue and value of the investee, the investor's exposure to variability of returns, the uncertainty of obtaining the required regulatory approval etc.)
- All relevant facts and circumstances should be considered - Judgement is required
- Need to reassess when facts and circumstances change

Step 2: Understanding how decisions about the relevant activities are made

- This is a crucial step to identify who has power over an investee
 - Need to understand the governance structure of each investee
- Simple cases: Investees are controlled by means of voting rights
 - **Example 1:** Decisions are determined based on the majority votes at shareholders' meetings → An investor that has the majority voting rights has power
 - **Example 2:** Decisions are determined based on the majority votes at board of directors' meetings → An investor that has the ability to appoint and remove the majority of the directors has power

Step 3: Identifying rights an investor has and rights held by others



- Power comes from rights
- Substantive rights vs. protective rights
 - Only substantive rights held by the investor and others are considered in assessing who has power
 - Protective rights do not give their holder power over an investee
 - Protective rights are rights designed to protect the interest of the party holding those rights without giving that party power over the entity
 - Protective rights relate to fundamental changes to the activities of an investee or apply in exceptional circumstances (although not all rights that apply in exceptional circumstances or are contingent on events are protective)

What are meant by ‘substantive rights’?

Principle: For a right to be substantive, the holder must have the practical ability to exercise that right

- Factors to be considered :
 - Whether or not there are any barriers that prevent holders from exercising their rights
 - Whether or not the parties that hold the rights would benefit from the exercise of those rights
 - Whether or not there is a mechanism in place that provides parties with the practical ability to exercise their rights collectively if they choose to do so
- Judgement is required taking into account all facts and circumstances

Examples of protective rights

- Examples in IFRS 10:
 - a lender's right to restrict a borrower from undertaking activities that could significantly change the credit risk of the borrower
 - non-controlling shareholders' right to approve capital expenditure that is greater than required in the ordinary course of business
 - a lender's right to seize the assets of a borrower if the borrower fails to meet the specified loan repayment conditions
- **How about the following?**
 - **approval from non-controlling shareholders with regard to changing constitutional documents?**
 - **approval from non-controlling shareholders with regard to transactions with related parties?**
 - **approval from non-controlling shareholders with regard to liquidation or commencement of bankruptcy proceedings?**

Are potential voting rights substantive?

OLD STANDARD

IAS 27 (2008).14 states: “Potential voting rights are not currently exercisable or convertible, when for example, they cannot be exercised or converted until a future date or until the occurrence of a future event.”

IAS 27 (2008).IG 1 states:
“consider the existence and effect of all potential voting rights that are currently exercisable or convertible ... all facts and circumstances to be examined except for intention and financial ability to exercise or convert potential voting rights...



Guidance under IFRS 10 on whether potential voting rights are substantive:

- more judgemental
- consider purpose, terms and conditions of the instruments, in/out of money.....
- need to consider those that are NOT currently exercisable e.g. whether the rights to direct the relevant activities of the investee can be exercised by the time the decisions about the relevant activities need to be made

Example 1 - Are potential voting rights substantive?

Facts

- The investee has annual shareholders' meetings at which decisions to direct relevant activities are made.
- The next scheduled shareholders' meeting is in eight months' time.
- Shareholders individually or collectively hold at least 5% can call a special meeting to change the existing policies over the relevant activities (need to give notice to shareholders for **at least 30 days**).
- Policies over the relevant activities can be changed only at special or scheduled shareholders' meetings.

Example 1 - Are potential voting rights substantive?

Investor A has entered into a forward contract – Investor A will get the majority shares in the investee upon the exercise of the forward contract.

The forward contract's settlement date is in 25 days.

Are the potential voting rights substantive?

- Yes, the forward contract will be settled in 25 days whilst the next shareholders' meeting at earliest will not be held within for at least 30 days

Under IAS 27 (2008), such a forward contract is not considered as currently exercisable.

Example 2 - Are potential voting rights substantive?

Same facts as Example 1, except that the forward contract's settlement date is in 6 months.

Are the potential voting rights substantive?

- No, the forward contract will be settled in 6 months whilst the next shareholders' meeting can be scheduled before the forward contract's settlement date

Under the previous version of IAS 27, such a forward contract is not considered as currently exercisable.

Are potential voting rights substantive?

- Guidance on whether potential voting rights are substantive:
 - whether or not potential voting rights would benefit their holder from the exercise of those rights
 - More likely to be substantive when the potential voting rights are in the money or the investor would benefit for other reasons (e.g. by realising synergies between the investor and the investee from the exercise of the instruments)

Example 3 - Are potential voting rights substantive?

Example 3 - Facts

- Investor A owns 49% of the ordinary shares of an investee, with the remaining 51% of the ordinary shares owned by 3 independent investors with equal percentage of ownership
- Investor A holds options that, if exercised, would give Investor A 55% of the ordinary shares of the investee that would be sufficient to direct the relevant activities of the investee
- Such options are **out of the money**

Question

- Can we conclude that the options are non-substantive (as they are out of the money)?

Example 3 - Are potential voting rights substantive?

Accounting response

- Not necessarily.
- May still be substantive taking into account the control premium the investor would gain from exercising the options



An investor with **less than a majority** of the voting rights

All facts and circumstances should be considered

Step 1

Consider:

- Contractual arrangements
- Potential voting rights held by the investor, other vote holders or other parties
- Size of the investor's holding of voting rights relative to the size and dispersion of the holdings of other vote holders

Sufficient evidence to conclude whether the investor has or does not have power?

Step 2

YES → No need to consider additional facts and circumstances

NO → Need to consider additional facts and circumstances

- Voting patterns at previous shareholders' meetings
- Rights to appoint or approve the investee's key management personnel
- Right to direct investee to enter into significant transactions
- Special relationship with the key management personnel of the investee
- Level of investor's exposure to variability in returns
- More

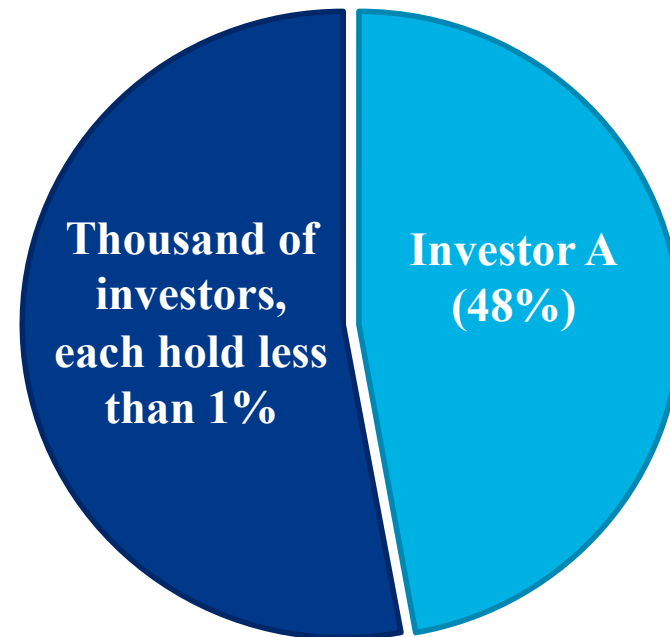
Still not clear → The investor does not have control over the investee

Investor's voting rights vs. other vote holders

Example 1:

Background

An investor holds **48 per cent** of the voting rights of an investee. The remaining voting rights are held by **thousands of shareholders**, none individually holding more than 1 per cent of the voting rights. None of the shareholders has any arrangements to consult any of the others or make collective decisions.

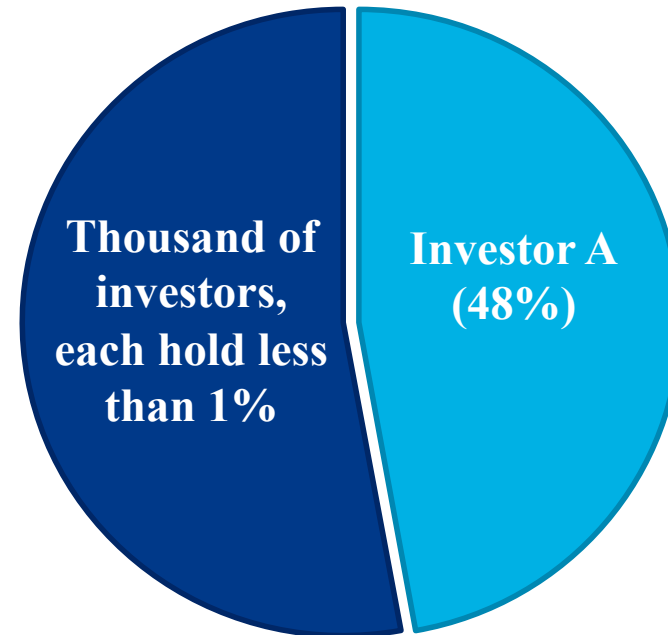


Investor's voting rights vs. other vote holders

Example 1(Cont'd):

When assessing the proportion of voting rights to acquire, on the basis of the relative size of the other shareholdings, the investor determined that a 48 per cent interest would be sufficient to give it control.

In this case, on the basis of the absolute size of its holding and the relative size of the other shareholdings, the investor concludes that it has a sufficiently dominant voting interest to meet the power criterion without the need to consider any other evidence of power.



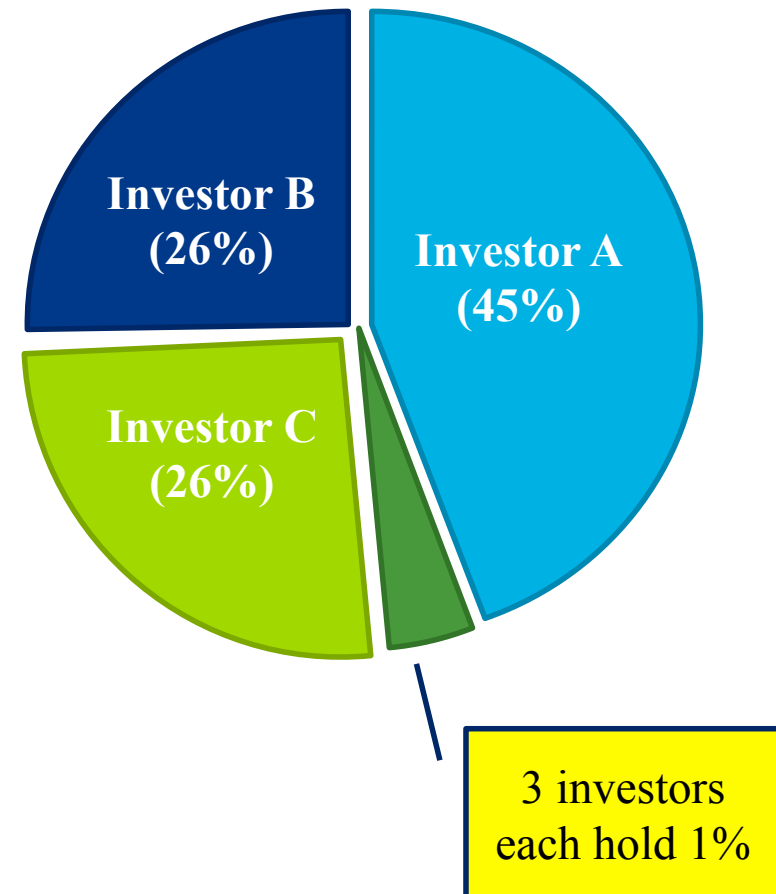
Only step 1 is required

Investor's voting rights vs. other vote holders

Example 2

Background

Investor A holds 45 per cent of the voting rights of an investee. Two other investors each hold 26 per cent of the voting rights of the investee. The remaining voting rights are held by three other shareholders, each holding 1 per cent. There are no other arrangements that affect decision-making.



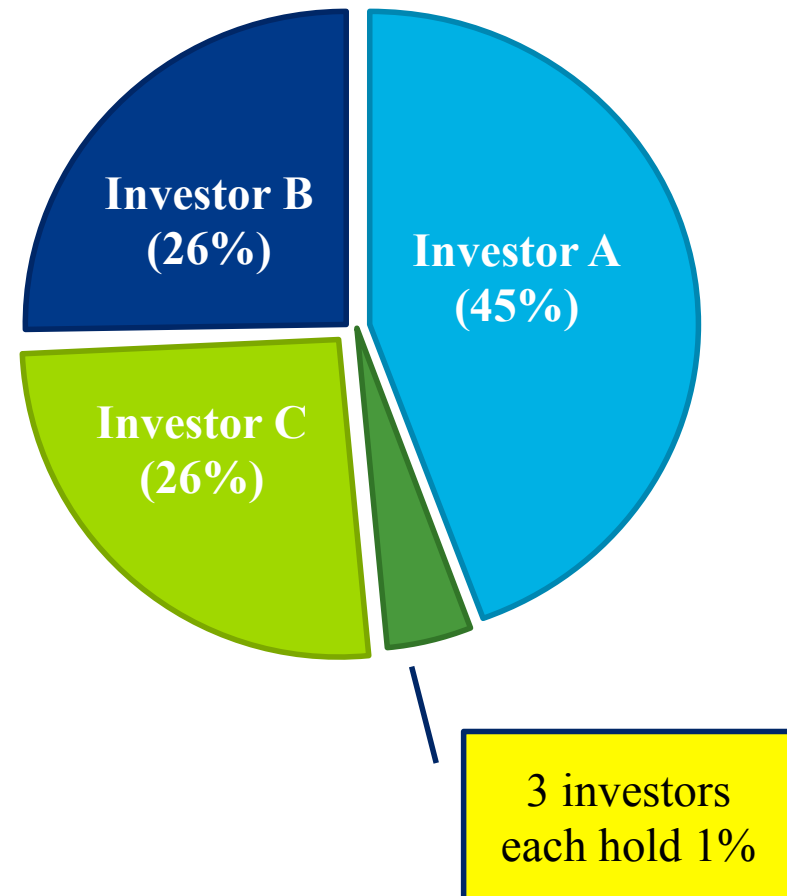
Investor's voting rights vs other vote holders

Example 2(Cont'd)

In this case, the size of investor A's voting interest and its size relative to the other shareholdings are sufficient to conclude that investor A does not have power. Only two other investors would need to cooperate to be able to prevent investor A from directing the relevant activities of the investee.



Only step 1 is required



Assessment of other facts and circumstances

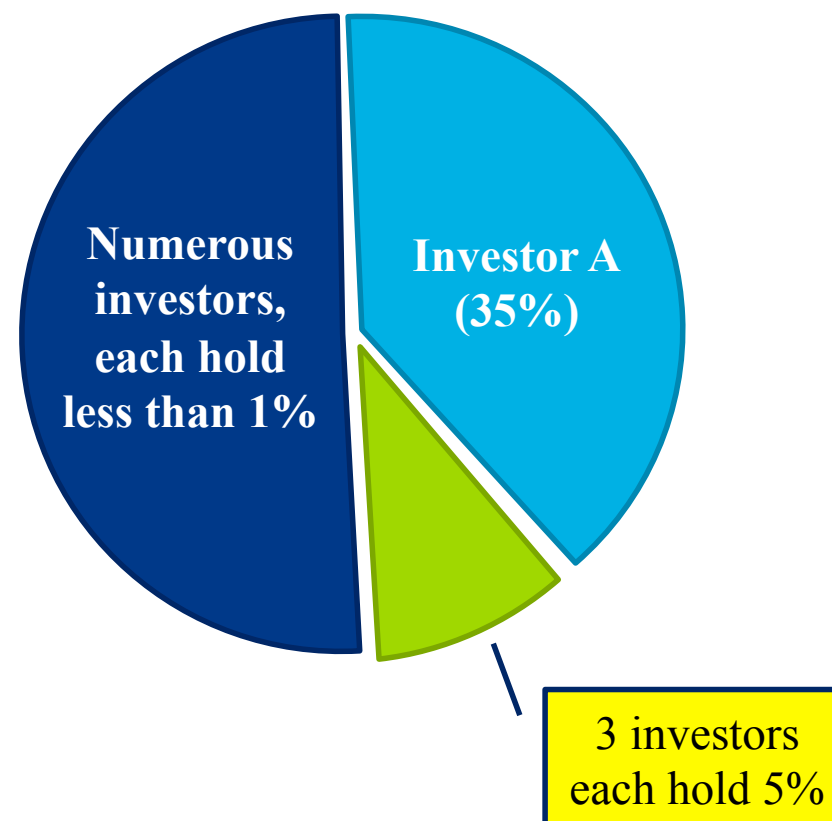
Example 3

Background

An investor holds 35 per cent of the voting rights of an investee. Three other shareholders each hold 5 per cent of the voting rights of the investee. The remaining voting rights are held by numerous other shareholders, none individually holding more than 1 per cent of the voting rights.

None of the shareholders has arrangements to consult any of the others or make collective decisions.

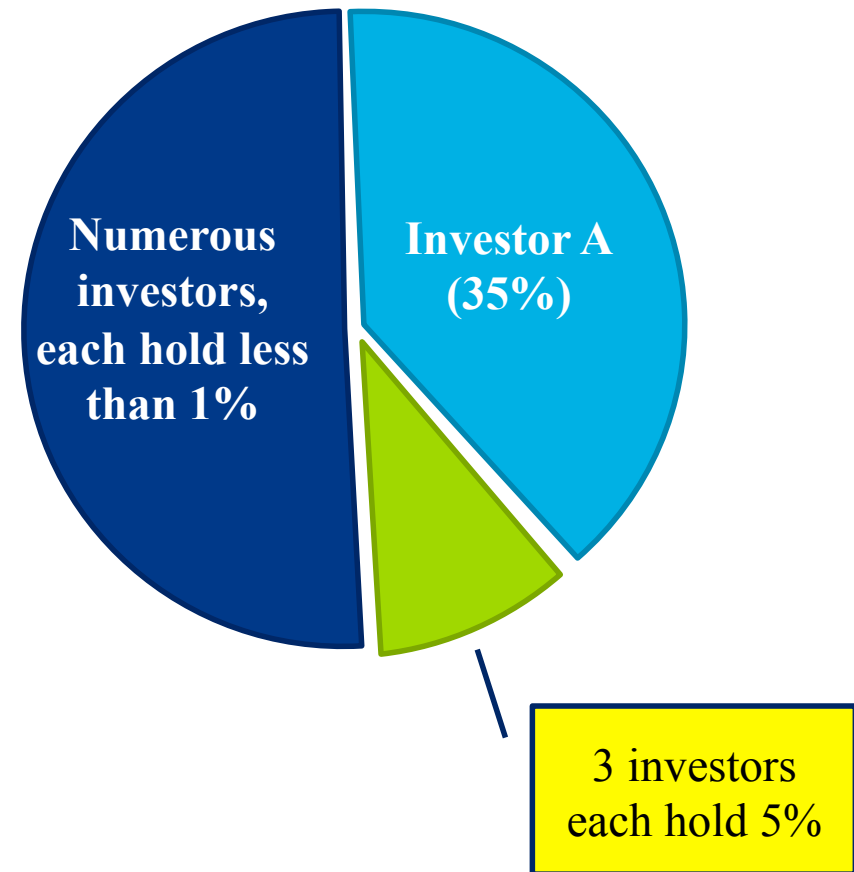
Decisions about the relevant activities of the investee require the approval of a majority of votes cast at relevant shareholders' meetings - 75 per cent of the voting rights of the investee have been cast at recent relevant shareholders' meetings.



Assessment of other facts and circumstances

Example 3 (Cont'd)

There was active participation of the other shareholders at recent shareholders' meetings, which indicates that the investor A would not have the practical ability to direct the relevant activities unilaterally, regardless of whether the investor has directed the relevant activities because a sufficient number of other shareholders voted in the same way as the investor.



Should a fund manager consolidate a fund it manages?

Is the fund manager acting as a principal or an agent?

Scope of the decision-maker's decision-making authority

Remuneration entitled by the decision-maker

Rights held by other parties

Decision-maker's exposure to variability of returns from other interests held



- Extensive guidance in IFRS 10
- Different weightings are to be applied to each of the above 4 factors on the basis of particular facts and circumstances.

Effective Date and Transition

- Effective for annual periods beginning on or after **1 January 2013**. Earlier application is permitted.
- If an entity applies IFRS 10 earlier, it should **disclose that fact** and apply IFRS 11, IFRS 12, IAS 27 (as amended in 2011) and IAS 28 (as amended in 2011) at the same time.
- General principles: apply **retrospectively** with limited exceptions
- In mid 2012, the IASB issued *Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance* (Amendments to IFRS 10, IFRS 11 and IFRS 12)
 - The amendments clarify the application of the transition guidance in IFRS 10, IFRS 11 and IFRS 12
 - Effective date: annual periods beginning on or after 1 January 2013 (same as that for IFRS 10, IFRS 11 and IFRS 12)

Circumstances under which comparative information should be adjusted retrospectively

At the date of initial application of IFRS 10 (i.e. the beginning of the annual period for which IFRS 10 is applied for the first time), is the entity consolidated under:

IAS 27/ SIC12?	IFRS 10?	Consolidation conclusion	Retrospective adjustment?	Reference to IFRS 10
Yes	Yes	Same	No	C3(a)
No	No		No	C3(b)
No	Yes	Different	Yes	C4
Yes	No		Yes	C5
Investee disposed of prior to date of initial application		Same	No	BC199B

IFRS 11

Joint Arrangements

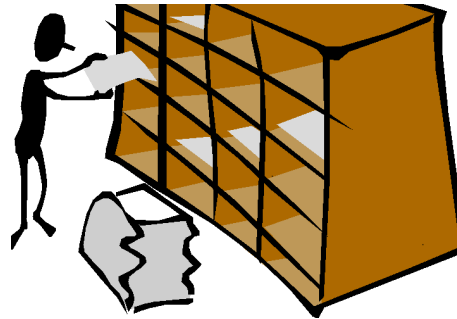


What are the issues being covered by IFRS 11?

1) What is meant by ‘joint control’?



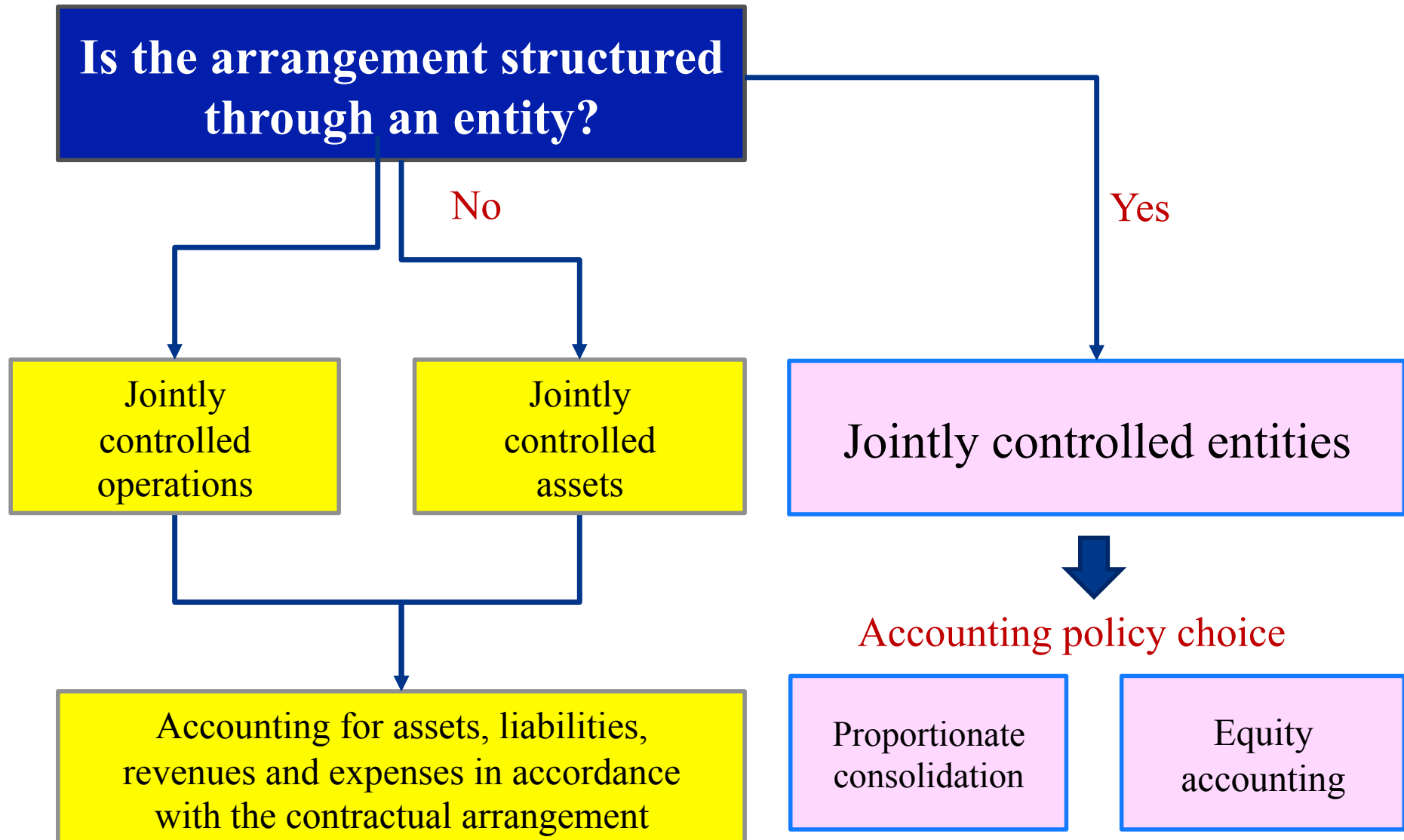
2) How should a joint arrangement be classified?



3) How should a party to the joint arrangement transit from IAS 31 to IFRS 11?



IAS 31 - Types of joint ventures and classification



IFRS 11 – Types of joint arrangements and classification

Principle: The classification should reflect the rights and obligations of the parties to the arrangement

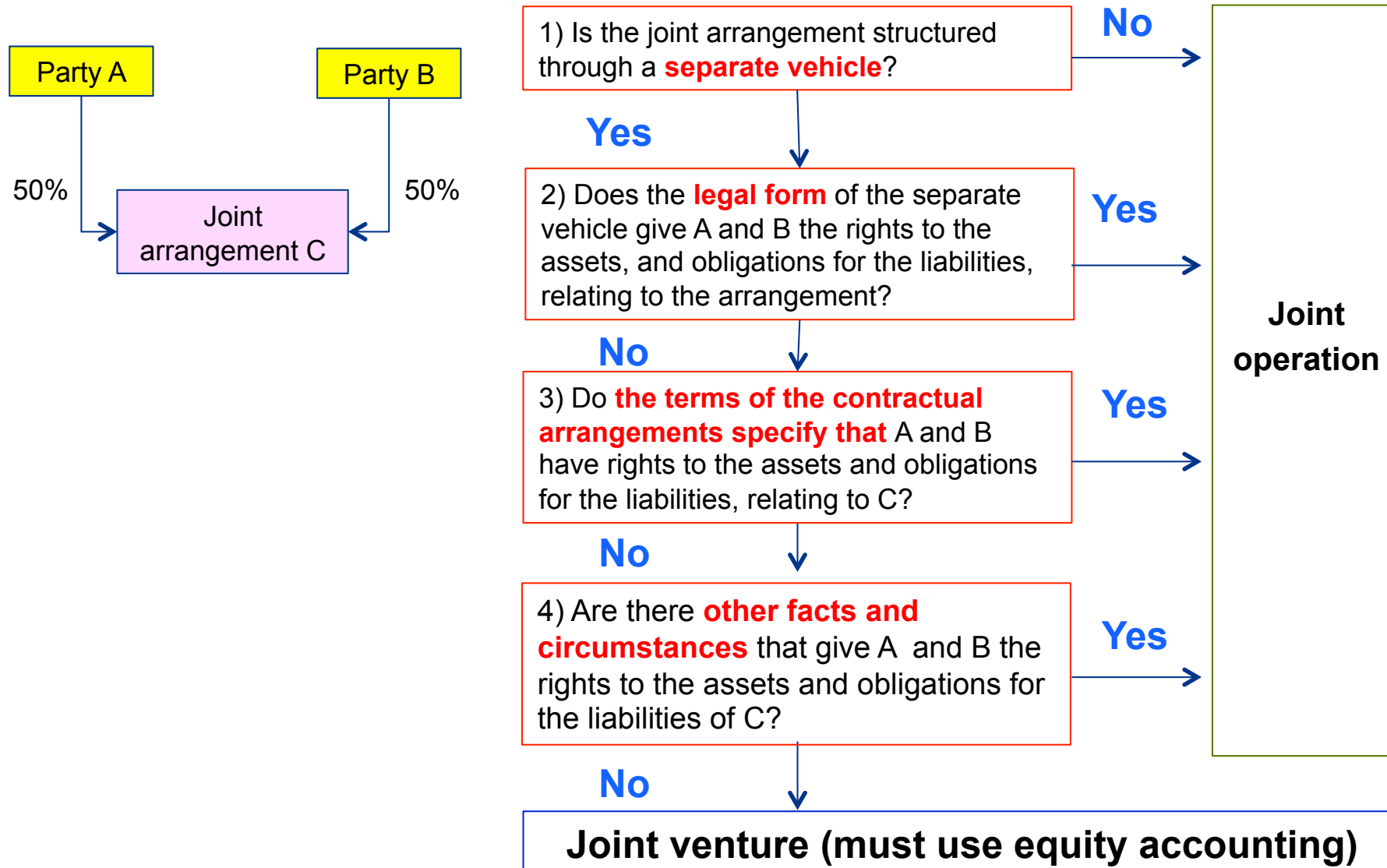
Joint operations - Rights to the assets and obligations for the liabilities of the arrangement

Each joint operator recognises its own assets, liabilities, income and expenses and its share of assets, liabilities, income and expenses

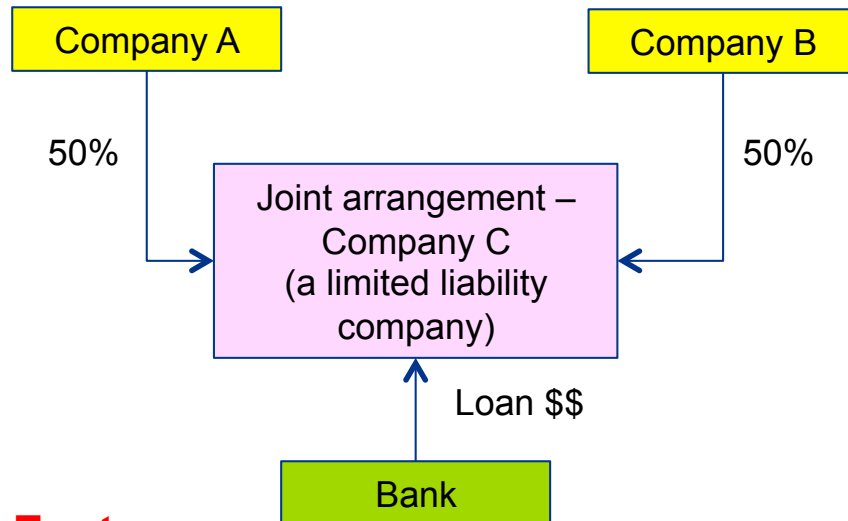
Joint ventures - Rights to the net assets of the arrangement

Must be accounted for using the equity method

Classification of a joint arrangement – Decision tree



Example 1 - Classification of a joint arrangement



Facts:

- Company C will develop residential properties and then sell them to 3rd parties.
- To finance the project, Co C borrows \$ from a bank.
- The agreement says that the proceeds from sale of properties will be used to repay the loan and any surplus will be distributed to A and B in proportion to A's and B's ownership interests in C.
- C will then be wound up.

1) Is the joint arrangement structured through a **separate vehicle**?

Yes

2) Does the **legal form** of the separate vehicle give A and B the rights to the assets, and obligations for the liabilities, relating to the arrangement?

No

Do **the terms of the contractual arrangements specify that** A and B have rights to the assets and obligations for the liabilities, relating to C?

No

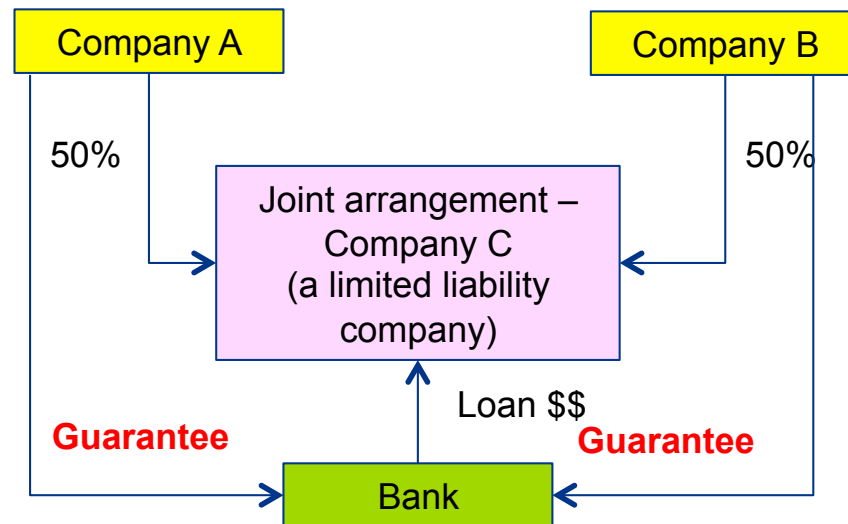
Are there **other facts and circumstances** that give A and B the rights to the assets and obligations for the liabilities of C?

No

Joint venture (must use equity accounting)

Example 2 - Classification of a joint arrangement

- **Same facts as Example 1**
- **In addition**, A and B provide guarantees to the Bank with regard to the bank loan.



1) Is the joint arrangement structured through a **separate vehicle**?

Yes

2) Does the **legal form** of the separate vehicle give A and B the rights to the assets, and obligations for the liabilities, relating to the arrangement?

No

3) Do **the terms of the contractual arrangements specify that** A and B have rights to the assets and obligations for the liabilities, relating to Co C?

No, not by the guarantee itself.

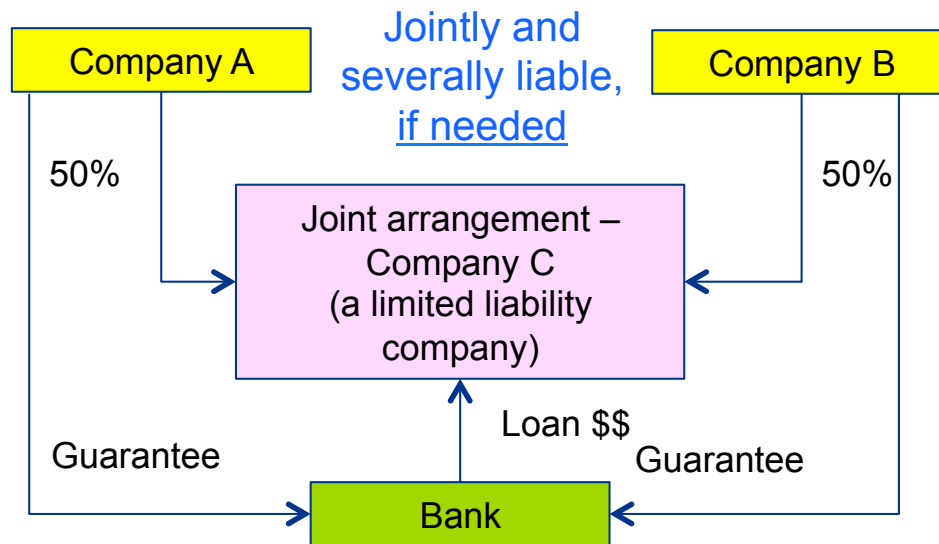
4) Are there **other facts and circumstances** that give A and B the rights to the assets and obligations for the liabilities of Co C?

No

Joint venture (must use equity accounting)

Example 3 - Classification of a joint arrangement

- **Same facts as Examples 1 and 2**
- **In addition**, there is an irrevocable agreement between A, B and Co C such that A and B agree to provide the necessary funds in equal amount, if required, to ensure that Co C is able to pay its obligations and comply with the applicable legislation and regulation.



1) Is the joint arrangement structured through a **separate vehicle**?

Yes

2) Does the **legal form** of the separate vehicle give A and B the rights to the assets, and obligations for the liabilities, relating to the arrangement?

No

3) Do **the terms of the contractual arrangements specify that** A and B have rights to the assets and obligations for the liabilities, relating to Co C?

No

4) Are there **other facts and circumstances** that give A and B the rights to the assets and obligations for the liabilities of Co C?

No

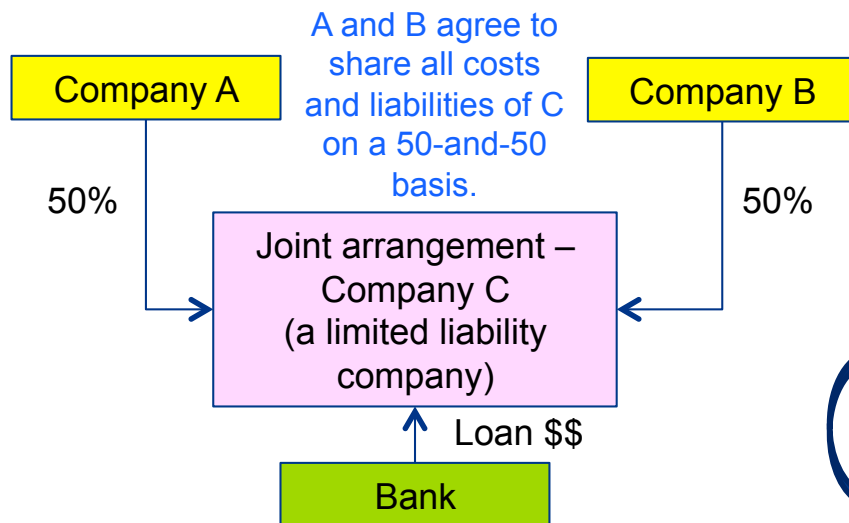
Joint venture (must use equity accounting)

A and B will only have the obligation when C is not able to settle its debts.

Example 4 - Classification of a joint arrangement

Same facts as Example 1 except that:

- There is an agreement between A, B and C such that A and B agree to share all costs and liabilities of C (including bank loans) on a 50-and-50 basis.
- The bank loan is still entered into in the name of C.



1) Is the joint arrangement structured through a **separate vehicle**?

Yes

2) Does the **legal form** of the separate vehicle give A and B the rights to the assets, and obligations for the liabilities, relating to the arrangement?

No

3) Do **the terms of the contractual arrangements result in** A and B having the obligations for the liabilities, relating to Co C?

Yes

→ A and B have obligations for the liabilities

4) Should the joint arrangement be classified as a joint operation?

No, unless the parties to the arrangement have rights to the assets relating to the joint arrangement.

A joint operation is defined as a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets **and** obligations for the liabilities, relating to the arrangement.

Guidance on ‘other facts and circumstances’ in IFRS 11

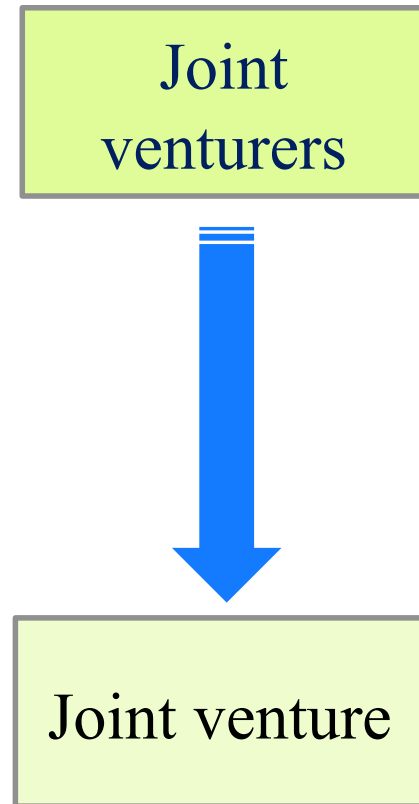
- The joint arrangement is formed with the primary purpose of providing outputs to the parties to the joint arrangement.
- Parties to the joint arrangement agree to purchase substantially all of the output produced by the joint arrangement.
- Liabilities incurred by the joint arrangement are in substance satisfied by the cash flows received from the parties through their purchases of the outputs.
- The joint arrangement depends on the parties on a continuous basis for settling the liabilities relating to the activity conducted through the joint arrangement.
- And such cash flows contribution are on a continuous basis (not contingent on occurrence of certain events).

Questions:

1) What is meant by ‘substantially all’?

2) How to deal with a scenario where the output sharing by the parties to the arrangement is different from their ownership interests?

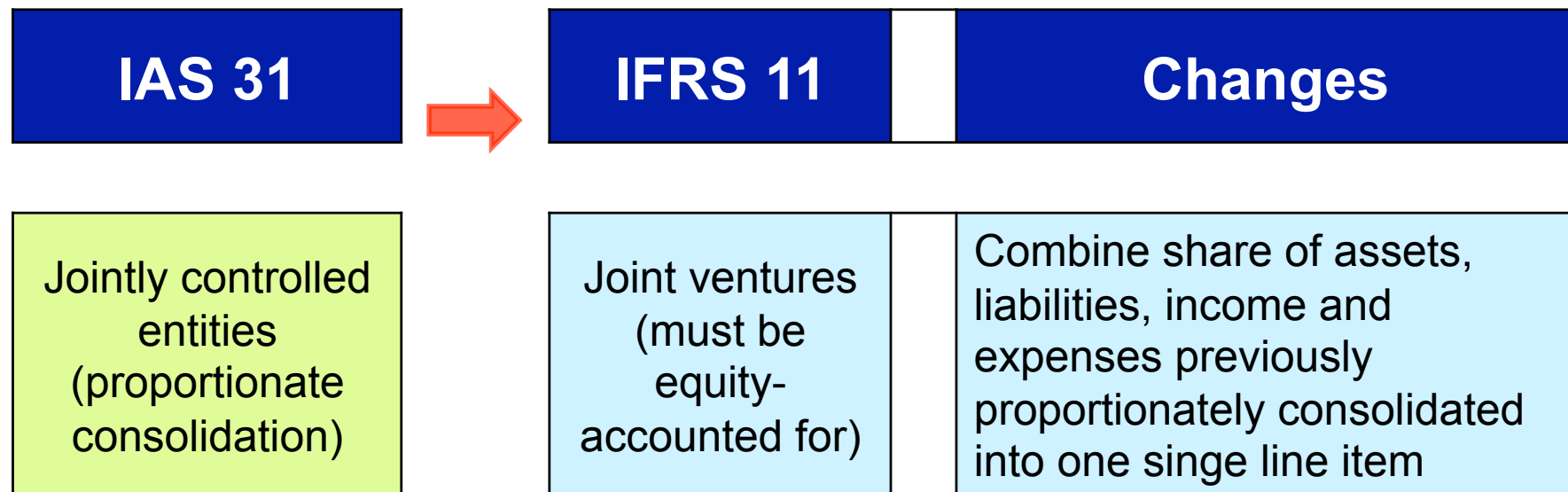
How should a joint venturer account for a joint venture?



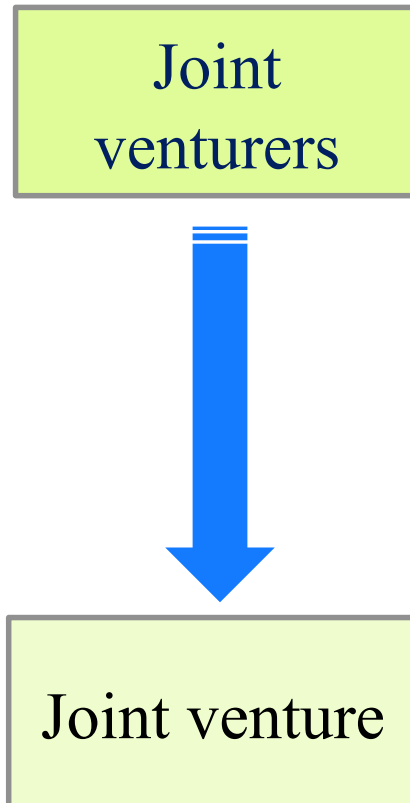
Consolidated financial statements of each joint venturer:

- **Only equity method is allowed**
→ one-line item on the primary financial statements
- Proportionate consolidation is no longer allowed

Impact of the application of IFRS 11



How should a joint venturer account for a joint venture?



Separate financial statements of each joint venturer:

- Follow IAS 27
- Cost or in accordance with IAS 39/IFRS 9

How should a joint operator account for a joint operation?

Joint operators



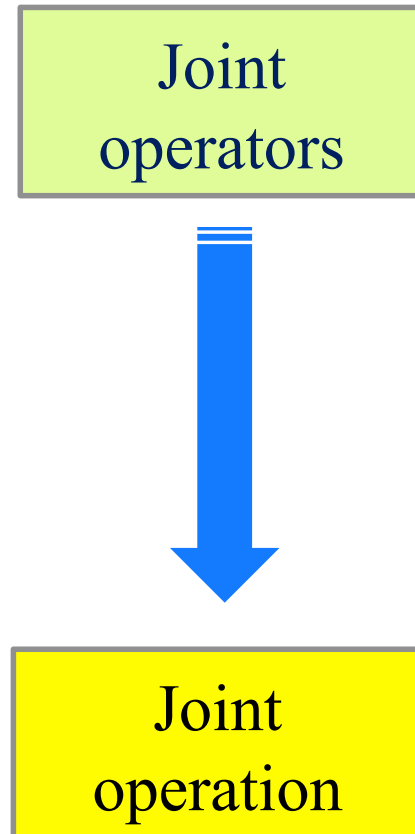
Joint operation

- Consolidated financial statements of each joint operator
 - Recognise its assets, liabilities, revenues and expenses relating to its interest in the joint operation and account for them in accordance with relevant IFRSs

Impact of the application of IFRS 11

IAS 31	IFRS 11	Changes
Jointly controlled entities (equity method)	Joint operations	<p>As at the beginning of the immediately preceding period (i.e. <u>1 January 2012</u>):</p> <ul style="list-style-type: none">• Derecognise the investment that was previously accounted for using the equity method.• Recognise interests in the assets and liabilities of Entity B on the basis of its rights and obligations in a specified proportion in accordance with the contractual arrangement.

How should a joint operator account for a joint operation?



- Separate financial statements of each joint operator
 - Same accounting as that in the consolidated financial statements of each joint operator

IFRS 12

Disclosures of Interests in Other Entities



Significant judgements and assumptions

- An entity needs to disclose information about significant judgements and assumptions it has made (and changes to those judgements and assumptions) in determining:
 - Whether it has control, joint control of an arrangement or significant influence over another entity; and
 - the type of joint arrangement (i.e. joint operation or joint venture) when the arrangement has been structured through a separate vehicle



Disclosures regarding interests in subsidiaries



Composition of the Group

IFRS 12 requires an entity to disclose information about **the composition of the Group.**

At the end of the reporting period, the Company has other subsidiaries that are not material to the Group. A majority of these subsidiaries operate in A Land. The principal activities of these subsidiaries are summarised as follows:

<u>Principal activities</u>	<u>Principal place of business</u>	<u>Number of subsidiaries</u>	
		<u>31/12/11</u>	<u>31/12/10</u>
Manufacture of electronic equipment	A Land	1	1
	B Land	2	2
		<u>3</u>	<u>3</u>
Manufacture of leisure goods	A Land	2	2
Construction	A Land	1	1
Toys manufacturing	A Land	Nil	1
		<u>6</u>	<u>7</u>

The interest that non-controlling interests have in the group's activities and cash flows

An entity shall disclose for **each** of its subsidiaries that have non-controlling interests (NCI) that are **material** to the reporting entity:

- a) the name and principal place of business (including country of incorporation if different from the principal place of business) of the subsidiary.
- b) the proportion of ownership interests (and voting rights if different from ownership interests) held by NCI.
- c) the profit or loss allocated to NCI of the subsidiary during the reporting period.
- d) accumulated NCI of the subsidiary at the end of the reporting period.
- e) summarised financial information about the subsidiary.

Summarised financial information in respect of each of the Group's subsidiaries that has material non-controlling interests is set out below. The summarised financial information below represents amounts before intragroup eliminations.

Subthree Limited	31/12/11 HK\$'000	31/12/10 HK\$'000
Current assets	32,100	31,400
Non-current assets	10,238	10,441
Current liabilities	(1,617)	(4,299)
Non-current liabilities	(5,121)	(5,342)
Equity attributable to owners of the Company	24,920	22,540
Non-controlling interests	10,680	9,660
	Year ended 31/12/11 HK\$'000	Year ended 31/12/10 HK\$'000
Revenue	6,200	6,101
Expenses	(2,800)	(2,834)
Profit (loss) for the year	3,400	3,267
Profit (loss) attributable to owners of the Company	2,380	2,287
Profit (loss) attributable to the non-controlling interests	1,020	980
Profit (loss) for the year	3,400	3,267
Other comprehensive income attributable to owners of the Company	-	-
Other comprehensive income attributable to the non-controlling interests	-	-
Other comprehensive income for the year	-	-
Total comprehensive income attributable to owners of the Company	2,380	2,287
Total comprehensive income attributable to the non-controlling interests	1,020	980
Total comprehensive income for the year	3,400	3,267
Dividends paid to non-controlling interests	-	-

Summarised financial information of subsidiaries that have material non-controlling interests (cont'd)

	Year ended 31/12/11 <u>HK\$'000</u>	Year ended 31/12/10 <u>HK\$'000</u>
Net cash inflow (outflow) from operating activities	<u>4,405</u>	<u>2,050</u>
Net cash inflow (outflow) from investing activities	<u>(330)</u>	<u>1,148</u>
Net cash inflow (outflow) from financing activities	<u>(3,489)</u>	<u>(315)</u>
Net cash inflow (outflow)	<u>586</u>	<u>2,883</u>



Deloitte.

德勤

Disclosures regarding interests in associates and joint arrangements



Nature, extent and financial effects in material joint ventures and associates

Disclosure requirements, amongst others, for each material joint venture and associate include the following:

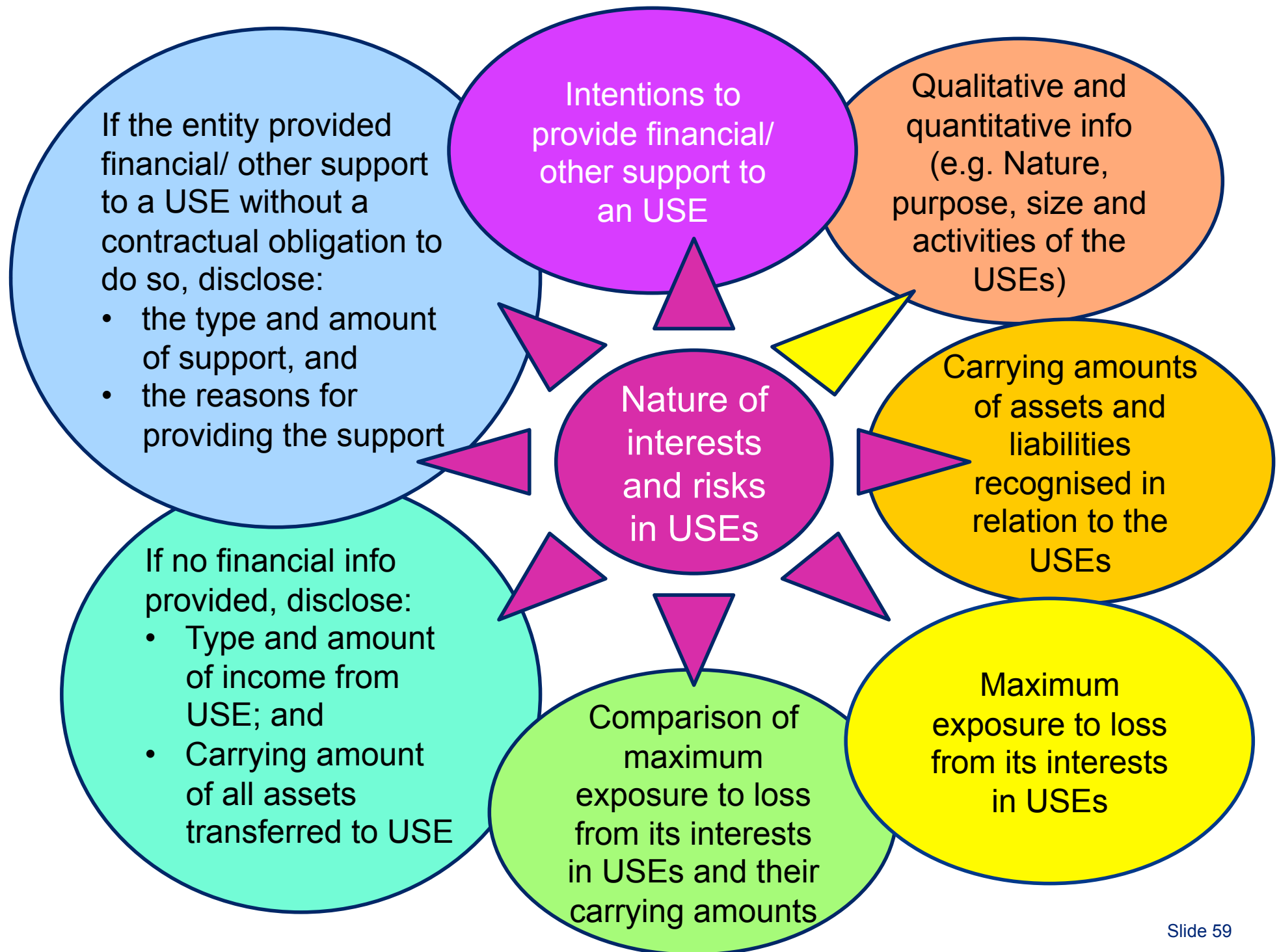
- i. whether the investment in the joint venture or associate is measured using the equity method or at fair value.
- ii. summarised financial information about the joint venture or associate.
- iii. if the joint venture or associate is accounted for using the equity method, the fair value of its investment in the joint venture or associate, if there is a quoted market price for the investment.
- iv. financial information
 - a) in aggregate for all individually immaterial joint ventures and separately,
 - b) in aggregate for all individually immaterial associates.

Summarised financial information

Should be the gross amounts (not the reporting entity's share of those amounts)	<u>Each</u> material joint venture	<u>Each</u> material associate
Current assets	✓	✓
Cash and cash equivalents	✓	
Non-current assets	✓	✓
Current liabilities	✓	✓
Certain current financial liabilities	✓	
Non-current liabilities	✓	✓
Certain non-current financial liabilities	✓	
Revenue	✓	✓
Depreciation/Amortisation	✓	
Interest income	✓	
Interest expense	✓	
Income tax expense/income	✓	
Dividends received from joint venture/ associate	✓	✓
Profit or loss from continuing operations	✓	✓
Post-tax profit or loss from discontinued operations	✓	✓
Other comprehensive income	✓	✓
Total comprehensive income	✓	✓

Disclosures regarding interests in unconsolidated structured entities (USEs)





Deloitte.

德勤