Implementing IFRS 10 Consolidated Financial Statements
AGENDA

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• Application
• Transition
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• Resources
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OVERVIEW
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**IFRS 10 Consolidated Financial Statements** outlines requirements for the preparation and presentation of consolidated financial statements, requiring entities to consolidate entities it controls.

- Previous IFRSs:
  - IAS 27 *Consolidated and Separate Financial Statements*
  - SIC-12 *Consolidation – Special Purpose Entities*

- IAS 27 is now limited to accounting for subsidiaries, jointly controlled entities, and associates in **separate** financial statements.

- IFRS 10 applicable to annual reporting periods beginning on or after January 1, 2013 (i.e., Q1 2013 for calendar year entities)
Definition of “control” key to determining what to consolidate

**New definition**
An investor controls an investee if and only if the investor has all of the following elements:

- power over the investee, i.e., the investor has existing rights that give it the ability to direct the relevant activities (the activities that significantly affect the investee's returns)
- exposure, or rights, to variable returns from its involvement
- ability to use its power over the investee to affect the amount of the investor's returns

**Previous definition**
Power to govern the financial and operating policies of an entity so as to obtain benefits from its activities
CONTROL

Power over investee?

NO

Exposure, or rights, to variable returns from involvement with investee?

NO

Ability to use power over investee to affect amount of returns?

NO

Controlling financial interest

Consolidate

Do not consolidate
CONTROL

• Issues for smaller entities will often centre around first criterion

• Second and third criteria more often exist in structured entities, agency situations
  o e.g., investor might have ability to make key decisions on behalf of another, but only earns a fixed management fee. In this case, investor likely has no exposure or right to variable returns from its involvement with investee.

• No “bright-lines”
KEY CONSIDERATIONS

• What is the purpose and design of the investee?
• What are the investee’s relevant activities and how are decisions about those activities made?
• Do the investor’s rights give it the current ability to direct those relevant activities?
• Is the investor exposed, or does it have rights, to variable returns from its involvement with the investee?
• Does the investor have the ability to use its power over the investee to affect the amount of its returns?

Control = Power + Exposure to variability in returns + Link between power and returns
PURPOSE AND DESIGN

• Consider purpose and design at various steps of analysis

• Is investee controlled solely through proportionate voting rights, such as ordinary shares, or is situation more complex?
  ○ e.g., consider if voting rights relate only to administrative tasks and the relevant activities are directed by other contractual arrangements

• Consider risks to which investee was designed to be exposed and which it was designed to pass on to other parties
  ○ the investor’s exposure (both downside and upside)
IDENTIFYING CONTROL - RELEVANT ACTIVITIES

• Focus on “relevant activities” that significantly affect investee’s returns

• Might change as entity’s state of development changes
  - e.g., one entity controls development and another controls manufacturing, control might move from one to the other

• Examples of decisions about relevant activities:
  - establishing investee’s operating and capital decisions, including budgets
  - appointing/remunerating/terminating the investee’s key management personnel or key service providers

• Important to understand investee’s governance structure
IDENTIFYING CONTROL - POWER OVER INVESTEES

- When one entity holds more than 50% of the voting power over investee’s relevant activities, and no restrictions apply or separate arrangements exist, in absence of any other factors, IFRS 10 will not usually change the analysis, unless there are facts to the contrary
  
  o “investor’s voting rights are sufficient to give it power over the investee regardless of whether it has exercised its voting power, unless those rights are not substantive or there are separate arrangements providing another entity with power over the investee”

- An entity may control an investee without having majority voting rights if it has practical ability to direct unilaterally relevant activities that significantly affect its returns (e.g., contractual arrangements, relative size of investor’s holdings, potential voting rights)

- The more parties that would need to act together to outvote investor, the more likely the investor will have power over an investee
• Investor considers its potential voting rights, and those held by others, as well as the rights currently held
  o these are rights to obtain voting rights of an investee, such as those arising from convertible instruments or options

• Consider potential voting rights only if they are substantive
  o Are there any barriers that prevent holder from exercising rights?
  o Do several parties need to agree for rights to become exercisable or operational?
  o Would the party holding the rights benefit from their exercise?
  o Are the rights exercisable when decisions about directing the relevant activities need to be made?

• Currently exercisable vs. substantive
An investor’s rights in an investee may be *protective* – relating only to fundamental changes in the investee’s activities or applying only in exceptional circumstances

Examples:

- a lender’s right to restrict a borrower from undertaking activities that could significantly change its credit risk to the lender’s detriment
- a lender’s right to seize a borrower’s assets if it fails to meet specified repayment conditions
- the right of a party holding a non-controlling interest to approve capital expenditure greater than what’s required in the ordinary course of business, or to approve the issue of equity or debt instruments

*Protective rights are designed to protect interest of the party holding those rights* *without* giving that party power over entity to which those rights relate
IDENTIFYING CONTROL - SPECIAL RELATIONSHIPS

Factors in combination with other rights may contribute to identifying power.

Examples:

• Are key management personnel, who have the ability to direct the relevant activities, current or previous employees of the investor?

• Are investee’s operations in some way dependent on the investor?
  o funding
  o guarantees by investor of investee’s obligations
  o reliance on technology or intellectual property
  o significant portion of investee’s activities conducted with/on behalf of investor

• Is a significant portion of investee’s activities involve or are conducted on behalf of the investor?

• Is investor’s exposure, or rights, to the returns from its involvement with investee disproportionately greater than its voting rights?
APPLICATION
Company X holds 38% of the common shares of Company A. Company X does not hold any other instrument of Company A that might be converted to common shares in the future.

Does Company X control Company A?
APPLICATION - COMPANY X

It is possible! Depends on specific facts. More information required.

Examples:

• What is the size of Company X’s shareholdings relative to size and dispersion of other shareholdings?
  o The more voting rights Company X holds compared to anyone else, and the greater number of other vote-holders that would need to act together to outvote Company X, the more likely Company X has practical ability to direct Company A’s relevant activities

• Do other vote holders or other parties hold potential voting rights?

• Are there any other relevant contractual arrangements?

• What is the voting pattern at past shareholder meetings?

• Does a special relationship (e.g., reliance on intellectual property) exist between Company X and Company A?

• What level of exposure does Company X have to variability in returns?
### APPLICATION

#### Step 1
- Number of voting rights investor holds (i.e., absolute size)
- Proportion of voting rights investor holds relative to other vote holders (i.e., the relative size)
- Number of parties that would need to act together to outvote investor (i.e., extent of dispersion)
- Potential voting rights held by investor, other vote holders & other parties
- Rights arising from other contractual arrangements

**Analysis conclusive?**

#### Step 2
- Voting patterns at shareholders’ meetings (i.e., other shareholders passive)
- Other evidence of power – e.g., IFRS 10.B18
- Special relationships with investee to suggest that investor has more than passive interest in the investee – e.g., IFRS 10.B19
- Level of investor’s exposure to variability in returns - e.g., IFRS 10.B20
- Other relevant facts and circumstances

**Analysis conclusive?**

**Consolidate**

**YES**

**YES**
IFRS 12, *Disclosure of interests in other entities* contains detailed disclosure requirements, including:

**Significant judgments and assumptions**

- Significant judgments and assumptions made in determining control
  - does not control entity even though hold *more* than half of the voting rights
  - controls entity even though it holds *less* than half of the voting rights

**Interests in subsidiaries**

- information about each subsidiary with material NCI, such as name, principal place of business and summarized financial information
- significant restrictions on assets and obligations to settle liabilities;
- subsidiaries that are consolidated using different year ends
INTERACTION BETWEEN IFRS 10, 11 AND 12 (AND IAS 28)

Control alone?

- yes
  - Consolidation in accordance with IFRS 10
    - Disclosures in accordance with IFRS 12

- no
  - Joint control?
    - yes
      - Define type of joint arrangement in accordance with IFRS 11
        - Joint Operation
          - Account for assets, liabilities, revenues and expenses
            - Disclosures in accordance with IFRS 12
        - Joint Venture
          - Account for an investment in accordance with IAS 28
            - Disclosures in accordance with IFRS 12
    - no
      - Significant influence?
        - yes
          - IFRS 9
        - no
          - Disclosures in accordance with IFRS 12

Source: IASB
TRANSITION
TRANSITION TO IFRS 10

• Applicable to annual periods beginning on or after 1 January 2013

• Generally requires retrospective application in accordance with IAS 8, except for impracticability exemptions

• Refer to CICA Reporting Alert: Amendments to IFRS 10, IFRS 11 and IFRS 12 – transition guidance
# TRANSITION TO IFRS 10

## Scenario 1: No change in consolidation status of investee
- No adjustments required

## Scenario 2: Consolidating a previously unconsolidated investee

<table>
<thead>
<tr>
<th>Investee a business</th>
<th>Investee not a business</th>
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<tbody>
<tr>
<td>- Consolidate from date control obtained per IFRS 10</td>
<td>- Consolidate from date control obtained per IFRS 10</td>
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<tr>
<td>- Apply IFRS 3 acquisition accounting - measure assets, liabilities and NCI</td>
<td>- Apply IFRS 3 acquisition accounting - measure assets, liabilities and NCI but <em>do not</em> recognize goodwill</td>
</tr>
<tr>
<td>- Difference from previous carrying amount adjusted to opening equity</td>
<td>- Difference from previous carrying amount adjusted to opening equity</td>
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<tr>
<td>- If impracticable (apply from earliest practical period)</td>
<td>- If impracticable (apply from earliest practical period)</td>
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Scenario 3: Deconsolidating a previously consolidated subsidiary

- Measure retained interest (e.g., using the equity method) as if IFRS 10 had always been applied from the date investment acquired (or control lost) – retrospectively.

- Difference between the previously recognized net asset and NCI, and the retained interest in the investee, is accounted for as an adjustment to equity.
## BUSINESS IMPLICATIONS

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<thead>
<tr>
<th>all financial statement line items</th>
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<td>performance metrics</td>
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<td>investor relations</td>
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**data collection – processes – controls – systems**
NEXT STEPS
NEXT STEPS

Examples:

• Identify all interests in other entities to be reassessed in accordance with IFRS 10 (and IFRS 11 and IAS 28)
• Gather information on rights of other shareholders, including:
  – other significant shareholdings in investee
  – historical behavior in investee shareholder votes
  – decision-making patterns at investee board meetings
  – potential voting rights and any barriers to exercise
  – contracts and other relationships with the investee
• Analyze interests against IFRS 10 guidance
  – Even where the answer *appears* straightforward (e.g., wholly-owned subsidiary) consider whether any restrictions exist that might prohibit exercising control
NEXT STEPS – cont’d

Examples cont’d:

- Establish new procedures to update information-gathering and to allow an ongoing assessment of control
- Assess whether any investees currently not consolidated should now be consolidated, or vice versa
- Determine date when new definition of control is met and assess ability to apply the transition procedures at that date
- Assess if the current financial reporting and IT system can handle consolidating more entities and can future and retrospective consolidated amounts be determined using current financial reporting system
- Determine MD&A disclosures and impact on key metrics
- Consider education and training
RESOURCES
The CICA Reporting Alerts on IFRS 10, Consolidated Financial Statements are designed to assist smaller public companies determine how IFRS 10 affects their business.

The CICA Reporting Alerts:

- Highlights guidance
- summarizes key changes
- suggests a plan of action
- answers commonly asked questions
- discusses transition guidance
Facilitator led course: New IFRSs for 2013 - FOUR Standards in TWO Days - NEW for 2013!

January 17 to 18, 2013, CICA Offices, Toronto, ON

Topics include:
• IFRS 10 - Consolidated Financial Statements
• IFRS 11 - Joint Arrangements
• IFRS 12 - Disclosure of Interest in Other Entities
• IFRS 13 - Fair Value Measurement

Click here to register for course:
QUESTIONS?