



## SLFRS 10 & 12

### Consolidated financial statements and Related Disclosures

(Effective in Sri Lanka from 1<sup>st</sup> January 2014)

Presented by:

**Nishan Fernando**  
FCA, MBA, ACMA(UK)  
(Chairman, Accounting Standards Committee and  
Past President of CA Sri Lanka)  
Managing Director, BDO Consulting (Pvt) Limited

1

IFRS 10 & 12 in the context of consolidation package

IFRS 10 'Consolidated Financial Statements' supersedes IAS 27 and SIC 12

IAS 27 renamed as and confined to 'Separate Financial Statements'

IFRS 11 'Joint Arrangements' replaces IAS 31 and SIC 13

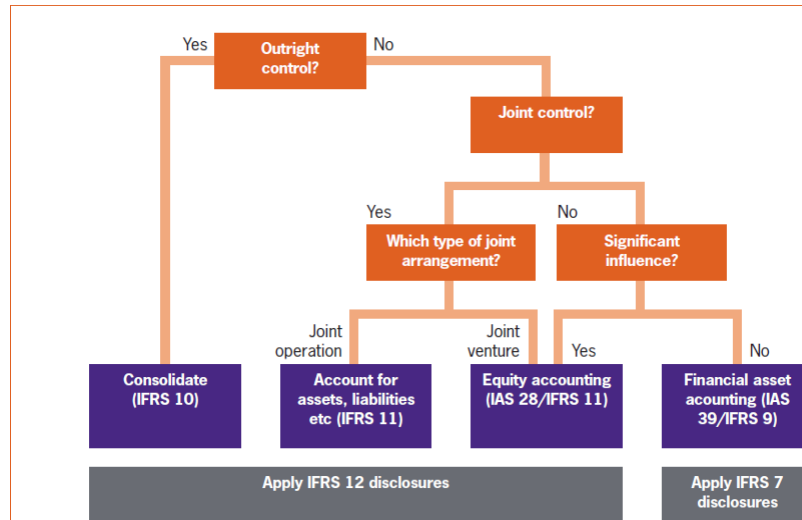
IFRS 12 'Disclosures of interests in other entities' encompasses all disclosures relating to Subsidiaries, Associates and Joint arrangements

IAS 28 renamed as 'investments in Associates and Joint Ventures'

Nishan Fernando

2

## Consolidation Package



Nishan Fernando

3

## Introduction – IFRS 10 Consolidated Financial Statements (CFS)

Establishes principles for the presentation and preparation of CFS

Supersedes IAS 27 and SIC 12

### Reasons for a new Standard

- Divergence in practice in applying IAS 27
- Perceived conflict of emphasis of concept of control, between IAS 27 and SIC 12
- To address the issue of off balance sheet vehicles

### Broad areas covered

- Objective & Scope, Principle of Control, Accounting Requirements & Definitions

Nishan Fernando

4

## Introduction – IFRS 12 Disclosure of Interests In other entities

Applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity

Supersedes IAS 27, IAS 28 and IAS 31

### Broad areas covered

- Objective & Scope
- Significant Judgements and Assumptions
- Interests in Subsidiaries
- Interests in unconsolidated Structured Entities

Nishan Fernando

5

## Objective – IFRS 10

To establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities

### IFRS 10 achieves this objective by:

- Requiring a parent to present consolidated financial statements
- Defining the principle of control and establishing control as the basis for consolidation
- Addressing application of principle of control
- Setting out accounting requirements for the preparation of CFS
- Defining an investment entity and setting out consolidation exceptions

Nishan Fernando

6

## Objective – IFRS 12

To require an entity to disclose information that enables users of its FS to evaluate:

- The nature of, and risks associated with, its *interests in other entities*
- The effects of those interests on its financial position, financial performance & cash flows

IFRS 12 achieves this objective by requiring an entity to disclose:

- The significant judgements and assumptions made in determining the nature of its interest
- Information about its interests in subsidiaries, joint arrangements and associates and *structured entities* that are not controlled by the entity

Nishan Fernando

7

## Scope – IFRS 10

### General Requirement

- An entity that is a parent shall present CFS

### Exemption 1 - A parent satisfying all of the following

- When the parent is a wholly owned subsidiary of another entity or partially owned where other investors do not object to non presentation of CFS
- Its debt or equity instruments are not publicly traded
- It is not in the process of listing its debt or equity
- Its ultimate or any intermediate parent produces IFRS compliant CFS that are available for public use

Nishan Fernando

8

## Scope – IFRS 10

### General Requirement

- An entity that is a parent shall present CFS

### Exemption 2 – Post Employment Benefit Plans

- When IAS 19 applies

### Exemption 3 – Investment Entities

- If it is required to measure all of its subsidiaries at FVTPL

Nishan Fernando

9

## Investment Entity

Obtains funds from one or more investors

for the purpose of providing those investor(s) with investment management services;



Commitment to investor(s) of its business purpose

Invest funds solely for returns from capital appreciation and/or investment income



Measurement and evaluation of performance

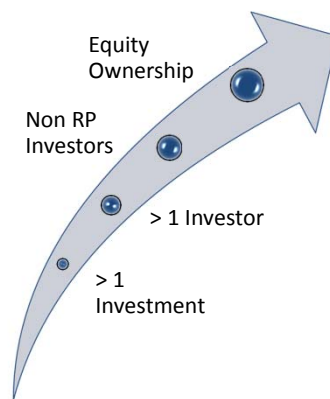
Substantially on a FV basis.

Nishan Fernando

10

## Investment Entity

### Typical Characteristics



Absence of a characteristic

- Doesn't disqualify

More disclosures

- Any changes will lead to reassessment

Change in status

- Account for prospectively

Nishan Fernando

11

## Investment Entity

Recognition of Subsidiaries

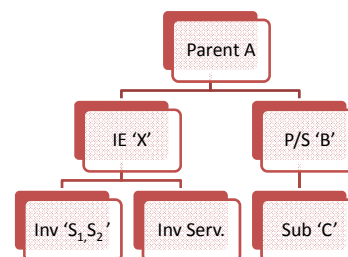
- Shall not consolidate
- Shall not apply IFRS 3
- Measure at FVTPL (IFRS 9)

Deviations

- Consolidate subsidiaries providing services related to the investment activities

Parent of an Investment Entity

- Shall consolidate all subsidiaries including those controlled through Investment Entity



Nishan Fernando

12

## Scope – IFRS 12

IFRS 12 shall be applied by an entity that has an interest in any one of the following:

- Subsidiaries, Joint arrangements, Associates or Unconsolidated structured entities

IFRS 12 does not apply to:

- Post employment or long term employee benefit plans (LKAS 19)
- An entity's separate financial statements (LKAS 27)
- An interest in a joint arrangement without joint control or significant influence
- An interest in another entity that is accounted for in accordance with SLFRS 9 other than when:
  - It is an interest in an associate or a JV measured at FV through P/L (LKAS 28)
  - It is an interest in an unconsolidated structured entity

Nishan Fernando

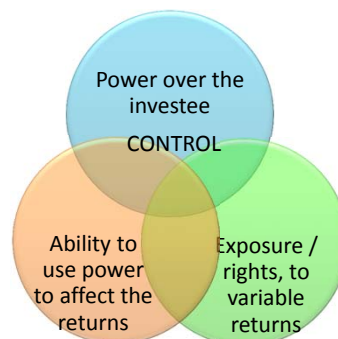
13

## Principle and Definition of Control

**Control of an investee** - An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

An investor shall determine whether it is a *parent* by assessing whether it controls the investee (regardless of the nature of involvement)

Reassess Control upon change to any one of the three elements



Three Elements of Control

Nishan Fernando

14

## Principle and Definition of Control

### IFRS 10

- An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

### IAS 27

- Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

### SIC-12 Circumstances that may indicate control relationship in an SPE:

- Activities of the SPE are being conducted on behalf of the entity according to its specific business needs so that the entity obtains benefits from the SPE's operation;
- The entity has the decision-making powers to obtain the majority of the benefits of the activities of the SPE;
- The entity has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incident to the activities of the SPE; or
- The entity retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

Nishan Fernando

15

## Principle and Definition of Control – Practical Implications

### IAS 27 refers to 'power' but IFRS 10 refers to 'rights' and 'ability'

- the revised definition and guidance clarify that owning a majority of the voting or other rights is not always necessary to have control
- control instead requires that the investor's power/rights are sufficient for it to unilaterally direct the activities that most affect the investee's returns
- more analysis and judgement will now be required to determine whether an investor with a significant minority of voting or other rights has control

### IAS 27 refers to governing the financial and operating policies but IFRS 10 refers to the ability to affect returns

- the new definition reflects the fact that IFRS 10 applies to special purpose or structured entities as well as more conventional entities
- in more complex control assessments IFRS 10 requires identification of the activities that most affect the investee's returns (the 'relevant activities'), and how they are directed, at a more granular level
- in simpler assessments involving conventional entities it will continue to be sufficient to consider activities at the financial and policy level

Nishan Fernando

16



## Principle and Definition of Control – Practical Implications

IAS 27 refers to obtaining 'benefits' while IFRS 10 requires 'exposure or rights to variable returns'

- 'benefits' and 'returns' are similar in substance although returns is probably a broader concept
- IFRS 10 clarifies that:
  - returns should be interpreted broadly eg to include synergy benefits as well as financial returns
  - returns can be negative or positive
  - a right to returns that is fixed is not consistent with control (although returns that are contractually-fixed are often still variable in substance – see Section C.3.2)

SIC-12 includes specific control indicators for special purpose entities (SPEs) while IFRS 10 does not

- SPE control assessments are in the scope of IFRS 10's single model
- IFRS 10 includes guidance on investees for which voting rights cannot significantly affect the returns and contractual rights determine the direction of the relevant activities
- SIC-12 has been applied in different ways by different entities and some approaches will no longer be sufficient eg assessments based only on:
  - quantitative analysis of risks and rewards
  - qualitative consideration of whether an SPE's activities are conducted on behalf of the investor and is on 'autopilot'

Nishan Fernando

17

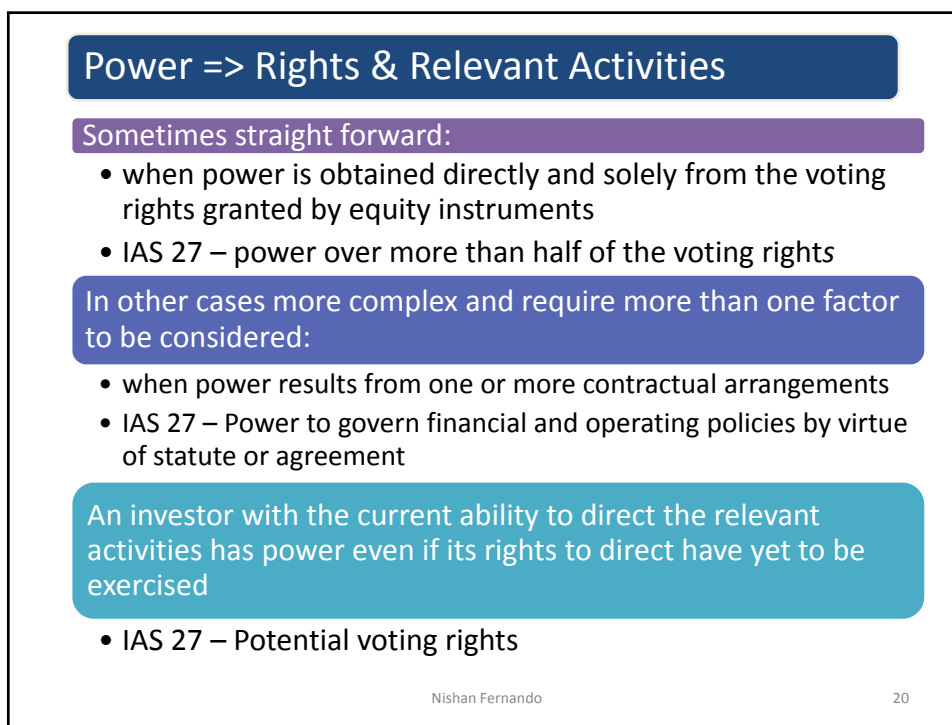
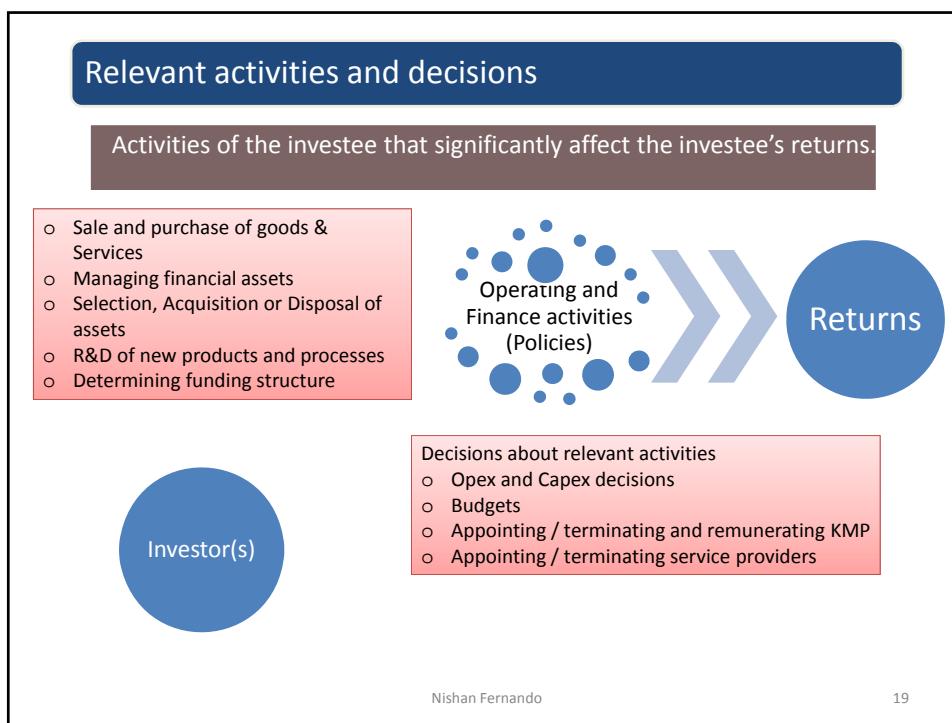
## Power

Existing rights that give current ability to direct the relevant activities



Nishan Fernando

18



## Power => Rights & Relevant Activities

If two or more investors each have existing rights that give them the unilateral ability to direct different relevant activities,

- the investor that has the current ability to direct the activities that most significantly affect the returns of the investee has power over the investee

An investor can have power over an investee even if other entities have existing rights that give them the current ability to participate in the direction of the relevant activities,

- ex- significant influence

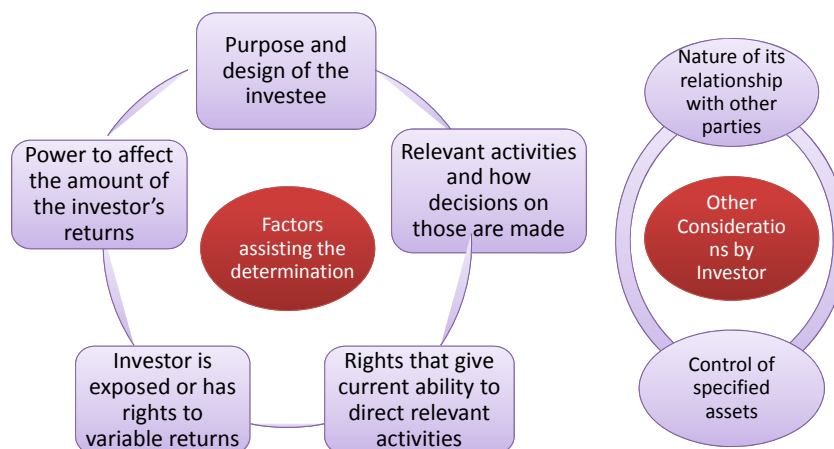
When rights are not straight forward additional factors are considered

Nishan Fernando

21

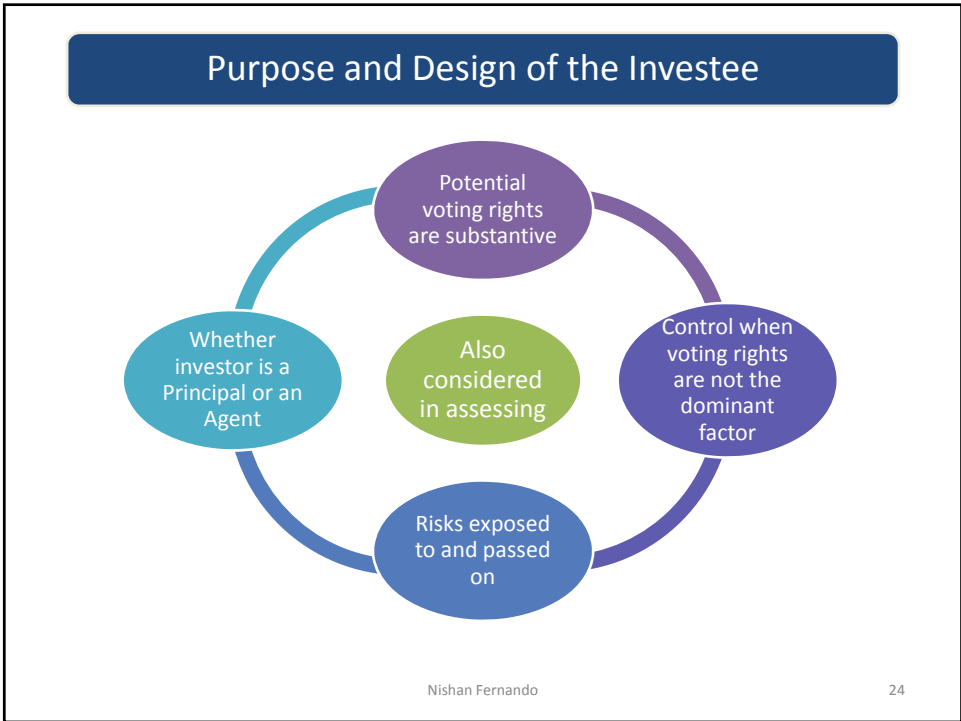
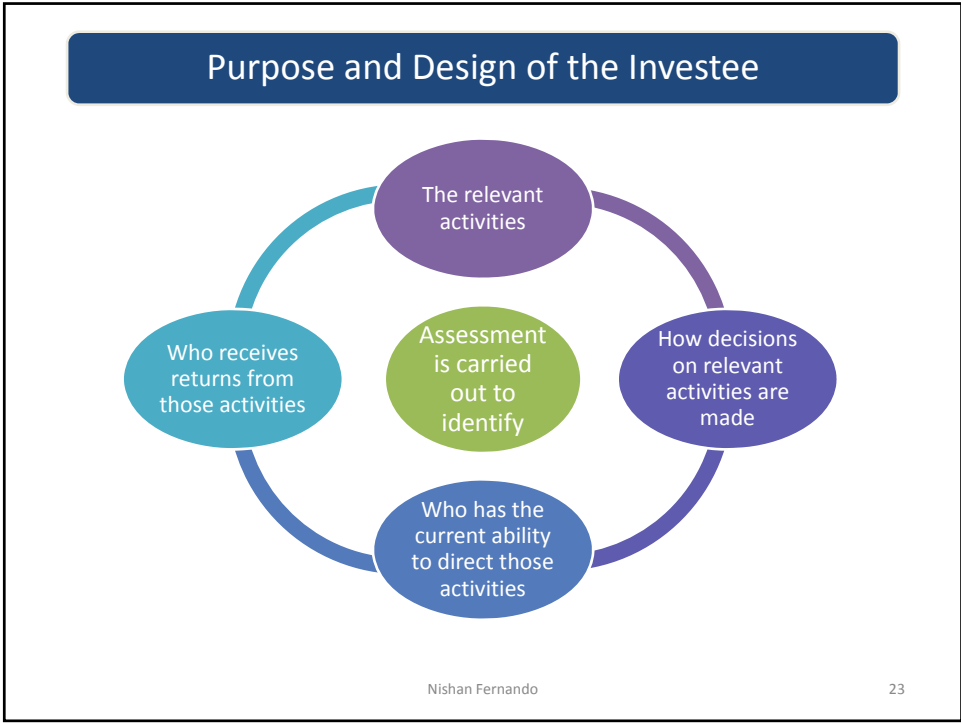
## Assessment of Control

To determine Control, an investor shall assess whether it has all three elements of Control



Nishan Fernando

22



## Relevant Activities and Decisions

Conventional operating entities/ governance structures	Feature	Special purpose or structured entities
<ul style="list-style-type: none"> <li>Numerous operating and financing activities</li> </ul>	Number and nature of relevant activities	<ul style="list-style-type: none"> <li>Few, depending on purpose and design and extent to which activities have been pre-determined</li> </ul>
<ul style="list-style-type: none"> <li>Broad-based decisions such as:               <ul style="list-style-type: none"> <li>Setting financial and operating policies</li> <li>Electing senior management</li> </ul> </li> </ul>	Decisions about relevant activities	<ul style="list-style-type: none"> <li>Specific decisions or processes depending on structure and relevant activities</li> </ul>
<ul style="list-style-type: none"> <li>Normally through voting rights</li> </ul>	Type of rights that direct the decisions	<ul style="list-style-type: none"> <li>Contractual rights</li> </ul>

Nishan Fernando

25

## Rights - Matters only when Substantive

### Power with majority of voting rights

- Relevant activities are directed by a vote of the majority holder
- A majority of the governing body that directs the relevant activities are appointed by a vote of the majority holder

### Majority voting rights but no power

- When the voting rights are not Substantive

### Power without majority voting rights

- Contractual arrangement with other vote holders
- Rights from other contractual arrangements
- Investor's voting rights
- Potential voting rights
- Combination

Nishan Fernando

26

## Substantive Rights

### Rights are Substantive

- Holder has practical ability to exercise the right
- Exercisable when decisions about the direction of the relevant activities need to be made
- Rights are not merely protective rights

### Only substantive rights are considered in assessing power

### Determining whether the rights are substantive requires

- Judgement
- Consideration of all facts and circumstances

Nishan Fernando

27

## Protective Rights

### Definition

- Rights designed to protect the interest of the holder without giving power over the entity
- Holder cannot have power or prevent another party from having power

### Examples

- A lender's right to restrict a borrower from undertaking activities changing the credit risk to the detriment of the lender
- Right of a lender to freeze the assets of the borrower in the event of default
- Right of non controlling interest to approve issue of debt or equity
- A Franchiser's decision making rights of a franchisee's activities pertaining to protection of the franchise brand

Nishan Fernando

28

## Exposure or rights to variable returns

Variable returns are those that are not fixed and have the potential to vary as a result of the performance of an investee

- Can be positive, negative or both positive and negative
- Variability depends on the substance (over legal form)
- Variability depends on the ability to generate sufficient income to pay the returns

### Examples of variable returns

- Dividends and other distributions
- Remuneration for servicing an investee's assets or liabilities
- Returns that are not available to other stake holders
- Access to future liquidity
- Residual interests

Nishan Fernando

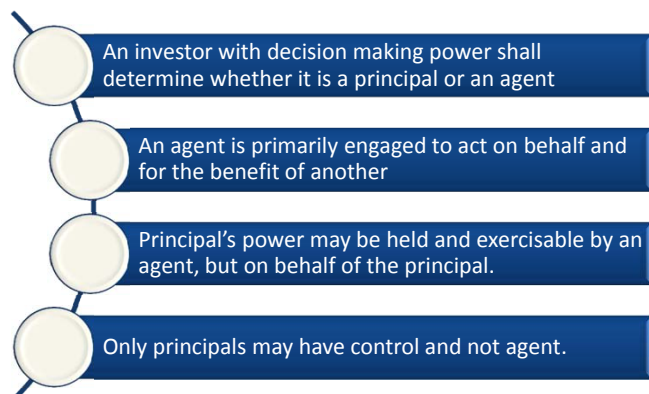
29

## Ability to use Power to affect Returns

On its own account as principal

On behalf of other investors as Agent

**Delegated Power**



Nishan Fernando

30

## Ability to use Power to affect Returns

Investor's decision-making rights held directly



Decision-making rights delegated by investor to an agent



Decision-making rights delegated to investor by other principal(s)



Investor's decision-making rights for IFRS 10 purposes

Nishan Fernando

31

## Agent or Principal? Factors considered

The scope of decision making authority – evaluated by considering

- Activities that are permitted
- Discretion when making decisions
- Level of involvement in design of the investee
- Risks designed to be passed

Rights held by other parties

- Substantive removal rights held by a single party or many parties
- Substantive rights held by other parties restricting discretion
- Rights exercisable by investee's board of directors

Remuneration entitlement

- Magnitude of and variability associated with remuneration to the returns of the investee

Exposure to variability of returns from other interests

Nishan Fernando

32



## Agent or Principal?

Indication of agent	Factor to assess	Indication of principal
Narrow	Scope of decision-making authority	Broad
More substantive	Rights held by other parties (eg kick-out rights)	Less substantive
Commensurate with services and/or includes only amounts and terms that are customary for similar services	Terms and amounts of decision-maker's remuneration	Large/highly variable relative to investee's overall expected returns
Minor/non-existent	Other interests held by decision-maker (magnitude and exposure to variability of returns)	Extensive

Nishan Fernando

33

## Relationship with Other Parties – de facto agents

### The investor shall consider

- whether they are de facto agents
- their decision making rights
- indirect exposure or rights to variable returns through de facto agent

### Examples of such other parties

- Investor's related parties
- A party that received its interest in the investee as a contribution or loan from investor
- A party that has agreed not to sell its interest in the investee without prior approval from investor
- A party that cannot finance its operations without subordinated financial support from the investor
- An investee where majority of KMP are from investor
- A party that has close business relationships

Nishan Fernando

34

## Control of Specified Assets - Silos

### An investor shall consider

- whether it treats a portion of an investee as a deemed separate entity and,
- if so whether it controls the deemed separate entity

### Condition for a deemed separate entity

- specified assets are the only source of payment for specified liabilities
- parties other than those with specified liabilities have no rights to the specified assets

### If the investor controls the deemed separate entity

- investor shall consolidate the same
- Other parties exclude that portion in their consolidation of the investee

Nishan Fernando

35

## Structured Entities

### Features and Attributes

- Restricted activities
- A narrow and well defined objective
- Insufficient equity to finance without subordinated financial support
- Financing in the form of instruments linked to investors

### Examples

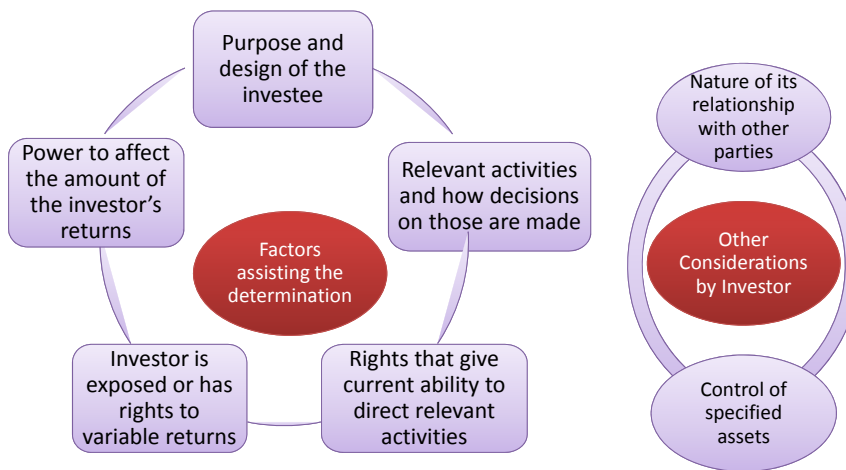
- Securitisation Vehicles
- Asset backed financngs
- Investment funds

Nishan Fernando

36

## Assessment of Control

To determine Control, an investor shall assess whether it has all three elements of Control



Nishan Fernando

37

## Accounting Requirements

### When preparing Consolidated Financial Statements

- Uniform accounting policies shall be used
- Consolidation begins from the date of obtaining control
- Financial statements of parent and subsidiaries shall have the same reporting date
- Profit/loss and changes in equity are allocated to parent and non controlling interest based on the existing ownership interest

### Non-controlling interest

- Presented in the consolidated SFP within equity but separately from the equity of the parent

### Changes in ownership interest

- Changes without losing control, are equity transactions
- If a parent loses control:
  - Assets and liabilities of the subsidiary are derecognized in the consolidated SFP
  - Any retained investment is recognised at FV (IFRS 9)
  - The gain or loss associated with loss of control is recognised

Nishan Fernando

38

# Disclosures

## Disclosure of Significant judgements and assumptions



Information about SJA in determining that it has (or has no) control of another entity

Specific disclosure of SJA when the investor

- doesn't control another entity in spite of holding >50% voting rights
- controls another entity though it holds <50% of the voting rights
- is an agent or a principal

## Disclosure of Interests in Subsidiaries

### Information that enables users of CFS to understand

- The composition of the group
- The non-controlling interest in the group's activities and cash flows

### Information that enables users of CFS to evaluate

- Nature and extent of significant restrictions on ability to access or use assets, and settle liabilities of the group
- Risks associated with interests in consolidated structures entities
- Consequences of changes in its ownership interest that do not result in a loss of control
- Consequences of losing control of a subsidiary during the reporting period

### When the reporting date is different from the parent

- Reporting period and the date of the end of that period
- Reason for using a different date or period

Nishan Fernando

41

## Disclosure of Information on Non-Controlling interest

Name of the subsidiary and Principal place of business / country of incorporation

Proportion of non-controlling ownership interest

Proportion of voting rights held by non-controlling interests

Profit or loss allocated to non-controlling interests during the reporting period

Accumulated non-controlling interests at the end of the reporting period

Dividends paid to non-controlling interests

Summarised financial information about the subsidiary

CA, NCA, CL, NCL, Revenue, Profit or Loss, TCI (before inter-company eliminations)

Nishan Fernando

42

## Disclosure of Significant Restrictions

Statutory, Contractual and regulatory restrictions on ability to use the assets and settle the liabilities of the group

- Restrictions on parent / subsidiaries to transfer cash or other assets
- Guarantees or other requirements that may restrict
  - Dividends and other capital distributions
  - Loans and advances

Restrictions arising from protective rights of non-controlling interests

- Settlement of external liabilities before settling parent
- Requirement of approval of non controlling interest

The carrying amounts in the CFS of assets and liabilities to which the above restrictions apply

Nishan Fernando

43

## Disclosure of Risks - Consolidated Structured Entities

Terms of any contractual arrangements that could require provision of financial support to a consolidated structured entity

Events or circumstances that could expose the reporting entity to a loss

Financial or other support provided to a consolidated structured entity without having a contractual arrangement

- Type and amount of support provided
- Situations where structured entity was assisted in obtaining financial support
- Reasons for providing the support

Financial or other support provided to a previously unconsolidated structured entity which is now consolidated as a result of the support provided

Any current intentions to provide financial or other support to a consolidated structured entity including intentions to assist in obtaining financial support

Nishan Fernando

44

### Disclosure of changes in ownership interest

#### There is no loss of control

- Present a schedule showing the effects on the equity attributable to owners of the parent

#### Loss of control

- Gain or loss
- Portion of the gain or loss attributable to measuring any retained investment at FV

Nishan Fernando

45

### Disclosure of Interests in unconsolidated structured entities (USE)

#### Information that enables users of financial statements to

- understand the nature and extent of its interests in USE
- evaluate risks associated with interests in unconsolidated structures entities

Nishan Fernando

46

Information that enables users of financial statements to understand the nature and extent of its interests in USE

Qualitative and quantitative information – nature, purpose, size, activities and how it is financed

Sponsored USE

- How it has decided which structured entities it has sponsored
- Income from those structured entities
- Carrying amount of all assets transferred

Nishan Fernando

47

Information that enables users of financial statements to evaluate risks associated with interests in unconsolidated structures entities

Carrying amounts of assets and liabilities relating to interests in USE

The line items in the SFP in which those assets and liabilities are recognised

Maximum exposure to loss including how it is determined

A comparison of the carrying amounts of the assets and liabilities of the entity relating to USE and entity's maximum exposure to loss from those entities

Financial or other support provided to a USE without having a contractual arrangement:

- Type and amount of support provided
- Situations where USE was assisted in obtaining financial support
- Reasons for providing the support






Any current intentions to provide financial or other support to a consolidated structured entity including intentions to assist in obtaining financial support

Nishan Fernando

48






## Definitions – IFRS 10

- 
**Consolidated financial statements** - The financial statements of a **group** in which the assets, liabilities, equity, income, expenses and cash flows of the **parent** and its **subsidiaries** are presented as those of a single economic entity.
- 
**Control of an investee** - An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.
- 
**Decision maker** - An entity with decision-making rights that is either a principal or an agent for other parties.
- 
**Group** - A **parent** and its **subsidiaries**
- 
**Non-controlling interest** - Equity in a **subsidiary** not attributable, directly or indirectly, to a **parent**.

Nishan Fernando

49

## Definitions – IFRS 10

- 
**Parent** - An entity that **controls** one or more entities.
- 
**Power** - Existing rights that give the current ability to direct the **relevant activities**.
- 
**Protective rights** - Rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.
- 
**Relevant activities** - For the purpose of this IFRS, relevant activities are activities of the investee that significantly affect the investee's returns.
- 
**Removal rights** - Rights to deprive the decision maker of its decision-making authority.
- 
**Subsidiary** - An entity that is controlled by another entity.

Nishan Fernando

50

## Definitions – IFRS 12

**Structured entity**

- An entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements

**Income from a structured entity**

- For the purpose of this IFRS, income from a **structured entity** includes, but is not limited to, recurring and non-recurring fees, interest, dividends, gains or losses on the measurement or de-recognition of interests in structured entities and gains or losses from the transfer of assets and liabilities to the structured entity

**Interest in another entity**

- For the purpose of this IFRS, an interest in another entity refers to contractual and non-contractual involvement that exposes an entity to variability of returns from the performance of the other entity. An interest in another entity can be evidenced by, but is not limited to, the holding of equity or debt instruments as well as other forms of involvement such as the provision of funding, liquidity support, credit enhancement and guarantees. It includes the means by which an entity has control or joint control of, or significant influence over, another entity. An entity does not necessarily have an interest in another entity solely because of a typical customer supplier relationship

Nishan Fernando

51

The views expressed in this presentation are those of the presenter.

Official positions of the CASL on technical matters are determined only after extensive due process and deliberation.



52

