WILL THE NEW CONSOLIDATION AND JOINT ARRANGEMENTS STANDARDS CHANGE YOUR FINANCIAL STATEMENTS?

THE NEW STANDARDS, AASB 10 *CONSOLIDATED FINANCIAL STATEMENTS* (AASB 10) AND AASB 11 *JOINT ARRANGEMENTS* (AASB 11), APPLY TO ANNUAL PERIODS BEGINNING ON OR AFTER 1 JANUARY 2013.

This means that disclosing entities preparing half-year numbers for 30 June 2013 and annual reporters at 31 December 2013 will be affected by these new standards. For 30 June 2013 year ends it would be expected that the impacts of any potential change of consolidation or equity accounting would be disclosed in the June 2013 financial report.

The question is: Will these new standards change your financial statements or not? Is this all a storm in a tea cup or will your financial statements change significantly?

It is difficult to answer the question without having some hard data to go on. Research done in our September 2013 article New consolidation, joint arrangements and fair value standards – Storm in a teacup? on how much work the Top 100 listed companies with 30 June year ends had done to determine the impacts of these new standards revealed that many companies had not even considered the impacts and were assuming that impacts would not be material.

The question can only be answered by performing a detailed assessment of all your investments to see whether consolidation or joint control classification will change. This article summarises some of the headline issues that may impact your assessment. You will need to refer to the text of AASB 10 *Consolidated Financial Statements* and AASB 11 *Joint Arrangements* for the complete picture.

More information can also be found in the BDO International publication Need to Know IFRS 10 *Consolidated Financial Statements*.

100 per cent owned groups

It is likely that many 100 per cent owned groups (i.e. with no non-controlling interests) will continue to consolidate all their investments already classified as subsidiaries. This is because all three elements of the new 'control' definition are likely to be met, i.e.:

- Power over investee (whether or not that power is used in practice)
- Exposure, or rights, to variable returns from the investee
- Ability to use power over investee to affect the investor's returns from the investee.

However, before automatically assuming that there are no changes, we recommend that you conduct an appropriate assessment of all three elements of the control definition to make sure that you have arrived at the correct conclusion.

Groups with non-controlling interests

Groups that contain non-controlling interests need to be carefully assessed to determine whether you still have control. In particular:

- Where you are consolidating on the basis of potential voting rights (e.g. options) that are currently exercisable under AASB 127 *Consolidated and Separate Financial Statements*, you need to reassess whether these are also substantive under AASB 10, i.e. you have the practical ability to exercise them and they are 'in-the-money'
- Whether you or the non-controlling interests have the current ability to direct the relevant activities that most significantly affect your entity's returns. You will need to assess the rights given to the minority shareholders to determine whether these rights are protective or substantive. If the non-controlling interest has substantive rights, i.e. it can prevent you from controlling the relevant activity, then you would not have control and would need to deconsolidate.

Passive investments, investments with significant influence or joint control

De facto control

Where you have investments accounted for as associates measured under AASB 128 *Investments in Associates*, you need to determine who the other shareholders are, and whether shares are closely held amongst the other shareholders or widely dispersed. If widely dispersed you need to assess whether your holding is large enough for you to have de facto control and whether you need to consolidate under AASB 10. This is particularly relevant to investments where you hold more than 40 per cent of the investee.

Joint control or control

If you hold investments which are accounted for as jointly controlled entities under AASB 131 *Interests in Joint Ventures*, you need to examine your joint operating agreements in detail to assess all three elements of the 'control' definition and determine who has the current ability to direct the relevant activities that most significantly affect returns.

'Joint control' under AASB 11 requires unanimous consent for all decisions about the relevant activities that most significantly affect returns. If the relevant activities are the day to day operations, decisions about which are left to the 'operator' who is one of the joint venture parties, it is likely that there is no joint control and indeed the operator controls the relevant activity of the investee. This means that the operator needs to consolidate the investee and you would equity account the investment as an associate.

Fund managers

AASB 10 introduces extensive guidance about when an entity is acting as agent or principal, with principals being required to consolidate. Some of the factors that should be considered to determine whether the entity is acting as principal or agent include, but are not limited to:

- Scope of the decision-making authority
- Rights held by other parties, e.g. kick-out rights
- Remuneration and whether it is commensurate with services provided
- Decision maker's exposure to variability of returns from other interests held in the investee.

Fund managers that have wide decision-making authority, cannot easily be removed and have equity or other interests in the fund may be considered to be acting as principal, and therefore required to consolidate under AASB 10. Despite the fact that remuneration is commensurate with services provided, in such cases, fund managers could be considered to be acting as principal, merely because the size of their investment provides sufficient variability of returns.

Special purpose entities (SPEs)

You will need to reassess the treatment of any SPEs that you currently consolidate. Under Interpretation 112 *Consolidation – Special Purpose Entities* the 'risks and rewards' test was weighted to force consolidation by the investor with exposure to the greatest variable returns. AASB 10 merely requires that the three limbs of the 'control' definition be met. Therefore in some cases, the investee with the greatest exposure to variable returns may not actually have any ability to control the SPE's relevant activity. Further, AASB 10 only requires an entity to have exposure to variable returns, rather than the majority of variable returns, in order to meet the requirement to consolidate.

Similarly, you will also need to determine whether any SPEs in which you invest, or which you manage, that you do not currently consolidate, need to be consolidated under AASB 10. Balance sheets could change significantly if SPEs now need to be consolidated or deconsolidated because 100 per cent of the SPE's assets and liabilities will need to be added or removed from the group's balance sheet, with a corresponding entry to add or remove non-controlling interests.

No proportionate consolidation for jointly controlled entities under AASB 131 *Interests in Joint Ventures*

Since 2007, groups have had the choice under AASB 131 to proportionately consolidate or equity account their investments in jointly controlled entities. Proportionate consolidation is common practice in the mining and extractives industry. AASB 11 no longer permits proportionate consolidation for 'joint ventures' which are joint arrangements structured through a separate vehicle. This could result in material changes to your balance sheet if you currently proportionately consolidate jointly controlled entities.

Structured vehicles could be joint operations

If you have jointly controlled entities under AASB 131 such as a partnership which you are equity accounting, you need to assess the rights and obligations of the partners to determine whether partners have rights to the gross assets and obligations for the gross liabilities of the partnership, or whether partners have rights to the net assets of the partnership. This is a legal question and will vary from one jurisdiction to another and depend on the agreement itself. Currently you will be equity accounting under AASB 131 but if you do not have rights to the net assets, under AASB 11 you may need to account for assets and liabilities according to your rights and obligations rather than equity accounting. This will have the effect of grossing up liabilities on your balance sheet rather than showing a one line equity accounted investment.

Summary

Disclosing entities with half-year reporting periods ending 30 June 2013 must apply these new standards. If you have not completed a detailed assessment of the impacts of AASB 10 and 11, you need to do so now.

Companies with 30 June 2013 year ends are required to disclose the impacts of accounting standards issued not yet effective under paragraph 30 of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*. The Australian Securities and Investments Commission (ASIC) have also publicly stated in their Media Release (27 November 2012) ASIC's areas of focus for 31 December 2012 financial reports (and likely to be included in their areas of focus for 30 June 2013 financial reports) that entities should be well advanced in determining the impact of these standards. We therefore recommend that you complete your consolidation assessment sooner rather than later. Please contact your engagement partner or manager if you require any assistance in this regard. This assessment should be documented so that it can be audited.