NEW CONSOLIDATION, JOINT ARRANGEMENTS AND FAIR VALUE STANDARDS – STORM IN A TEACUP?

MOST PREPARERS OF FINANCIAL STATEMENTS WOULD BE AWARE BY NOW OF THE NEXT 'BIG BANG' OF NEW AND AMENDED ACCOUNTING STANDARDS THAT APPLY FROM 1 JANUARY 2013, WHICH INCLUDE THE CONSOLIDATION, JOINT VENTURE AND FAIR VALUE STANDARDS AS FOLLOWS:

- AASB 10 *Consolidated Financial Statements*
- AASB 11 *Joint Arrangements*
- AASB 12 *Disclosure of Interests in Other Entities*
- AASB 127 *Separate Financial Statements*
- AASB 128 *Investments in Associates and Joint Ventures*
- AASB 13 *Fair Value Measurement*.

Disclosing the impact of standards issued but not yet effective

Unless you are preparing financial statements using the Reduced Disclosure Requirements, general purpose and special purpose financial statements must include details of new standards, or amendments to existing standards that, when adopted, could have a material impact on the financial statements (refer AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, paragraph 30). This could refer to material changes to amounts recognised in the financial statements, as well as material changes to, or additional disclosures.

Also, if the impact of the new or amended standard is known, this must be disclosed, i.e. quantified. If the impact is not known or reasonably estimable, you need to disclose that fact.

This article looks at the extent and quality of these disclosures provided by the Top 100 listed companies in their annual reports for 30 June 2012. It also assesses whether application of these new standards will result in as many changes as first thought, or whether it is all just a storm in a teacup and preparers of financial statements consider that there will be no major impacts.

AASB 10 *Consolidated Financial Statements*

Boiler plate disclosures

From our review of the Top 100 listed companies with 30 June 2012 year ends that had lodged their annual reports at time of writing this article, we have observed a spread of disclosures of the impacts of AASB 10 on first time application. However much of it was a form of boiler plate type disclosures such as:

- Not mentioning AASB 10 at all
- The impact of AASB 10 had not yet been quantified
- Does not expect a significant/material impact but yet to perform a detailed analysis
- General statement that may lead to some entities currently being equity accounted needing to be consolidated in future but without quantification of impact.

The stars

At the time of writing, only the Centro Retail Fund and the Goodman Group had provided a detailed explanation about how they may be impacted. We can conclude from this data that:

- Entities are struggling with the principles in AASB 10 to decide whether there are differences or not
- Are adopting a 'wait and see' approach, i.e. wait and see what everyone else is going to disclose and then decide what our impacts might be
- Have yet to fully determine the impacts.

Centro Retail Fund explained that some entities currently held as managed funds at fair value through profit or loss may need to be consolidated in the future. They also provided a discussion of some of the factors they were considering as part of their analysis. As their analysis was not yet completed, no quantified impact was provided.

The Goodman Group explained that they had assessed the impact of AASB 10 and did not consider that it would result in a material change to investees that are consolidated because for the group's managed funds, the power to direct the relevant activities that significantly affect returns of the managed funds lie with either an investment committee (comprising a majority of non-Goodman investor representatives) or an independent board.

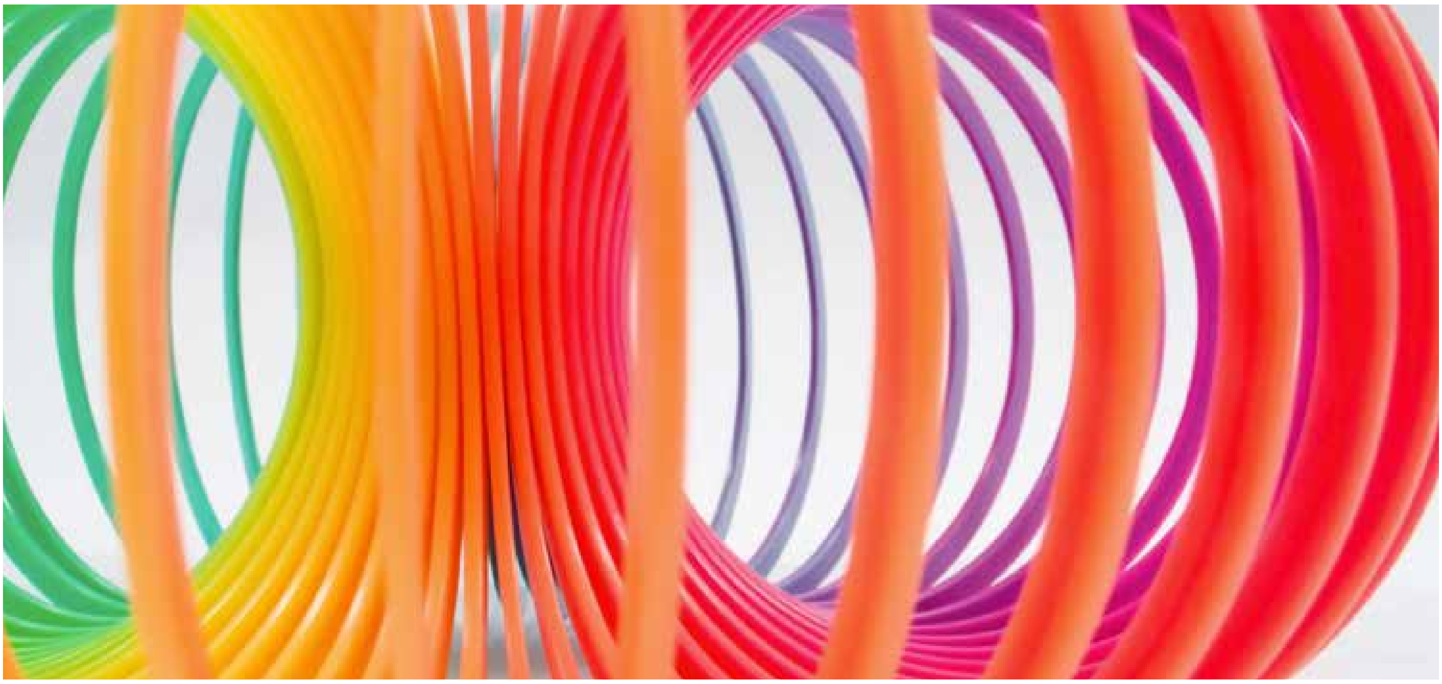
Transition date is upon us

Transition date is upon us and preparers of financial statements need to fast track their analyses of AASB 10 impacts.

The International Accounting Standards Board (IASB) has clarified that the **date of initial application** is the **beginning of the annual reporting period for which IFRS 10 is applied for the first time**, therefore the date of initial application for 31 December 2013 year ends and 30 June 2014 year ends is 1 January 2013 and 1 July 2013 respectively.

If you have not already started your AASB 10 impact assessment, you need to be aware that you need to decide on 1 January 2013/1 July 2013 whether entities you currently consolidate will still be consolidated under AASB 10 and vice versa. Unless you anticipate major changes to your group structures between now and then, you should be able to complete most of your assessments now.

Although the date of initial application is either 1 January 2013 or 1 July 2013 (beginning of annual reporting period for which the standard is first applied), the transitional requirements are such that if you identify changes to the entities you do or do not consolidate as at the transition dates, you need to go back and restate any differences in the prior period.



Example:
Group A has a December year end and transitions to AASB 10 on 1 January 2013. In its 31 December 2012 financial statements, Group A equity accounted Company Z, a company in which it has a 49 per cent holding. When applying AASB 10 to the 31 December 2013 financial statements, Group A determines that Company Z should be consolidated. This consolidation needs to be reflected in the restated comparatives.

What to look out for

Coca Cola Amatil adopted AASB 10, 11 and 12 early in their 31 December 2011 financial statements. The statements disclose that the standards had no financial impact on first time adoption and no noticeable impact on the level of disclosure. This would suggest that 'run of the mill' groups with majority owned trading subsidiaries and no special purpose entities are likely to have no or insignificant impacts when they first adopt AASB 10.

However, entities would be wise to start a detailed assessment, paying particular attention to the following situations:

'De facto' control
If you own 40-49 per cent of the shares in a company and the remaining shareholders are widely dispersed, there is a reasonable possibility that you may be considered to have 'de facto' control and will need to consolidate under AASB 10. There are no 'bright lines' in AASB 10 to determine at what percentage you have 'de facto' control, therefore you will need to apply judgement to determine whether a smaller holding of say 30 or 40 per cent gives 'de facto' control.

Majority holdings without control
You may have a 52 per cent interest in an entity where you do not have control under AASB 10 because you do not have power, i.e. you do not have the ability to direct the relevant activities that most significantly affect your returns. An example of this is given in AASB 10 whereby two investors set up a company to develop a pharmaceutical drug and obtain regulatory approval and then to manufacture and market the drug after approval has been obtained. Investor A is responsible for developing the drug and obtaining approval. Investor B is responsible for manufacture and marketing the drug. The development and approval of the drug could be considered relevant activities and so could the manufacture and marketing. Therefore you need to decide which of the relevant activities most significantly affect your returns. If you have the ability to direct those relevant activities that most significantly affect your returns then you still have control, otherwise not.

Substantive rights
If you currently own less than 50 per cent of a company but consolidate it because you hold options that are currently exercisable to throw you over the 50 per cent threshold, you need to consider whether these options are substantive or not. If they are deeply out of the money they are not substantive and you would need to deconsolidate this entity under AASB 10.

Fund managers
Fund managers with less than a 50 per cent interest in entities they manage currently would probably not consolidate such entities. The revised definition of 'control' in AASB 10 requires fund managers to now consider whether such investments subject them to variable returns such that they are acting as principal (and therefore should consolidate) rather than as agent (and not need to consolidate).

You will need to do a detailed assessment of things like the scope of your decision-making authority, whether other parties have 'kick out' rights, whether your remuneration is commensurate with services performed or more variable in nature and whether you have exposure to other variable returns such as from your holding in the investment entity (the higher your holding the higher the chance of variable returns and the need to consolidate). These are complex assessments requiring the exercise of professional judgement and you will need to get agreement with your auditors.

Banks, credit unions and entities with special purpose entities
Any entities such as banks, credit unions and others with special purpose entities are likely to be impacted by AASB 10. You may have previously consolidated a special purpose entity based on 'risks and rewards' requirements in Interpretation 112 *Consolidation – Special Purpose Entities* but under AASB 10 the group may be required to deconsolidate because you do not have power over the relevant activities, e.g. the bank bears the residual risk on a securitised loan book, but has no management role in the special purpose vehicle (SPV).

Conversely banks may be required to consolidate SPV's they manage and only earn fixed returns from that were previously not consolidated because the 'risk and rewards test' did not explicitly consider credit risk.

Interestingly, the only bank to report so far is Commonwealth Bank of Australia which has a 30 June 2012 year end. They comment only in general that AASB 10 is not expected to result in significant changes to the group's accounting policies.

For more information about AASB 10, refer to our detailed article on the equivalent international standard, IFRS 10 in Accounting News, July 2011.

AASB 11 *Joint Arrangements*

AASB 11 has unusual transition arrangements in that it applies from the beginning of the earliest period presented. This means that if two periods are presented, then AASB 11 applies from the beginning of the prior period, however, if three periods are presented then AASB 11 applies from the beginning of the earliest period.

Example 1
ABC Limited has a 31 December 2013 year end.

It presents comparatives for the year ended 31 December 2012.

AASB 11 applies from 1 January 2012 (beginning of earliest comparative period).

Example 2
ABC Limited has a 31 December 2013 year end.

It presents comparatives for the year ended 31 December 2012 and 31 December 2011.

AASB 11 applies from 1 January 2011 (beginning of earliest comparative period) so restatement needed for an extra year.

This means that we have essentially passed the transition date for AASB 11 and companies should, by now, have done a detailed assessment of the impact of the new joint arrangement principles, i.e. determined:

- Whether you have joint control
- Whether you have a joint operation (have rights to assets and obligations for liabilities) or a joint venture (rights to net assets of the joint arrangement)
- Whether you will need to change your basis of accounting (e.g. joint ventures must be equity accounted – there is no longer an option to proportionately consolidate)
- If the joint arrangement is structured through a separate vehicle, whether the terms of the contract or other facts and circumstances change your rights and those of the other joint venture parties from having rights in net assets of the arrangement, to having rights to assets and obligations for liabilities of the arrangement. If so, this may need to be accounted for as a joint operation rather than being equity accounted.

At the time of writing this article, a review of the Top 100 ASX listed companies that had lodged 30 June 2012 annual reports showed that the majority of companies resorted to boiler plate disclosure of the possible impacts of AASB 11 when it is first adopted. Examples of disclosures included:

- No mention of AASB 11 at all
- AASB 11 mentioned with a statement that the company is yet to assess the impact
- AASB 11 mentioned with a statement that while the impact is not expected to be material/significant, the company is yet to conduct a detailed analysis of impacts
- Will most likely qualify as joint operations (with no discussion or quantification of impacts).

The best disclosure so far was for Telstra who considered all jointly controlled entities and concluded that nothing in these agreements gave Telstra direct rights over assets or obligations to settle liabilities, such that they should be classified as joint operations, and therefore these entities will continue to be equity accounted.

For more information about AASB 11, refer to our detailed article on the equivalent international standard, IFRS 11, in Accounting News, June 2011.

AASB 13 *Fair Value Measurement*

Fortunately for preparers of financial statements, AASB 13 *Fair Value Measurement* has transitional requirements so that any changes to fair value measurements in the financial statements are made prospectively and comparative disclosures are not required in the first year. This means that you have a bit of lead time in order to determine the impact of this standard on your financial statements for 2013, and can get away with boiler plate type disclosures for AASB 108, paragraph 30, such as "We are yet to determine which, if any, of our current measurement techniques will change."

There is ongoing debate between the accounting profession and valuers as to the correct interpretation of some key terms contained in AASB 13. Entities will need to keep a watching brief on emerging interpretations to determine changes, if any, to fair value measurement techniques.

Some valuation practices are expected to change, for example, control premiums and discounts should no longer be taken into account when determining fair value because these are not a characteristic of the unit of account being valued (e.g. individual shares), but rather a characteristic of the entity's holding.

Despite the prospective application of this standard, we encourage preparers of financial statements to start examining valuation techniques now for all items recognised and disclosed at fair value in the financial statements because there may be complex and interpretive issues to consider for items such as financial instruments, land and buildings, agricultural assets and investments properties.

For more information about AASB 13, refer to our detailed article on the equivalent international standard, IFRS 13, in Accounting News, June 2011.

Storm in a teacup?

AASB 10
Our initial assessment when AASB 10 was first issued was that for 'stock standard' trading groups there would be little impact, but for entities with 'de facto' control, options that were not substantive, and for fund managers and banks, that this standard could have a big impact.

Based on data published so far in annual reports at 'the big end of town' (for Top 100 listed entities lodging 30 June 2012 annual reports at time of writing), we are either looking at companies that have not made detailed assessments or that in the context of larger groups, the impacts could be insignificant. For example, big banks always failed the derecognition criteria of financial assets in AASB 139 *Financial Instruments: Recognition and Measurement* and therefore will not be faced with the possibility of having to now consolidate special purpose vehicles because the assets and borrowings were always recognised on the balance sheet anyway. Or perhaps in the context of big banks, any previously unconsolidated special purpose entities are indeed immaterial to the entire balance sheet.

AASB 10 may be a storm in a teacup for the larger banks but the same may not apply for smaller Authorised Deposit-taking Institutions (ADI's). They may have fewer special purpose entities which are more material to the balance sheet and hence AASB 10 could have a material impact. Similarly, some of the larger fund managers have disclosed that their AASB 10 principal vs. agent analysis has not thrown up any major changes. Perhaps this is because these larger fund managers tend to hold shares in larger listed entities, but would have a small proportionate ownership interest, and therefore conclude that their variability of returns will be too low to indicate that they are acting as principal. Again, smaller fund managers should be cautious and not automatically assume that if the 'big end of town' has no material impact that they won't either. Smaller fund managers may own larger stakes in unlisted entities which could indicate greater variability of returns, and hence, acting as principal.

AASB 11
Joint arrangements are prevalent in the mining and exploration sectors. At the time of writing, the bigger mining entities by market capitalisation with 30 June 2012 year ends such as BHP Billiton Limited and Newcrest Mining Limited had not lodged their financial statements, nor had many smaller explorers. We were therefore unable to observe the extent of their disclosures about AASB 11 implications. It will be interesting to determine the extent to which full assessments have taken place once these financial statements are available. We will endeavour to update you in future editions of this newsletter.

Most of the larger miners that had lodged their financial statements had disclosed that they were still continuing to assess the impact of AASB 11, or that it was not expected to have an impact.

This begs the question as to whether we should expect similar insignificant impacts from smaller listed groups and unlisted groups. Time will tell!