

# IFRS news

## ‘Reporting entity’ takes shape

Mary Dolson provides an overview of the raft of new standards and amendments published by the IASB last month.

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The IASB has delivered a package of new and revised standards that address the ‘reporting entity’ under IFRS. The package includes three new standards and two significantly amended existing standards. The new standards are IFRS 10, ‘Consolidated financial statements’ (see p4), IFRS 11, ‘Joint arrangements’ (see p2) and IFRS 12, ‘Disclosure of interests in other entities’. IAS 28, ‘Investments in associates’, has been amended in line with the changes to accounting for joint arrangements. The guidance on accounting for separate financial statements has been retained in IAS 27, which has been renamed ‘Separate financial statements’.

The consolidation project has resulted in single definition of control under IFRS, eliminating the voting rights model in IAS 27 and the risks and rewards approach of SIC 12. The project has been described as ‘low change’ by the IASB. However, the new definition of control and extensive

application guidance may result in changes for entities that might have ‘de facto control’ over other entities. The inclusion of guidance on principal and agent roles in control will be of particular interest to investment managers.

The new standard on joint arrangements has eliminated proportionate consolidation as a policy choice for jointly controlled entities. Joint arrangements will be classified as ‘joint operations’ or ‘joint ventures’, based on the rights and obligations of the participants. Equity accounting is required for participants in a joint venture. Participants in a joint operation will account for their right and obligations in a manner similar to the accounting for jointly controlled assets or operations today.

The removal of SIC 12, particularly the activities test, may well change the control assessment for structured entities.

### *Practical guide to business combinations – determining what a business is under IFRS 3 (2008)*

Application of the revised business combinations standard, IFRS 3 (2008), has revealed a number of implementation challenges. One of the most significant is the determination of what a business is. The definition of a business was only changed to include the three words: ‘is capable of’. However, the inclusion of expanded

application guidance, changes to the scope of the standard and convergence with US GAAP has led to more transactions being seen as business combinations compared to the conclusions reached under the previous standard. This [practical guide](#) looks at the key issues arising in practice, using examples and step-by-step implementation guidance.

## ***IFRS 11 brings major change to accounting for joint ventures***

**The IASB has issued the long-awaited IFRS 11, 'Joint arrangements', as part of a 'package' of five new standards (see p1). Derek Carmichael in PwC's Accounting Consulting Services Central Team looks at the requirements.**

Key features of the standard are as follows:

- Changes in the definitions have reduced the 'types' of joint arrangements to two: joint operations and joint ventures;
- The existing policy choice of proportionate consolidation for jointly controlled entities has been eliminated;
- Equity accounting is mandatory for participants in joint ventures; and
- Entities that participate in joint operations will follow accounting much like that for joint assets or joint operations today.

### ***Underlying principles***

A joint arrangement is defined as being an arrangement where two or more parties contractually agree to share control. Joint control exists only when the decisions about activities that significantly affect the returns of an arrangement require the unanimous consent of the parties sharing control.

All parties to a joint arrangement should recognise their rights and obligations arising from the arrangement. The focus is no longer on the legal structure of joint arrangements, but rather on how rights and obligations are shared by the parties to the joint arrangement.

The structure and form of the arrangement is only one of the factors to consider in assessing each party's rights and obligations. The terms and conditions agreed by the parties (for example, agreements that may modify the legal structure or form of the arrangement) and



**Derek Carmichael**

other relevant facts and circumstances should also be considered. If the facts and circumstances change, a venturer needs to reassess:

- whether it has joint control; and/or
- the type of joint arrangement in which it is involved.

### ***Types of joint arrangements and their measurement***

IFRS 11 classifies joint arrangements as either joint operations or joint ventures. The 'jointly controlled assets' classification in IAS 31, 'Interests in joint ventures', has been merged into joint operations, as both types of arrangements generally result in the same accounting outcome.

A joint operation is a joint arrangement that gives parties to the arrangement direct rights to the assets and obligations for the liabilities. A joint operator will recognise its interest based on its involvement in the

joint operation (that is, based on its direct rights and obligations) rather than on the participation interest it has in the joint arrangement.

A joint operator in a joint operation therefore recognises in its own financial statements:

- its assets, including its share of any assets held jointly;
- its liabilities, including its share of any liabilities incurred jointly;
- its revenue from the sale of its share of the output of the joint operation;
- its share of the revenue from the sale of the output by the joint operation; and
- its expenses, including its share of any expenses incurred jointly.

A joint venture, in contrast, gives the parties rights to the net assets or outcome of the arrangement. A joint venturer does not have rights to individual assets or obligations for individual liabilities of the joint venture. Instead, joint venturers share in the net assets and, in turn, the outcome (profit or loss) of the activity undertaken by the joint venture. Joint ventures are accounted for using the equity method in accordance with IAS 28, 'Investments in associates'. Entities can no longer account for an interest in a joint venture using the proportionate consolidation method.

The standard also provides guidance for parties that participate in joint arrangements but do not have joint control.

### ***Am I affected?***

Entities with existing joint arrangements or that plan to enter into new joint arrangements will be affected by the new standard. These entities will need to assess their arrangements to determine whether they have invested in a joint operation or a joint venture upon adoption of the new standard or upon entering into the arrangement.

Entities that have been accounting for their interest in a joint venture using

proportionate consolidation will no longer be allowed to use this method; instead they will account for the joint venture using the equity method. In addition, there may be some entities that previously equity-accounted for investments that may need to account for their share of assets and liabilities now that there is less focus on the structure of the arrangement.

The transition provisions of IFRS 11 require entities to apply the new rules at the beginning of the earliest period presented upon adoption. When transitioning from the proportionate consolidation method to the equity method, entities should recognise their initial investment in the joint venture as the aggregate of the carrying amounts that were previously proportionately consolidated. In transitioning from the equity method to accounting for assets and liabilities, entities should recognise their share of each of the assets and liabilities in the joint operation, with specific rules detailing how to account for any difference from the previous carrying amount of the investment.

### ***What do I need to do?***

The new standard is applicable for annual accounting periods beginning on or after 1 January 2013. Earlier application is permitted if the entire package of standards is adopted at the same time.

Management of entities that are party to joint arrangements should evaluate how the requirements of the new standard will affect the way they account for their existing or new joint arrangements. The accounting may have a significant impact on entities' financial results and financial position, which should be clearly communicated to stakeholders as soon as possible.

Management should also carefully consider the planned timing of their adoption. If they wish to retain the current accounting for existing arrangements, now is the time to consider how the terms of these arrangements can be reworked or restructured to achieve this.

## **Consolidation standard revises definition of control**

**The IASB has issued the long-awaited IFRS 10, 'Consolidated financial statements', as part of the group of five new standards that address the scope of the reporting entity (see p1). Director in PwC's Accounting Consulting Services Central Team, Caroline Woodward, looks at the requirements.**

Key features of the standard are:

- IFRS 10 replaces all of the guidance on control and consolidation in IAS 27, 'Consolidated and separate financial statements', and SIC 12, 'Consolidation – special purpose entities';
- IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control. The new definition is supported by extensive application guidance that addresses the different ways in which a reporting entity (investor) might control another entity (investee);
- The changed definition and application guidance is not expected to result in widespread change in the consolidation decisions made by IFRS reporting entities, although some entities could see significant changes. All entities will need to consider the new guidance;
- The core principle that a consolidated entity presents a parent and its subsidiaries as if they are a single entity remains unchanged, as do the mechanics of consolidation; and
- IFRS 10 excludes guidance specifically for investment companies, as the IASB continues to work on a project on accounting by investment companies for controlled entities.

### **Revised definition of control**

The revised definition of control focuses on the need to have both power and variable returns before control is present. Power is the current ability to direct the activities that significantly influence returns.



**Caroline Woodward**

Returns must vary and can be positive, negative or both.

The determination of power is based on current facts and circumstances and is continuously assessed. The fact that control is intended to be temporary does not obviate the requirement to consolidate any investee under the control of the investor. Voting rights or contractual rights may be evidence of power, or a combination of the two may give an investor power. Power does not have to be exercised. An investor with more than half the voting rights would meet the power criteria in the absence of restrictions or other circumstances.

The application guidance includes examples illustrating when an investor may have control with less than half of the voting rights. When assessing if it controls the investee, an investor should consider potential voting rights, economic dependency and the size of its shareholding

in comparison to other holdings, together with voting patterns at shareholder meetings. This last consideration will bring the notion of 'de facto' firmly within the consolidation standard.

IFRS 10 also includes guidance on participating and protective rights. Participating rights give an investor the ability to direct the activities of an investee that significantly affect the returns. Protective rights (often known as veto rights) will only give an investor the ability to block certain decisions outside the ordinary course of business.

The new standard includes guidance on agent/principal relationships. An investor (the agent) may be engaged to act on behalf of a single party or a group of parties (the 'principals'). Certain power is delegated to the agent – for example, to manage investments. The investor may or may not have control over the pooled investment funds. IFRS 10 includes a number of factors to consider when determining whether the investor has control or is an agent.

The revised definition of control and associated guidance replaces not only the definition and guidance in IAS 27 but also the four indicators of control in SIC 12.

### ***Am I affected?***

IFRS 10 has the potential to affect all reporting entities (investors) that control one or more investees under the revised definition of control. The determination of control and consolidation decisions may not change for many entities. However, the new guidance will need to be understood and considered in the context of each investor's business.

### ***What do I need to do?***

The revised standard is effective for annual periods beginning on or after 1 January 2013; earlier application is permitted. IFRS preparers should consider whether IFRS 10 will affect their control decisions and consolidated financial statements.

## ***Key standard out on disclosure of interests in other entities***

**The IASB has issued IFRS 12, 'Disclosure of interests in other entities', as part of the group of five new (see p1). Koon Min Wong in PwC's Accounting Consulting Services Central Team, provides an overview.**

Key features of IFRS 12 are:

- IFRS 12 sets out the required disclosures for entities reporting under the two new standards, IFRS 10, 'Consolidated financial statements', and IFRS 11, 'Joint arrangements'; it replaces the disclosure requirements currently found in IAS 28, 'Investments in associates'; and
- It requires entities to disclose information that helps users to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint



**Koon Min Wong**

arrangements (JAs) and unconsolidated structured entities.

Disclosures are required in the areas outlined below.

### ***Significant judgements and assumptions***

Significant judgements and assumptions made in determining whether the entity controls, jointly controls, significantly influences or has some other interests in other entities include:

- an assessment of principal-agent relationships in consolidation;
- determination of the type of JA; and
- any override of presumptions of significant influence and control when voting rights range from 20% to 50%, and exceed 50%, respectively.

### ***Interests in subsidiaries***

This includes information about:

- group composition;
- interests of non-controlling interests (NCI) in group activities and cash flows, and information about each subsidiary that has material NCI;
- significant restrictions on access to assets and obligations to settle liabilities;
- risks associated with consolidated structured entities, such as arrangements that could require the group to provide financial support;
- a schedule of the impact on parent equity is required for changes in the ownership interest in a subsidiary without a loss of control;
- detail of any gain/loss recognised on loss of control, and the line item in the statement of comprehensive income in which it is recognised; and
- subsidiaries that are consolidated using different year ends.

### ***Interests in JAs and associates***

Detailed disclosures include:

- the name, country of incorporation and principal place of business;
- proportion of ownership interest and measurement method;
- summarised financial information;
- fair value (if published quotations are available);
- significant restrictions on the ability to transfer funds or repay loans;
- year-ends of JAs or associates if different from the parent's; and
- unrecognised share of losses, commitments and contingent liabilities.

### ***Interests in unconsolidated structured entities***

Detailed disclosures include:

- the nature, purpose, size, activities and financing of the structured entity;
- the policy for determining structured entities that are sponsored;
- a summary of income from structured entities;
- the carrying amount of assets transferred;
- the recognised assets and liabilities relating to structured entities;
- the maximum loss arising from such involvement; and
- information on financial or other support provided to such entities.

### ***Am I affected?***

IFRS 12 is effective for annual periods beginning on or after 1 January 2013, with earlier application permitted. An entity can provide any or all of the above disclosures without having to apply IFRS 12 in its entirety, or IFRS 10 or 11, or the amended IAS 27 or 28.

### ***What do I need to do?***

Management should consider whether it needs to implement additional processes to compile the required information.

## ***IASB and FASB issue guidance on fair value measurement and disclosure***

**The IASB has completed its joint project with the FASB on fair value measurement, issued as IFRS 13, 'Fair value measurement'. Director in PwC's Accounting Consulting Services Central Team, Jessica Taurae, explains the key provisions.**

IFRS 13 explains how to measure fair value and aims to enhance fair value disclosures; it does not say when to measure fair value or require additional fair value measurements.

The project converges IFRS and US GAAP on how to measure fair value, although there will continue to be differences in certain respects, including when fair value measurements are required and when day 1 gains and losses can be recognised.

### ***Key provisions***

#### ***Scope***

The guidance in IFRS 13 does not apply to transactions within the scope of IFRS 2, 'Share-based payment', or IAS 17, 'Leases', or to certain other measurements that are required by other standards and are similar to, but are not, fair value (for example, value in use in IAS 36, 'Impairment of assets').

#### ***Definition of fair value***

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The fair value of a liability therefore reflects non-performance risk (that is, own credit risk).

#### ***Principal or most advantageous market***

A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place in the principal market for the asset or liability or, in the absence of



**Jessica Taurae**

a principal market, in the most advantageous market for the asset or liability.

The principal market is the market with the greatest volume and level of activity for the asset or liability that can be accessed by the entity.

#### ***Market participant assumptions***

Fair value is measured using the same assumptions and taking into account the same characteristics of the asset or liability as market participants would. Fair value is a market-based, not entity-specific measurement.

#### ***Highest and best use***

For non-financial assets only, fair value is determined based on the highest and best use of the asset as determined by a market participant.

### *Bid and ask prices*

The use of bid prices for asset positions and ask prices for liability positions is permitted if those prices are most representative of fair value in the circumstances, but it is not required.

### *Fair value hierarchy*

Fair value measurements are categorised into a three-level hierarchy, based on the type of inputs to the valuation techniques used, as follows:

- Level 1 inputs are quoted prices in active markets for items identical to the asset or liability being measured. Consistent with current IFRS, if there is a quoted price in an active market (that is, a Level 1 input), an entity uses that price without adjustment when measuring fair value;
- Level 2 inputs are other observable inputs; and
- Level 3 inputs are unobservable inputs that nevertheless must be developed to reflect the assumptions that market participants would use when determining an appropriate price for the asset or liability.

Each fair value measurement is categorised based on the lowest level input that is significant to it.

### *Disclosures*

The guidance includes enhanced disclosure requirements that could result in significantly more work for reporting entities. These requirements are similar to those in IFRS 7, 'Financial instruments: Disclosures', but apply to all assets and liabilities measured at fair value, not just financial ones.

The required disclosures include:

- information about the hierarchy level into which fair value measurements fall;
- transfers between Levels 1 and 2;

- methods and inputs to the fair value measurements and changes in valuation techniques; and
- additional disclosures for Level 3 measurements that include a reconciliation of opening and closing balances, quantitative information about unobservable inputs and assumptions used, a description of the valuation processes in place, and qualitative discussion about the sensitivity of recurring Level 3 measurements.

### *Am I affected?*

IFRS 13 is effective for annual periods beginning on or after 1 January 2013, with earlier application permitted. It is applied prospectively as of the beginning of the annual period in which it is initially applied. The disclosure requirements of the new guidance do not need to be applied in comparative information for periods before initial application of IFRS 13.

Almost all entities use fair value measurements and will therefore be subject to the new requirements. Some changes may be required (for example, bid/ask spread and inclusion of own credit risk) to those fair value measurements today, which will largely affect financial institutions and investment entities. However, there are enhanced disclosure requirements that will be required by all entities.

### *What do I need to do?*

Preparers should begin by evaluating the nature and extent of the fair value measurements that they are currently required to make under IFRS. Management will need to determine which, if any, of the measurement techniques used will have to change as a result of the new guidance, and what additional disclosures will be necessary.

## IFRS news marks its 100th edition

As *IFRS news* celebrates its 100<sup>th</sup> edition this month, we look at some of our stats and take a light-hearted view of headlines that haven't happened... yet.

### IFRS news fact-file

- *IFRS news* first issue was published in September 2002.
- The articles in the September 2002 edition were: First-time application of IFRS; Country profile – France: A holistic approach to 2005; Discussion paper on share-based payments (later IFRS 2).
- We publish editions for 14 countries. A number of additional countries translate into local language.
- We have readers in nearly every country in the world, with a circulation of around 8,000.
- We have covered financial instruments issues in approximately 75% of editions.
- 'IFRS' has been the most searched term on average on PwC's website since 2002.

### Headlines so far unseen

- IASB takes a year off
- IFRS Esperanto version now out
- All derivatives off balance sheet
- Financial statements cannot exceed 23 pages
- France adopts Japanese GAAP
- FASB moves to Fargo, North Dakota
- JK Rowling recruited to edit new standards
- Peter Holgate sets IFRS 9 to music as a requiem mass
- Lady Gaga appointed as new chairman

Thank you for reading *IFRS news*. If you have any suggestions or comments about the newsletter, contact: [joanna.c.malvern@uk.pwc.com](mailto:joanna.c.malvern@uk.pwc.com)

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