IFRS Foundation

IFRS Conference

Thursday 27 and Friday 28 June 2013
NH Grand Krasnapolsky Hotel, Amsterdam

Special Interest Session

Implementing IFRS 10 *Consolidated Financial Statements* and IFRS 12 *Disclosure of Interests in Other Entities*

PHILIPPE DANJOU
Member
IASB

ALAN TEIXEIRA
Senior Director, Technical Activities
IASB

SANDRA THOMPSON
Partner
PwC

DAVID BRADBERY
Managing Director, EMEA Head Technical Accounting Group Finance
Barclays

International Financial Reporting Standards

IFRS 10 *Consolidated Financial Statements* including related disclosures in IFRS **12**

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

IFRS™

Why we undertook the project

Issues – IAS 27 / SIC12	Solution – IFRS 10, 12
Inconsistencies in practice • Tension between IAS 27 (control) and SIC 12 (risk and rewards) • Inconsistent application	• A single control model for all entities • Clear principle of control • Additional application guidance
Disclosures and financial crisis • Sufficient guidance for structured entities? • Reputational risk as a basis for consolidation? • Inadequate disclosures?	• SIC 12 performed well. Use of existing principles to create a sound foundation for SPEs • Enhanced disclosures particularly for unconsolidated structured entities

IFRS™

International Financial Reporting Standards

IFRS 10

IFRS™

Definition of control

<u>Definition of control</u>:

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.

✓ Single consolidation model for all entities, including structured entities

✓ Consolidation based on control – 'power so as to benefit' model
  - Controller must have some exposure to risks and rewards.
  - Exposure is an indicator of control but is not control of itself
  - Power arises from rights—voting rights (either majority or less than a majority), potential voting rights, other contractual arrangements, or a combination thereof.

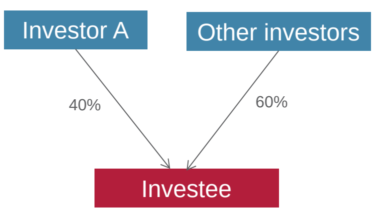
IFRS™

Control <50% voting rights

- Entity can control with less than 50% of voting rights.
- Factors to consider include:
  - Size of the holding relative to the size and dispersion of other vote holders
  - Substantive potential voting rights
  - Other contractual rights
- If the above not conclusive consider additional facts and circumstances that provide evidence of power (eg voting patterns at previous board meeting, etc)
- If no evidence of power, entity does not control

IFRS™

Example: Control <50% voting rights



- Investor A owns 40% of voting rights and, via shareholding, has appointed the Chairman and CEO of Investee
- Does Investor A control Investee?
  - If the other investors are widely dispersed (there are thousands of other investors)?
  - If there are only two other investors?
  - If other investors holding 40% actively participate in shareholders meetings?
- What if Investor A sells 10% of its shareholding?

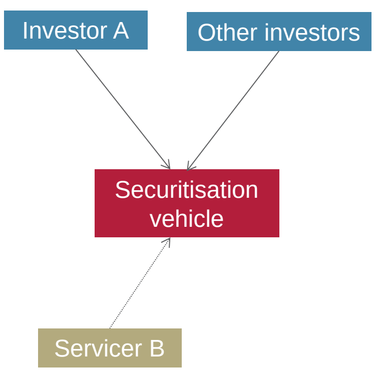
IFRS™

Structured entities

General principles apply for assessing control for all types of entities (ie…)

- Consider the purpose and design
- Identify the activities of the investee that significantly affect the returns of the investee (ie the relevant activities)
- Identify how decisions about relevant activities are made
- Determine whether the rights of the investor give it the ability to direct the relevant activities
- Determine whether the investor is exposed, or has rights, to the variability associated with the returns of the investee
- Determine whether the investor has the ability to use its power over the investee to affect its own returns

Example: Structured entities



- Investor A transfers receivables to securitisation vehicle and appoints Servicer B to manage day-to-day cash flow streams
- Investor A can step in and manage the receivables upon default
- Investor A holds notes issued by Securitisation vehicle
- Does Investor A control Securitisation vehicle?

Agency relationships

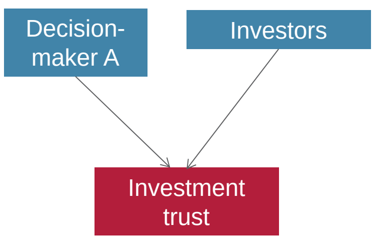
9

Consider all of the following factors:

- scope of the decision-making authority
- rights held by other parties (ie kick-out rights)
- remuneration of the decision-maker
- other interests that the decision maker holds in the investee

Example: Agency relationships

10



- Decision-maker A has broad decision making powers
- Can be removed by simple majority vote of investors
- Remunerated via market-based fee – 1% of assets under management and 20% of profits over a hurdle
- Does Decision-maker A control Investment trust if it has:
  - no equity interest?
  - equity interest of 2%?
  - equity interest of 20%?

Investment entities

Final amendments to IFRS 10: Published October 2012

An investment entity is one:

- Whose only substantive activities are investing for returns that are earned solely from investment income and/or capital appreciation
- That manages and evaluates performance of investments on a fair value basis

Accounting

- An investment entity measures investments in subsidiaries, JVs and associates at fair value
- Any parent of an investment entity (that is not an investment entity) consolidates subsidiaries, and measures JVs and associates of its investment entity subsidiary at fair value

International Financial Reporting Standards

IFRS 12

Scope

13

Combined disclosure standard for:

- Subsidiaries
- Joint arrangements
- Associates
- Unconsolidated structured entities

Disclosure objective

14

To disclose information that helps users of financial statements evaluate:

(a) the nature of, and risks associated with, an entity's interests in other entities, and

(b) the financial effects of those interests on the entity's financial position, financial performance and cash flows

Subsidiaries

- The composition of the group
- Involvement of NCI in the group's activities (including profit or loss allocation and summarised financial information for subsidiaries with large NCI)
- The effect of significant or unusual restrictions on assets and liabilities
- The nature of, and changes in, the risks associated with structured entities

Unconsolidated structured entities

Nature of interests in unconsolidated structured entities

- eg nature, purpose, size, activities and financing
- For sponsors not providing other risk disclosures
  - Type of income earned
  - The carrying amount of all assets transferred

Nature of, and changes in, the risks associated with an entity's interests

- Carrying amount of the assets and liabilities recognised
- Maximum exposure to loss and comparison to carrying amounts
- Non-contractual support provided

IFRS 10 and IFRS 12

Effective date

- Annual periods beginning on or after 1 January 2013
- Investment entities amendment effective 1 January 2014 (early application permitted)

Transition relief

- No retrospective adjustment required for entities disposed of in the comparative period(s)
- Requirement to present adjusted comparatives limited to immediately preceding period
- Comparative disclosures relating to unconsolidated structured entities not required when IFRS 12 first applied

IFRS

Thank you

IFRS

www.pwc.co.uk

IFRS Foundation: Special Interest Session

IFRS 10 – Investment entities

Sandra Thompson

June 2013

pwc

Agenda

Overview

What is an investment entity?

Limitations to exception from consolidation

Implementation issues:

- Litigation and property funds
- Technology/R&D funds
- Master-feeder structures
- Sovereign wealth funds
- Local regulatory requirements

Overview

- Amendments to IFRS 10, IFRS 12 and IAS 27
  - o Effective 1 January 2014
  - o Early application permitted – subject to endorsement by EU
  - o Endorsement expected Q3 2013

PROVIDES EXCEPTION TO CONSOLIDATION

Investment in subsidiary measured at
FAIR VALUE THROUGH PROFIT OR LOSS

- Specific disclosure requirements in amendments
- IFRS 12 disclosure requirements also apply

What is an investment entity?

- Definition of an Investment Entity
  - o Obtains funds from one or more investors
  - o Purpose to provide them with investment management services
  - o Business purpose to invest solely for capital appreciation and investment income
  - o Measures and evaluates performance of investments on fair value basis

What is an investment entity (2)
Determining whether the definition is met

- Business purpose test
  - o How presents itself to investors. Activities and services

- Exit strategy
  - o How capital appreciation will be realised. Eg IPO, trade sale, private placement, sales of assets, collecting term debt

- Earnings from investments
  - o Must not receive benefits unavailable to unrelated parties, Eg rights to acquire or use technology or products/services

- Fair value measurement
  - o Primary measure for substantially all investments, both to evaluate investments and in financial statements

Definition of an investment entity (3)
Permitted activities

- Investment-related services
  - o Advisory and administrative services to investors and 3rd parties
  - o Management services to investees
  - o Financial support to investees

- Permitted if extension of operations
  - o Even if substantial

- Exemption not permitted if separate substantive activity
  - o Judgement required where mixed business model
  - o Where services provided by subsidiary as a separate substantive activity, would consolidate

Typical characteristics of an investment entity

- More than one investment/more than one investor
  - Single investment can be OK, eg in start up, liquidation temporarily
- Unrelated investors
  - Less likely will obtain benefits other than capital appreciation
- Ownership interests
  - Typically in form of equity or similar giving a pro rata share of net assets. Can have different classes.

ABSENCE OF ANY TYPICAL CHARACTERISTICS DOES NOT DISQUALIFY FROM INVESTMENT ENTITY CLASSIFICATION

Limitations to exception from consolidation

Investment entity will normally not consolidate subsidiaries

FAIR VALUE UNDER IAS 39/ IFRS 9

BUT

WILL consolidate subsidiaries providing services relating to investment activities

PARENT of investment entity consolidates all entities it controls

UNLESS PARENT IS INVESTMENT ENTITY

INCLUDING

ALL subsidiaries controlled through the investment entity

Implementation issues – business purpose Litigation and property funds

Litigation

Fund invests in contractual claims

Advances money to litigants

Return based on lawsuit result

Measure investments at fair value

Property

Fund invests in real estate assets and companies which own, manage and lease out assets

Return based on dividends, share of profits and capital appreciation

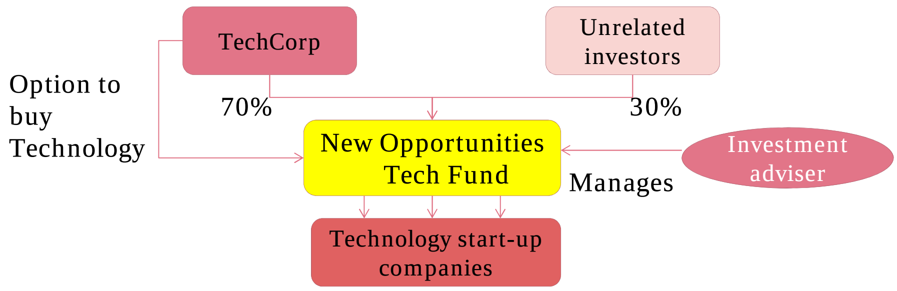
Measure investments at fair value

What might prevent qualification as investment entity?

Level of involvement in operating and strategic decisions of investees:

- Making decisions on when to proceed with litigation or settle
- Participation in property and asset management activities (maintenance, capital expenditure, marketing and tenant selection)

Implementation issues – business purpose Technology/R&D funds

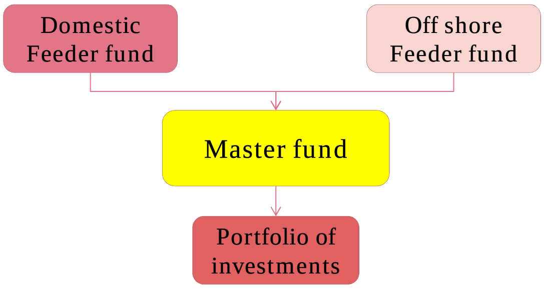


- TechCorp holds fair value options to acquire investments held by NOTF
- Likely to exercise if businesses or technology developed would benefit operations of TechCorp
- No plans for exiting investments identified by fund

Would TechCorp qualify as investment entity?

No – no exit strategy and benefits other than capital appreciation

Implementation issues – exit strategy
Master-feeder structures



- Feeder funds invest in master fund
- No plan to exit master fund

Absence of exit strategy mean not qualify as investment entity?

If master fund has exit strategy for investments, feeders can still qualify

Implementation issues – single investor
Sovereign wealth funds

- Government sets up sovereign wealth fund as separate legal entity
  - o Manages income from natural resources
  - o Funds future pensions and significant state capital projects
  - o Fund employs team of professional investment managers
  - o Public and internal reports on fair value basis

Is the sovereign wealth fund an investment entity?

Yes:

- Set up to provide investment management services to investor
- Objective of capital appreciation and investment income
- Measures investments on fair value basis and reports funds on same
- One investor (government) but in substance investing funds of citizens

Implementation issues – presentation
Local regulatory requirements

- Some jurisdictions require line-by-line consolidated financials

For an investment entity:
Would this comply with IFRS?

- We think "No"
  - ❑ IFRS 10 says an investment entity "shall not consolidate"
  - ❑ Fair value approach is mandatory
  - ❑ Financial statements produced for regulatory requirements
    - o Could describe as "Special purpose"
    - o Not "in compliance with IFRS"

Questions?

Implementing IFRS 10 and IFRS 12
A practitioner's perspective

BARCLAYS

David Bradbery
Technical Accounting Group, EMEA Head
June 2013

Overview

IFRS 10 - Consolidation	IFRS 12 - disclosure
Consolidation of entities where parent has power, variability and the ability to affect returns through its power	Extensive new disclosures relating to structured entities either in which you hold an interest or have sponsored
Principal versus agent – kick out rights no longer prevail	Definition of 'interest' very broad and includes Trading portfolio
Constant reassessment of consolidation	Disclosure required where you have, have to, or intend to provide support to a Structured Entity (SE), including consolidated SEs
Modified retrospective application – full application with some reliefs but only 1 year of comparatives	Increased disclosures relating to consolidated group – including restrictions, non controlling interests and significant judgements on which entities to consolidate
Barclays Status	**Barclays Status**
Adopted from 1 Jan 2013, restatement document issued May 2013	In progress – next milestone full dry run after H2

BARCLAYS

Key elements for running a successful implementation project

- Senior Sponsorship
- Ownership & accountability
- Governance & resources
- Awareness & training
- Communicating progress
- Dependencies

- Competing projects: CRD IV, CoRep, Netting, EDTF, IFRS 9
- Timetable, milestones, monitoring
- Decentralisation
- Throughout the project
- Capital, FINREP

Themes

IFRS 10 and IFRS 12 are both significant projects

Information required is dispersed in Businesses

New and challenging requirements

Many competing projects - including Business As Usual

Clear vision of end state essential

* Will be confirmed Q4 when final standard issued

BARCLAYS

Key lessons from IFRS 10

- Communication
- Buy – in : obtaining appropriate co-operation and sponsorship
- "Golden source" Identification of entities
- Combine with IFRS 12?
- Early auditor engagement and agreement to Policy decisions
- Process for ongoing reassessment
- Revisiting consolidation decisions under SIC 12

BARCLAYS

Financial impacts of IFRS 10

- **Barclays consolidated 79 new entities and deconsolidated 63 entities**
- **Reduced equity by £477m**
- **Reduced gross assets by £145m**
- **Increased liabilities by £332m**

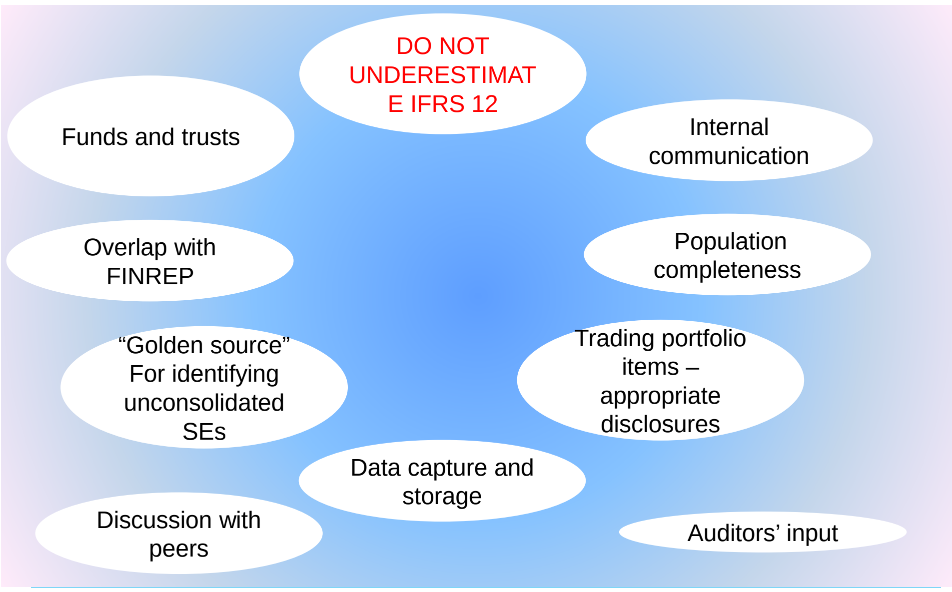
The main sources of newly consolidated entities were:

- Investment funds, where our management fees, the lack of practical kick out rights and performance guarantees provided meant we had power and exposure to variability
- Securitisation vehicles where more junior tranches had been eliminated due to the performance of the collateral. The assets, measured at FV, were less than the loans carried at amortised cost
- Investment funds contributed increase in liabilities for amounts due to unit holders.

* Will be confirmed Q4 when final standard issued.

BARCLAYS

Key lessons so far from IFRS 12



BARCLAYS

Implementing IFRS 10 and IFRS 12,
A practitioner's perspective

BARCLAYS

David Bradbery
Technical Accounting Group, EMEA Head
June 2013