Special Interest Session

Implementing IFRSs 10 and 12

CHUNGWOO SUH
Member
IASB

REINHARD KLEMMER
Partner
KPMG

ARTHUR LANG
Group CFO
Capitaland Limited
To assist you to prepare for the implementation of forthcoming IFRS 10 Consolidated Financial Statements and IFRS 12 Disclosure of Interests in Other Entities, the IFRS Foundation will hold an intensive half-day session immediately before the IFRS conference, on the morning of 29 May 2014.

09:00  Registration and refreshments

09:30  Introduction to the requirements
       Chungwoo Suh
       Member
       IASB

10:15  Advisor’s perspective
       Reinhard Klemmer
       Partner
       KPMG

10:45  Preparer’s perspective
       Arthur Lang
       Group CFO
       Capitaland Limited

11:15  Round-table Q&A
       Chair: Chungwoo Suh, Member, IASB
       Panellists:
       • Reinhard Klemmer
       • Arthur Lang

11:55  Concluding comments
       Chungwoo Suh
       Member
       IASB

12:00  Close session
Why we undertook the project

**Issues – IAS 27 / SIC12**

- Inconsistencies in practice
  - Tension between IAS 27 (control) and SIC 12 (risk and rewards)
  - Inconsistent application
- Disclosures and financial crisis
  - Sufficient guidance for structured entities?
  - Reputational risk as a basis for consolidation?
  - Inadequate disclosures?

**Solution – IFRS 10, 12**

- A single control model for all entities
- Clear principle of control
- Additional application guidance
- SIC 12 performed well. Use of existing principles to create a sound foundation for SPEs
- Enhanced disclosures particularly for unconsolidated structured entities
Definition of control

**Definition of control:**
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.
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

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?
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?
Consider all of the following factors:

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

Example: Agency relationships

- 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
  - 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

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

Combined disclosure standard for:
- Subsidiaries
- Joint arrangements
- Associates
- Unconsolidated structured entities

**Disclosure objective**

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

Thank you
IFRS 10 application issues

IFRS Foundation Conference
Singapore
May 2014

The Bigger Picture

Power
Emerging Issues
IFRS 10 – The Bigger Picture

1. Significant judgment is required and no easy way out
2. It will take time to adjust and accounting practice to become GAAP
3. There will be a period of uncertainty and diversity
4. Optimization is taking place and structuring opportunities will be explored
5. The “power” analysis appears to be the more challenging one, not surprisingly

IFRS 10 – The Bigger Picture (cont’d)

6. Power takes over control from economics
7. De-facto situations are de-facto problems
8. Principal-Agent considerations are new
9. How to reconcile to the legal view?
10. How to address regulation and differing jurisdictions?
“Purpose & Design” is central to control analysis

Understand the investee

Power

Exposure to variability

Linkage

Fact-finding

Elements of control
P&D is central to power analysis
– Step-by-step guide to identifying relevant activities

1. **Step 1** Understand the investee
   - Investor’s role in P&D
   - Risks investee is designed to be exposed to
   - Risks designed to be passed on to parties involved

2. **Step 2** All activities
   - Identify all activities that affect investee’s returns

3. **Step 3** Significant activities
   - Identify the activities that significantly affect returns

4. **Step 4** Most significant activities
   - Identify the activities that most significantly affect returns

P&D is not a relevant activity, but heavily shapes the power analysis

---

**Power analysis – the keys**

- P&D is not a relevant activity, but key to shape the power analysis
- Differing levels of power over design – regulated industries
- Relevant activities can take place outside the investee by design
- Termination, liquidation or similar rights may also be relevant
- No relevant activities? Very rare!
- Multiple relevant activities managed by different parties at the same time
- Can there be power by accident?
- How to weight the different aspects?
Case 1: Securitisation vehicle
– Role of P&D

**Facts**
- SV designed to provide liquidity to Company, via buying Company’s receivables with bank loans
- Transfer criteria predetermined in founding documents – no discretion
- Company services receivables. Receivables put back to Company upon default
- Structure, including credit framework, renegotiated by all parties annually in advance

**Who has power over SV?**

**Power: Company**

---

Case 1: Securitisation vehicle
– Role of P&D – who has power?

**Step 1 Understand the investee**
- Provide liquidity to Company
- SV designed to be exposed to credit risk
- Credit risk designed to be passed on to Company via put

**Step 2 All activities**
- Selecting receivables – but predetermined at inception
- Routine servicing: Company
- Managing receivables in default: Company

**Step 3 Significant activities**
- Managing receivables in default: Company

**Step 4 Most significant activities**
- Not applicable: one significant activity only

**Power: Company**
Case 2: Singapore REIT
– Role of P&D

Unitholders (likely to be widely dispersed)

asset management services

Kick-out rights - The Asset Manager can be removed by a resolution passed by a simple majority of unitholders present and voting at a meeting of unitholders duly convened and held. Sponsor can vote.

Maximum exposure to variability/magnitude arising from units + fees below 37%

Sponsor does not consolidate REIT

Fee name | Rate (%) | Basis
---|---|---
(1) Asset management base fee | 0.5 | Gross property value
(1) Asset management acquisition fee | 1.0 | Property purchase price
(1) Asset management disposal fee | 0.5 | Property sale price
(1) Asset management performance fee | 4.5 | Net income before gains on disposal or revaluation of properties
(1) Property management performance fee | 2.0 | Net property income
(1) Property management base fee | 3.0 | Gross rentals

Linkage – Key points

- Is the kick-out right the most relevant?
- Consider how an exposure to variability of a nature different from that of other investors might influence a decision-maker’s actions
- Purpose and Design and Regulation
- What about de-facto agents?
Case 2A: Singapore REIT – Alternative Structure

Role of P&D

100% Real Properties

Trustee

Unitholders (likely to be widely dispersed)

Asset management Services

Asset Management Fees

Trustee’s Fees

Unitholders represent unitholders

Board of directors

Sponsor

Decision making over the REIT must be substantively detached from the sponsor

Power: Voting vs contractual rights

Assess whether investor has power over relevant activities

Consider only substantive rights

Voting rights are relevant:

Majority of voting rights

Less than a majority of voting rights

Rights held by others

Consider

Agreements with others

Other contractual agreements

Potential voting rights

De facto power

Rights other than voting rights are relevant

Purpose and design

Evidence of practical ability to direct

Special relationships

Exposure to variability of returns

Is there a gating question like the old IAS 27 and SIC 12?
Power: Voting vs contractual rights (cont’d)

- In-depth analysis might not be required for a majority of investees, but watch out!
- Are a party’s rights sufficient to give it power over another entity?
- Power comes from existing rights that give the current ability to direct relevant activities
- Potentially relevant in assessing power over:
  - A troubled debtor
  - A customer/supplier
  - Fund structures

Case 3: Power over a troubled debtor

**Facts**
- If covenant is breached, Bank has right to take ownership of substantially all S’s operating assets
- S breaches the covenant and Bank’s right become exercisable
- Bank indicates that it does not intend to exercise its rights in the coming months. It will wait and see if S’s trading condition improve
Power over a troubled debtor

Step 1: Has there been a trigger for reassessment?

Yes

Step 2: Are the rights sufficient to give the lender power?

How significant are the lender's rights in relation to the relevant activities?

What is the effect of the debtor's economic circumstances (on the debtor's relevant activities)?

Power: Voting vs contractual rights

- Key points

- IFRS 10 does not have a gating question to the power analysis like the old IAS 27/SIC 12

- Watch out for cases where contractual arrangements may confer power

- Structured entities is potentially a wider concept than SPEs under SIC-12, and may capture some operating entities
Case 4: Interests held by related party and de facto agency

Facts
When assessing control over the fund from Fund Manager’s perspective, how should the interest held by a related party be considered in the ‘linkage’ analysis?

- View 1: Related party interests are always included in quantitative ‘aggregate economic interest’ evaluation
- View 2: Related party interests are considered on a qualitative basis in marginal cases
- View 3: Related party interests are always ignored

Is there a de facto agency relationship?
De-Facto Control – Practice Issues

20 largest shareholders

<table>
<thead>
<tr>
<th>Name of Shareholder</th>
<th>No. of shares</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 X Holdings (Private) Ltd</td>
<td>750,847,103.00</td>
<td>26.98</td>
</tr>
<tr>
<td>2 Cimbank Nominees Singapore Pte Ltd</td>
<td>437,468,216.96</td>
<td>15.73</td>
</tr>
<tr>
<td>3 DBS Nominees Pte Ltd</td>
<td>423,318,116.22</td>
<td>15.22</td>
</tr>
<tr>
<td>4 DBS Vickers Securities (S) Pte Ltd</td>
<td>289,829,207.02</td>
<td>10.42</td>
</tr>
<tr>
<td>5 DBSN Services Pte Ltd</td>
<td>257,827,802.10</td>
<td>9.27</td>
</tr>
<tr>
<td>6 HSBC (Singapore) Nominees Pte Ltd</td>
<td>154,195,960.20</td>
<td>5.54</td>
</tr>
<tr>
<td>7 United Overseas Bank Nominees Pte Ltd</td>
<td>90,956,828.22</td>
<td>3.27</td>
</tr>
<tr>
<td>8 BNP Paribas Securities Services Singapore Branch</td>
<td>33,828,847.74</td>
<td>1.22</td>
</tr>
<tr>
<td>9 Raffles Nominees (Pte) Ltd</td>
<td>32,774,220.78</td>
<td>1.18</td>
</tr>
<tr>
<td>10 Lee, Lee &amp; Lee Pte Ltd</td>
<td>14,535,000.00</td>
<td>0.52</td>
</tr>
<tr>
<td>11 Lee Foundation</td>
<td>10,421,824.50</td>
<td>0.37</td>
</tr>
<tr>
<td>12 DB Nominees (S) Pte Ltd</td>
<td>10,281,851.96</td>
<td>0.37</td>
</tr>
<tr>
<td>13 Bank of Singapore Nominees Pte Ltd</td>
<td>9,206,467.98</td>
<td>0.33</td>
</tr>
<tr>
<td>14 BNP Paribas Nominees Singapore Pte Ltd</td>
<td>7,786,472.94</td>
<td>0.28</td>
</tr>
<tr>
<td>15 DBS Vickers Securities (S) Pte Ltd</td>
<td>7,189,975.92</td>
<td>0.26</td>
</tr>
<tr>
<td>16 OCBC Securities Private Ltd</td>
<td>5,942,752.56</td>
<td>0.21</td>
</tr>
<tr>
<td>17 CAT Holdings Limited</td>
<td>4,114,625.94</td>
<td>0.15</td>
</tr>
<tr>
<td>18 UOB Kay Hian Pte Ltd</td>
<td>2,562,244.08</td>
<td>0.09</td>
</tr>
<tr>
<td>19 OCBC Nominees Singapore Pte Ltd</td>
<td>2,435,935.44</td>
<td>0.09</td>
</tr>
<tr>
<td>20 Mr. and Mdm. Wee</td>
<td>2,224,827.06</td>
<td>0.09</td>
</tr>
<tr>
<td>Total</td>
<td>2,547,545,230.62</td>
<td>91.58</td>
</tr>
</tbody>
</table>

Shareholder Issues

- The passive shareholder issue
- Is the largest shareholder required to assess for de-facto control?
- Consolidation decisions depending on the actions of others outside my control
- When does a change of control occur?
- Practice will have to evolve over time...
Thank You

Reinhard Klemmer
Partner
Professional Practice
KPMG LLP Singapore
+65 6213 2333
rkleinme2@kpmg.com.sg