EFRAG
European Financial Reporting Advisory Group

IFRS 10 and IFRS 12: Consolidation and related disclosures

Private Consultation

***Confidentiality:* All of the information that you provide to EFRAG in response to this questionnaire and at the interviews with EFRAG staff will remain confidential. Information used in the effects report will be presented in such a way that no individual company and person will be able to be identified.**

This Questionnaire has been prepared by EFRAG staff.

Introduction

1 In May 2011, the IASB published IFRS 10 *Consolidated Financial Statements* and IFRS 12 *Disclosure of Interests in Other Entities*[1] as part of a package of new standards on consolidation. IFRS 10 and IFRS 12 are referred to in this document as 'the new standards' or 'the new requirements'.

2 The IASB also published a Project summary and a Feedback statement that explains the background and the work done in developing the new requirements. An Effect Analysis of the impacts of IFRS 10 and IFRS 12 was published by the IASB in September 2011.

Background

3 The European Financial Reporting Advisory Group (EFRAG) is currently performing an initial assessment of the new standards against the technical criteria for the endorsement in the EU and also an initial effect study.

4 Implementation of the new requirements may result in different levels of operational difficulty and related costs and benefits for preparers. Changes in accounting are likely to occur in the case of more complex relationships with investees, which will require consideration of all relevant facts and circumstances to determine whether a reporting entity controls an investee.

5 The impact of implementing the disclosure requirements in IFRS 12 is likely to vary from entity to entity.

Objective of this private consultation

6 To gather additional input for the initial assessment of the new requirements, EFRAG has decided to ask preparers for input.

1 At the same time, the IASB also published IFRS 11 *Joint Arrangements* and the consequential amendments to IAS 27 *Separate Financial Statements* (2011) and IAS 28 *Investments in Associates and Joint Ventures* (2011).

7 The results of this consultation will be considered by EFRAG in drafting its endorsement advice and effect study report on the new standards. EFRAG's initial assessment of the new standards against the technical criteria for their endorsement in the EU is expected to be issued for public comment in November 2011.

8 This consultation is intended to **test the implementation** of IFRS 10 and 12 and estimate the expected impact regarding related costs and benefits for preparers. Therefore, it does not aim to test the full set of the new requirements and will focus only on the areas that may require preparers to apply more judgement, and therefore are likely to be challenging for them. We believe that the challenges will mostly arise in the control assessment and increased disclosure requirements and have identified these areas as being:

(a) identifying the investee's relevant activities;

(b) assessing de facto control and potential voting rights and determining the date of when 'control' is obtained;

(c) assessing when an investor is an agent and when it is a principal;

(d) applying the control model in IFRS 10 to structured entities (SPEs); and

(e) expanded disclosure requirements under IFRS 12.

What we ask you to do

9 As a participant you are asked to go through the new requirements in respect of the areas identified above and to apply them to a representative sample of your investees that reflects the various structures of investees your organisation is involved with (referred to throughout this questionnaire as "the sample").

10 Based on the sample, we would ask you to report any implementation and operational issues that you experience when applying the new requirements. In doing this work, you should describe any operational difficulty encountered in assessing control under the different fact patterns tested and complying with the disclosure requirements in IFRS 12.

11 We would appreciate you to make an estimate of the expected impact, if any, of the new requirements on the financial position and performance of your company, and the effort (in terms of associated costs) needed to implement the changes. Some of the costs of the initial application of the new standards may include educational efforts required to read and understand the new requirements and their application. Other initial and ongoing costs could include changes to systems and information gathering processes.

12 Please inform us also of the benefits you consider the new standards to generate for your organisation. Some of the benefits may derive from the inclusion of clear guidance on consolidation and application of principles.

13 This questionnaire comprises a targeted set of questions, which will guide you step-by-step through the "field test" of the new requirements. Please document your observations and findings in the sections specified. You are kindly requested to send the completed questionnaire to latif.oylan@efrag.org **by 17 October 2011**. After reviewing the results, we may wish to conduct an interview with you either by

telephone or face-to-face to discuss the responses to the questions. Please provide the details about yourself in paragraph 16.

14 In summary, you are asked to do the following:

(a) read the new requirements;

[for ease of reference all the questions in this Questionnaire are introduced by a description of the main changes to existing IAS 27]

(b) identify the different facts and patterns within your organisation which result in different scenarios regarding the relationship with your investees;

(c) select a sample of investees that reflects the various structures your organisation is involved with, and for each of the areas in scope of this consultation (as outlined in paragraph 8) apply the new requirements;

(d) document your findings in respect of any operational difficulty that you encounter;

(e) document the estimated impact of implementing the new requirements with regard to costs and benefits associated with implementation; and

(f) document your findings in respect of any operational difficulty in respect of implementation of the disclosure requirements in IFRS 12.

15 This document has been structured as follows :

(a) Part A : IFRS 10 Cons*olidated Financial Statements*

(b) Part B : IFRS 12 *Disclosure of Interests in Other Entities*

(c) Part C : Other matters.

Questions for Preparers

Contact information

16 Please provide the following details about your company:

(a) Please provide a short description of your activity/industry:

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(b) Country where you are located:

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(c) Contact details including e-mail address:

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PART A: IFRS 10 *CONSOLIDATED FINANCIAL STATEMENTS*

Section 1 Ability to direct the investee's relevant activities

Main changes to IAS 27 (2008)

IFRS 10 introduces the concept of 'relevant activities'. Relevant activities are those activities of the investee that significantly affect the investee's returns. Existing IAS 27 *Consolidated and Separate Financial Statements* (2008), in defining control, refers to the power to govern an investee's operating and financial policies. The concept of relevant activities is broader than the reference to operating and financial policies in IAS 27 (2008).

Under the new requirements, to assess control preparers first would need to identify the relevant activities of an investee in order to determine whether they have the current ability to direct them. The relevant activities of an entity may change over time; and preparers will need to reconsider their assessment when facts and circumstances change.

Identifying the relevant activities may be challenging and may require prepares to apply judgement, especially to investees which are structured entities (as defined in IFRS 12), or to situations, in which several investors have the ability to direct different relevant activities. IFRS 12 defines a structured entity as an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity.

Current approach

17 Do you have any interests in structured entities or investees, in which two or more investors have the ability to direct different relevant activities (as defined in IFRS 10)? If not, please move to Section 2 (de facto control).

☐ Yes ☐ No

(IFRS 12 defines an interest in another entity as a contractual or non-contractual involvement that exposes an entity to the variability of returns from the performance of another entity)

18 Based on the sample of investees selected, do you have any investees for which control over the operating and financial policies might not represent control over the relevant activities of that investee? If yes, please provide us with an example for each scenario that you have identified in your portfolio of investees and the arguments supporting your conclusions.

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19 Did you encounter any operational difficulty in identifying the relevant activities of the sample of investees selected, when assessing control? If yes, please provide a brief description.

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Implementing IFRS 10

20 Based on the sample of investees selected, do you have any investees for which the nature of the relevant activities changes over time (e.g. the investee carries out an activity in phases), and in which two or more investors are each responsible for a different phase (see paragraph B13 and Application Example 1 of IFRS 10)? If yes, please describe the fact pattern.

☐ Yes ☐ No

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21 Based on the sample of investees selected, do you consider that the introduction of the concept of relevant activities will have a significant impact on the way you conclude your assessment of control and therefore on your statement of financial position? If yes, please provide an indication of magnitude of the impact (as a proportion of your total assets) and a brief explanation to support your response.

☐ Yes ☐ No

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22 Will you need to modify an existing process or implement a new one to comply with this new requirement? If yes, please provide an indication of magnitude of the impact (as a proportion of your total assets) and a brief explanation to support your response.

☐ Yes ☐ No

Section 2 De facto control

Main changes to IAS 27 (2008) IAS 27 provided limited guidance on de facto control, which has led to diversity in practice. It was unclear, when assessing control, if a reporting entity should follow a strict focus on voting and other contractual rights (legal approach) or a wider view taking into account the reporting entity's ability to direct activities through the rights it holds (economic approach) for assessing control. IFRS 10 states that an investor can control an investee without owing more than half of the investees voting rights, for example through a contractual arrangement between the investor and the other vote holders, rights arising from other contractual arrangements or other voting rights. IFRS 10 clarifies that only substantive rights are considered in determining whether an entity controls the investee. Determining whether a right is substantive will require considering a number of factors, including the existence of any barriers that prevent the holder from exercising the rights, the ability of several parties to exercise their rights collectively, if needed, and the ability of the holder to benefit from exercising those rights. To assess the existence of de facto control under the new requirements, preparers would need to follow a two-step approach. First, preparers should consider the size of their holding of voting rights relative to the size and dispersion of the holding of other vote holders, potential voting rights (see Section 3) held by them and other vote holders, and the existence of other contractual arrangements. However, if the these factors alone are not conclusive to determine de facto control, preparers would need to consider the following additional facts and circumstances: voting patterns at previous shareholder's meetings, evidence of power, any special relationships with the investee and the level of their exposure to variability in the investee's returns.

Current approach

23 Do you currently consolidate an investee on the basis of de facto control?

☐ Yes ☐ No

If yes, please indicate your ownership interest in such investee(s) and the arguments you use to support your assessment of control.

Implementing IFRS 10

24 Applying the concept of de facto control in assessing control can be operationally challenging. Based on the sample of investees selected for testing, did you encounter any operational difficulties in assessing the circumstances involving de facto control?

☐ Yes ☐ No

If yes, which of the following issues were most challenging in assessing de facto control? Please explain why.

(a) Determining if other shareholders are sufficiently dispersed.

(b) Obtaining information about agreements between other shareholders.

(c) Access to information and assessment of whether rights held by other shareholders are substantive.

(d) Other.

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25 Are your existing information systems and reporting processes able to provide you with information required for making an analysis about de facto control? If not, how do you plan to obtain that information? Please provide a brief explanation.

☐ Yes ☐ No

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26 Based on the sample of investees selected, did you experience any difficulty in determining the date when you obtained de facto control over an investee? If yes, please describe the underlying issue and explain your conclusion.

☐ Yes ☐ No

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27 Do the application guidance and illustrative examples in IFRS 10 provide appropriate guidance for assessing whether or not de facto control exists? If not, please provide a brief explanation to support your response.

☐ Yes ☐ No

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28 Based on the findings of the sample of investees selected, do you consider that the new guidance on de facto control will have a significant impact on your conclusion on the assessment of control and therefore on your statement of financial position? For example, changes in the shareholders' composition may trigger a change in control.

☐ Yes ☐ No

(a) If yes, please explain why and indicate the magnitude (as a proportion of your total assets).

(b) If yes, please provide us with examples of situations, in which the new guidance on de facto control results in the consolidation of an investee that previously not consolidated (or vice versa).

Section 3 Potential voting rights

Main changes to IAS 27 (2008)

IAS 27 specified that potential voting rights should be included in the assessment of control only if they are currently exercisable. IFRS 10 focuses only on potential voting rights that are substantive in nature; the 'currently exercisable' criterion in IAS 27 (2008) has been removed. Consequently, in some cases currently exercisable potential voting rights might not be considered substantive or vice versa. In assessing such rights, market conditions (i.e. whether or not the option is in the money) and the entity's intention would have to be considered, while under IAS 27 (2008) these factors were generally not taken into account.

Current approach

29 Do you have any investees, in which you or other parties hold potential voting rights in the form of options, forwards, warrants, convertible instruments that, if exercised or converted would give their holder the right to acquire shares in the investee? If yes, could you please describe the nature of those contracts (e.g. type of contract with the counterparty)? If not, please move to Section 4.

☐ Yes ☐ No

Implementing IFRS 10

30 In applying the new requirements on potential voting rights to the sample of investees selected for testing, did you encounter any operational difficulties in determining whether any rights held by your company or others are substantive?

☐ Yes ☐ No

If yes, please provide a brief description of the areas of difficulty.

31 Do you consider the application guidance (including the application examples) on potential voting rights in IFRS 10 appropriate for making your assessment or do they introduce any difficulties to your assessment? If you find the assessment more

complex (for example, assessing whether potential voting rights, that are currently out of the money, are substantive or not), please explain why.

☐ Yes ☐ No

32 The new requirements in respect of potential voting rights might change the existing conclusions about control in some cases. Based on the sample of investees selected:

(a) Do the new requirements on potential voting rights have a significant impact on the statement of financial position? If yes, please provide examples and an indication of the expected magnitude (as a proportion of your total assets).

☐ Yes ☐ No

(b) Do you have potential voting rights that are not currently exercisable but might be considered substantive under IFRS 10? If yes, please provide us with examples.

☐ Yes ☐ No

(c) Do you have potential voting rights that are currently "out of the money" but might be considered substantive under IFRS 10? If yes, please provide us with examples.

☐ Yes ☐ No

Section 4 Agency relationships

Main changes to IAS 27 (2008)

IAS 27 and SIC-12 did not provide specific guidance on how to assess whether an investor with decision making rights is acting as a principal or an agent on behalf of others. IFRS 10 introduces the concept of delegated power and provides guidance regarding the determination of whether a decision maker acts as a principal or an agent. The standard stresses the link between power and returns and clarifies that in order to control an investee both elements are necessary.

In assessing agency relationships, preparers would first need to consider a range of factors, including whether any single party holds substantial rights to remove the decision maker without cause. This fact alone is sufficient to conclude that the decision maker is an agent. If more than one party holds such rights (and no individual party can remove the decision maker without the agreement of other parties) those rights are not, in isolation, conclusive in determining that a decision maker acts primarily on behalf and for the benefit of others. (However, the assessment might be different if a decision maker can be removed for cause (i.e. only for breach of contract).

In the absence of unilateral removal rights without cause, the following factors would have to be considered to determine whether the decision maker has control:

(a) scope of the decision-making authority;

(b) rights held by other parties;

(c) remuneration (whether it is at market rates); and

(d) the decision maker's exposure to variability of returns.

The greater the magnitude of, and variability associated with the last two factors above, the more likely the decision maker is a principal.

Current approach

33 Do you have any relationships with investees, in which you have been delegated decision-making rights to direct their relevant activities on behalf of others, for example, asset management or fund management investees? If not, please move to Section 5.

☐ Yes ☐ No

Implementing IFRS 10

34 Based on the sample of investees selected for testing this requirement, do any other investors (either individually or collectively) have removal rights (whether with or without cause)?

☐ Yes ☐ No

If yes, please list examples of the different scenarios or (and) facts, which may exist in your company, and provide a brief description of the nature of the removal rights for each example (e.g. whether they are widely dispersed or held by a single party, if they are exercisable only for a limited period of time and whether the removal rights are rather more akin to protective rights which involve removal for cause such as breach of contract).

35 Did you encounter any operational difficulties in assessing whether these removal rights are substantive or not? If yes, please provide a brief explanation.

☐ Yes ☐ No

36 In the absence of such unilateral removal rights, did you encounter any operational difficulties in determining whether you are acting as an agent or a principal? For example, access to information about rights held by other parties or the remuneration of other fund managers. If yes, please provide a brief explanation.

☐ Yes ☐ No

37 Do you consider the application guidance in IFRS 10 (including the application examples) on applying the control principle to agency relationships, appropriate for making your assessment of whether an investor with decision making rights is acting as a principal or an agent on behalf of others? For example, in determining the point at which returns from an investee turn from insignificant to significant, or other key considerations in determining which party controls (see paragraph B72 and Example 14, including its variations, in IFRS 10). If not, please explain why.

☐ Yes ☐ No

38 Based on the findings from the sample of investees selected to test the new requirements on agency relationships, do you consider the new requirements to have a significant impact on the statement of financial position? If yes, please include arguments to support your response and provide an indication of magnitude (as a proportion of your total assets).

☐ Yes ☐ No

Section 5 Structured entities (also referred to as special purpose entities "SPE's")

Main changes to IAS 27 (2008)

IFRS 10 introduces a single control model that is applied to all investees (including structured entities[2], referred to as SPEs in SIC-12 *Consolidation Special Purpose Entities*, in which voting rights are not relevant in assessing control). The new standard provides additional guidance about which factors to consider in determining control of investees considered to be structured entities.

[2] IFRS 12 defines a structured entity as an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity.

IFRS 10 moves away from 'bright lines' used in SIC-12. In order to control a structured entity under the new requirements, an investor would need to meet the three elements of the control definition: have the ability to direct its relevant activities, have exposure or rights to variable returns, and the ability to affect those returns.

Some entities would no longer be consolidated when the investor is exposed to the majority of risks and rewards but has no power to direct the investees' relevant activities. In other cases, structured entities will have to be consolidated when the investor has the ability to direct the relevant activities and has some exposure to returns and ability to affect those returns, but not necessarily the majority of risks and rewards.

Current approach

39 Do you have any interests in structured entities as defined in IFRS 12 (generally considered to be special purpose entities under IAS 27 and SIC-12)? If not, please move to Section 6.

☐ Yes ☐ No

Implementing IFRS 10

40 Based on the sample selected to assess control of structured entities, please indicate the fact patterns/features associated with the structured entities. Please give an indication of the significance of the involvement of interests in structured entities for your organisation.

(a) Have you encountered any operational difficulties in assessing whether you have control over them in accordance with IFRS 10. If yes, please provide a description of the operational difficulty.

☐ Yes ☐ No

(b) Have you identified any structured entities which you control under the new requirements but which you did not control under IAS 27 and SIC-12? If yes, please provide a brief description of the fact patterns.

☐ Yes ☐ No

(c) Have you identified any structured entities which you control under IAS 27 and SIC-12 but which you do not control under IFRS 10? If yes, please provide a brief description of the fact patterns.

☐ Yes ☐ No

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41 Do you consider the application guidance (including the application examples) in IFRS 10 appropriate for making your assessment of control over these types of entities? If not, please explain why.

☐ Yes ☐ No

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42 Based on the findings of the sample of investees selected for testing, do you consider that the initial application of the new requirements will have a significant impact on your statement of financial position? If yes, please provide arguments to support your response and indicate the magnitude (as a proportion of your total assets).

☐ Yes ☐ No

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Section 6 Impact in terms of costs and benefits of implementing IFRS 10

Note to participants

The following section is intended to assess the *incremental* one-off and on-going costs of implementing the new requirements.

Examples of costs include, but are not limited to, training of employees, changes to accounting and reporting systems, changes to existing and implementation of new processes, audit and valuation services fees etc.

43 Based on the results of your analysis of IFRS 10, please indicate the main benefits of the new standard for you:

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44 Please provide a list of costs that you expect to incur and an estimate of their magnitude Please indicate a quantitative estimate of an amount (e.g. a point estimate, a range of amounts or expressed as a percentage). If you are unable to

make a quantitative estimate, please provide a narrative description of the expected effort:

Type	Estimated impact
One-off costs	
[ ]	[ ]
[ ]	[ ]
[ ]	[ ]
On-going costs	
[ ]	[ ]
[ ]	[ ]
[ ]	[ ]

45 How would you rate the overall operational difficulty of applying the new requirements to the sample of investees that you have tested?

Area of assessment	High	Moderate	Low
Ability to direct the relevant activities	☐	☐	☐
De facto control	☐	☐	☐
Potential voting rights	☐	☐	☐
Agency relationships	☐	☐	☐
Consolidation of structured entities	☐	☐	☐

If you indicate 'high', please explain such difficulties.

46 Do you have access to the information that is necessary to apply the new requirements on a retrospective basis? If not, please indicate how you are going to address this issue.

☐ Yes ☐ No

47 If you need to consolidate or deconsolidate an investee(s), will the requirement to present a third statement of financial position at the beginning of the earliest comparative period pose operational difficulties?

☐ Yes ☐ No

48 Will the period of time before the mandatory effective date of 1 January 2013 be sufficient for your company to implement the new requirements? If not, please explain why and indicate the date, from which it would be feasible to implement.

☐ Yes ☐ No

49 Have you identified any other issue relating to the transitional requirements that you would like to comment on? If yes, please provide a brief description of the issue.

☐ Yes ☐ No

PART B: IFRS 12 *DISCLOSURE OF INTEREST IN OTHER ENTITIES*

Section 1 Consolidated investees

Main changes to IAS 27 (2008)

IFRS 12 provides comprehensive disclosure about a reporting entity's interest in other entities.

IFRS 12 requires an entity to provide additional disclosures, including:

a) significant judgements and assumptions made in determining whether an entity has control in de facto circumstances, through agency relationships and over structured entities;

b) information about subsidiaries with material non-controlling interest (NCI);

c) significant restrictions on the use of assets and settlement of liabilities; and

d) nature of risks from an entity's involvement with consolidated structured entities.

50 Based on the findings from the sample of investees selected to test the new disclosure requirements, did you encounter any difficulty in meeting these requirements? If yes, please indicate the areas for which you had operational difficulty and why?

☐ Yes ☐ No

Section 2 Unconsolidated structured entities

Main changes to IAS 27 (2008)

IAS 27 and SIC 12 provided no disclosure requirements for unconsolidated structured entities.

IFRS 12 defines a structured entity as an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity. Examples include securitisation vehicles, asset-backed financings and certain investment funds. [IFRS 12 Appendix A, B22-B24]

The new standard requires the following disclosures to help users understand the nature of the investor's interests and risks associated with unconsolidated structured entities [IFRS 12.24-31]:

a) nature, purpose, size and activities of the structured entity;

b) mechanism of financing of the structured entity;

c) carrying amount of the assets and liabilities relating to its interests in unconsolidated structured entities;

d) comparison of the maximum exposure to loss from those entities to the carrying amount of assets and liabilities;

e) the type and amount of the support provided to the structured entity without a contractual obligation to do so, and reasons for that; and

f) current intention to provide support to the structured entity.

51 Based on the findings from the sample of investees selected to test the new disclosure requirements, did you have sufficient information (or access to information) to meet the disclosure requirements? If not, please indicate the cause of any operational challenges.

☐ Yes ☐ No

52 IFRS 12 defines a number of terms used in the standard; however some terms remain undefined (for example, a 'sponsored entity'). In addition, it does not include guidance on the calculation of the maximum exposure to risk. Do the lack of guidance and some undefined terms introduce any difficulty for you in meeting the disclosure requirements? Please provide a brief explanation to support your response.

☐ Yes ☐ No

Section 3 Impact in terms of costs and benefits of implementing the new disclosure requirements

53 Based on the results of your analysis of IFRS 12, please indicate which are the main benefits of the new standard:

54 Please provide a list of costs that you expect to incur and an estimate of their magnitude Please indicate a quantitative estimate of an amount (e.g. a point estimate, a range of amounts or expressed as a percentage). If you are unable to make a quantitative estimate, please provide a narrative description of the expected effort:

Type	Estimated impact
One-off costs	
[ ]	[ ]
[ ]	[ ]
[ ]	[ ]
Ongoing costs	
[ ]	[ ]
[ ]	[ ]
[ ]	[ ]

55 How would you rate the overall operational difficulty of applying the new requirements to the investees that you have tested?

Scope of disclosures	High	Moderate	Low
Consolidated investees	☐	☐	☐
Unconsolidated structured entities	☐	☐	☐

If you indicate 'high', please explain such difficulties.

56 How would rate the usefulness, understandability and relevance of the application guidance in IFRS 12?

Scope of disclosures	High	Moderate	Low
Consolidated investees	☐	☐	☐
Unconsolidated structured entities	☐	☐	☐

57 Will the period of time before the mandatory effective date of 1 January 2013 be sufficient for your company to implement the new requirements? If not, please explain why and indicate the date, from which it would be feasible to implement.

☐ Yes ☐ No

58 Have you identified any other issues relating to the disclosure requirements that you would like to comment on? If yes, please provide a brief description of the issue.

☐ Yes ☐ No

PART C: OTHER MATTERS

59 Please use this space to indicate and explain other areas or issues which you consider of interest which have not been included in this document, bearing in mind that the purpose of this document is focused on the operational aspects of implementing the new standards, and obtaining an estimate of the expected impact regarding related costs and benefits for preparers and not on discussing these standards from a technical accounting approach.

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