

STAFF PAPER

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Project	Comprehensive review of the <i>IFRS for SMEs</i> ® Standard		
Paper topic	<i>IFRS 10 Consolidated Financial Statements</i>		
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Purpose

1. At this meeting we are asking Board members if the Request for Information, that will be issued as part of the 2019 Comprehensive Review of the *IFRS for SMEs* Standard should seek views on whether and how the requirements of the *IFRS for SMEs* Standard should be aligned with IFRS 10 *Consolidated Financial Statements*.
2. The objective of the Request for Information is to obtain evidence that will assist the Board in deciding whether and how to develop an Exposure Draft of amendments to the *IFRS for SMEs* Standard.

Summary of staff recommendations

3. The staff recommends that the Board seek views in the Request for Information on whether and how Section 9 *Consolidated and Separate Financial Statements* of the *IFRS for SMEs* Standard could be aligned with IFRS 10, namely:
 - (a) aligning the definition of control in the *IFRS for SMEs* Standard with IFRS 10;
 - (b) introducing a simplification whereby when an entity concludes it has power over an investee directly and solely from the voting rights which allow it to control the relevant activities of the investee, it should be permitted to

consolidate the investee without having to assess the remaining elements of the definition, that is returns and the link between power and returns; and

- (c) the need for the *IFRS for SMEs* Standard to address the accounting for investment entities.

Structure of this paper

4. This paper is structured as follows:

- (a) background (paragraphs 5–10):
 - (i) overview of IFRS 10 (paragraphs 5–8);
 - (ii) overview of Section 9 (paragraphs 9–10);
- (b) IFRS 10 and the 2012 Comprehensive Review of the *IFRS for SMEs* Standard (paragraphs 11–13);
- (c) applying the alignment principles (paragraphs 14–48)
 - (i) principle 1—relevance (paragraphs 16–39);
 - (ii) principle 2—simplicity (paragraphs 40–44);
 - (iii) principle 3—faithful representation (paragraphs 45–48);
- (d) stakeholder views (paragraphs 49–57);
- (e) investment entities (paragraphs 58–69);
 - (i) background (paragraphs 58–61)
 - (ii) SMEIG discussion (paragraphs 62–66);
 - (iii) staff analysis and recommendation (paragraphs 67–69);
- (f) questions for the Board;
- (g) Appendix A—Summary of SMEIG members’ views on whether to align the *IFRS for SMEs* Standard with IFRS 10; and
- (h) Appendix B—Overview of Section 9 and differences between IFRS 10 and Section 9.

Background

Overview of IFRS 10

5. The objective of IFRS 10 is to establish principles for preparing and presenting consolidated financial statements when an entity controls one or more other entities.¹
6. IFRS 10 addressed the divergence in practice that could arise when entities applied IAS 27 *Consolidated and Separate Financial Statements*² and SIC-12 *Consolidation – Special Purpose Entities*.³ Whilst the basic consolidation model and principles in IAS 27 and SIC-12 were sound, they were not always applied consistently, and it was often difficult to assess whether an entity should apply IAS 27 or SIC-12.⁴
7. IFRS 10 introduced a single consolidation model for all entities based on the concept of control, irrespective of the nature of the investee (that is, whether an entity is controlled through the voting rights of investors or through other contractual arrangements as is common in special purpose entities).
8. The requirements of IFRS 10 state that an investor controls an investee if and only if the investor has all the following:⁵
 - (a) power over the investee (power);
 - (b) exposure, or rights, to variable returns from its involvement with the investee (returns); and
 - (c) the ability to use its power over the investee to affect the amount of the investor’s returns (link between power and returns).

¹ IFRS 10 *Consolidated Financial Statements* paragraph 1.

² IAS 27 *Consolidated and Separate Financial Statements* was reissued in 2008 and is superseded by IAS 27 *Separate Financial Statements* and IFRS 10 *Consolidated Financial Statements* with effect from annual periods beginning on or after 1 January 2013.

³ Superseded by IFRS 10 and IFRS 12 *Disclosure of Interests in Other Entities* effective 1 January 2013.

⁴ IFRS 10 and Effects Analysis for IFRS 12, September 2011 (page 5).

⁵ IFRS 10 paragraph 7.

Overview of Section 9

9. Section 9 of the *IFRS for SMEs* Standard is based on IAS 27 (2008). An overview of the requirements of Section 9 and a list of the differences between IFRS 10 and Section 9 are provided in Appendix B.
10. The most significant difference between IFRS 10 and Section 9 relates to the definition of control.

IFRS 10 and the 2012 Comprehensive Review of the *IFRS for SMEs* Standard

11. The Board had already issued IFRS 10 when the 2012 Comprehensive Review of the *IFRS for SMEs* Standard (2012 Review) was undertaken. The 2012 Request for Information asked the following question about aligning the definition of control in Section 9 with IFRS 10:

Should the following changes be considered, but modified as appropriate to reflect the needs of users of SME financial statements and cost-benefit considerations?

- (a) agency relationships, where one entity legally appoints another to act on its behalf. This guidance is particularly relevant to investments managers that make decisions on behalf of investors. Fund managers and entities that hold assets for a broad group of outsiders as a primary business are generally outside the scope of the *IFRS for SMEs*;
- (b) control with less than a majority of the voting rights, sometimes called 'de facto control' (this principle is already addressed in paragraph 9.5 of the *IFRS for SMEs* Standard but in less detail than in IFRS 10);
- (c) assessing control where potential voting rights exist, such as options, rights or conversion features that, if exercised, give the holder additional voting rights (this principle is already addressed in paragraph 9.6 of the *IFRS for SMEs* but in less detail than in IFRS 10).

12. In considering the above question and having obtained views from relevant stakeholders, the Board decided not to amend the *IFRS for SMEs* Standard to incorporate the changes introduced by IFRS 10 and made the following observations:⁶

IFRS 10, IFRS 11 and IFRS 13 only recently became effective and they introduce complex changes that are expected to result in, and benefit from, significant implementation guidance in practice. Furthermore, they would be expected to have limited practical impact on the majority of SMEs, because the new requirements are unlikely to affect many common fair value measurements and the accounting for groups of entities with a simple group structure.

13. In the staff's view, it is appropriate to revisit aligning the *IFRS for SMEs* Standard with IFRS 10 for the following reasons:

- (a) as the 2012 Review was the first review following the *IFRS for SMEs* Standard being issued, the Board prioritised providing entities with a stable platform⁷ over aligning the *IFRS for SMEs* Standard with full IFRS Standards. The *IFRS for SMEs* Standard has been effective since 2009 with minor amendments made in 2015 following the 2012 Review. Entities are familiar with applying the requirements of the *IFRS for SMEs* Standards.
- (b) the changes introduced by IFRS 10 were not effective during the 2012 Review. Consequently, no implementation experience of IFRS 10 was available for respondents to consider when responding to the 2012 Request for Information. Greater implementation experience of IFRS 10 is now available, as it has been effective since 1 January 2013. Entities have developed practical experience and familiarity with IFRS 10. In addition, the Board plans to commence the Post-implementation Review of IFRS 10 in the second half of 2019.

⁶ Basis for Conclusions on the *IFRS for SMEs* Standard paragraph BC198(a).

⁷ Basis for Conclusions on the *IFRS for SMEs* Standard paragraph BC189.

Applying the alignment principles

14. At its May 2019 meeting (Agenda Paper 30A), the Board decided that to determine whether and how to align the *IFRS for SMEs* Standard with new and amended IFRS Standards, it would apply three principles:
- (a) relevance;
 - (b) simplicity; and
 - (c) faithful representation.
15. The following paragraphs apply the alignment principles to assist the Board in determining whether and how to align the *IFRS for SMEs* Standard with IFRS 10.

Principle 1—Relevance

16. When the Board developed the *IFRS for SMEs* Standard it concluded that consolidated financial statements are essential for users of SMEs' financial statements when two entities operate as a single economic entity.⁸
17. Section 9 of the *IFRS for SMEs* Standard defines the circumstances in which an entity applying the Standard presents consolidated financial statements and the procedures for preparing those financial statements.
18. For the 2019 Review, the question is not whether consolidation is relevant but whether aligning Section 9 and IFRS 10 will improve the quality of information provided to users of the financial statements prepared applying the *IFRS for SMEs* Standard.
19. Appendix B of this paper provides a list of the differences between IFRS 10 and Section 9, which include:
- (a) the definition of control;
 - (b) the requirement to present consolidated financial statements; and
 - (c) other differences.

⁸ Basis for Conclusions on the *IFRS for SMEs* Standard paragraph BC147.

Definition of control

20. Section 9 provides that control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity.⁹ Control is defined as:
- ...the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities....¹⁰
21. Section 9 also addresses:
- (a) *special purposes entities (SPEs)* and requires consolidated financial statements that include the entity and any SPEs controlled by that entity.¹¹
 - (b) *potential voting rights*. Potential voting rights are included in the assessment of control when they are currently exercisable by the investor.¹²
22. IFRS 10 articulates the principle of control so it can be applied to all investees. The Standard defines control as consisting of three elements: power, exposure to variable returns and an investor's ability to use power to affect its amount of variable returns.
- Power*
23. IFRS 10 provides that an investor has power over an investee when the investor has existing rights that give it the current ability to direct the investee's relevant activities.¹³ Power arises from rights. Sometimes assessing power is straightforward, such as when power over an investee is obtained directly and solely from the voting rights granted by equity instruments such as shares and can be assessed by considering the voting rights from those shareholdings.¹⁴
24. The *IFRS for SMEs* Standard states control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power

⁹ *IFRS for SMEs* Standard paragraph 9.5.

¹⁰ *IFRS for SMEs* Standard paragraph 9.4.

¹¹ *IFRS for SMEs* Standard paragraph 9.11.

¹² *IFRS for SMEs* Standard paragraph 9.6.

¹³ IFRS 10 paragraph 10.

¹⁴ IFRS 10 paragraph 11.

of an entity. The presumption may be overcome in exceptional circumstances if it can be clearly demonstrated that such ownership does not constitute control¹⁵.

25. IFRS 10 states that an investor with the current ability to direct the relevant activities has power even if its right to direct have yet to be exercised¹⁶. In contrast, the *IFRS for SMEs* Standard only takes into consideration currently exercisable rights.¹⁷

Returns

26. Applying IFRS 10, when assessing whether an investor has control of an investee, the investor determines whether it is exposed, or has rights, to variable returns from its involvement with the investee.¹⁸
27. Section 9 includes, as part of the definition of control, the ability to obtain benefits from the subsidiary's activities.¹⁹
28. In addition, Section 9 provides separately a list of circumstances that could indicate that an entity controls an SPE including, among others, the entity having rights to obtain the majority of the benefits from the SPE.²⁰
29. Aligning the Section 9 definition of control with IFRS 10 will provide a single consolidation model that applies to all types of entities and would not require separate guidance on SPEs.

Link between power and returns

30. The third element of the definition of control in IFRS 10 relates to the investee's ability to use its power to affect the investor's returns from its involvement with the investee.²¹

¹⁵ *IFRS for SMEs* Standard paragraph 9.5.

¹⁶ IFRS 10 paragraph 12.

¹⁷ *IFRS for SMEs* Standard paragraph 9.6.

¹⁸ IFRS 10 Paragraph B55.

¹⁹ *IFRS for SMEs* Standard paragraph 9.4.

²⁰ *IFRS for SMEs* Standard paragraph 9.11(c).

²¹ IFRS 10 paragraph 17.

31. This assessment requires an investor with decision-making rights to determine whether it is a principal or an agent in relation to the investee. IFRS 10 provides a list of factors and examples to consider when making this assessment.²²
32. Section 9 of the *IFRS for SMEs* Standard does not address principal and agent relationships.

Staff conclusion on aligning the definition of control

33. IFRS 10 builds on the concepts in IAS 27 and SIC-12 and combines them into a single consolidation model, based on the principle of control. The current definition of control in Section 9 is based on the definition of control from the superseded version of IAS 27 and includes some of the guidance from SIC-12—it is not a single model.
34. By aligning the definition of control, preparers applying the *IFRS for SMEs* Standard would benefit from clearer principles underlying the definition of control of an investee—removing doubts about the different requirements for assessing control. That is, aligning the definition of control will remove the need for entities to make separate assessments (see paragraph 29 above) based either on power to govern financial and operating policies or, for SPEs, on exposure to most of the risks and rewards.
35. Using a single control model that applies to all entities removes uncertainty about which guidance to apply to different entities. The control model in IFRS 10 clarifies requirements that were either implicitly embedded or clarifies the issues addressed in IAS 27 and SIC-12 and provides additional application guidance.
36. In the staff’s view, aligning the Section 9 definition of control with IFRS 10 will change how an entity assesses control and improves financial reporting by leading to more consistent and appropriate consolidation decisions in situations in which no one party holds more than 50% of the voting rights of an investee.

²² IFRS 10 paragraphs B60–B72.

37. Aligning the definition of control in Section 9 with IFRS 10 will not introduce significantly new concepts that entities applying the *IFRS for SMEs* Standard are not familiar with. For example:
- (a) Section 9 already requires voting rights be considered, if they are currently exercisable. IFRS 10 provides a more principle-based approach to considering potential voting rights when assessing control, which requires that substantive potential voting rights must be considered.
 - (b) the concept of control without a majority of voting rights is implicit in Section 9—the Standard does not provide explicit guidance about that concept.
 - (c) IFRS 10 includes application guidance regarding situations in which control is difficult to assess, including situations involving agency relationships, relationships with entities designed so voting rights are not the dominant factor in assessing control (‘structured entities’), potential voting rights and control without a majority of voting rights.
 - (d) The staff proposes the Board seeks views on aligning the Section 9 definition of control is aligned with IFRS 10 and supporting guidance (including that on agency relationships). However, the staff does not recommend including all the application guidance in IFRS 10 in the *IFRS for SMEs* Standard.

38. The Effects Analysis for IFRS 10 states:

At a very basic level, however, most consolidation decisions should be unaffected by the new consolidation model in IFRS 10. Change is most likely to occur around the margins, in the cases of the more complex structures.

Requirement to present consolidated financial statements and other differences

39. Appendix B of this paper also provides details regarding differences between Section 9 and IFRS 10. The staff is not recommending the Board seeks views on these differences as these relate to simplifications the Board had previously introduced into the *IFRS for SMEs* Standard.

Principle 2—Simplicity

40. Requiring a single control model that applies to all types of entities is in itself a simplification.
41. As noted above, paragraph 9.5 of the *IFRS for SMEs* Standard includes a presumption that control exists when the parent owns, directly or indirectly, more than half of the voting rights. The staff thinks the Board should seek views in the Request for Information on retaining this relief.
42. That is, the staff proposes that Section 9 include a simplification of the IFRS 10 definition of control such that when an entity concludes it has power over an investee directly and solely from the voting rights that allow it to control the relevant activities of the entity, it should presume to control the entity. However, an entity should be permitted to rebut this presumption if it can demonstrate it does not have exposure, or rights, to variable returns from its involvement with the investee and the ability to use its power over the investee to affect the amount of the investor's returns.
43. This proposed simplification will assist entities applying the *IFRS for SMEs* Standard where they control another entity directly through voting rights, as such entities will not need to review other elements of the definition of control.
44. The staff proposes that the Board seeks views in the Request for Information on the proposed simplification to be introduced into Section 9 of the *IFRS for SMEs* Standard, when aligning with IFRS 10.

Principle 3—Faithful representation

45. The analysis in this paper relating to the principle of relevance sets out the staff's view that the requirements and guidance on control in IFRS 10 will lead to more consistent accounting by detailing what an entity considers in assessing control. In applying the principle of simplicity, the staff proposes the Board seeks views on one simplification to the control model in IFRS 10.
46. In this section, the staff assesses whether consolidated financial statements prepared applying the proposed simplifications would provide information that faithfully represents investees in which investors have control, and that is useful to users of financial statements prepared applying the *IFRS for SMEs* Standard.
47. The staff does not believe introducing the simplification will cause an entity to represent information less faithfully—an entity that concludes it has power over an investee directly and solely from the voting rights but does not believe it has control, can rebut the presumption.
48. Consequently, applying the proposed simplification will have a similar outcome to applying IFRS 10.

Stakeholder views

49. In February 2019 the staff asked members of the Small and Medium-sized Entities Implementation Group (SMEIG) for their views on whether to align the *IFRS for SMEs* Standard with IFRS 10.
50. A summary of their responses is set out in Appendix A. SMEIG members were not asked whether they support or object to aligning the *IFRS for SMEs* Standard with IFRS 10.
51. The main objection raised by the SMEIG members against aligning the *IFRS for SMEs* Standard with IFRS 10 relates to the lack of implementation experience and that IFRS 10 is generally not relevant to SMEs.
52. Other stakeholders' views on whether to align the *IFRS for SMEs* Standard with IFRS 10 are mixed.

53. The Asian-Oceanian Standard-Setters Group survey on the *IFRS for SMEs* Standard found that ten jurisdictions—Cambodia²³, China, India, Korea, Malaysia, Nepal, Pakistan,²⁴ the Philippines,²⁵ Sri Lanka and Syria—opposed aligning the *IFRS for SMEs* Standard with IFRS 10. These respondents were concerned about the uncertainty of the outcome of the Post-implementation Review of IFRS 10, the timeline for which is not yet available. Furthermore, in their view, although IFRS 10, is supported by significant implementation guidance, the complex changes would be expected to have a limited practical impact on the majority of SMEs because the new requirements are unlikely to affect the accounting for groups of entities with a simple group structure.
54. One jurisdiction, Thailand²⁶, was in favour of alignment because SMEs that acquire subsidiaries that are not listed but have ultimate parents that apply full IFRS Standards have the burden of converting their financial statements to consolidate them with those of the ultimate parent.
55. The UK Financial Reporting Council (FRC) proposed aligning FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* with IFRS 10. Ten respondents agreed with the FRC’s proposal, one respondent agreed with reservations and fourteen respondents disagreed.
56. The respondents who disagreed with the proposal provided the following reasons:
- (a) the implementation costs would far outweigh the benefit given that there would be no practical effect on the vast majority of entities, yet all entities would still have to go through an exercise to determine there was no change.
 - (b) the proposal did not satisfy the principle of balancing improvements with stability.

²³ Cambodia allows entities to use the *IFRS for SMEs* Standard which is adopted without modification.

²⁴ China, India, Korea, Nepal and Pakistan do not use the *IFRS for SMEs* Standard.

²⁵ Malaysia, Sri Lanka and the Philippines’ accounting standards for SMEs are substantively identical to the *IFRS for SMEs* Standard.

²⁶ Thailand does not use the *IFRS for SMEs* Standard.

- (c) ensuring the revised definition of control could be applied in practice would require a significant amount of implementation guidance to be added to FRS 102.
- (d) the revised definition is of limited relevance to entities within the scope of FRS 102.

57. The staff has taken into account the concerns raised by stakeholders when applying the alignment principles (in particular, simplicity) in making recommendations to the Board.

Investment entities

Background

58. In October 2012, the Board issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), which provides that an investment entity shall not consolidate its subsidiaries, but instead measures an investment in a subsidiary at fair value through profit or loss.²⁷
59. IFRS 10 defines an investment entity as an entity that:
- (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
 - (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
 - (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.
60. The amendment was considered during the 2012 Review and the Board decided it would be inconsistent to incorporate this amendment into the *IFRS for SMEs* Standard because the Board has decided not to incorporate IFRS 10.
61. Furthermore, the amendment was a recent change at that time and so no implementation experience had been developed.

²⁷ IFRS 10 paragraph 31.

SMEIG discussion

62. In June 2019 the staff asked the SMEIG members two questions about introducing the consolidation exception for an investment entity into the *IFRS for SMEs* Standard:

Question 1:

Do you consider the *IFRS for SMEs* Standard needs to address the accounting for investment entities?

Question 2:

If so, do you agree the definition of an investment entity should be introduced into the *IFRS for SMEs* Standard together with the requirement to measure an investment in a subsidiary at fair value through profit or loss?

63. Sixteen SMEIG members (62%) responded to the questions.

64. Nine SMEIG members agree the *IFRS for SMEs* Standard needs to address the accounting for investment entities. One of these SMEIG members mentioned that the exception to consolidation of investment entities will be a cost relief for investment entities applying the *IFRS for SMEs* Standard.

65. SMEIG members who do not consider the *IFRS for SMEs* Standard needs to address the accounting for investment entities expressed the following views:

- (a) very few SMEs operate as investment entities;
- (b) investment entities have public accountability and cannot apply the *IFRS for SMEs* Standard;
- (c) investment entities applying the *IFRS for SMEs* Standard may not have their investment strategies sufficiently documented to demonstrate that they meet all the requirements for classification as investment entities or may not have the inclination to document strategies in as much detail as IFRS 10 requires; and
- (d) alignment would place undue burden on investment entities to determine the fair values of non-listed companies. Consequently, investment

entities applying the *IFRS for SMEs* Standard should be provided a relief to determine the fair value of investments.

66. All SMEIG members who consider that the *IFRS for SMEs* Standard needs to address the accounting for investment entities agreed with the proposition in question 2 above.

Staff analysis and recommendation

67. Given the mixed response, the staff was unable to obtain a clear view on whether it is common for SMEs to operate as investment entities.
68. The staff thinks the requirement for investment entities to recognise investments in subsidiaries at fair value can be viewed as a form of simplification. Furthermore, it can be a substantial cost relief for SMEs operating as investment entities. Requiring an investment entity to prepare consolidated financial statements could result in significant additional costs, without commensurate benefit.
69. The staff recommends the Board seek views in the Request for Information on the need for the *IFRS for SMEs* Standard to address the accounting for investment entities.

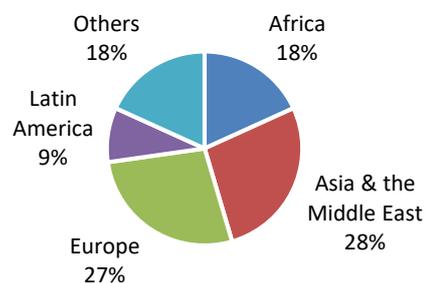
Questions for the Board

Board members are asked whether they agree with the recommendations to seek views in the Request for Information on aligning the *IFRS for SMEs* Standard with IFRS 10, including:

- (a) aligning the definition of control in the *IFRS for SMEs* Standard with IFRS 10;
- (b) introducing a simplification whereby when an entity concludes it has power over an investee directly and solely from the voting rights which allow it to control the relevant activities of the entity, it should be permitted to consolidate the investee without having to assess the remaining elements of the definition, that is returns and the link between power and returns); and
- (c) assessing the need for the *IFRS for SMEs* Standard to address the accounting for investment entities.

Appendix A—Summary of SMEIG members’ views on whether to align the *IFRS for SMEs* Standard with IFRS 10

- A1. On 29 January 2019 a questionnaire was sent to SME Implementation Group (SMEIG) members to seek their views on whether to align the *IFRS for SMEs* Standard with IFRS 10 *Consolidated Financial Statements*.
- A2. Eleven SMEIG members (42%) responded to the survey. The geographical distribution of the responses received is shown in the chart below.



- A3. The main reasons given by SMEIG members (number of members making comments shown in brackets) for aligning the *IFRS for SMEs* Standard with IFRS 10 are that:
- (a) the reasons presented previously for not aligning the *IFRS for SMEs* Standard with IFRS 10 no longer apply (one respondent); and
 - (b) the revised definition of ‘control’ in IFRS 10 is a new and important concept (four respondents).
- A4. The main reasons given by SMEIG members (number of members making comments shown in brackets) for not aligning the *IFRS for SMEs* Standard with IFRS 10 are that:
- (a) the lack of implementation experience (two respondents);
 - (b) IFRS 10 is generally not relevant to entities applying the *IFRS for SMEs* Standard (three respondents); and
 - (c) the existing definition of ‘control’ in Section 9 is adequate for entities applying the *IFRS for SMEs* Standard (one respondent).

Appendix B—Overview of Section 9 and differences between IFRS 10 and Section 9

Overview of Section 9

B1. Section 9 prescribes the circumstances in which an entity applying the *IFRS for SMEs* Standard presents consolidated financial statements. It also includes guidance on separate and combined financial statements prepared in accordance with the Standard.

Consolidated financial statements

B2. Except in the limited circumstances set out in paragraphs 9.3 and 9.3C of the *IFRS for SMEs* Standard, a parent entity is required to present consolidated financial statements.

B3. The Glossary of terms of the *IFRS for SMEs* Standard defines a subsidiary as ‘an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent)’.

Separate financial statements

B4. The *IFRS for SMEs* Standard does not require separate financial statements to be presented. However, where separate financial statements are prepared, Section 9 requires an entity to account for its investments in subsidiaries, jointly controlled entities and associates in those financial statements adopting one of the following accounting policies:

- (a) cost less impairment;
- (b) fair value with changes recognised in profit or loss; or
- (c) the equity method.

Combined financial statements

B5. The *IFRS for SMEs* Standard does not require combined financial statements to be presented. The fundamental principle of combined financial statements is that they present financial information about two or more entities under common control.

Differences between IFRS 10 and Section 9

B6. The main differences between the requirements of IFRS 10 and Section 9 are as described in the paragraphs that follow.

Definition of control

B7. Both full IFRS Standards and the *IFRS for SMEs* Standard use ‘control’ to determine what is consolidated. However, the definitions of control are different.

B8. The Glossary of terms of the *IFRS for SMEs* Standard defines ‘control (of an entity)’ as ‘the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities’.

B9. Appendix A to IFRS 10 defines control of an entity as follows:

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.

B10. The IFRS 10 definition consists of three elements: power, exposure to variable returns and an investor’s ability to use power to affect the level of its variable returns.

B11. Applying the *IFRS for SMEs* Standard, only currently exercisable potential voting rights are considered when assessing control. Applying IFRS 10, they are considered if they are substantive; in other words, the holder must have the practical ability to exercise the right. Consequently, potential voting rights may need to be considered under IFRS 10 even if they are not currently exercisable.

Requirement to present consolidated financial statements

B12. A parent applying the *IFRS for SMEs* Standard need not present consolidated financial statements if the parent is itself a subsidiary and its ultimate parent (or any intermediate parent) produces consolidated general-purpose financial statements that comply with full IFRS Standards or the *IFRS for SMEs* Standard.

- B13. IFRS 10 sets out different conditions that specify when a parent need not present consolidated financial statements including the following:
- (a) if the parent is itself a subsidiary, it must either be a wholly owned subsidiary or, if it is only a partially owned subsidiary, all the subsidiary's other owners must have been informed about, and made no objection to, the parent failing to present consolidated financial statements; and
 - (b) the ultimate parent (or any intermediate parent) must produce consolidated general-purpose financial statements that comply with full IFRS Standards, not the *IFRS for SMEs* Standard.

Other differences

- B14. The *IFRS for SMEs* Standard prohibits any cumulative amount of exchange differences relating to a foreign operation, that were previously recognised in other comprehensive income, from being reclassified from equity to profit or loss (as a reclassification adjustment) when the gain or loss on disposal is recognised. IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires that the amount is reclassified from equity to profit or loss.²⁸
- B15. Where the separate financial statements of a parent are prepared in conformity with the *IFRS for SMEs* Standard, an entity is required to adopt a policy of accounting for its investment in subsidiaries, associates and jointly controlled entities either at cost less impairment or at fair value with changes in fair value being recognised in profit or loss, or by applying the equity method. Applying full IFRS Standards, in specified circumstances, an entity may elect to present changes in the fair value of an equity investment in other comprehensive income (instead of in profit or loss).

²⁸ IAS 21 *The Effects of Changes in Foreign Exchange Rates* paragraph 48.

- B16. Paragraph 9.16 of the *IFRS for SMEs* Standard requires consolidated financial statements to be prepared using the financial statements of a parent and its subsidiaries prepared as of the same reporting date ‘unless it is impracticable to do so’. If it is impracticable to prepare the financial statements of a subsidiary as of the same reporting date as the parent, the parent entity consolidates the financial information of the subsidiary using the most recent financial statements of the subsidiary, adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements. IFRS 10 has similar requirements, however, it specifies three months as the maximum difference between the reporting dates, and any difference between the dates of the financial statements are required to be the same from period to period.
- B17. Paragraph 9.3A of the *IFRS for SMEs* Standard provides that ‘a subsidiary is not consolidated if it is acquired and is held with the intention of selling or disposing of it within one year from its acquisition date’. Such a subsidiary is accounted for in accordance with the requirements in Section 11 (at fair value through profit or loss, or if it cannot be measured without undue cost or effort, at cost less impairment). Full IFRS Standards require such subsidiaries to be measured and presented in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, if they meet the criteria of a disposal group classified as held for sale.
- B18. Applying full IFRS Standards, when a parent ceases to control its former subsidiary but nevertheless continues to hold an investment in it, any such investment will be measured at fair value. Applying paragraph 9.19 of the *IFRS for SMEs* Standard, the carrying amount ‘at the date that the entity ceases to be a subsidiary shall be regarded as the cost on initial measurement of the financial asset’ which is accounted for either as a financial asset in accordance with Section 11 or 12, or as investments in an associate or joint venture, in which case Section 14 or 15 applies.
- B19. The *IFRS for SMEs* Standard states that combined financial statements are a single set of financial statements of two or more entities under common control (as described in paragraph 19.2(a)). Full IFRS Standards do not address combined financial statements.