



HKFRS 10 Consolidated Financial Statements
HKFRS 12 Disclosure of Interests in Other Entities
HKAS 27 (2011) Separate Financial Statements

HKICPA Standard Setting Department Staff Summary (June 2011)

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The HKICPA Standard Setting Department welcomes your comments and feedback, which should be sent to commentletters@hkicpa.org.hk.

Introduction

1. HKFRS 10 *Consolidated Financial Statements* contains a single consolidation model that identifies control as the basis for consolidation for all types of entities, while HKFRS 12 *Disclosure of Interests in Other Entities* requires a reporting entity to disclose information that helps users to assess the nature and financial effects of the reporting entity's relationship with other entities. As a result, HKAS 27 *Separate Financial Statements* has been amended that what remains in HKAS 27 (2011) is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements.
2. The three standards will be effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

Reasons for issuing HKFRS 10, HKFRS 12 and HKAS 27 (2011)

3. The objective of the Hong Kong Institute of Certified Public Accountants (HKICPA) in issuing HKFRS 10, HKFRS 12 and HKAS 27 (2011) is to maintain international convergence arising from the issuance of IFRS 10, IFRS 12 and IAS 27 by the International Accounting Standards Board's (IASB).
4. Perceived inconsistencies between the consolidation guidance in HKAS 27 *Consolidated and Separate Financial Statements* and HK(SIC) – Int 12 *Consolidation – Special Purpose Entities* resulted in diversity in practice. HKAS 27 used control as the basis for consolidation, while HK(SIC) – Int 12 focused more on risks and rewards. Although the guidance in HK(SIC) – Int 12 applied to special purpose entities, there was confusion over which entities met the definition of a special purpose entity and, thus, whether to apply HKAS 27 and HK(SIC) – Int 12.
5. The global financial crisis highlighted the importance of enhancing disclosure requirements, in particular for special purpose or structured entities

Main features of HKFRS 10 and HKFRS 12

6. An investor controls an investee when it 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.
7. Thus, an investor controls an investee if and only if the investor has all of the following:
 - a. Power over the investee;
 - b. Exposure, or rights, to variable returns from its involvement with the investee; and
 - c. The ability to use its power over the investee to affect the amount of the investor's returns.
8. In the most straightforward case, the investor that holds a majority of those voting rights, in the absence of any other factors, controls the investee.
9. However, in more complex cases, it may be necessary to consider some or all of the following factors that may assist in making that determination:
 - a. The purpose and design of the investee;
 - b. What the relevant activities are and how decisions about those activities are made;
 - c. Whether the rights of the investor give it the current ability to direct the relevant activities;
 - d. Whether the investor is exposed, or has rights, to variable returns from its involvement with the investee;
 - e. Whether the investor has the ability to use its power over the investee to affect the amount of the investor's returns (that is, there needs to be a link between power and returns); and
 - f. The nature of its relationship with other parties.
10. Power exists when the investor has existing rights that give the current ability to direct the activities that significantly affect the investee's returns (that is, the relevant activities). Power most commonly arises through voting rights granted by equity instruments, but can also arise through other contractual arrangements.
11. An investor, in assessing whether it has power, considers only substantive rights relating to the investee (held by the investor and others). For a right to be substantive, the holder must have the practical ability to exercise its rights when decisions about the direction of the relevant activities need to be made.
12. Protective rights are rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate. An investor that holds only protective rights cannot have power or prevent another party from having power over an investee.

13. An investor can have power even if it holds less than a majority of the voting rights of an investee. An investor can have power with less than a majority of the voting rights of an investee, for example, through;
 - a. A contractual arrangement between the investor and other vote holders;
 - b. Rights arising from other contractual arrangements;
 - c. The investor's voting rights;
 - d. Potential voting rights; or
 - e. A combination of the above.
14. To control an investee, an investor must be exposed, or have rights, to variable returns from its involvement with the investee. Variable returns are returns that are not fixed and have the potential to vary as a result of the performance of an investee. Variable returns can be only positive, only negative or both positive and negative.
15. HKFRS 10 introduces guidance on assessing whether an entity with decision making rights is a principal or an agent. When an investor with decision-making rights (a decision maker) assesses whether it controls an investee, it shall determine whether it is a principal or an agent. A decision maker shall consider the overall relationship between itself, the investee being managed and other parties involved with the investee, in particular all the factors below, in determining whether it is an agent:
 - a. The scope of its decision-making authority over the investee,
 - b. The rights held by other parties,
 - c. The remuneration to which it is entitled in accordance with the remuneration agreement(s);
 - d. The decision maker's exposure to variability of returns from other interests that it holds in the investee.
16. Determining whether a decision maker is an agent requires an evaluation of all the factors listed above unless a single party holds substantive rights to remove the decision maker (removal rights) and can remove the decision maker without cause.
17. HKFRS 10 requires an investor to consider whether it treats a portion of an investee as a deemed separate entity and, if so, whether it controls the deemed separate entity (often called a 'silo').
18. An investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control.
19. HKFRS 12 is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet vehicles.
20. The Standard requires an entity to disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows.

21. HKFRS 12 establishes disclosure objectives according to which an entity discloses information that enables users of its financial statements
- (a) to understand:
 - (i) the significant judgements and assumptions (and changes to those judgements and assumptions) made in determining the nature of its interest in another entity or arrangement (ie control, joint control or significant influence), and in determining the type of joint arrangement in which it has an interest; and
 - (ii) the interest that non-controlling interests have in the group's activities and cash flows; and
 - (b) to evaluate:
 - (i) the nature and extent of significant restrictions on its ability to access or use assets, and settle liabilities, of the group;
 - (ii) the nature of, and changes in, the risks associated with its interests in consolidated structured entities;
 - (iii) the nature and extent of its interests in unconsolidated structured entities, and the nature of, and changes in, the risks associated with those interests;
 - (iv) the nature, extent and financial effects of its interests in joint arrangements and associates, and the nature of the risks associated with those interests;
 - (v) the consequences of changes in a parent's ownership interest in a subsidiary that do not result in a loss of control; and
 - (vi) the consequences of losing control of a subsidiary during the reporting period.
22. HKFRS 12 specifies minimum disclosures that an entity must provide. If the minimum disclosures required by this Standard are not sufficient to meet the disclosure objective, an entity discloses whatever additional information is necessary to meet that objective.

Other references on HKFRS 10/IFRS 10 and HKFRS 12/IFRS 12

1. BDO HKFRSs/IFRSs Update
http://www.bdo.com.hk/file_publication.php/114/BDO_HKFRSs_Update_3_2011.pdf
2. Deloitte IFRS in Focus on IFRS 10
<http://www.iasplus.com/iasplus/1105ifrs10.pdf>
3. Deloitte IFRS in Focus on IFRS 12
<http://www.iasplus.com/iasplus/1105ifrs12.pdf>
4. Ernst & Young 'IFRS Developments' on consolidated financial statements, joint arrangements and disclosure of interests in other entities
[http://www.ey.com/Publication/vwLUAssets/IFRS_Developments_Issue_1/\\$File/IFRS_Developments_Issue_1_GL_IFRS.pdf](http://www.ey.com/Publication/vwLUAssets/IFRS_Developments_Issue_1/$File/IFRS_Developments_Issue_1_GL_IFRS.pdf)



5. KPMG 'First Impressions: Consolidated Financial Statements'
<http://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Newsletters/First- Impressions/Documents/First- Impressions-O-1105-Consolidated-financial-state-ments.pdf>
6. KPMG 'In the Headlines' on consolidation: a new single control model
<http://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Newsletters/In- the-headlines/Documents/In-the-headlines-O-201105-14.pdf>
7. KPMG 'In the Headlines' on extensive disclosures about interests in other entities
<http://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Newsletters/In- the-headlines/Documents/In-the-headlines-O-201105-16.pdf>
8. PricewaterhouseCoopers 'IFRS/HKFRS News Supplement'
http://www.pwchk.com/webmedia/doc/634418262516543111_hkfrs_news_may2011_sup.pdf

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