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# Clarifying IFRS 10 transition

## Date of initial application defined

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IN THE HEADLINES

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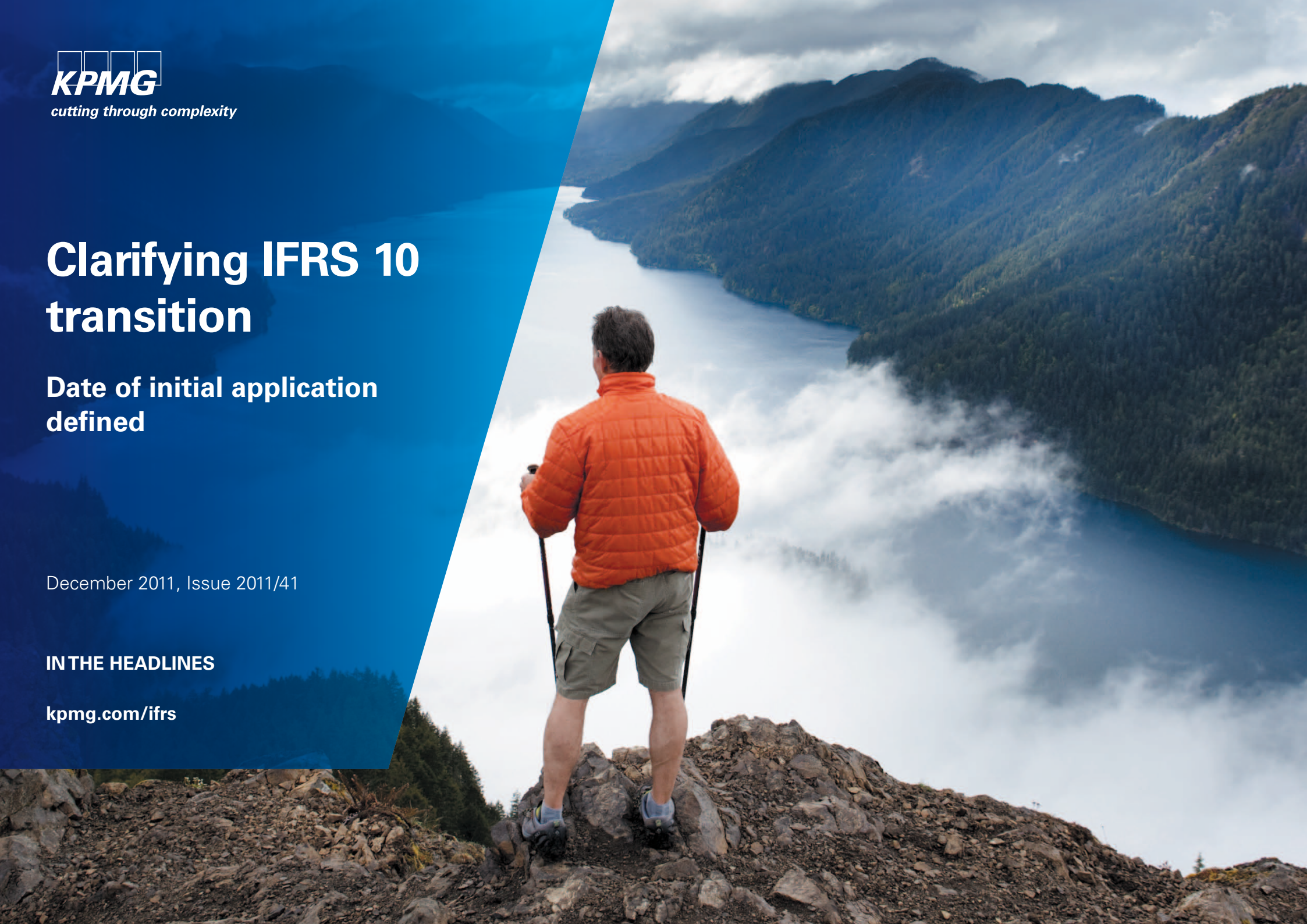

> “We welcome the proposals. They clarify that there is no requirement to consolidate and then deconsolidate the same investee when adopting IFRS 10.”
>
> – Paul Munter, KPMG’s global IFRS business combinations and consolidation leader

## A retrospective approach

IFRS 10 *Consolidated Financial Statements* is effective for annual periods beginning on or after 1 January 2013. It contains a general principle of retrospective application upon adoption.

There is, however, a lack of clarity in the transitional requirements in IFRS 10 compared to the Board’s intention. Assuming no early adoption, a 31 December annual reporting date and one year of comparative information, the following questions are unclear.

(1) Does an investor test whether there is a change in the consolidation conclusion for its investees at 1 January 2012 or 1 January 2013?

In other words, what is the ‘date of initial application’ of the standard? This is particularly important when an investee would be consolidated for the first time under IFRS 10 but control is lost in 2012.

(2) If the test is performed at 1 January 2013, then what happens in the comparative information?

## Date of initial application defined

The IASB proposes that the date of initial application be defined as the beginning of the annual reporting period in which IFRS 10 is applied for the first time. It is at this date that an investor would test whether there is a change in the consolidation conclusion for its investees. Continuing the above example, the date of initial application would be 1 January 2013.

## Approach to comparatives clarified

If the consolidation conclusion remains unchanged at the date of initial application (1 January 2013 in the above example), then no adjustments to the previous accounting would be required. Continuing the example, assume that the investor disposes of an investee in 2012; the investee is not consolidated under current standards, but would be consolidated under IFRS 10. The proposals mean that the investor would not consolidate and then deconsolidate the investee in adopting IFRS 10.

However, unless impracticable, comparatives would be adjusted when the consolidation conclusion changes at the date of initial application.

- **Investees being consolidated for the first time:** the investor would apply IFRS 3 *Business Combinations* (without goodwill, when not a business) as of the date of obtaining control.
- **Investees being deconsolidated:** the investee’s carrying amount would be determined as if IFRS 10 had been effective at the date of losing control.

Any adjustments would be recognised in retained earnings at the beginning of the earliest comparative period presented. However, while the Board’s intention is unclear, it seems that any adjustments would be recognised in profit or loss when control was obtained/lost in the comparative period(s).

When retrospective application is impracticable, the transitional requirements would be applied at the beginning of the earliest period practicable (i.e. the date that control is deemed to be obtained/lost).

These proposals are illustrated in more detail on the adjacent page.

## Other transitional uncertainties remain

The IFRS 10 transitional requirements in their entirety are discussed in our publication *First Impressions: Consolidated Financial Statements*. This publication raises other transitional issues that may be relevant to your adoption of IFRS 10. These issues include determining which version of IFRS 3 to apply in the adoption of IFRS 10, and the transitional approach for newly consolidated investees that are not businesses.

## Investee consolidated upon adoption of IFRS 10: comparative information

The requirements as clarified by the proposed amendment in such a case are as follows:

**1** Determine date at which investor obtained control over investee per IFRS 10.

**Investee is a business**

**2** Measure net assets and NCI as if acquisition accounting had been applied at that date.

**Investee not a business**

**2** Measure net assets and NCI as if investee consolidated from that date. Use IFRS 3 for initial measurement, but do not recognise any goodwill.

**3** Difference between (2) and carrying amount of investment recognised in retained earnings at beginning of earliest comparative period. Comparative period(s) adjusted retrospectively.

- **If step 2 is impracticable, then deemed acquisition date is beginning of earliest period for which step 2 is practicable.**
- **Step 3 is then applied at deemed acquisition date and comparative period(s) restated unless deemed acquisition date is beginning of current period.**

### Example

Parent P has an involvement in Investee S (a business), which is not consolidated at present. P has a 31 December annual reporting date and presents one year of comparative information. P assesses whether S would be consolidated in accordance with IFRS 10 as at 1 January 2013, which is its date of initial application of IFRS 10, and concludes that S would be consolidated.

P then follows these steps:

1) It determines that if IFRS 10 had been effective, then it would have obtained control of S on 16 May 2007.
2) P measures S's assets, liabilities and non-controlling interests (NCI) according to IFRS 3 and determines goodwill as of 16 May 2007. Next, P determines the carrying amounts of S's net assets and NCI as of 1 January 2012 as if S had been consolidated since 16 May 2007.
3) The difference between the newly determined carrying amounts at 1 January 2012 and the existing carrying amount of the investment in S at 1 January 2012 is recognised in retained earnings at that date.

## Investee deconsolidated upon adoption of IFRS 10: comparative information

The requirements as clarified by the proposed amendment in such a case are as follows:

**1** Determine date at which investor would have stopped consolidating investee per IFRS 10.

**2** Measure retained interest at amount at which it would have been measured had IFRS 10 been effective at that date.

**3** Difference between previously recognised net assets and NCI, and retained interest in investee, recognised in retained earnings at beginning of earliest period presented. Comparative period(s) adjusted retrospectively.

- **If step 2 is impracticable, then investor applies IFRS 10 for a loss of control at beginning of earliest period for which it is practicable, and applies step 3 at that date.**
- **Comparative period(s) restated unless date control is deemed lost is beginning of current period.**

### Example

Parent P has an involvement in Investee D, which is consolidated at present. P has a 31 December annual reporting date and presents one year of comparative information. P assesses whether D would be consolidated in accordance with IFRS 10 as at 1 January 2013, which is its date of initial application of IFRS 10, and concludes that D would not be consolidated.

P then follows these steps:

1) It determines that if IFRS 10 had been effective, then it would have lost control of D on 1 July 2009.
2) P accounts for the loss of control of D and measures its retained interest in D as of 1 July 2009 in accordance with IFRS 10. Next, P remeasures its interest in D as of 1 January 2012 in accordance with the relevant IFRS.
3) The difference between the newly determined carrying amount of the investment in S at 1 January 2012 and the existing consolidated carrying amounts at 1 January 2012 is recognised in retained earnings at that date.

## Basic facts

IFRS 10 introduces a new approach to determining which investees should be consolidated. It was issued by the IASB in May 2011 as part of its new suite of consolidation and related standards. IFRS 10 also replaced existing requirements for joint ventures (now joint arrangements), made limited amendments in relation to associates and established additional disclosure requirements. Our publication *First Impressions: Consolidated Financial Statements* discusses this new approach in detail.

IFRS 10 is effective for annual periods beginning on or after 1 January 2013. Early adoption is permitted as long as the complete set of consolidation and related standards is adopted at the same time.

The subject of this publication, ED/2011/7 *Transition Guidance – Proposed amendments to IFRS 10*, was issued by the IASB on 20 December 2011. The proposed effective date is annual periods beginning on or after 1 January 2013, matching IFRS 10. Early adoption would be required in the event that IFRS 10 were adopted early.

The comment period for the proposals ends on 21 March 2012.

## Find out more

For more information on the amendments, please go to the IASB Press Release or speak to your usual KPMG contact.



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## Timeline[1]

**20 December 2011:**
ED published and comment period begins

**21 March 2012:**
Comment period ends

**1 January 2013:**
Proposed date of adoption, corresponding to the date of initial application of IFRS 10

**31 December 2013:**
First annual financial statements in which IFRS 10 applies

1 Assumes a 31 December annual reporting date