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# International Financial Reporting Standards

## Financial Assets

(IAS 27, IAS 28, IAS 31, IAS 39, IFRS 3)

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## Applicable Standards / Interpretations

- IFRS 3, Business Combinations
- IAS 27, Consolidated and Separate Financial Statements
- IAS 28, Investments in Associates
- IAS 31, Interests in Joint Ventures
- IAS 39, Financial Instruments: Recognition and Measurement
- IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
- Sic 12, Consolidation – Special Purpose Entities
- IFRIC AMENDMENT TO SIC-12: Scope of SIC-12 Consolidation—Special Purpose Entities
- SIC-13, Jointly Controlled Entities – Non-Monetary Contributions by Venturers



## Definitions

- **A *subsidiary* is an entity, including an unincorporated entity such as a partnership, that is *controlled* by another entity (known as the parent). (IFRS 3, IAS 27.4, IAS 28.2)**
- **A *joint venture* is a contractual agreement whereby two or more parties undertake an economic activity which is subject to *joint control*. (IAS 31.2)**
- **An *associate* is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture. (IAS 28.2)**
- **A *financial asset* is any asset that is  
(d) an equity instrument of another enterprise. (IAS 32.11)**



## Definition of control

- **The power to govern the financial and operating policies of an entity so as to obtain benefits from its activities (IAS 24.9, IAS 27.4, IAS 28.2, IAS 31.3, IFRS 3A)**
- Indications:
  - power over more than half of the voting rights by virtue of an agreement with other investors
  - power to govern financial and operating policies of the entity under a statute or an agreement
  - power to appoint or remove the majority of the members of the board of directors or equivalent governing body and control of the entity is by that board or body
  - power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the entity is by that board or body



## Definition of joint control

- **Contractually agreed sharing of control over an economic activity**  
(IAS 31.3)
  - **Jointly controlled operations:** use of the assets and other resources of the venturers rather than the establishment of a corporation, partnership or other entity
  - **Jointly controlled assets:** joint ownership by the venturers of one or more assets contributed to, or acquired for the purpose of, the joint venture
  - **Jointly controlled entities:** establishment of a corporation, partnership or other entity



## Definition of significant influence

- **The power to participate in the financial and operating policy decisions of an economic activity but is not control or joint control over those policies (IAS 24.9, IAS 28.2, IAS 31.3)**
- Indications:
  - representation on the board of directors or equivalent governing body of the investee
  - participation in policy-making processes, including participation in decisions about dividends or other distributions
  - material transactions between the investor and the investee
  - interchange of managerial personnel
  - provision of essential technical information



## Levels of control

### Indications

- 0 - 20%      no influence
- 20 - 50%    significant influence
- 50%          joint control
- 50 - 100%   control



## Special purpose entities (SPEs)

- To be consolidated when the substance of the relationship between an entity and the SPE indicates that the SPE is controlled by that entity
- Examples of control situations are:
  - in substance, the activities of the SPE are being conducted on behalf of the entity according to its specific business needs so that the entity obtains benefits from the SPE's operation
  - in substance, the entity has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an auto-pilot mechanism, the entity has delegated these decision-making powers
  - in substance, the entity has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incident to the activities of the SPE
  - in substance, the entity retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities



## SPE - example

### Power plant

- owners: ABB 10%, GE 20%, Venezuelan Government 70%
- supplier: Shell (fuel)
- other suppliers: ABB 40%, GE+others
- customer: Caracas Power
- operator: ABB

Does ABB have control or significant influence?



## **IAS 27: presentation of consolidated financial statements**

A parent need not present consolidated financial statements if and only if:

- (a) the parent is itself a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;
- (b) the parent's debt or equity instruments are not traded in a public market ( a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);
- (c) the parent did not file, nor is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market;
- (d) the ultimate or any intermediate parent of the parent produces consolidated financial statements available for public use that comply with IFRS



## IAS 27: accounting for subsidiaries (1)

Consolidated financial statements shall include all subsidiaries of the parent.

Exceptions:

- if on acquisition a subsidiary meets the criteria to be classified as held for sale in accordance with IFRS 5, it shall be accounted for in accordance with that Standard (at the lower of its carrying amount and fair value less costs to sell)
- a parent loses control when it loses the power to govern the financial and operating policies of an investee so as to obtain benefit from its activities
- an investment in an entity shall be accounted for in accordance with IAS 39 from the date it ceases to be a subsidiary provided that it does not become an associate as defined in IAS 28 or a jointly controlled entity as described in IAS 31



## IAS 27: accounting for subsidiaries (2)

In parent's separate financial statements:

- at cost; or
- In accordance with IAS 39.



## IAS 31: accounting for jointly-controlled entity

- Proportionate consolidation
  - combine the share of assets, liabilities, income and expense with the same captions in consolidated FS
  - show the share of assets, liabilities, income and expense as separate line items in consolidated FS
- Equity method
- Exception:
  - interests in jointly controlled entities that are classified as held for sale in accordance with IFRS 5 shall be accounted for in accordance with that IFRS



## IAS 28: accounting for associates

Equity method except when:

- (a) the investment is classified as held for sale in accordance with IFRS 5
- (b) the exception in paragraph 10 of IAS 27, allowing a parent that also has an investment in an associate not to present consolidated financial statements
- (c) all of the following apply:
  - (i) the investor is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the investor not applying the equity method
  - (ii) the investor's debt or equity instruments....



## **IAS 39: financial asset that is an equity instrument of another entity**

- at fair value through profit or loss
- available for sale
  - initial measurement at cost (which is the fair value of the consideration given)
  - subsequent measurement at fair value
  - gains and losses on remeasurement recognised directly in equity
- investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured
  - at cost



## **IFRS 3: definition of a business combination**

**The bringing together of separate entities or businesses into one reporting entity**

IASB: no uniting of interests, only acquisition  
US GAAP: no uniting, only acquisition, SFAS 141  
German GAAP: uniting and acquisition



## IFRS 3: acquisition

- one of the combining entity (acquirer) obtains control over the other entity (acquiree)
- reverse acquisition
  - an entity obtains ownership of the shares of another entity but as part of the exchange transaction issues enough voting shares such that control of the combined entities passes to the owners of the entity whose shares have been acquired
  - legal acquirer issues consolidated financial statements
  - accounting acquirer at cost, accounting acquiree at fair value



## **IFRS 3: cost of a business combination**

- The acquirer shall measure the cost of a business combination as the aggregate of:
  - (a) the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree; plus
  - (b) any costs directly attributable to the business combination.



## IFRS 3: acquired assets and liabilities (1)

The acquirer shall, at the acquisition date, allocate the cost of a business combination by recognising the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the recognition criteria in paragraph 37 at their fair values at that date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, which shall be recognised at fair value less costs to sell. Any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities so recognised shall be accounted for in accordance with paragraphs 51-57.



## IFRS 3: acquired assets and liabilities (2)

- The acquirer shall recognise separately the acquiree's identifiable assets, liabilities and contingent liabilities at the acquisition date only if they satisfy the following criteria at that date:
  - (a) in the case of an asset other than an *intangible asset*, it is probable that any associated future economic benefits will flow to the acquirer, and its fair value can be measured reliably;
  - (b) in the case of a liability other than a contingent liability, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and its fair value can be measured reliably;
  - (c) in the case of an intangible asset or a contingent liability, its fair value can be measured reliably.



## IFRS 3: restructuring provision (1)

- (a) The acquirer shall recognise liabilities for terminating or reducing the activities of the acquiree as part of allocating the cost of the combination only when the acquiree has, at the acquisition date, an existing liability for restructuring recognised in accordance with IAS 37 *Provisions*; and
- (b) the acquirer, when allocating the cost of the combination, shall not recognise liabilities for future losses or other costs expected to be incurred as a result existence will be confirmed only by the occurrence or



## **IFRS 3: restructuring provision (2)**

A payment that an entity is contractually required to make, for example, to its employees or suppliers in the event that it is acquired in a business combination is a present obligation of the entity that is regarded as a contingent liability until it becomes probable that a business combination will take place. The contractual obligation is recognised as a liability by that entity in accordance with IAS 37 when a business combination becomes probable and the liability can be measured reliably. Therefore, when the business combination is effected, that liability of the acquiree is recognised by the acquirer as part of allocating the cost of the combination.



## **IFRS 3: restructuring provision (3)**

However, an acquiree's restructuring plan whose execution is conditional upon its being acquired in a business combination is not, immediately before the business combination, a present obligation of the acquiree. Nor is it a contingent liability of the acquiree immediately before the combination because it is not a possible obligation arising from a past event whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the acquiree. Therefore, an acquirer shall not recognise a liability for such restructuring plans as part of allocating the cost of the combination.



## **IFRS 3: acquired assets and liabilities (3)**

After their initial recognition, the acquirer shall measure contingent liabilities that are recognised separately in accordance with paragraph 36 at the higher of:

- (a) the amount that would be recognised in accordance with IAS 37, and
- (b) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18



## IFRS 3: goodwill

- The acquirer shall, at the acquisition date:
  - (a) recognise goodwill acquired in a business combination as an asset; and
  - (b) initially measure that goodwill at its cost, being the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised in accordance with paragraph 36.

After initial recognition, the acquirer shall measure goodwill acquired in a business combination at cost less any accumulated impairment



## **IFRS 3: excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over cost**

- If the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised in accordance with paragraph 36 exceeds the cost of the business combination, the acquirer shall:
  - (a) reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination; and
  - (b) recognise immediately in profit or loss any excess remaining after that reassessment.



## **IFRS 3: non-controlling interest (1)**

Any non-controlling interest in the acquiree is stated at the non-controlling interest's proportion of the net fair values of the acquired assets, liabilities and contingent liabilities.



## IFRS 3: some issues

- Business combination achieved in stages: each exchange transaction shall be treated separately
- Initial accounting determined provisionally: the acquirer shall recognise any adjustments to the provisional values as a result of completing the initial accounting
  - Within twelve months of the acquisition date; and
  - From the acquisition date
- Adjustments to the initial accounting after that initial accounting is complete shall be recognised only to correct an error in accordance with IAS 8.
- Deferred taxation



## IFRS 3: disclosure (1)

- An acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of business combinations that were effected:
  - (a) during the period.
  - (b) after the balance sheet date but before the financial statements are authorised for issue.
- An acquirer shall disclose information that enables users of its financial statements to evaluate the financial effects of gains , losses, error corrections and other adjustments recognised in the current period that relate to business combinations that were effected in the current or in previous periods.



## IFRS 3: disclosure (2) / transition

- An entity shall disclose information that enables users of its financial statements to evaluate changes in the carrying amount of goodwill during the period.
- This IFRS shall apply to the accounting for business combinations for which the agreement date is on or after 31 March 2004.
- An entity is permitted to apply the requirements of this IFRS to goodwill existing at or acquired after, and to business combinations occurring from, any date before the effective dates outlined, provided:
  - (a) the valuations and other information needed to apply the IFRS to past business combinations were obtained at the time those combinations were initially accounted for; and
  - (b) the entity also applies IAS 36 and IAS 38 as revised in 2004 prospectively from that same date.



## Main differences between IFRS and Commercial Code

- Accounting for business combinations under the Commercial Code is quite different from accounting for the same transaction under IFRS. The differences arise mainly from the methods of consolidation and the treatment of differences arising. Under paragraph 301 two methods are applicable, either using carrying amounts or fair value.
- Under the Commercial Code the pooling-of-interests method is still permitted.



## Wesentliche Unterschiede zum HGB

- Die Vorgehensweise bei der Kaufpreisallokation ist im HGB nicht detailliert geregelt. Gemäß § 300 Abs. 1 HGB sind die Vermögensgegenstände, schulden und Rechnungsabgrenzungsposten des Tochterunternehmens vollständig aufzunehmen, so lange keine Bilanzierungsverbote oder -wahlrechte bestehen.
- Bei der Aufdeckung stiller Reserven im Rahmen der Kaufpreisallokation fallen nach IFRS latente Steuern an, nach HGB nicht.
- Der impairment-only-approach hat sich in Deutschland bisher nicht durchsetzen können. Stattdessen existieren nach § 255 Abs. 4 und § 309 Abs. 1 HGB folgende Wahlrechte für die Bilanzierung des Goodwills:
- (1) im Jahr des Zusammenschlusses sofort Aufwand, (2) in jedem folgenden Geschäftsjahr zu mindestens einem Viertel tilgen, (3) planmäßig über die voraussichtliche Nutzungsdauer abschreiben, (4) offen mit den Rücklagen verrechnen.



## Wesentliche Unterschiede zum HGB

- Der negative Unterschiedsbetrag ist auf der Passivseite auszuweisen und darf nur insoweit ergebniswirksam aufgelöst werden, als Negativentwicklungen oder Aufwendungen, die zum Erwerbszeitpunkt oder bei Erstkonsolidierung prognostiziert worden waren, tatsächlich eintreten oder am Abschlussstichtag feststeht, dass der negative Unterschiedsbetrag einem realisierten Gewinn entspricht.
- DRS 4 entspricht weitgehend IAS 22 (1998).



## Consolidation (1) - reporting dates

The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall be prepared as of the same reporting date. When the reporting dates of the parent and a subsidiary are different, the subsidiary prepares, for consolidation purposes, additional financial statements as of the same date as the financial statements of the parent unless it is impracticable to do so.

When, in accordance with paragraph 26, the financial statements of a subsidiary used in the preparation of consolidated financial statements are prepared as of a reporting date different from that of the parent, adjustments shall be made for the effects of significant transactions or events that occur between that date and the date of the parents financial statements. In any case, the difference between the reporting date of the subsidiary and that of the parent shall be no more than three months. The length of the reporting periods and any difference in the reporting dates shall be the same from period to period.



## Consolidation (2) - accounting policies

- Consolidated financial statements shall be prepared using uniform accounting policies for like transactions and other events in similar circumstances.



## Consolidation (3a) - currency translation

- The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:
  - (a) assets and liabilities for each balance sheet presented (ie including comparatives) shall be translated at the closing rate at the date of that balance sheet;
  - (b) income and expenses for each income statement (ie including comparatives) shall be translated at exchange rates at the dates of the transactions; and
  - (c) all resulting exchange differences shall be recognised as a separate component of equity.



## Consolidation (3b) - currency translation

- The results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:
  - (a) all amounts (ie assets, liabilities, equity items, income and expenses, including comparatives) shall be translated at the closing rate at the date of the most recent balance sheet, except that
  - (b) when amounts are translated into the currency of a non-hyperinflationary economy, comparative amounts shall be those that were presented as current year amounts in the relevant prior year financial statements (ie not adjusted for subsequent changes in the price level or subsequent changes in exchange rates).



## Consolidation (4) - date of first consolidation

“As from the date of acquisition, an acquirer should:

- (a) incorporate into the income statement the results of operations of the acquiree; and
- (b) recognise in the balance sheet the identifiable assets and liabilities of the acquiree and any goodwill or negative goodwill arising on the acquisition.”

➔ ***The date of acquisition is the date on which control is effectively transferred.***



## Consolidation (5) - intragroup items

- Intragroup balances, transactions, income and expenses shall be eliminated in full.
- Intragroup losses may indicate an impairment that requires recognition in the consolidated financial statements. IAS 12 Income Taxes applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.



## Consolidation (6) - disclosure

- (a) the nature of the relationship between the parent and a subsidiary when the parent does not own, directly or indirectly through subsidiaries, more than half of the voting power;
- (b) the reasons why the ownership, directly or indirectly through subsidiaries, of more than half of the voting or potential voting power of an investee does not constitute control;
- (c) the reporting date of the financial statements of a subsidiary when such financial statements are used to prepare consolidated financial statements and are as of a reporting date or for a period that is different from that of the parent, and the reason for using a different reporting date or period; and
- (d) the nature and extent of any significant restrictions (eg resulting from borrowing arrangements or regulatory requirements) on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends or to repay loans or advances.



## Joint ventures (1a) - transactions between JV and venturer

- When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction shall reflect the substance of the transaction. While the assets are retained by the joint venture, and provided the venturer has transferred the significant risks and rewards of ownership, the venturer shall recognise only that portion of the gain or loss that is attributable to the interests of the other venturers. The venturer shall recognise the full amount of any loss when the contribution or sale provides evidence of a reduction in the net realisable value of current assets or an impairment loss.



## Joint ventures (1b) - transactions between JV and venturer

- When a venturer purchases assets from a joint venture, the venturer shall not recognise its share of the profits of the joint venture from the transaction until it resells the assets to an independent party. A venturer shall recognise its share of the losses resulting from these transactions in the same way as profits except that losses shall be recognised immediately when they represent a reduction in the net realisable value of current assets or an impairment loss.



## Joint ventures (2a) - disclosure

- A venturer shall disclose the aggregate amount of the following contingent liabilities, unless the probability of loss is remote, separately from the amount of other contingent liabilities:
  - (a) any contingent liabilities that the venturer has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities that have been incurred jointly with other venturers;
  - (b) its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable; and
  - (c) those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a joint venture.



## Joint ventures (2b) - disclosure

- A venturer shall disclose the aggregate amount of the following commitments in respect of its interests in joint ventures separately from other commitments:
  - (a) any capital commitments of the venturer in relation to its interests in joint ventures and its share in the capital commitments that have been incurred jointly with other venturers; and
  - (b) its share of the capital commitments of the joint ventures themselves.



## Joint ventures (2c) - disclosure

- A venturer shall disclose a listing and description of interests in significant joint ventures and the proportion of ownership interest held in jointly controlled entities. A venturer that recognises its interests in jointly controlled entities using the line-by-line reporting format for proportionate consolidation or the equity method shall disclose the aggregate amounts of each of current assets, long-term assets, current liabilities, long-term liabilities, income and expenses related to its interests in joint ventures.
- A venturer shall disclose the method it uses to recognise its interests in jointly controlled entities.



## Significant differences to the Commercial Code

- Auch das HGB gestattet das Wahlrecht, die Quotenkonsolidierung oder die Equity-Bilanzierung anzuwenden, wenn ein Unternehmen von einem in den Konzernabschluss einbezogenen Unternehmen mit einem oder mehreren nicht in den Konzernabschluss einbezogenen Unternehmen gemeinschaftlich geführt wird. Nach § 310 Abs. 1 HGB muss das Unternehmen aber tatsächlich gemeinschaftlich geführt werden; die reine Möglichkeit der gemeinschaftlichen Führung wie nach IAS 31.2 reicht dazu nicht aus.



## Main differences between IFRS and Commercial Code

- Die Anwendung der Quotenkonsolidierung ist im Einzelabschluss, anders als nach IAS 31, nicht möglich. Die Vorgehensweise der Quotenkonsolidierung nach § 310 HGB entspricht weitgehend der nach IFRS.
- Nach dem deutschen Handelsrecht löst die gemeinschaftliche Führung eines Unternehmens allein noch keine Konzernrechnungslegungspflicht aus. Da nach § 310 Abs. 2 HGB die sonstigen Konsolidierungsmaßnahmen entsprechend der Vollkonsolidierung anzuwenden sind, ist davon auszugehen, dass eine Zwischenerfolgseliminierung – unabhängig von der Lieferrichtung – quotaal vorzunehmen ist.



## Equity method (1)

- An investment in an associate is accounted for using the equity method from the date on which it becomes an associate. On acquisition of the investment any difference between the cost of the investment and the investor's share of the net fair values of the associate's identifiable assets, liabilities and contingent liabilities is accounted for in accordance with IFRS 3. Therefore:
  - (a) Goodwill relating to an associate is included in the carrying amount of the investment. However, amortisation of that goodwill is not permitted and is therefore not included in the determination of the investor's share of the associate's profits or losses.
  - (b) Any excess of the investor's share of the net fair value of the associate's identifiable assets, liabilities and contingent liabilities over the cost of the investment is excluded from the carrying amount of the investment and is instead included as income in the determination of the investor's share of the associate's profit or loss in the period in which the investment is acquired.



## Equity method (2)

The most recent available financial statements of the associate are used by the investor in applying the equity method. When the reporting dates of the investor and the associate are different, the associate prepares, for the use of the investor, financial statements as of the same date as the financial statements of the investor unless it is impracticable to do so.



## Equity method (3) - accounting policies

The investor's financial statements shall be prepared using uniform accounting policies for like transactions and events in similar circumstances.

If an associate uses accounting policies other than those of the investor for like transactions and events in similar circumstances, adjustments shall be made to conform the associate's accounting policies to those of the investor when the associate's financial statements are used by the investor in applying the equity method. The investor's financial statements are usually prepared using uniform accounting policies for like transactions and events in similar circumstances. In many cases, if an associate uses accounting policies other than those adopted by the investor for like transactions and events in similar circumstances, appropriate adjustments are made to the associate's financial statements when they are used by the investor in applying the equity method. If it is not practicable for such adjustments to be calculated, that fact is generally disclosed.”



## Equity method (4) – Impairment losses

- After application of the equity method, including recognising the associate's losses in accordance with paragraph 29, the investor applies the requirements of IAS 39 to determine whether it is necessary to recognise any additional impairment loss with respect to the investor's net investment in the associate.
- The investor also applies the requirements of IAS 39 to determine whether any additional impairment loss is recognised with respect to the investor's interest in the associate that does not constitute part of the net investment and the amount of that impairment loss.



## Equity method (5) - recognition of losses

- After the investor's interest is reduced to zero, additional losses are provided for, and a liability is recognised, only to the extent that the investor has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the investor resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.



## Equity method (6a) - disclosure

- The following disclosures shall be made:
  - (a) the fair value of investments in associates for which there are published price quotations;
  - (b) summarised financial information of associates, including the aggregated amounts of assets, liabilities, revenues and profit or loss;
  - (c) the reasons why the presumption that an investor does not have significant influence is overcome if the investor holds, directly or indirectly through subsidiaries, less than 20 per cent of the voting or potential voting power of the investee but concludes that it has significant influence;
  - (d) the reasons why the presumption that an investor has significant influence is overcome if the investor holds, directly or indirectly through subsidiaries, 20 per cent or more of the voting or potential voting power of the investee but concludes that it does not have significant influence;



## Equity method (6b) - disclosure

- (e) the reporting date of the financial statements of an associate, when such financial statements are used in applying the equity method and are as of a reporting date or for a period that is different from that of the investor, and the reason for using a different reporting date or different period;
- (f) the nature and extent of any significant restrictions (eg resulting from borrowing arrangements or regulatory requirements) on the ability of associates to transfer funds to the investor in the form of cash dividends, or repayment of loans or advances;
- (g) the unrecognised share of losses of an associate, both for the period and cumulatively, if an investor has discontinued recognition of its share of losses of an associate;
- (h) the fact that an associate is not accounted for using the equity method in accordance with paragraph 13; and



## Equity method (6c) - disclosure

- (i) summarised financial information of associates, either individually or in groups, that are not accounted for using the equity method, including the amounts of total assets, total liabilities, revenues and profit or loss.
38. Investments in associates accounted for using the equity method shall be classified as non-current assets. The investor's share of the profit or loss of such associates, and the carrying amount of those investments, shall be separately disclosed. The investor's share of any discontinuing operations of such associates shall also be separately disclosed.
39. The investor's share of changes recognised directly in the associate's equity shall be recognised directly in equity by the investor and shall be disclosed in the statement of changes in equity as required by IAS 1 Presentation of Financial Statements.



## Equity method (6d) - disclosure

40. In accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets, the investor shall disclose:
- (a) its share of the contingent liabilities of an associate incurred jointly with other investors; and
  - (b) those contingent liabilities that arise because the investor is severally liable for all or part of the liabilities of the associate.



## Main differences between Commercial Code and IFRS

- Under the Commercial Code the equity method can be applied if the parent company exercises significant influence. IAS 28 requires the power to exercise the influence. This difference can be explained by pointing out that the power to exercise is easier to audit than the exercising.
- Goodwill arising when acquiring shares in another entity is to be dealt with under paragraph 309. Goodwill can be amortised or netted against the reserves. Under IFRS goodwill is recognised as an asset and impaired. Scheduled amortisation or netting against the reserves is not permitted.



## Main difference between Commercial Code and IFRS

- Under the Commercial Code assets and liabilities are measured at fair value limited by the acquisition cost of the shares – a different treatment than applied when fully consolidating. IFRS does not limit the fair value exercise to the acquisition cost. Any excess of the investor's share of the net fair value of the associate's identifiable assets, liabilities and contingent liabilities over the cost of the investment is excluded from the carrying amount of the investment and is instead included as income in the determination of the investor's share of the associate's profit or loss in the period in which the investment is acquired.
- German Accounting Standard 8 und German Accounting Standard 9 are based on IAS 27 and IAS 28 before the improvements in 2003.



## Changes?

- Business Combinations Phase II
- ED issued June 2005, comment deadline 28 October 2005
  - Issues related to the application of the purchase method
  - Issues that are excluded from Business Combinations Phase I
    - Business combinations involving two or more mutual entities
    - Business combinations in which separate entities are brought together to form a reporting entity by contract only
- Joint project with FASB to converge guidance on accounting for business combinations



## Changes?

- Project consolidation (including special purpose entities)
  - Concept of control should require satisfaction of three criteria:
    - the ability to direct financing and operating policy (the 'power criterion'); and
    - ii. the ability to access benefits (the 'benefit criterion'); and
    - iii. the ability to use such power so as to increase those benefits.
- ED later in 2006



Deutsches Rechnungslegungs Standards  
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