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RESEARCH ARTICLE

New trends in consolidation – challenging the changes of new IFRS rules

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Abstract

In 2011, the consolidation rules changed repeatedly and substantially in IFRS. In earlier years, consolidation regulations have been modified many times, changing the impact of transactions with entities covered by the scope of consolidation, and that of the transactions with non-controlling interests, but in 2011 less technical, but rather significant changes took place, which altered the scope of consolidation. The purpose of this paper is to describe the comparison of changes with earlier regulations, and to examine how the financial statements of a group of companies would be modified as a result of these changes, and also to explore what effect this change makes on the financial indicators of a group of companies. It is shown that the financial statements of a group of companies may change substantially even if no modification occurs in the group of companies, and only the modification of the rules is executed. The paper points out the outstanding fact that as a result of the revised regulations, the consolidated financial statements are to be assessed from a different perspective, because the so far unambiguous rules which we have become accustomed to for years have been overwritten, and hence the liquidity, solvency and profitability of a consolidated group of companies may change significantly vis-á-vis the earlier years.

Keywords

quota consolidation · joint ventures · equity method · goodwill

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Introduction

In 2011, the IFRS[1] system saw a change in consolidation rules again. In 2008, the consolidation regulations had been reviewed, and they changed the impact of transactions with companies covered by the scope of consolidation, and that of the transactions with non-controlling owners, but in the year 2011 less technical, but rather significant changes took place, which altered the scope of consolidation.

The purpose of this paper is to discuss these changes in comparison with the earlier rules, and to show how as a result of these changes the financial statements of a group of companies are modified if no change occurs in the group of companies, only the modification of regulations is executed. I demonstrate that as a result of these changes, the solvency and profitability of a group of companies appear entirely differently, causing extremely important deviations in certain cases, and I examine whether as a result of the information obtained about the group of companies, the investors and owners are better supplied with information.

1 Previous regulations

Standards about the currently applicable consolidation methodology

In the IFRS regulations, several standards deal with the issues of consolidation. The various standards are different in view of the types of task (full, proportional, quota), but resulting from the framework characteristics of the IFRSs, they do not have a full scope, because IFRS 3 (Business combinations) backs each standard with a range of facilities like the accounting of differences from equity consolidation or calculating the initial cost of a shareholding [10].

The consolidation-related standards in IFRS are as follows:

- **IAS 27** – Consolidated financial statements and accounting for investments in subsidiaries
- **IAS 28** – Investments in associates
- **IAS 31** – Interests in joint ventures
- **IFRS 3** – Business combinations

[1] International Financial Reporting Standards

The interpretations related to consolidation are as follows:

SIC-12 Consolidation – special purpose entities

SIC-13 Jointly controlled entities – non-monetary contributions by venturers

In this paper, concentrating on the impact of 2011 changes, the consolidation rules for subsidiaries and those for jointly controlled entities will be discussed, because the modifications characteristically involve these two areas. However, in order to present the changes, first the currently applicable regulations and then the modifications introduced some years ago (in 2008) will be described.

1.1 Consolidated financial statements and accounting for investments in subsidiaries (standards IAS 27 and IFRS 3)

IAS 27 and IFRS 3 standards deal with preparing the consolidated financial statements of entities which are under the control and management of a parent company, and with the accounting for investments in subsidiaries as presented in the individual statements of the parent company. Which entity is qualified to be a parent company in accordance with the currently applicable IFRS regulations? The Hungarian equivalent of controlling interest is directing ability. This could cover the same definition, but according to IFRS rules it does not (they do not mean the same, as they are also different in various national definitions of the controlling interest) [9].The difference is in the assessment of the votes to be cast actually by the parent company and in the voting rights to be exercised potentially by the parent company. IAS 27 demands the entity to examine such stock warrants, share purchase options, debt or capital instruments convertible to ordinary shares, which if potentially drawn or redeemed, provide voting rights to an entity or reduce the voting rights of another party.

Potential voting rights may not be considered to be actually drawable or redeemable if until a future time or until the occurring of a future event they cannot be drawn or redeemed. If these circumstances do not prevail, the potentially castable votes must be taken into consideration in the qualification.[2]

In defining the standards, the parent company is the venturer which has a subsidiary, i.e. exercises control over another entity, directly or through another subsidiary indirectly.

To demonstrate controlling interest, the standards discuss several cases, which are the following[3]:

- The entity owns – directly or through its subsidiaries indirectly – more than one half of the voting rights over another entity[4], but
- a control may also prevail if one half or less of the voting rights is held by the entity, but
  - an agreement with other investors grants the disposal over more than one half of the voting rights, or
  - it is able to direct the financial and operating policy of the other entity through a legislation or agreement, or
  - it is able to elect or withdraw most of the members of the Board or a management body equivalent to the Board, and the controlling of the entity is carried out through these bodies, or
  - it is able to cast the majority of the votes at the meetings of the Board or an equivalent managing body and the entity is controlled through these bodies.

The consolidated financial statements must be drawn up by all parent companies, with certain exceptions:

1 If the owners of the parent company (the parent companies) have been informed that they do not prepare consolidated statements and no objection has been raised,

2 The securities of the parent company are not marketed publicly and no application to do so has been submitted,

3 The parent company has a superior parent company which prepares and presents the consolidated financial statements prepared on the basis of IFRSs.

On the basis of the discussion above, consequently, the finding is that the exemption options granted by the Hungarian Accounting Act do not apply in this case to the consolidation.

The consolidation procedures

The parent company and subsidiary statements falling within the scope of these standards must be evaluated and presented by the full consolidation method.

The major tasks of full consolidation are as follows:

- equity consolidation
- Intercompany balance consolidation
- Consolidation of intra-group transactions
- Intercompany income/expense elimination

The Hungarian Accounting Act also identifies these tasks as part of the full consolidation, but a further task is represented by the calculation of deferred tax not specified by the IFRS standards by this way. (When calculating deferred tax, the entity calculates how much tax payment obligation it would have had if it operated as a company, or if the tax so calculated differs from the combined tax payment obligations, then the difference is specified as deferred tax receivables or payables as against the profits.) IFRS requires deferred tax calculation on the result of eliminations.

[2] Pay attention to the fact that in harmony with Hungarian regulations, in the course of qualification within the scope of consolidations, even the IFRS examines the voting rights (and not the ownership rights) at the companies.

[3] IAS 27, para. 13. I do not discuss all the definitions used by the standard, but the definitions relevant to this paper only.

[4] Except when under certain identified conditions it can be proven unambiguously that such an ownership does not imply control.

To prepare the consolidated financial statements, the financial figures (statement of financial position, profit and loss, etc.) of the parent company and subsidiaries are combined and then those accumulations that fail to present a realistic picture about the group of companies are excluded, provided that they are run as a single entity.

In this paper I do not present the details of the tasks in full consolidation, but of course it is inevitable to note that significant deviations can be seen as against the stipulations of the Hungarian Accounting Act. Since, however, the consolidation changes between 2008 and 2011 did not involve these tasks, they would not be discussed in details now.

The time of acquisition and the accounting policy, presentation obligations

The consolidated financial statements may include the profits of subsidiary operations from the time the acquisition took place, i.e. after control over the purchased subsidiary is actually transferred to the buyer, and in this case the profit and loss statement of the subsidiary must be split between the two periods [14].

For the entities in a group of companies, it is advisable to identify and apply a uniform accounting policy when drawing up each statement. If the entities do not apply a uniform accounting policy, they must say so in the consolidated financial statements and they must point out the deviations. Wherever there are important differences and the impact made on the consolidated financial statements is significant, the differences caused by the different accounting policy must be shown regarding each balance sheet and profit line.

Due to the importance of influence exerted by the subsidiaries, the standard specifies a multiple presentation approach concerning an investment in the subsidiary, which is regulated by this standard.

Changes in the specifications of the standards IAS 27 and IFRS 3 regarding the financial years commencing after 1 July 2009 – i.e. the currently applicable regulations

In 2008, IASB[5] and FASB[6] jointly as part of the convergence project modified the currently applicable consolidation rules. In the course of this alteration, they paid attention to the differences that prevailed earlier between the two systems, and to the expectations identified in view of the need for changes in the future. In addition to these two expectations, they modified the rules of consolidation, which were not only changed for the US accounting users, but also for the applicants of IFRS, i.e. global consolidation regulations were introduced.

Before going into the detailed discussion of the standard, it is important to note the existence of a newly introduced definition 'non-controlling interests' in the standard. This expression is nothing else than the renaming of the earlier 'minority interest' or 'external shareholder interest' or 'minority shareholding', which are now used consistently in consolidation, i.e. the IFRS standards use the same expressions.

What was the reason for changing the standard, and what incited the standard makers to alter the earlier well-established system? First of all the external shareholder interest (hereinafter using the new name it will be called non-controlling interest) was not consistently shown in the consolidated financial statements. All entities agreed that the equity share of non-controlling interests must be shown on the liabilities side, separated from the shareholding of the parent company, because this is a share which does not belong to it, but the positioning in the balance sheet was different for each company. In addition, beyond the various presentation tasks, deviations were also found in the assessment and therefore the standard makers decided to make the presentation and assessment issues unambiguous.

Accordingly, the standard requires:

- The separate showing of the subsidiary equity part per non-controlling interest in the statement of financial position within equity, but separated from the parent company's equity,
- The separation of the current year profit attributable to non-controlling interest from the parent company profit, which must be shown in a separate line in the profit and loss statement,
- The changes in the shareholding of parent company must be accounted for in a consistent way, if the control eligibility is retained (this will represent a significant change). This means that the shareholding of the parent company in the subsidiary may increase or decrease, while maintaining the control eligibility (more than 50% share of the votes), either by purchasing a new shareholding or by selling the existing one. All such economic transactions must be accounted for on the basis of the same regulations, as an equity transaction.
- If a subsidiary is removed from the scope of consolidation as a subsidiary, the amount of shareholding remaining in the subsidiary must be re-assessed at fair value. During the exclusion of the subsidiary, the non-controlling subsidiary equity must be assessed at fair value vis-à-vis assessment at the book value.
- The companies must present sufficient presentation information to make sure that the parent company and non-controlling interest particulars can be identified unambiguously.

The new standard changes substantially the accounting rules of a change in the partnership share of the subsidiary, if the control eligibility of the parent company is retained. For example, the shareholding of a parent company in its subsidiary may change by purchasing further shares in the same subsidiary,

[5] International Accounting Standards Board,
[6] Financial Accounting Standards Board

but it may also change by selling a certain part of the subsidiary shareholding, while maintaining the control eligibility. The standard makes it unambiguous that these transactions must be accounted for in the equity (!). Before issuing the standard, such changes in the shareholding had to be and should have been accounted for in several parts and in many ways. Again according to the earlier accounting regulations, the new shareholdings in a subsidiary had to be accounted for according to the regulations of the purchase method, i.e. new differences arising on equity consolidation (goodwill or negative goodwill) [2] could be generated on each new transaction. This accounting obligation has been eliminated, and the accounting of a further purchase of shareholding from non-controlling interest cannot be treated in accordance with the purchase method according to the new standard, i.e. differences may not arise on equity consolidation. However, let us not forget that in this way the costs of the parent company are also reduced, because it does not have to hire a value appraiser to value the net assets of the subsidiary, in the case of each and every shareholding purchase.

The standard also changes the accounting regulations of disposing a subsidiary. Accordingly, the parent company may only realise during a disposal the profit or loss arising on future equity purchases of the subsidiary. The parent company must exclude the subsidiary from consolidation when its control eligibility is terminated. If a subsidiary is excluded from the scope of consolidation as a subsidiary, the amount of shareholding remaining in the subsidiary is to be re-assessed at fair value. During the exclusion of a subsidiary, the non-controlling subsidiary equity must be re-assessed at fair value vis-à-vis assessment at the book value. Earlier, the amount of remaining shareholding was not reassessed, but it remained at the book value, and the profit or loss of sale was accounted for by using this as a benchmark.

The standard further extended the information to be presented in the notes to the financial statements, and an accurate identification is demanded regarding the parent company part and the particulars of non-controlling interest.

In summary, the most important changes of standards revised in 2008 are as follows:

1 ***Full goodwill method:*** *IFRS 3 enables the assessment at the fair value of any non-controlling interest in the purchased entity or the recognition of 100% of the goodwill of the purchased company and not only the part of the goodwill that goes to the purchasing company (full goodwill method). This method can be selected on an eventual (ad hoc) basis, i.e. for each transaction.*

2 *In the case of* ***sequential purchases,*** *the fair value of the assets and liabilities of the purchased entity is determined at the time of acquiring control. Accordingly, goodwill is the difference between the fair value applicable on the date of acquisition of the shareholding existing earlier in the purchased entity and the consideration paid, and the value of acquired net assets.*

3 ***Loss of control:*** *the decreasing of ownership share in a subsidiary investment which entails losing control, results in reassessing the fair value of remaining stake. The difference between the fair and book value is the profit or loss of cancelling the shareholding, which is to be accounted for at the expense of the profits.*

4 ***Transaction costs*****:** *The costs related to the acquisition are to be expensed in the relevant period, and it is not to be taken into consideration in the goodwill. The buyer must account as liabilities at the time of acquisition the deferred future payments. If the extent of liabilities accounted for the deferred future consideration changes as a result of an event occurring after the acquisition date, the difference is to be accounted for in the profit and not as a modification of the goodwill pursuant to the applicable IFRS regulations.*

1.2 Interests in joint ventures (IAS 31)

IAS 31 deals with the accounting of interests in joint ventures, the reporting of joint venture assets, liabilities, incomes and expenses in the financial statements of the venturers and investors of the joint venture, regardless of the structure or form of joint venture activities. However, it does not deal with the rules of accounting the investments in risk capital investor entities or investor funds or closed-end funds[7].

According to the standard, the following are qualified as joint ventures:

- Jointly controlled operations,
- Jointly controlled assets,
- Jointly controlled entities.

They are characterised by a founding contract or agreement and this contract or agreement must establish joint control over the entity (a single venturer may not unilaterally control the operations).

Jointly controlled operations

Jointly controlled operations mean that each venturer uses its own real estate properties, machines and equipment, and each covers its own expenses and liabilities. The joint venture agreement is generally such a tool which enables the venturers to share the incomes and expenses stemming from selling a joint product. One example is brought up by the standard: several venturers co-ordinate their operations to create and sell for example an aeroplane, where each venturer receives an agreed share of the revenues.

In the case of interests in jointly controlled operations, the venturer must show the following in its statements:

[7] The risk capital investor organisations, investment funds, closed-end funds and similar entities must be initially identified as having fair value in comparison with the profit or they are qualified as those which are held for a trading purpose and they are accounted for in accordance with the standard IAS 39. According to IAS 39, such investments must be evaluated at fair value, accounting for fair value changes in the profits of the period when the change occurred.

- The assets controlled and the liabilities assumed by it, and
- The arising costs and a share of the revenues obtained by selling products or services of the joint venture[8].

Jointly controlled assets

Jointly controlled assets mean the assets which are obtained by several venturers and dedicated to the purposes of the joint venture. In this case the relevant assets are used by each entity, sharing the incomes and expenses.

In the case of investments in the jointly controlled assets, the venturer must show in the statements:

- From the jointly controlled assets, the part controlled by the relevant venturer in a breakdown by the characteristics of the assets,
- The liabilities assumed by it,
- The venturer's share of the liabilities jointly assumed with the other venturers in association with the joint venture,
- The revenues obtained by selling or using its share of the joint venture's products, together with its share of the joint venture's expenses,
- The expenses arising in association with its interests in the joint venture[9].

Jointly controlled entities

Jointly managed entities are joint ventures implying the setting up of a business organisation in which each venturer has an interest. The entity operates in the same way as other entities, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity.

Consolidation procedures

The standard allows two methods to assess the jointly controlled venture investments falling within the scope of this standard:

- **Equity method:** This is a method of accounting whereby an interest in a jointly controlled entity is initially recorded at cost and adjusted thereafter for the post-acquisition change in the venturer's share of net assets of the jointly controlled entity. The profit or loss of the venturer includes the venturer's share of the profit or loss of the jointly controlled entity.
- **Proportionate accounting:** this is a method of accounting whereby a venturer's share of each of the assets, liabilities, income and expenses of a jointly controlled entity is combined line by line with similar items in the venturer's financial statements or reported as separate line items in the venturer's financial statements.

[8] IAS 31, para. 15.
[9] IAS 31, para. 21.

It is an important difference between the two methods that in proportionate accounting, the proportional (quota) statement of financial position and profit and loss statement of the jointly controlled entity is added to the parent company's statement of financial position and profit and loss, while in the case of using the equity method, this is not done, but the change in equity of the interests in the jointly controlled entity is accounted for in the line of the value of shareholding. The two methods represent a huge difference when comparing the statement of financial position and the profit and loss statement even in the case of the same entity, and therefore of course it can be expected that some kind of unification will take place [7].

Transactions between jointly controlled entities and venturer, and the disclosure obligations

The profits and losses arising from the transactions between the investor and the venturer are only presented in the investor's statements up to the extent of non-associated investor interests in the jointly controlled entity. As such a transaction, the standard identifies for example the profit differences arising in the course of selling assets between the two parties. From the profits and losses arising at the jointly controlled entity and stemming from such transactions, the investor's share must be excluded[10].

In the notes, on the basis of the standard, the following information must be presented in association with our jointly controlled entities:

- The appropriate listing and presentation of significant jointly controlled entities, including the ratio of venturer's interests and – if not identical – the ratio of owned voting rights, and
- The methods applied in the accounting of such investments. If the equity method has been chosen, the combined amounts of current assets, invested assets, short and long term liabilities and incomes and expenses must be shown.
- The capital commitments and shareholdings of the venturer in association with any of its joint ventures.

2 Most important changes

The new consolidation standards: IFRS 10, IFRS 11, IFRS 12

On 12 May 2011, in the name of the convergence programme, IASB and FASB issued the following joint standards:

IFRS 10	– Consolidated Financial Statements
IFRS 11	– Joint Arrangements
IFRS 12	– Disclosure of Involvement with Other Entities
IAS 27 (Revised)	– Separate Financial Statements
IAS 28 (Revised)	– Investments in Associates and Joint Ventures

As a predecessor of the standards, the IASB had disclosed

[10] IAS 28, Para. 22.

on 18 December 2008 its Exposure Draft, ED 10 about Consolidated Financial Statements, which made a proposal on a new standard to replace the consolidation standard "IAS 27 – Consolidated and separate financial statements" and "SIC 12: Consolidation – Special purpose entities". ED 10 reflected the results achieved so far during the IASB consolidation project. This project has been on the IASB agenda since 2003, and at the same time in light of the global financial crisis and on the basis of the recommendations of Financial Stability Forum and other organisations, project execution has been accelerated in recent periods. The purpose of ED 10 was to combine in a single standard the official guidelines about consolidation accounting.

The major proposals were the following:

- modifying the definition of control, including detailed application guidelines, and
- extended disclosure in the case of both consolidated and non-consolidated entities.

The project did not involve the detailed consolidation procedures or the accounting of changes occurring in the venturer's interests, and therefore the text of IAS 27 (according to the 2008 revision) was transferred to the new standard. In addition, no such modification has been proposed in view of which the organisations should prepare consolidated financial statements. When the consolidation-related requirements were transferred to the new standard, IAS 27 was given a new title and structure, and after this it applies to separate financial statements only.

This paper deals with the changes of stipulations applying to subsidiaries and jointly controlled entities vis-à-vis the 2008 rules, and therefore the rules relevant from this aspect in the new standards will be presented.

2.1 IFRS 10 and modifying the definition of control

The purpose of the standard IFRS 10 is to identify the rules applying to consolidated statements in case the parent company has control over a subsidiary. Earlier, this was regulated by the standard IAS 27 on separate and consolidated statements, but the new standards separate the two areas. In IAS 27, only the separate statements of a subsidiary involved in consolidation is regulated, while the IFRS 10 specifies the regulations of consolidated statements. IFRS 10 also supersedes the interpretation of SIC 12 (Consolidation – Special purpose entities).

The changing definition of control

On the basis of proposals, control has been redefined in the following way: a company drawing up statements controls a different organisation, if the company drawing up the statements is able to direct the activities of the other organisation in order to make sure that returns for the company drawing up the statements are generated.

The most important elements of definition expressed in details below are:

- ability to direct the activities of the other organisation, and
- eligibility to obtain the returns.

The existence of the ability to direct a different organisation does not necessarily mean that the organisation preparing the financial statements must actively make use of this ability (for example, if an entity has a golden share in a different company which provides voting rights to it, it is not to be taken for granted that it will veto all decisions). When determining whether control prevails, the company drawing up the financial statements must jointly take into consideration this ability and the returns, in order to decide how it can make use of the controlling interest for accomplishing returns. Control must be reviewed on an ongoing basis.

According to the new standard, the controlling ability of the activities of the other organisation is a broader notion than the control notion found earlier in IAS 27, i.e. the ability to control the financial and operating policy of a different entity. According to a section in ED 10 (the basis of conclusions), the power to direct the strategic operational and financial policy of an organisation is only one possibility by which the power to direct the activities of an organisation can be exerted. The other options of exercising this ability include the manifesting of interests through voting rights, options or transferable instruments or contractual stipulations, or a combination thereof. An entity drawing up the statements may also exercise such powers by participating in setting up the operations of the other organisation or in the decision making process which determines the activities of the other organisation.

It may happen that if the activities or transaction options of an organisation are limited to the areas identified in the articles of association, it is not absolutely necessary for the organisation to have a Board of Directors or a different company management body for directing its activities, because the need to make strategic operational and financing decisions on an ongoing basis is unlikely. The obtaining of control over an organisation may be achieved even by participating in its founding. The existence of power to direct a different organisation does not necessarily mean that the entity drawing up the statements must actively exercise this power. Therefore, the definition of control primarily focuses on the possibility of exercising control and not on its actual use.

It may also happen that there is a passive venturer having majority voting rights, who does not regularly exercise its voting rights, and yet it is qualified as a controller of the subsidiary, because it has the power to run the activities of the subsidiary any time by making use of its voting rights. This is one of the most important points of modifying the definition.

The proposed modified definition refers to the returns achieved by the entity drawing up the financial statements (and not the benefit featuring by definition in the currently applicable IAS 27). This change is aimed at making it clear that the definition covers both positive and negative profits (the word 'benefit'

used in the currently applicable standard only refers to positive profits according to the general interpretation). According to the wording of the proposal, such returns are not limited exclusively to a profit that can be expressed in figures; and it can be made use of by the entity preparing the financial statements in various forms, e.g. dividends, fees, know-how, cost saving, etc. In the course of defining whether control prevails, the entity drawing up the financial statements must take into consideration this ability and the returns jointly, i.e. to decide how to make use of the controlling interest to achieve returns.

The detailed application guidelines facilitating the interpretation of the revised definition make it clear that control may not be shared: according to the standard only one party may control an organisation, although of course a different organisation also has the right to advocate its interests.

The new standard sets out from the assumption that if an entity owns more than one half of the voting rights of a different organisation, then the entity has controlling interests in that organisation. The new standard provides further detailed guidelines about the situations when the entity drawing up the financial statements only has a minority of voting rights, and also when there is a structured entity among the parties. On the basis of the new standard, the entity drawing up the financial statements may have the power to direct the activities of the other organisation, even if it owns only the minority of voting rights, assuming that at the same time it has more voting rights than any other party, and such voting rights are sufficient to determine the other party's strategic operating and financing policies (for example, it is the only party to have a share which grants veto rights). The proposal setting the standard on its way has brought up a situation as an example, namely that when the entity drawing up the financial statements is such a controlling shareholder which has a minority of voting rights, but at the same time the other shareholders are unorganised, and in the course of exercising their voting rights they do not actively co-operate with one another (i.e. for example, a company has a lot of small venturers with an ownership share of 1 to 2% each, and there is a company which has an ownership share of 40%. In this case it does not have more than one half of the voting rights and yet it is able to exercise control when compared with the others, and therefore this will result in a parent company relationship).

The guidelines also cover the issue of *de facto* control, which has lead to contradictions in the case of IAS 27. The draft standard has called attention to the fact that an entity drawing up the financial statements may also have the power to direct a different organisation in other ways. According to appendix B9 of the ED 10, the following clues indicate that control prevails, even if an entity possesses less than the majority of voting rights. The indicators of control in the case of lacking majority voting rights are as follows:

- an entity drawing up financial statements has a dominating position in the control body, and therefore may determine the strategic operating and financing policies (for example, a dominant position in the process of electing the members of the organisation's managing body, and in obtaining authorisations from the other owners of voting rights; and appointing of members in the positions becoming vacant in the managing body of the organisation until the next election),
- an entity drawing up financial statements may appoint, recruit, transfer or discharge the most important managers of the organisation,
- an entity drawing up financial statements shares its resources with another organisation (this may mean identical persons in the managing bodies of the organisation and the entity preparing the financial statements or in the management or in the circle of other associates),
- an entity drawing up financial statements may instruct the other organisation to execute significant transactions that serve the reporting entity's interest,
- an entity drawing up financial statements has access to the remaining assets of the other organisation, for example by liquidating or taking over the assets of the other organisation; or on the basis of the articles of association or a separate agreement it has access to the resources of the other organisation.

Consequently, according to the new standard it is possible that the entity drawing up the financial statements has controlling interest in the other organisation even if it owns less than half of the voting rights.

Concerning potential voting rights, IAS 27 only takes into consideration the actually exercised rights. The standard specifies that in case the options or transferable instruments paving the way for potential voting rights can be called currently, then in the course of determining whether control prevails, the potential voting rights must be generally considered as if they were actually existing voting rights. The new draft standard has made a proposal about a more general approach, according to which the organisation drawing up the statements must decide whether the obtaining power of voting rights stemming from the ownership of options and transferable instruments – in view of all the relevant facts and circumstances of the case – enables the entity preparing the statements to direct the operations of the other entity. This means that the instruments mentioned above must not necessarily be callable at once to influence the existence of control. However, even the immediately callable instruments do not necessarily imply that control exists.

Hence, on the basis of the standard, the definition of control is not easy to determine. Earlier, in IAS 27 again the controlling interest determined whether a subsidiary was involved or not, but in that case the controlling interest primarily indicated whether the parent company had a majority, i.e. more than 50% voting rights or not. The new standard, however, defines the control in a different way: an investor has controlling interest

over an investment if pro rata with its shareholding it has the right to obtain various incomes and benefits from the profits of the company, and it has the ability to influence this income level through the control rights[11].

On this basis, a parent company has controlling interest in a subsidiary, if all the conditions below are met:

1 the parent company has the power to direct significant operations,

2 the parent company has the right to obtain income from the subsidiary,

3 the parent company is able to influence the income level of the subsidiary, i.e. it has 'power' over it.

These rights, of course, stem from rights given by the investments. It is important that on the basis of protection rights defined earlier in the standard it is not possible to have controlling interest in a subsidiary and hence such a shareholding may never represent parent company control.

Structured entities

The new standard deals separately with structured entities. According to the IASB, structured entities are similar to special purpose organisations falling currently within the scope of SIC 12. Although the intention is to set up a uniform accounting model of consolidation, which would mean that control in the case of structured entities must be determined in the same way as for any other organisation, IASB believed that in the case of structured entities further application guidelines are required. In accordance with the draft standard, whether another organisation under the control of an entity preparing the statements corresponds to the definition of a structured entity would not influence the accounting. At the same time, from a disclosure aspect, it is important to determine whether an organisation – although it would not be under the control of the company drawing up the statements – is qualified as a structural entity or not, because in such cases further disclosure requirements must be expected.

According to the definition of the new standard, a structured entity is an organisation with limited operations. In defining control over such structured entities, the new standard specifies the considering of further factors. They are important factors, and therefore the regulations about sharing the returns and making decisions about the operations of the structured entity must also be analysed. The new standard says that in the course of reviewing the existence of control, all relevant facts and circumstances must be taken into consideration, and furthermore recommendations are also given. The options and transferable instruments must not necessarily be immediately callable to influence the result of determining control.

[11] IFRS 10:5-6, IFRS 10:8

The factors to be taken into consideration in the course of an analysis relating to the control of structured entities are as follows:

- the purpose and hierarchy of the structured entity,
- returns realised by the entity which prepares statements, on the basis of its relationship with the structured entity (generally, the more sensitive the company which draws up statements to the changes in returns, the higher is the probability that it has the power of control),
- the operations of a structured entity, with special regard to how predetermined the strategic operating and financing policies controlling the operations are (generally such activities are limited and predetermined),
- related arrangements,
- the ability of the company which draws up statements to modify the limitations or the predetermined strategic operating and financing policies,
- if the company which prepares statements proceeds as a proxy of another party, or if another party proceeds as a proxy of the company which draws up the statements.

The new standard contains an additional guideline for determining control in the case of an assignment relationship (with an agent). The agent proceeds on behalf of another party (the principal). Although the agent has all the eligibilities to control the operations of the organisation, it is expected to proceed in accordance with the principal's interests. Therefore, if the company which draws up financial statements exclusively works as an agent, it may not have control, because it does not have the power on the basis of which it could have a share of returns from the organisation's operations. The agent receives a predetermined, fixed fee from the principal for rendering services. If, however, the agent's remuneration is pro rata with the performance, it could be difficult to make a distinction between an assignment relationship and control. In such cases, the organisation must decide whether its dependence on changes in the profit could be compared with an investor's position.

Consolidation procedures

There is no change in the method applied during the preparation of a consolidated financial statement. The methods are still the following:

- the assets, liabilities, equity, income, expenses and cash flow of the parent company and the subsidiaries must be added up,
- the shareholding of the parent company must be excluded as against the equity part of each subsidiary (in harmony with the specifications of the business combinations standard IFRS 3), and then
- the assets, liabilities, incomes and expenses among the parties must be excluded.

The parent company can still involve the subsidiary in the consolidation only from the time when the control eligibility is established, and this is to be done on the basis of the fair value of equity applying on the date of acquisition, and if the control eligibility is terminated it may not be consolidated any more as a subsidiary. The specification is maintained that the financial statements for the consolidation must be drawn up with the same statement date for the parent company and the subsidiary, except in cases when this may not be implemented. If execution is impossible, then these two dates may continue to differ, but there may not be more than three months between the two dates.

The non-controlling interest (earlier external venturer interest) continues to be the part of the net profits and net assets stemming from the operations of a subsidiary which are attributable to shareholdings not owned by the parent company either directly or indirectly through subsidiaries. The non-controlling interest may still assume a negative value if the payment obligation of minority shareholders can be legally manifested.

Non-controlling interest is to be shown in consolidated statements within the equity, separately from the equity of the parent company.

It can be seen well that substantial differences have appeared primarily in determining the control power of the parent company. This means that it may happen: an entity qualified to be a subsidiary earlier is no longer qualified as a subsidiary by the business organisation, and the opposite is also possible. However, this may cause significant changes in the tasks, and also in the main lines of the consolidated financial statements (let us imagine skipping an important subsidiary from the statements), and therefore parent companies which prepare consolidated financial statements are advised to examine this change as soon as possible.

2.2 IFRS 11: Joint arrangements

The purpose of the standard is to determine the definition and types of joint arrangements. Earlier, this was regulated by IAS 31 on joint ventures, which was replaced by IFRS 11. The IFRS 11 standard supersedes also the SIC 13 interpretation (jointly controlled entities – non-monetary contributions by entities).

On the basis of the standard, the types of joint arrangements can be the following:

- Joint operations: where the parties have a joint right to have control over the assets and related liabilities featuring in the arrangement. The standard calls this joint operations [IFRS 11:15],
- Jointly controlled entity: where the parties have a joint right to have control over the net assets of the entity. The standard calls this the venturers of a joint venture [IFRS 11:16].

Accounting

In the case of joint operations, the venturer presents the following in its books [IFRS 11:20]:

- its assets, including its share of the jointly controlled assets,
- liabilities, including its share of the jointly controlled liabilities,
- incomes, including incomes resulting from joint operations and its share of the revenues from joint operations,
- the expenses and its share of the expenses of joint operations.

In the case of jointly controlled entities:

Shareholdings in jointly controlled entities are to be consolidated by the equity method identified in the standard IAS 28 (investments in associates). This means that the opportunity has been abolished to consolidate a jointly controlled entity by the proportional quota method.

Disclosure issues

A significant change as against the earlier situation is that neither IFRS 10, nor IFRS 11 identifies a disclosure obligation. This, however, does not mean that there is no such obligation, but the fact that all the disclosure obligations related to the scope of consolidation have been transferred to a separate standard which is IFRS 12 (Disclosure of interests in other entities.).

Obligatory application and preliminary application

IFRS 10 and IFRS 11 are to be applied on an obligatory basis for the financial years commencing after 1 January 2013, but in harmony with the specifications of the standard IAS 8, this is to be done retroactively. The only exemption from this is if the parent company consolidates such an entity which it has not consolidated before or an entity which it should have consolidated earlier. Of course, IFRS 10 and IFRS 11 can be applied previously but in this case each of the new standards must be applied on a previous basis.

In summary, the most important changes of the standards revised in 2011 are as follows:

1. ***Change in the definition of control:*** *an entity which draws up financial statements controls another organisation, if the entity which prepares financial statements is able to direct the operations of the other organisation to make sure that it provides returns to the entity which draws up financial statements (i.e. this does not mean that it holds the majority of votes)!*
2. ***Taking into consideration the potential voting rights:*** *it is not necessary to be immediately callable to influence the existence of control.*
3. ***Appearance of structured entities:*** *a structured entity is an organisation with limited operations. It may not be qualified to be a parent company.*
4. ***Consolidation procedures of joint ventures:*** *the proportional quota consolidation is abolished, consolidation is only permitted by the equity method.*

5 ***Regulation of separate financial statements:*** *regulations about compiling the separate financial statements of a subsidiary to be involved in the consolidation have been published.*

6 ***Separation of disclosure obligations:*** *in association with the consolidation, the disclosure obligations of each type of company have been removed from the given standard and they are controlled by a separate standard.*

The impact of changes on the company's wealth and its financial and income situation

3 The impact of changing the new consolidation standards on the consolidated financial statements

In order to recognise the impact of the changes above on the consolidated financial statements, the modifications are examined on the basis of an illustrative example.

There is a group of companies, where the PARENT company has two investments, companies A and B. They both have 70% voting and ownership rights in the company, while company B is jointly run together with another company on a parity basis, with 50% voting and ownership rights. According to the current regulations, PARENT involves company A with a full consolidation, and company B with a proportional quota consolidation. For simplicity, no intercompany transaction takes place in the group of companies and company A was purchased in the beginning of the year, and company B was founded by the PARENT.

According to the currently applicable regulations, a simple version of the statement of financial and profit and loss statement is on the (Table 1)

Let us assume that in addition to the 70% ownership of the PARENT company, the minority shareholder having a 30% share of the company A has a golden share, i.e. it may veto any time the decisions of the PARENT company. However, the minority owner has never made use of this opportunity.

On the basis of the new standard revisions, however:

- the controlling interest is to be reviewed. On this basis, control is not held by the PARENT company, consequently it may not be qualified as a parent company, and hence it may not make use of the full consolidation.
- in the case of jointly controlled entities, the proportional quota consolidation has been abolished, and therefore this investment may only be consolidated by equity method.

According to the new consolidation rules, the consolidated financial statements of the group of companies will be like this: (Table 2)

It is obvious to see that according to the two methods the equity and the profits of the parent company are the same. But, each line of the balance sheet items and profit and loss statement are different, because the parent company had to treat the statements of the investment in an entirely different way. While in the previous method all the assets, liabilities and profit items of the subsidiary are known practically (and the same applies to the proportional assets, liabilities, and profits of the jointly controlled entity), according to the new method only the value of investment is shown in the statements. This also means that the notes are expected to meet much more disclosure challenges [7].

On the basis of the discussion above, company A as a parent company will not be consolidated any more by the PARENT company, but by the minority venturer who was presented as non-controlling interest before. It is not negligible to note that in this case the jointly controlled entity providing the 50% shareholding will NOT be consolidated by any entity, and only its investment will be valued, because the proportional consolidation method has been abolished. Therefore, the assets, liabilities and profit lines of the jointly controlled entity will not appear in the consolidated financial statements of any entity.

The change in the financial indicators of the group of companies is also worth examining. The equity ratio of the group of companies as against the balance sheet total on the basis of the revised standard has grown by nearly 10%, with the same date of the group of companies considered in both cases. It is important to call attention to the fact that in this case when this year is compared in time related to the earlier statements of the same group of companies, distorted results may be obtained, but at the same time it is also important that when comparing the financial statements of the other groups of companies, similar problems may be encountered.

Conclusions and summary

The IFRS system saw a change in consolidation regulations again in 2011. In 2008, the consolidation rules have been reviewed already, changing the impact of transactions with entities covered by the scope of consolidation, and that of the transactions with non-controlling interests, but in 2011 less technical, but rather significant changes took place, which altered the scope of consolidation.

In this paper I have presented these changes in comparison with the earlier rules, and showed how the financial statements of a group of companies were modified as a result of these changes. Significant changes can be seen in the qualification of subsidiaries, associated companies and jointly controlled entities as well as in their involvement in the consolidation.

Of the changes in the consolidation standards, the change in the control qualification of subsidiaries, and the narrowing of consolidation methods for jointly controlled entities were emphasised. As a result of changing the control qualification of subsidiaries, it may be found out about certain subsidiaries that in the future they cannot be consolidated as subsidiaries, while in the case of certain entities it may become clear as a result that so far they have not prepared consolidated financial statements, but because one of their investments was qualified as a subsidiary, they would be forced to prepare consolidated financial statements. In the case of both parties, regarding consolidated financial statements, significant changes in wealth, income

Tab. 1. Statement of financial position and profit and loss statement of the group of companies according to the currently applicable regulations

Statement of financial position	**PARENT**	**A**	**B**	**Eliminations**	**Total**
Non-current assets	125 000	32 530	25 600	6 600	189 730
Investments:					
Investment in A	15 000	–	–	– 15 000	–
Investment in B	5 000	–	–	– 5 000	–
Current assets					
	145 000	**32 530**	**25 600**	**- 13 400**	**189 730**
Shareholder's equity	65 000	18 000	7 000	– 18 800	71 200
Non-controlling interest				5 400	5 400
	65 000	18 000	7 000	– 13 400	76 600
Liabilities	80 000	14 530	18 600		113 130
	145 000	**32 530**	**25 600**	**- 13 400**	**189 730**
Profit and loss statement	**PARENT**	**A**	**B**	**Eliminations**	**Total**
Incomes	65 800	30 000	6 000		101 800
Expenses	55 680	24 000	4 000		83 680
After tax profits	**10 120**	**6 000**	**2 000**	**-**	**18 120**
attributable to:					
Parent company	10 120	4 200	2 000		16 320
Non-controlling interest	–	1 800	–		1 800

Tab. 2. Statement of financial position and profit and loss statement of the group of companies according to the revised regulations

Statement of financial position	**PARENT**	**A**	**B**	**Eliminations**	**Total**
Non-current assets	125 000				125 000
Investments:					
Investment in A	15 000			4 200	19 200
Investment in B	5 000			2 000	7 000
Current assets					
	145 000			**6 200**	**151 200**
Shareholder's equity	65 000			6 200	71 200
Non-controlling interest					–
	65 000			6 200	71 200
Liabilities	80 000				80 000
	145 000			**6 200**	**151 200**
Profit and loss statement	**PARENT**	**A**	**B**	**Eliminations**	**Total**
Incomes	65 800				65 800
Expenses	55 680				55 680
Profits of associated and jointly controlled entity	–			6 200	6 200
After tax profits	**10 120**	**–**	**–**	**6 200**	**16 320**
attributable to:					
Parent company	10 120	–	–		16 320
Non-controlling interest	–	–	–		–

and finances are entailed by altering the definition of control.

Earlier, the jointly controlled entities were involved in the consolidated financial statements by proportional quota consolidation or by the equity method, in accordance with the consolidated accounting policy of the organisation. In the case of a group of companies, these methods are applied on a mixed basis,

and generally on a uniform basis in the consolidation of jointly controlled entities. Actually, comparability could have been adversely affected by allowing the use of the two methods, because this resulted in substantial differences of the consolidated financial statements technically. The narrowing of the methods can be obviously justified by the decreasing of these alternatives, but in this case after the abolishing of proportional quota consolidation method we may have to face the fact that the assets, liabilities, incomes and expenses of a jointly controlled entity will not appear in any consolidated financial statements, and hence no information will be available about large jointly controlled entities in the financial statements, only in the notes. It would be worth examining why – when the narrowing of methods was raised – it was not the proportional quota consolidation which was maintained as a single consolidation method, while abolishing the equity method in the case of jointly controlled entities.

I have demonstrated in the paper that as a result of these changes, the wealth and profitability position of the group of companies appears quite differently, and therefore it is not certain that for the investors they present the wealth and profitability of the group of companies by more intensively supporting a true and realistic picture. In certain groups of companies, the creditors, investors, and other interest groups tie contractual conditions to various indicators and financial criteria (for example, the ratio of external funds), and determining these indicators (levels) may require revisions as a result of the changes in the standards, but will at least demand the examination of how the standard will influence the financial indicators of the groups of companies.

It can be seen clearly that the modification of regulations causes substantial changes in the balance sheet and profit and loss statement of consolidated financial statements, even if no transaction at all takes place within the group of companies essentially. It is important to recognise that as a result of the modified rules, we have to evaluate consolidated financial statements from a different perspective, because the so far unambiguous rules which we have become accustomed to for years have been overwritten. In the course of describing the presented changes, I have pointed out the criticism which has been raised by the way since the introduction of changes that in the course of consolidating a jointly controlled entity according to the new regulations, the assets and liabilities of the jointly controlled entity proper will not be featured in any consolidated financial statements in the future, and this may also cause conceptual changes in the evaluation and assessment of assets and liabilities of the group of companies.

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