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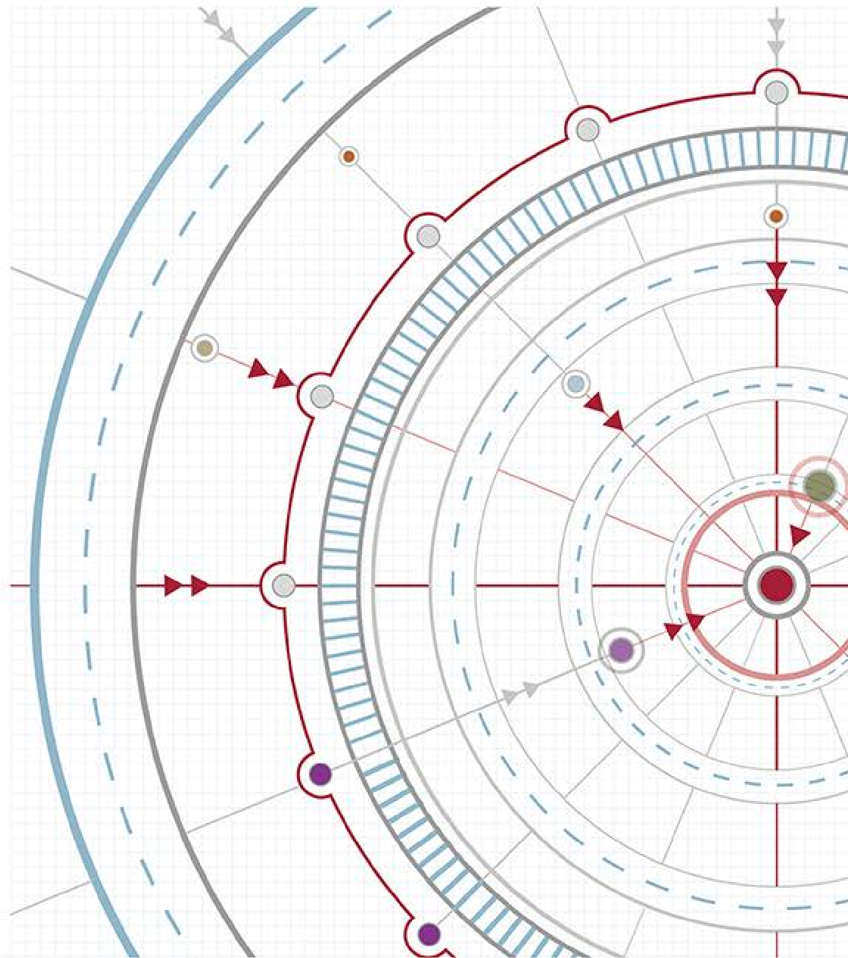

The impact of IFRS 10 on consolidated financial reporting

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Why is this important?

- Starting a Post-Implementation Review (PIR) of
  - IFRS 10 Consolidated Financial Statements
  - IFRS 11 Joint Arrangements
  - IFRS 12 Disclosure of Interests in Other Entities
- PIRs assess how well a standard is working.
  - PIRs should be evidenced based.
  - Research is an important contributor to a complete set of evidence.

Fundamental Question & Authors' Primary Conclusion

- The fundamental question with respect to IFRS 10 is:
- Does IFRS 10's principles-based definition of control lead to:
  - more appropriate classification of subsidiaries for consolidated statements? and
  - more informative financial statements?
- Authors Primary Conclusion is:
- The adoption of IFRS 10 is associated with:
  - firms consolidating fewer subsidiaries
  - a decrease in the likelihood of firms consolidating non-majority owned subsidiaries
- There is evidence that something is happening, but we need clearer evidence and causal links to help us make decisions

Interesting results in Table 6

Supports IFRS 10 provides more appropriate accounting

PRE period	SUBCOUNT		SUBSNONMAJORITY = 1	
POST period	Coeff	Sig	Coeff	Sig
Post	0.214	0.01	0.149	ns
Leverage	0.105	0.01	0.117	ns
Leverage*Post	-0.049	0.10	-0.182	0.10
Sum above Lev Lev*Post	0.056	marg sig?	-0.065	ns
Big4	0.504	0.01	-0.213	0.01
Big4*Post	-0.140	0.05	0.136	ns
Sum above Big4 Big4*Pos	0.364	sig	-0.077	ns
CEOown	0.421	0.01	-2.519	0.01
CEOown*Post	-0.505	0.01	1.945	0.01
Sum above CEOown CEOown*Post	-0.084	prob ns	-0.574	prob ns
Loss	-0.247	0.05	0.267	0.01
Loss*Post	0.048	ns	-0.276	0.01
Sum above Loss Loss*Pos	-0.199	prob sig	-0.009	ns

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Opportunities to increase the contribution – Sample and Design 1

- The number of subsidiaries and the incidence of at least one non-majority subsidiary can be attributed to different causes.
  - Given 1092 /2000 firm-years, then each of the two main dependent variables can change from a firm entering or leaving the sample based on the availability of date.
  - The two variables can change from firms entering or leaving the 500, although this is a smaller risk.
  - Firms may add or dispose of investments for economic reasons that have nothing to do with IFRS 10.
    - Similarly, firms may increase or decrease their ownership share for economic reasons.
- These reasons have little to do with IFRS 10

Opportunities to increase the contribution – Sample and Design 2

- It would be useful to focus on changes that can be attributed to IFRS 10:
  - Firms may use their judgment or the latitude a standard allows to classify non-majority owned investments as subsidiaries or not.
    - The majority owned must be consolidated.
  - Firms could reduce their ownership interest or completely dispose of investments to achieve a non-consolidation outcome. This can apply to majority-owned or non-majority owned investments.
- In contrast to the prior slide, these reasons capture effects that are potentially directly or indirectly important to assessing IFRS 10
- It would be good to try and refine the analysis to capture these effects more clearly.

Opportunities to increase the contribution – Focus and Reader Understanding

- Useful to have a complete set of descriptive statistics and simple parametric and non-parametric correlations for all variables.
  - Enhances a reader's understanding and confidence
- Useful to know the period to period change in number of subsidiaries and consolidated non-majority subsidiaries for a within firm analysis.
  - Try to attribute these changes to economic and/or accounting decisions
    - Possibly analyse changes as mini cases to supplement statistical analysis
  - How material are these changes? There is no descriptive information.
  - Is there a theory explaining what to expect if an entity reduces its subsidiaries by one or more? Results in Table 7 suggest a radical change in how the market values an entity in the post period. Why?
- Given hand collection did you consider collecting missing data to increase sample size?

Opportunities to increase the contribution – Financial Reporting Choices and Incentives

- There are two main potential financial statement effects, leverage and income effects.
  - Consolidating a subsidiary increases leverage on the balance sheet relative to not consolidating.
  - Consolidating or ceasing to consolidate can affect profit or loss (EBIT) relative to using the equity method. These are:
    1. Positive/negative income subsidiaries increase/decrease profit or loss (or EBIT) relative to not consolidating.
       - Possibly impact bonus plans (test CEO Bonus interactions?)
       - market valuations can still be based on net profit or loss attributable to the parent, so valuation likely not affected.
    2. Losing control & ceasing consolidation triggers a fair valuation of the remaining interest. Firms can generate a gain in profit or loss by ceasing to consolidate

Conclusion

- Helpful to know that there appears to be an impact to IFRS 10, more likely positive than negative.
- The authors can potentially provide a more refined and focused analysis
  - Distinguish subsidiary changes at a within firm level, and assess the motivation for the change more precisely
  - Use this in the broader empirical tests
  - Consider mini case investigations of specific firm decisions
- Such an analysis should be helpful in IASB's PIR.

- Thank you

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