
**STATUTORY BOARD
FINANCIAL
REPORTING STANDARD**

**SB-FRS 27, SB-FRS
28, SB-FRS 31**

Guidance on Implementing
**SB-FRS 27 Consolidated and Separate
Financial Statements, SB-FRS 28 Investments
in Associates and SB-FRS 31 Interests in Joint
Ventures**

Guidance on implementing SB-FRS 27 Consolidated and Separate Financial Statements, SB-FRS 28 Investments in Associates and SB-FRS 31 Interests in Joint Ventures

This guidance accompanies SB-FRS 27, SB-FRS 28 and SB-FRS 31, but is not part of them.

Consideration of potential voting rights

Introduction

- IG1 Paragraphs 14, 15 and 19 of SB-FRS 27 Consolidated and Separate Financial Statements (as amended in 2008) and paragraphs 8 and 9 of SB-FRS 28 Investments in Associates require an entity to consider the existence and effect of all potential voting rights that are currently exercisable or convertible. They also require all facts and circumstances that affect potential voting rights to be examined, except the intention of management and the financial ability to exercise or convert potential voting rights. Because the definition of joint control in paragraph 3 of SB-FRS 31 Interests in Joint Ventures depends upon the definition of control, and because that Standard is linked to SB-FRS 28 for application of the equity method, this guidance is also relevant to SB-FRS 31.

Guidance

- IG2 Paragraph 4 of SB-FRS 27 defines control as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Paragraph 2 of SB-FRS 28 defines significant influence as the power to participate in the financial and operating policy decisions of the investee but not to control those policies. Paragraph 3 of SB-FRS 31 defines joint control as the contractually agreed sharing of control over an economic activity. In these contexts, power refers to the ability to do or effect something. Consequently, an entity has control, joint control or significant influence when it currently has the ability to exercise that power, regardless of whether control, joint control or significant influence is actively demonstrated or is passive in nature. Potential voting rights held by an entity that are currently exercisable or convertible provide this ability. The ability to exercise power does not exist when potential voting rights lack economic substance (eg the exercise price is set in a manner that precludes exercise or conversion in any feasible scenario). Consequently, potential voting rights are considered when, in substance, they provide the ability to exercise power.
- IG3 Control and significant influence also arise in the circumstances described in paragraph 13 of SB-FRS 27 and paragraphs 6 and 7 of SB-FRS 28 respectively, which include consideration of the relative ownership of voting rights. SB-FRS 31 depends on SB-FRS 27 and SB-FRS 28 and references to SB-FRS 27 and SB-FRS 28 from this point onwards should be read as being relevant to SB-FRS 31. Nevertheless it should be borne in mind that joint control involves contractual sharing of control and this contractual aspect is likely to be the critical determinant. Potential voting rights such as share call options and convertible debt are capable of changing an entity's voting power over another entity—if the potential voting rights are exercised or converted, then the relative ownership of the ordinary shares carrying voting rights changes. Consequently, the existence of control (the definition of which permits only one entity to have control of another entity) and significant influence are determined only after assessing all the factors described in paragraph 13 of SB-FRS 27 and paragraphs 6 and 7 of SB-FRS 28 respectively, and considering the existence and effect of potential voting rights. In addition, the entity examines all facts and circumstances that affect potential voting rights except the intention of management and the financial ability to exercise or convert such rights. The intention of management does not affect the existence of power and the financial ability of an entity to exercise or convert potential voting rights is difficult to assess.

- IG4 An entity may initially conclude that it controls or significantly influence another entity after considering the potential voting rights that it can currently exercise or convert. However, the entity may not control or significantly influence the other entity when potential voting rights held by other parties are also currently exercisable or convertible. Consequently, an entity considers all potential voting rights held by it and by other parties that are currently exercisable or convertible when determining whether it controls or significantly influences another entity. For example, all share call options are considered, whether held by the entity or another party. Furthermore, the definition of control in paragraph 4 of SB-FRS 27 permits only one entity to have control of another entity. Therefore, when two or more entities each hold significant voting rights, both actual and potential, the factors in paragraph 13 of SB-FRS 27 are reassessed to determine which entity has control.
- IG5 The proportion allocated to the parent and non-controlling interests in preparing consolidated financial statements in accordance with SB-FRS 27, and the proportion allocated to an investor that accounts for its investment using the equity method in accordance with SB-FRS 28, are determined solely on the basis of present ownership interests. The proportion allocated is determined taking into account the eventual exercise of potential voting rights and other derivatives that, in substance, give access at present to the economic benefits associated with an ownership interest.
- IG6 In some circumstances an entity has, in substance, a present ownership as a result of a transaction that gives it access to the economic benefits associated with an ownership interest. In such circumstances, the proportion allocated is determined taking into account the eventual exercise of those potential voting rights and other derivatives that give the entity access to the economic benefits at present.
- IG7 SB-FRS 39 Financial Instruments: Recognition and Measurement does not apply to interests in subsidiaries, associates and jointly controlled entities that are consolidated, accounted for using the equity method or proportionately consolidated in accordance with SB-FRS 27, SB-FRS 28 and SB-FRS 31 respectively. When instruments containing potential voting rights in substance currently give access to the economic benefits associated with an ownership interest, and the investment is accounted for in one of the above ways, the instruments are not subject to the requirements of SB-FRS 39. In all other cases, instruments containing potential voting rights are accounted for in accordance with SB-FRS 39.

Illustrative examples

IG8 The five examples below each illustrate one aspect of a potential voting right. In applying SB-FRS 27, SB-FRS 28 or SB-FRS 31, an entity considers all aspects. The existence of control, significant influence and joint control can be determined only after assessing the other factors described in SB-FRS 27, SB-FRS 28 and SB-FRS 31. For the purpose of these examples, however, those other factors are presumed not to affect the determination, even though they may affect it when assessed.

Example 1: Options are out of the money

Entities A and B own 80 per cent and 20 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity C. Entity A sells one-half of its interest to Entity D and buys call options from Entity D that are exercisable at any time at a premium to the market price when issued, and if exercised would give Entity A its original 80 per cent ownership interest and voting rights.

Though the options are out of the money, they are currently exercisable and give Entity A the power to continue to set the operating and financial policies of Entity C, because Entity A could exercise its options now. The existence of the potential voting rights, as well as the other factors described in paragraph 13 of SB-FRS 27, are considered and it is determined that Entity A controls Entity C.

Example 2: Possibility of exercise or conversion

Entities A, B and C own 40 per cent, 30 per cent and 30 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity D. Entity A also owns call options that are exercisable at any time at the fair value of the underlying shares and if exercised would give it an additional 20 per cent of the voting rights in Entity D and reduce Entity B's and Entity C's interests to 20 per cent each. If the options are exercised, Entity A will have control over more than one-half of the voting power. The existence of the potential voting rights, as well as the other factors described in paragraph 13 of SB-FRS 27 and paragraphs 6 and 7 of SB-FRS 28, are considered and it is determined that Entity A controls Entity D.

Example 3: Other rights that have the potential to increase an entity's voting power or reduce another entity's voting power

Entities A, B and C own 25 per cent, 35 per cent and 40 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity D. Entities B and C also have share warrants that are exercisable at any time at a fixed price and provide potential voting rights. Entity A has a call option to purchase these share warrants at any time for a nominal amount. If the call option is exercised, Entity A would have the potential to increase its ownership interest, and thereby its voting rights, in Entity D to 51 per cent (and dilute Entity B's interest to 23 per cent and Entity C's interest to 26 per cent).

Although the share warrants are not owned by Entity A, they are considered in assessing control because they are currently exercisable by Entities B and C. Normally, if an action (eg purchase or exercise of another right) is required before an entity has ownership of a potential voting right, the potential voting right is not regarded as held by the entity. However, the share warrants are, in substance, held by Entity A, because the terms of the call option are designed to ensure Entity A's position. The combination of the call option and share warrants gives Entity A the power to set the operating and financial policies of Entity D, because Entity A could currently exercise the option and share warrants. The other factors described in paragraph 13 of SB-FRS 27 and paragraphs 6 and 7 of SB-FRS 28 are also considered, and it is determined that Entity A, not Entity B or C, controls Entity D.

Example 4: Management intention

Entities A, B and C each own 33 per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity D. Entities A, B and C each have the right to appoint two directors to the board of Entity D. Entity A also owns call options that are exercisable at a fixed price at any time and if exercised would give it all the voting rights in Entity D. The management of Entity A does not intend to exercise the call options, even if Entities B and C do not vote in the same manner as Entity A. The existence of the potential voting rights, as well as the other factors described in paragraph 13 of SB-FRS 27 and paragraphs 6 and 7 of SB-FRS 28, are considered and it is determined that Entity A controls Entity D. The intention of Entity A's management does not influence the assessment.

Example 5: Financial ability

Entities A and B own 55 per cent and 45 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity C. Entity B also holds debt instruments that are convertible into ordinary shares of Entity C. The debt can be converted at a substantial price, in comparison with Entity B's net assets, at any time and if converted would require Entity B to borrow additional funds to make the payment. If the debt were to be converted, Entity B would hold 70 per cent of the voting rights and Entity A's interest would reduce to 30 per cent.

Although the debt instruments are convertible at a substantial price, they are currently convertible and the conversion feature gives Entity B the power to set the operating and financial policies of Entity C. The existence of the potential voting rights, as well as the other factors described in paragraph 13 of SB-FRS 27, are considered and it is determined that Entity B, not Entity A, controls Entity C. The financial ability of Entity B to pay the conversion price does not influence the assessment.

Appendix

Amendments to guidance on other SB-FRSs

The following amendments to guidance on other SB-FRSs are necessary in order to ensure consistency with the amendments to SB-FRS 27 and the related amendments to other SB-FRSs. In the amended paragraphs, new text is underlined and deleted text is struck through.

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The amendments contained in this appendix when SB-FRS 27, as amended in 2009, was issued have been incorporated into the guidance on implementing SB-FRSs 1, 101 and 105, and the appendix (now renamed illustrative examples) accompanying SB-FRS 7.