



**IGRAP 11**

**ACCOUNTING STANDARDS BOARD**

**INTERPRETATION OF THE STANDARDS OF  
GENERALLY RECOGNISED ACCOUNTING  
PRACTICE**

**CONSOLIDATION – SPECIAL PURPOSE ENTITIES**

**(IGRAP 11)**

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### **Acknowledgement**

This Interpretation of the Standards of Generally Recognised Accounting Practice (IGRAP) is drawn primarily from the equivalent Interpretation of the International Financial Reporting Standard on *Consolidation – Special Purpose Entities* (SIC 12) issued by the International Financial Reporting Interpretations Committee (IFRIC) of the International Accounting Standards Board (IASB). The IASB has issued a comprehensive body of IFRICs. Extracts of the IFRIC on *Consolidation – Special Purpose Entities* are reproduced in these Interpretations of the Standards of GRAP with the permission of the IASB.

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## **CONSOLIDATION – SPECIAL PURPOSE ENTITIES**

### **Introduction**

### **Interpretations of the Standards of Generally Recognised Accounting Practice**

The Accounting Standards Board (Board) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

The Board must determine GRAP for:

- (a) departments (national and provincial);
- (b) public entities;
- (c) constitutional institutions;
- (d) municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and
- (e) Parliament and the provincial legislatures.

The above are collectively referred to as “entities”.

The Board has approved the application of Statements of Generally Accepted Accounting Practice (GAAP), codified by the Accounting Practices Board (APB) and issued by the South African Institute of Chartered Accountants (SAICA) to be GRAP for:

- (a) government business enterprises (GBEs)(as defined in the PFMA);
- (b) trading entities (as defined in the PFMA);
- (c) any other entity, other than a municipality, whose ordinary shares, potential ordinary shares or debt are publicly traded on the capital markets; and
- (d) entities under the ownership control of any of these entities.

The Board believes that Statements of GAAP are relevant and applicable to financial statements prepared by all such entities including those under their ownership control.

Financial statements should be described as complying with Standards of GRAP only if they comply with all the requirements of each applicable Standard of GRAP and any related Interpretations of the Standards of GRAP.

Any limitation of the applicability of specific Standards or Interpretations of the Standards of GRAP is made clear in those Standards or Interpretations of the Standards of GRAP.



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The Interpretation of the Standard of GRAP on *Consolidation – Special Purpose Entities* is set out in paragraphs .01 to .13. All paragraphs in this Interpretation of the Standards of GRAP have equal authority. The status and authority of appendices are dealt with in the preamble to each appendix. This Interpretation of the Standards of GRAP should be read in the context of its objective, its basis for conclusions if applicable, the *Preface to Standards of GRAP*, the *Preface to the Interpretations of the Standards of GRAP* and the *Framework for the Preparation and Presentation of Financial Statements*.

Standards of GRAP and Interpretations of Standards of GRAP should also be read in conjunction with any directives issued by the Board prescribing transitional provisions, as well as any regulations issued by the Minister of Finance regarding the effective dates of the Standards of GRAP, published in the Government Gazette.

Reference may be made to a Standard of GRAP that has not been issued at the time of issue of this Interpretation of the Standards of GRAP. This is done to avoid having to change the Standards already issued when a later Standard is subsequently issued. Paragraph .12 of the Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.



## **Interpretation of the Standards of GRAP on *Consolidation – Special Purpose Entities***

### **References**

- *Framework for the Preparation and Presentation of Financial Statements*
- GRAP 3 *Accounting Policies, Changes in Accounting Estimates and Errors* (as revised in 2010)
- GRAP 9 *Revenue from Exchange Transactions* (as revised in 2010)
- GRAP 17 *Property, Plant and Equipment* (as revised in 2010)
- GRAP 23 *Revenue from Non-exchange Transactions (Taxes and Transfers)*
- *Guideline on Accounting for Public-private Partnership Agreements*

### **Issue**

- .01 An entity may be created to accomplish a narrow and well-defined objective (e.g. to effect a lease, research and development activities or a securitisation of financial assets). Such a special purpose entity ('SPE') may take the form of a corporation, trust, partnership or unincorporated entity. SPEs often are created with legal arrangements that impose strict and sometimes permanent limits on the decision-making powers of their management over the operations of the SPE. Frequently, these provisions specify that the policy guiding the ongoing activities of the SPE cannot be modified, other than perhaps by its creator or sponsor (ie they operate on so-called 'autopilot').
- .02 The sponsor (or entity on whose behalf the SPE was created) frequently transfers assets to the SPE, obtains the right to use assets held by the SPE or performs services for the SPE, while other parties ('capital providers') may provide the funding to the SPE. An entity that engages in transactions with an SPE (frequently the creator or sponsor) may in substance control the SPE.
- .03 A beneficial interest in an SPE may, for example, take the form of a debt instrument, an equity instrument, a participation right, a residual interest or a lease. Some beneficial interests may simply provide the holder with a fixed or stated rate of return, while others give the holder rights or access to other future economic benefits or service potential of the SPE's activities. In most cases, the creator or sponsor (or the entity on whose behalf the SPE was created) retains a significant beneficial interest in the SPE's activities, even though it may own little or none of the SPE's net assets.

- .04 The Standard of GRAP on *Consolidated and Separate Financial Statements* requires the consolidation of entities that are controlled by the reporting entity. However, the Standard of GRAP does not provide explicit guidance on the consolidation of SPEs.
- .05 The issue is under what circumstances an entity should consolidate an SPE.
- .06 This Interpretation of the Standards of GRAP does not apply to post-employment benefit plans or other long-term employee benefit plans to which the Standard of GRAP on *Employee Benefits* applies.
- .07 A transfer of assets from an entity to an SPE may qualify as a sale by that entity. Even if the transfer does qualify as a sale, the provisions of the Standard of GRAP on *Consolidated and Separate Financial Statements* and this Interpretation of the Standards of GRAP may mean that the entity should consolidate the SPE. This Interpretation of the Standards of GRAP does not address the circumstances in which sale treatment should apply for the entity or the elimination of the consequences of such a sale upon consolidation.

### Consensus

- .08 An SPE shall be consolidated when the substance of the relationship between an entity and the SPE indicates that the SPE is controlled by that entity.
- .09 In the context of an SPE, control may arise through the predetermination of the activities of the SPE (operating on 'autopilot') or otherwise. Paragraphs .34 to .36 in the Standard of GRAP on *Consolidated and Separate Financial Statements* indicates several circumstances which result in control even in cases where an entity owns one half or less of the voting power of another entity. Similarly, control may exist even in cases where an entity owns little or none of the SPE's net assets. The application of the control concept requires, in each case, judgement in the context of all relevant factors.
- .10 In addition to the situations described in paragraphs .34 to .36 in the Standard of GRAP on *Consolidated and Separate Financial Statements*, the following circumstances, for example, may indicate a relationship in which an entity controls an SPE and consequently should consolidate the SPE (additional guidance is provided in the Appendix to this Interpretation of the Standards of GRAP):
- in substance, the activities of the SPE are being conducted on behalf of the entity according to its specific operational needs so that the entity obtains benefits from the SPE's operation;



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- 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 'autopilot' 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; or
- 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.

### Transitional provisions

**.11 All changes resulting from the application of this Interpretation of the Standards of GRAP shall be accounted for in accordance with the requirements of the Standard of GRAP on Accounting Policies, Changes in Accounting Estimates and Errors (as revised in 2010).**

### Effective date

#### Initial adoption of the Standards of GRAP

**.12 This Interpretation of the Standards of GRAP becomes effective with reference to the effective date of the applicable Standards of GRAP as determined by the Minister of Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999, as amended.**

#### Entities already applying Standards of GRAP

**.13 An entity shall apply this Interpretation of the Standards of GRAP for annual financial statements covering periods beginning on or after DDMMYYYY [in conjunction with the effective date to be determined by the Minister of Finance for GRAP 105, 106 and 107].**

## Appendix

*This appendix is illustrative only and does not form part of this Interpretation of the Standards of GRAP. The purpose of the appendix is to illustrate the application of this Interpretation to assist in clarifying its meaning.*

### Indicators of control over an SPE

The examples in paragraph .10 of this Interpretation are intended to indicate types of circumstances that should be considered in evaluating a particular arrangement in light of the substance-over-form principle. The guidance provided in this Interpretation and in this Appendix is not intended to be used as 'a comprehensive checklist' of conditions that must be met cumulatively in order to require consolidation of an SPE.

#### *(a) Activities*

The activities of the SPE, in substance, are being conducted on behalf of the reporting entity, which directly or indirectly created the SPE according to its specific operational needs.

Examples are:

- the SPE is principally engaged in providing a source of long-term capital to an entity or funding to support an entity's ongoing major or central operations; or
- the SPE provides a supply of goods or services that is consistent with an entity's ongoing major or central operations which, without the existence of the SPE, would have to be provided by the entity itself.

Economic dependence of an entity on the reporting entity (such as relations of suppliers to a significant customer) does not, by itself, lead to control.

#### *(b) Decision-making*

The reporting entity, in substance, has the decision-making powers to control or to obtain control of the SPE or its assets, including certain decision-making powers coming into existence after the formation of the SPE. Such decision-making powers may have been delegated by establishing an 'autopilot' mechanism.

Examples are:

- power to unilaterally dissolve an SPE;
- power to change the SPE's charter or bylaws; or
- power to veto proposed changes of the SPE's charter or bylaws.

*(c) Benefits*

The reporting entity, in substance, has rights to obtain a majority of the benefits of the SPE's activities through a statute, contract, agreement, or trust deed, or any other scheme, arrangement or device. Such rights to benefits in the SPE may be indicators of control when they are specified in favour of an entity that is engaged in transactions with an SPE and that entity stands to gain those benefits from the financial performance of the SPE.

Examples are:

- rights to a majority of any economic benefits or service potential distributed by an entity in the form of future net cash flows, earnings, net assets, or other economic benefits or service potential; or
- rights to majority residual interests in scheduled residual distributions or in a liquidation of the SPE.

*(d) Risks*

An indication of control may be obtained by evaluating the risks of each party engaging in transactions with an SPE. Frequently, the reporting entity guarantees a return or credit protection directly or indirectly through the SPE to outside investors who provide substantially all of the capital to the SPE. As a result of the guarantee, the entity retains residual or ownership risks and the investors are, in substance, only lenders because their exposure to surpluses and deficits is limited.

Examples are:

- the capital providers do not have a significant interest in the underlying net assets of the SPE;
- the capital providers do not have rights to the future economic benefits or service potential of the SPE;
- the capital providers are not substantively exposed to the inherent risks of the underlying net assets or operations of the SPE; or
- in substance, the capital providers receive mainly consideration equivalent to a lender's return through a debt or interest in the net asset of the entity.



## **Comparison with the Interpretation of IFRS on *Consolidation – Special Purpose Entities* (SIC 12) (December 1998)**

This Interpretation of the Standards of GRAP on *Consolidation – Special Purpose Entities* (IGRAP 11) is drawn primarily from the Interpretation of IFRS on *Consolidation – Special Purpose Entities* (SIC 12). The main differences between this Interpretation and SIC 12 are as follows:

- This Interpretation uses different terminology, in certain instances, from SIC 12. The most significant examples are the use of the terms “management”, “operation” and “net asset”. The equivalent terms in SIC 12 are “governing board, trustee or management”, “business” and “equity” respectively.
- The term “service potential” has been incorporated in this Interpretation as equivalent terms for “future economic benefits” to be public sector specific.