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Educational Case

Accounting for complex investment transactions

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ABSTRACT

This case study exposes students to complex investment transactions. You must document the following: (1) apply the appropriate accounting literature along with its provisions and justify the order of its application; (2) identify and interpret key facts to classify the given investments and relations; (3) discuss the choice of key assumptions that are central to the analysis; (4) interpret the nature of all investment relations with Holdings; discuss all Owner level and below relations; (5) discuss how accounting for varied levels of influence impact the items reported on/off the face of investors' financial statements; (6) from DT's perspective, discuss the potential positives and negatives of its arrangement with Owner with respect to Holdings; and (7) after analyzing additional facts, discuss the nature of the relations of Simon and Herb III with Owner.

1. Case study

1.1. Case information

Herb Huskie is contemplating taking his company (Herb Huskies Investors) public in an initial public offering (the "IPO"). He holds over 50 investments in the real estate industry and as part of the IPO process must provide audited consolidated financial statements. Herb Huskie decided to hire an audit firm with vast IPO experience. As such, all relations must be analyzed to determine how to account for Herb Huskie's investments in the new financial statements. To start, your audit manager has selected Holdings, LLC[1] ("Holdings") as the first investment for the analysis. Holdings is an investment

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[1] LLC is the US equivalent of a UK Ltd.

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company that owns and operates 16 real estate entities, HH I–HH XVI, each entity managing multiple buildings (BLDG), with individual property owners (SWD). The basic business plan for Holdings' investments includes: (1) executing sales when the timing is appropriate, also known as property re-positioning, (2) spending significant capital to improve, reposition and/or re-tenant the assets; (3) executing a significant lease-up strategy for the properties; and (4) refinancing of individual properties when necessary.

As presented in the attached ownership/relation chart (Fig. 1), Holdings has two equity investors: 80% by DT, LLC ("DT") and 20% by Owner, LLC ("Owner"). Owner is jointly owned (50/50) by Simon, LLC ("Simon") and Herb Capital Investment Fund III ("Herb III"). Herb III is an entity wholly owned by Herb Huskies Investors. Holdings is managed by Manager, LLC ("Manager"), an affiliate of Herb Huskies Investors. Manager has no ownership interest in Holdings and receives no management fee; however it receives remuneration in the form of a 1% acquisition fee related to Holdings and its subsidiaries' purchased value of seven predetermined properties (already present in the portfolio). Another affiliate of Herb Huskies Investors, "Property Manager," engages in property management and entered into property management contracts with Holdings' subsidiaries (i.e. HH I–HH XVI) at the lowest tier ownership entities (SWD), whereby the Property Manager earns a fee of 3–4% of property level revenues.

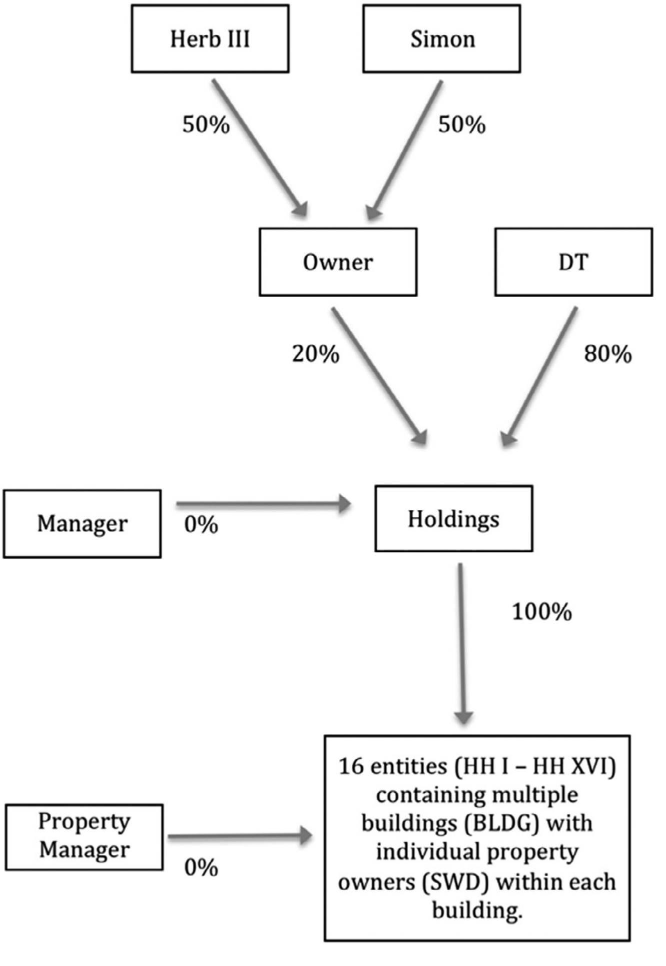

Fig. 1. Holdings' ownership/relation chart.

The fees earned by the Property Manager are at rates that would be incurred if a third-party provided the service (i.e. an arm's length transaction). Termination of the agreements is for cause only, i.e. severe misconduct such as theft, workplace violence or major insubordination that would fundamentally breach the contract's terms.

DT and Owner, collectively referred to as "Members," have equal decision-making rights within the Limited Liability Agreement of Holdings ("the Agreement"). The decision-making rights are outlined below:

- *Certificate* – approval for amending the organizational structure of Holdings or any of its subsidiaries, including mergers or other major structural changes.
- *Forming Subsidiaries* – approval of the establishment of any new subsidiaries.
- *Annual Business Plan* – approving and adopting an operating budget, including leasing guidelines, financing, capital improvements, replacements, purchases, tenant improvements, leasing commissions, and any amendment, modification or other change to any of the foregoing.
- *Subsidiary Major Decisions* – approval of strategic financial and operating decisions of any of the Holdings' subsidiaries.
- *Transfers* – approval of any sale or transfer of Members' interest.
- *Indebtedness* – approval for Holdings or for any of its subsidiaries incurring, or becoming liable for, or permitting to exist, any mortgage, financing or other indebtedness.
- *Corporate Transactions* – approval of any issuance or sale of securities.
- *Financial Matters* – approval for selecting banks, setting reserves levels and other costs that maybe outside the approved budget.
- *Property Matters* – approval for major repairs, development, redevelopment or modification (including changing the nature of utilization) of any property.
- *Leasing* – approval for all lease parameters and activities.
- *Legal Action* – approval of the processing of any legal actions.
- *Bankruptcy* – approval for filing or responding to any bankruptcy petition.
- *Professionals* – approval for appointing or replacing the auditing and financial advisory firms as well as attorneys, accountants, or other similar professionals on behalf of Holdings or any of its subsidiaries.
- *Distributions* – approval of any distributions of net cash flow or capital proceeds.
- *Environmental* – approval of the appropriate course of action in relation to environmental matters.
- *Service Contracts* – approval of entering into any service or supply contracts.
- *Out of Ordinary Course of Business* – approval for entering into any agreement, incurring any obligation with respect to Holdings, a subsidiary, or a project which could be considered by reasonably prudent persons to be out of the ordinary course of the business of Holdings or any of its subsidiaries.
- *Binding Agreements* – approval before entering into any agreement that purports to bind, or obligates Holdings, any of its subsidiary or the Members.

The Members made significant equity contributions to allow Holdings to obtain third-party, non-recourse mortgage financing to purchase properties owned by the 16 real estate entities. The contributions also provided Holdings with large cash reserves to support property operations and fund property repositioning. As of December 31, 2013, Holdings had total assets of $291 million (including, but not limited to, $248 million in real estate held for investment, $2.6 million in operating cash, and $14.1 million in cash capital expenditure reserves); total liabilities of $269 million (including $261 million in mortgage debt); and $22 million in Members' equity (initial capital contributions were $98.5 million). The Agreement also stipulates how the Members allocate profits and losses and distribute cash. Only Members receive profit and loss allocations.

The Manager, whom DT and Owner jointly appointed, performs administrative and operating services specified as follows:

- ensuring the compliance of all Holdings' subsidiaries with the Members' approved major decisions including the Members' approved budgets,

- taking the necessary actions to maintain Holdings' status as a limited liability company in good standing, and
- preparing and submitting operating budgets to the Members for approval.

Additionally, the Manager:
- may appoint a party to be an officer of Holdings, but only with the approval of the Members,
- is authorized to enter into property management and leasing agreements with other parties but only under the Members' pre-designated terms,
- shall require Holdings and its subsidiaries to maintain insurance under the Members' pre-determined terms, and
- shall maintain books and records for Holdings and its subsidiaries.

As previously noted, the Agreement provides that the Manager is not compensated for these services but will receive a 1% acquisition fee related to Holdings and its subsidiaries' purchased value of seven predetermined properties.

Property management agreements represent service contracts and provide for the Property Manager to run the day-to-day operations of Holdings subsidiaries' properties (these agreements, as already noted, are with the lower tier entities SWD). The agreements contractually provide that the Property Manager must abide by the Members' approved annual budget and limits potential decisions that can be made outside of the approved budgets. The Property Manager can hire/fire property level personnel (e.g. cleaners, custodians, and maintenance staff and similar) but, such decisions are made within Members' pre-approved guidelines for the number of positions and remuneration levels. The Property Manager can also spend amounts outside the budgeted activity to maintain the properties, but these amounts are limited to $5,000 individually and $10,000 in total for a 30-day period and are not considered material to the overall property budget.

1.2. Task

You must help advise your audit manager on how to interpret and account for investment relations at Owner/DT level and below. Please document the following: (1) apply the appropriate authoritative accounting literature along with its provisions and justify the order of its application; (2) identify and interpret key facts to classify the given investments and relations; (3) discuss the choice of key assumptions that are central to the analysis; (4) interpret the nature of all investment relations with Holdings; discuss all Owner level and below relations; (5) discuss how accounting methods for varied levels of influence impact the items reported on/off the face of investors' financial statements; (6) from DT's perspective, discuss the potential positives and negatives of the arrangement between DT and Owner with respect to Holdings; and (7) for this question ONLY, assume the following: The ownership ratio has been altered to Simon holding 20% and Herb III 15% of shares in Owner. All shares of the Owner bear equal voting rights. The rest of shareholding is dispersed and held by multiple shareholders, none individually owning more than 5% of equity. Simon has a contractual right to appoint 2 out of 5 members of the Board of Directors of Owner and the Board approves the strategic operational and financial decisions of the company. Discuss the nature of the relations of Simon and Herb III with Owner.

2. Case teaching notes

2.1. Overview and learning objectives

This case: (1) examines the worldwide importance of investment[2] accounting in modern financial reporting by analyzing multiple investments, and (2) develops competencies (research, critical

[2] IASB uses the term 'group' accounting instead of 'investment' accounting.

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thinking, and technological skills) advocated by the AICPA in its Core Competency Framework.[3] Each objective will be discussed in more detail in the following sections.

This case differs from previously published work by examining: (1) investment accounting in multiple jurisdictions (the case was tested in a US university under US GAAP and an EU institution under IFRS); (2) the revised most recent qualitative rules to identify a variable interest entity (VIE)/subsidiary (see: ASC 810[4]) and (3) multiple investments (i.e. VIEs/subsidiaries, associates and joint ventures under ASC 323 and ASC 810.[5] Previously published cases related to the subject matter (Davis, 2004 and Chasteen, 2005) required students to examine *single* relations between two companies and to analyze the complexities of variable interest entities under the previous Financial Interpretation (FIN) 46(R) quantitative rules. The case also draws students' attention to how accounting methods for varied level of influence impacts the items reported on/off the face of financial statements.

We write the case from the perspective of US GAAP investments, provide footnote references to IFRS, and for instructors wishing to use IFRS only solutions, provide separate IFRS succinct solutions in the Appendix. In the appendix, we also provide a discussion of the importance of group accounting under IFRS and explain why instructors may wish to examine both sets of standards (US GAAP and IFRS) when using the case. The extended memo solutions provide IFRS references in the footnotes only.

2.1.1. *The importance of investment accounting*

Issues regarding the scope of investment accounting are timely and of great topical importance (Christodoulou, 2010 and Davis, 2011). As evidenced by multiple SEC filings,[6] many firms owning more than 50% in another entity, do not consolidate that entity, but instead account for it using the equity method of accounting. This is a strategy to facilitate off-balance sheet financing and change the outward appearance of the 'parent entity'. The investment accounting's full economic impact relative to a firm's financial statements is discussed in detail below.

Globalization has enhanced the tendency of many businesses to expand and diversify their activities by creating new operations or acquiring existing ones. Consequently, economic activities are no longer conducted through an individual enterprise but through groups of inter-related businesses (Mumford, 1982 and Alexander, 1999). As accounting for separate investment members does not provide a complete picture of the investment's activities, consolidated financial statements seek to combine relevant information about the business activities of separate legal entities which are working together as a single economic entity (Alexander, 1999; Moonitz, 1942, 1978; Nobes, 1987, 1993). Over the years, determining the boundaries of an investment reporting entity has become a major challenging conceptual and technical issue in financial accounting (Bahnson, McAllister, & Miller, 2008; Flower, 2004; Nobes, 1987, 2009; Stenka & Taylor, 2010). Regulations determining the composition of an investment can instigate many economic consequences through: (1) implications for accounting numbers reported on the balance sheet; (2) financial relations existing off-balance sheet (and associated measurements of gearing, risk, and debt capacity); and (3) the numbers reported in the income statement (with associated impacts on measured performance and financial ratios of efficiency and profitability) (Diggle & Nobes, 1994; Mian & Smith, 1990a, 1990b; Paterson, 2003; Peasnell & Yaansah, 1988).

The importance of the scope of investment accounting relative to off-balance sheet financing schemes has been amplified by the global financial crisis resulting in investment accounting becoming the

[3] http://www.aicpa.org/InterestAreas/AccountingEducation/Resources/CurriculumDevelopment/CoreCompetencyFrameworkandEducationalCompetencyAssessmentWebSite/Pages/default.aspx.

[4] IFRS 10.

[5] IFRS 10, IAS 28, IFRS 11.

[6] See for example, Boston Properties, Inc. 2013 10-K; Piedmont Office Realty Trust Inc. 2013 10-K; Parkway Properties Inc., 2013 10-K; Kimco Realty Corporation 2013 10-K; and Liberty Property Trust 2013 10K.

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center of controversy in recent US and international regulatory developments as acknowledged by accounting practitioners (Ernst & Young, 2011) and by the academic community (Arnold, 2009; Camfferman & Zeff, 2007; Hopwood, 2009; Langmead & Soroosh, 2011).

The US Securities and Exchange Commission (SEC) has acknowledged the importance of complex investment relations and related matters relative to off-balance sheet financing.[7] The FASB and its predecessor, the Accounting Principles Board (APB), and the Emerging Issues Task Force (EITF) have also tackled investment issues (e.g. consolidation and the equity method to account for investments) by releasing several pronouncements and amendments throughout the years. The originally issued APB 18: *The Equity Method of Accounting for Investments In Common Stock (1971) (ASC* 323 – Investments – Equity Method and Joint Ventures) has been subsequently amended by FIN 35: *Criteria for Applying the Equity Method of Accounting for Investments in Common Stock: An Interpretation of APB No. 18* (1981); EITF 02-148: *Whether an Investor Should Apply the Equity Method of Accounting to Investments Other Than Common Stock* (Emerging Issues Task Force (EITF) 2002); EITF 08-06: *Equity Method Investment Accounting Considerations*; and ASU 2010-02: *Consolidation (Topic 810): Accounting and Reporting for Decreases in Ownership of a Subsidiary – a Scope Clarification* (Emerging Issues Task Force (EITF) 2008). FIN 46 (R), *Consolidation of Variable Interest Entities* (FASB 2003), was first amended by SFAS 167, *Amendments to FASB Interpretation No. 46(R)* (FASB 2009) (ASC 810 – Consolidation). SAFS 167 changed the consolidation model from a quantitative to a qualitative nature requiring professional judgment. However, since the 2009 Codification, several new ASUs update consolidation standards for both public and private companies (e.g. ASU 2009-17: *Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities;* ASU 2010-02: *Consolidation (Topic 810): Accounting and Reporting for Decreases in Ownership of a Subsidiary – a Scope Clarification*; and ASU 2014-07: *Consolidation (Topic 810): Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements).*

This case is based on the current codification that has changed the focus of analysis from a quantitative (i.e. clear cut) to a more qualitative approach when assessing the level of influence and associated exposures to the variability of benefits and risks when determining the nature of the relations. This provides students with a learning experience based on applying the more recent principle-based standards that involve a higher degree of professional judgment.

2.1.3. Development of skills

The AICPA's, Core Competency Framework,[8] outlines several skills required for students entering the accountancy profession. These skills are relevant and transferable to any business related career. Below, we discuss how the case addresses some of these competencies.

2.1.3.1. Research. Continuously evolving regulatory provisions require student's research proficiency including examining and applying current relevant primary sources such as ASC 810[9] and ASC 323.[10] Beyond the interpretation and application of relevant standards, the case's multiple investments require students to use a specific order of literature application, e.g. VIE/subsidiary codification analysis should be addressed prior to applying any other literature.

2.1.3.2. Problem solving/decision-making/critical thinking. These competencies require students to "display effective problem solving and decision-making skills, good insight, and judgment, plus innovative and

[7] SEC (2005). Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet implications, Special Purpose Entities, and Transparency of Fillings by Issues. Washington: the US Securities and Exchange Commission.

[8] http://www.aicpa.org/interestareas/accountingeducation/resources/pages/corecompetency.aspx.

[9] IFRS 10.

[10] IAS 28.

creative thinking." In order to complete the case, students must make judgments regarding the applicability of regulatory provisions to complex business scenarios.

2.1.3.3. Leverage technology and communication skills. Entering business professionals must use technology/communication tools effectively and efficiently. To prepare and deliver the case, students shall use and strengthen data collection and processing skills such as using online codification databases, word processing and presentation technologies. The case also facilitates effective communication and team working skills. These are very valuable skills that are essential for a successful career in business.

2.2. Implementation guidance

We suggest using the case in an undergraduate advanced accounting course, a graduate research course or a graduate (i.e. MSc, MAS, or MBA) accounting course. We implemented the case in both a graduate research course in the US (3 class sections Fall 2010; 1 class section Spring 2012) and in a graduate accounting course in Europe (1 class section Spring 2013).

Applying the case differs between graduate and undergraduate courses. Since a graduate course should generally foster independent research capabilities and critical thinking skills, instructors may provide less initial guidance. At the same time, in an undergraduate accounting course, instructors might need to spend additional time lecturing on investment accounting fundamentals and demonstrating how to access and navigate within the Codification and eIFRS before assigning the case.

Instructors could assign the case as an individual or group project. The US MAS accounting research course assigned the case as a group project followed by group presentations while the European MSc course assigned the case as a group project with no subsequent presentations. In both countries, students worked in three- to five-member groups.

As a complex technical matter, students often find difficulty mastering investment accounting concepts that could require further guidance. While providing an organizational chart, one author found student difficulty in determining the substance of the entities' connections and thus, it is suggested the students amend the chart to add additional case facts. Also, a co-author used drop-in sessions to allow students the opportunity to ask questions related to the case. But, this tool should be used carefully to ensure that students receive additional general guidance/direction and not answers to specific questions relating to the case which could limit the achievement of learning objectives that enhance critical thinking and independent research skills.

2.3. Student assessment

We evaluated case effectiveness by summarizing student scores and by evaluating student survey responses. Questions 5 through 7 were added after testing and thus, do not appear in the assessment. We collected both the scores and the survey data in 2010, 2012 and 2013.

2.3.1. Student scores

Table 1, a grading rubric, presents the percentages of students correctly considering each case issue. US students adequately addressed the relevant accounting literature (83.5% to 91.8%) and analyzed the nature of relations between the entities above Holdings (91.8%). However, they marginally addressed the requirements to explicitly state relations between the entities (78.8%), the order of literature application (77.6%), and relevant key assumptions as a basis for the analysis (77.6%). Only 62.4% of the students correctly determined the nature of relations between the entities below Holdings. These results are generally consistent with the scores of the international students who performed slightly lower especially in relation to the analysis of the substance of the relations between the entities above Holdings (80.8% compared to the US students' score of 91.8%). In line with US students' scores, the international students also seemed to have more difficulty with addressing the nature of relations between the entities below Holdings (60.0%). It may be advisable for instructors to emphasize to students the need to analyze each row of entities in the organizational chart.

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Table 1
Assessment rubric: US and international percentage of students correctly addressing issue.

Group:	Available Points	US	International
Addressed case requirements:			
Assessment of varied level of relations	5	78.8%	78.0%
Explicitly stated applied order of literature	2.5	77.6%	75.8%
Explicitly stated assumptions	2.5	77.6%	79.6%
Examined the following literature:			
Consolidation with respect to VIE/subsidiaries	2.5	83.5%	84.8%
Consolidation not VIE/subsidiaries	2.5	88.2%	78.2%
Equity method	2.5	91.8%	90.8%
Partnerships/joint ventures	2.5	81.2%	80.8%
Built an argument for how to account for entities			
Addressed the entities above Holdings	15	91.8%	80.8%
Addressed the entities below Holdings	5	62.4%	60.0%
Discussed how significant influence impacts financials	3	N/A	N/A
Discussed the positives and negatives of DT's arrangement	4	N/A	N/A
Discussed the relations in the additional scenario	3	N/A	N/A
Total points*	50	81.4%	78.0%

* The last three questions were added after testing. The original point total equaled 40.

2.3.2. Student perceptions

Our indirect student assessment (survey data) used a five-point Likert-type scale from 5, "strongly agree," through 3, "neither agree nor disagree," to 1 "strongly disagree" (see Tables 2 and 3).[11] All surveys included the following items:

1. By completing the Herb Huskies Investors case, I gained a better understanding of the scope of investment accounting.
2. By completing the Herb Huskies Investors case, I gained a better understanding of consolidation of other than a majority owned entity.
3. By completing the Herb Huskies Investors case, I gained a better understanding of equity method accounting.
4. By completing the Herb Huskies Investors case, I gained a better understanding of varied level of investment relations.
5. Completion of the Herb Huskies Investors case helped me understand how accountants use professional accounting standards and literature to guide their decisions regarding financial statement presentation and disclosure.
6. This case helped me understand that financial accounting presentation and disclosure issues are subject to interpretation and require professional judgment.

Tables 2 and 3 present results for the survey questions. We performed univariate testing to examine whether students' answers differed significantly from a neutral response (mid-point value of 3). Per Tables 2 and 3, all results indicate that student answers differ significantly ($p < 0.001$) from neutral (mid-point), suggesting that they felt that they achieved case objectives shown in the survey.[12]

[11] We performed sensitivity tests on the indirect data assessment to determine combinability of the data; the case was administered to 4 different US class sections. Three questions (Q1–Q3) in one class section (section 4) differed from the other class sections. Therefore, we performed all tests with and without data collected from section 4. Results of the reduced sample (three sections; 68 observations) are comparable (no difference in significance) to that of all sections (four sections, 83 observations). Therefore, we present the combined responses of all sections.

[12] While students felt they had fulfilled the specified objectives, they did not perform strongly on the case's conceptual issues as evidenced in Table 1.

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Table 2
US univariate and median tests.

Question	No. of obs.	Mean	Median	Std dev	*t*-Value (significance) Mean = 3	*z*-Value (significance) Median = 3
1. By completing the Herb Huskies Investors case, I gained a better understanding of the scope of investment accounting.	83	3.99	4.00	0.85	10.61(<0.0001)	30.5(<0.0001)
2. By completing the Herb Huskies Investors case, I gained a better understanding of consolidation of other than a majority owned entity.	83	4.04	4.00	0.71	13.37(<0.0001)	34(<0.0001)
3. By completing the Herb Huskies Investors case, I gained a better understanding of equity method accounting.	83	3.82	4.00	0.80	9.35(<0.0001)	25.5(<0.0001)
4. By completing the Herb Huskies Investors case, I gained a better understanding of varied level of investment relationships.	83	3.94	4.00	0.80	10.68(<0.0001)	31(<0.0001)
5. Completion of the Herb Huskies Investors case helped me understand how accountants use professional accounting standards and literature to guide their decisions regarding financial statement presentation and disclosure.	83	4.29	4.00	0.67	17.47(<0.0001)	37(<0.0001)
6. This case helped me understand that financial accounting presentation and disclosure issues are subject to interpretation and require professional judgment.	83	4.42	5.00	0.68	18.97(<0.0001)	37.5(<0.0001)

Indirect student assessment (survey data) using a five-point Likert-type scale survey, where 5 represents "strongly agree," 3 represents "neither agree or disagree," and 1 represents "strongly disagree" appears in Table 1.[13] The results of median tests are consistent with the results of the mean tests. All results are statistically significant at the 1% level.

Providing a comment space at the bottom of each survey, we elicited student remarks of the case's usefulness regarding practical applications relative to recent financial crises and the issues of off-balance sheet financing. The students appreciated that we base the case on a 'real world' scenario that required using current regulatory provisions. They also commented favorably on the fact that the task required an analytical/critical approach and necessitated independent reading and further research. They perceived that as a beneficial factor in terms of their future careers.

2.4. *Suggested solutions*

US case solutions are available by contacting Dr. Natalie T. Churyk at nchuryk@niu.edu.

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[13] See Footnote 11.

Table 3
International univariate and median tests.

Question	No. of obs.	Mean	Median	Std dev	t-Value (significance) Mean = 3	z-Value (significance) Median = 3
1. By completing the Herb Huskies Investors case, I gained a better understanding of the scope of investment accounting.	43	3.67	4.00	0.64	6.86(<0.0001)	14(<0.0001)
2. By completing the Herb Huskies Investors case, I gained a better understanding of consolidation of other than a majority owned entity.	43	3.77	4.00	0.65	7.76(<0.0001)	15.5(<0.0001)
3. By completing the Herb Huskies Investors case, I gained a better understanding of equity method accounting.	43	3.49	4.00	0.94	3.42(0.0014)	8.5(0.0023)
4. By completing the Herb Huskies Investors case, I gained a better understanding of varied level of investment relationships.	43	3.72	4.00	0.80	5.93(<0.0001)	14(<0.0001)
5. Completion of the Herb Huskies Investors case helped me understand how accountants use professional accounting standards and literature to guide their decisions regarding financial statement presentation and disclosure.	43	3.51	4.00	0.96	3.49(0.0011)	9.5(0.0005)
6. This case helped me understand that financial accounting presentation and disclosure issues are subject to interpretation and require professional judgment.	43	3.88	4.00	0.59	9.89(<0.0001)	16.5(<0.0001)

Indirect student assessment (survey data) using a five-point Likert-type scale survey, where 5 represents "strongly agree," 3 represents "neither agree or disagree," and 1 represents "strongly disagree" appears in Table 2. The results of median tests are consistent with the results of the mean tests. All results are statistically significant at the 1% level.

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Appendix

1. The importance of group accounting under IFRS

The Financial Stability Forum (FSF)(2008) and Group of Twenty (G-20) (2008) have identified issues of the scope of consolidation along with related disclosures as one of the main financial reporting matters that required regulators' attention. Consequently, following the recommendations of the FSF and G-20, the IASB accelerated the project on group accounting and proceeded to directly publishing the consolidation exposure draft that led to the release of the new consolidation standard IFRS 10, *Consolidated Financial Statements* in 2011.[14] Concurrently, the IASB issued IFRS 11, *Joint Arrangements* (IASB, 2011) and the revised IAS 28, *Associates and Joint Ventures* (IASB 2011). IFRS 10 outlines the applications of full consolidation method to all controlled entities, while IAS 28 prescribes how to apply the equity method to investments in associates (with significant influence) and joint ventures (with joint control over arrangements with the rights to the net assets of those arrangements). IFRS 11 classifies joint arrangements into joint ventures and joint operations (the latter with joint control over arrangements with rights to the assets, and obligations for the liabilities relating to that arrangement) and

[14] ED 10 also resulted in the release of IFRS 12, *Disclosure of Interests in Other Entities* (IASB, 2011).

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prescribes relevant accounting treatments. All of the above standards apply to annual periods beginning on or after 1 January 2013.

2. *Why an instructor might consider using both US GAAP and IFRS*

The case analysis applies both US GAAP and IFRS providing a relevant context, as they are the two most prominent world financial reporting regimes. Considering the sheer size of the US capital markets and the large number of firms reporting under US GAAP (within and outside the US), US GAAP provides a pre-eminent worldwide financial reporting framework (Hail, Leuz, & Wysocki, 2010a, 2010b; Herz, 2003). At the same time, many worldwide companies increasingly apply IFRS.[15] The SEC considered adopting IFRS for all US listed companies in its Work Plan (SEC 2010) that also outlines the processes the SEC followed to make an IFRS adoption determination. Its final Staff Paper (July 2012) summarized the efforts to address concerns related to IFRS but did not address when, or how US firms should adopt IFRS. The FASB and IASB have been working together toward convergence since 2002 when the SEC announced its support of a Memorandum of Understanding (Norwalk Agreement) between the two boards. Currently, the future of further convergence is quite uncertain (Pacter, 2014).

The fact that the case reports findings from both regimes contributes to the material's flexibility and usefulness to the extent that educators in multiple jurisdictions can adopt it. The case should also help US educators in institutions that teach IFRS to supplement US GAAP.

3. *Suggested succinct solution under IFRS*

International case solutions are available by contacting Dr. Renata Stenka at r.i.stenka@henley.ac.uk

4. *IFRS and USGAAP comparison*

Instructors and students will find that the solutions between US GAAP and IFRS are the same with the exception of a few terminology differences and a potential fair presentation override. The fair presentation override (also, referred to as "true and fair view override") is included in IAS 1 *Presentation of Financial Statements.*

IAS 1 requires that "financial statements present fairly the financial position, financial performance, and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income, and expenses set out in the Conceptual Framework and the standards (para 15). IAS 1 does, however, acknowledge that there may be rare circumstances where management may conclude that compliance with IFRS requirements would be so misleading that it would conflict with the objective of financial statements set out in the Conceptual Framework." In such situations, the entity is required to depart from the IFRS requirements, as long as the relevant regulatory framework requires, or otherwise does not prohibit, such a departure. Obviously, any such departure necessitates detailed disclosures, including the rationale for the decision, the treatment required versus the treatment adopted, and the nature and financial effect of the departure (para. 19, 20).

In terms of the fair presentation override when applied to the case scenario, students should note that the consolidation requirement is based on the decision-making powers and thus 80% of DT's equity ownership in Holdings wouldn't justify application of the override and result in DT fully consolidating Holdings.

[15] According to the AICPA: International Financial Reporting Standards (IFRS): an AICPA backgrounder (2011), at the time of writing the paper over 122 countries worldwide use international accounting standards on either a compulsory or permitted basis and more countries are expected to follow in the near future (Gannon & Ashwal, 2004; Pacter, 2014). From January 1, 2005, all EU listed companies have been required to apply IFRS in their consolidated statements. Australia and New Zealand have adopted modified IFRS (referred to as A-IFRS and NZ-IFRS respectively). Japan began permitting certain qualifying domestic companies to apply IFRS for fiscal years beginning April 1, 2010. Brazil started using international standards in 2010 and Canada adopted IFRS in full on January 1, 2011. Mexico adopted IFRS for all listed entities starting in 2012; Hong Kong uses national standards that are equivalent to IFRS; and China is in the process of converging with the standards.

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