

Staff draft

IFRS X Consolidated Financial Statements

STAFF DRAFT — SUBJECT TO CHANGE

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STAFF DRAFT — SUBJECT TO CHANGE

IFRS X Consolidated Financial Statements

Core principle

- 1 **A parent shall present consolidated financial statements as those of a single economic entity.**
- 2 This IFRS:
 - (a) identifies the principles of *control*, and determines how to identify whether an investor controls an investee and therefore must consolidate the investee; and
 - (b) sets out the principles for the preparation of *consolidated financial statements*.

Scope

- 3 This IFRS applies to all entities, except as follows:
 - (a) a *parent* need not present consolidated financial statements if it meets all of the following conditions:
 - (i) the parent is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;
 - (ii) the parent's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);
 - (iii) the parent did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and
 - (iv) the ultimate or any intermediate parent of the parent produces consolidated financial statements available for public use that comply with IFRSs.

- (b) post-employment benefit plans or other long-term employee benefit plans to which IAS 19 *Employee Benefits* applies.
- 4 The accounting requirements for business combinations and its effect on consolidation, including goodwill arising on a business combination, are set out in IFRS 3 *Business Combinations*.

Control

- 5 **An investor shall determine whether it is a parent by assessing whether it controls one or more investees.**
- 6 **An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.**
- 7 **Thus, an investor controls an investee if and only if the investor has all of the following elements:**
- (a) **power over the investee (see paragraphs 10–14);**
 - (b) **exposure, or rights, to variable returns from its involvement with the investee (see paragraphs 15 and 16); and**
 - (c) **the ability to use its power over the investee to affect the amount of the investor's returns (see paragraph 17).**
- 8 An investor shall consider all relevant facts and circumstances when assessing whether it controls an investee. The investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 7 (see paragraphs B76–B80).
- 9 Two or more investors can collectively control an investee when they must act together to direct the activities that significantly affect the returns of the investee. In such cases, because neither investor can direct the activities without the cooperation of the other investor, neither investor controls the investee. Each investor would account for its interest in the investee accordance with the relevant IFRSs such as IFRS Z *Joint Arrangements*, IAS 28 *Accounting for Associates* or IFRS 9 *Financial Instruments*.

Power

- 10 An investor has power over an investee when the investor has existing rights that give it the current ability to direct the activities that significantly affect the investee's returns ('the relevant activities').
- 11 Power arises from rights. Sometimes assessing power is straightforward, such as when power over an investee is obtained directly and solely from the voting rights granted by equity instruments such as shares and can be assessed by considering the voting rights from those shareholdings. In other cases the assessment will be more complex, requiring a number of factors to be considered, for example when power is embedded in one or more contractual arrangements.
- 12 An investor with the current ability to direct the relevant activities has power even if its rights to direct have yet to be exercised. Evidence that the investor has been directing relevant activities can help determine whether the investor has power, but such evidence is not in itself conclusive in determining whether the investor has power over an investee.
- 13 If two or more unrelated investors each have existing rights that provide the unilateral ability to direct different relevant activities, the investor that has the current ability to direct the activities that most significantly affect the returns of the investee has power over the investee.
- 14 An investor can control an investee even if other entities have existing rights that give them the current ability to participate in the direction of the relevant activities. However, an investor that holds only protective rights cannot have power over an investee (see paragraphs B22–B24), and consequently cannot have control over the investee.

Returns

- 15 An investor must be exposed, or have rights, to variable returns from its involvement with an investee to control the investee. Such returns must have the potential to vary as a result of the investee's performance and can be positive, negative, or both.

- 16 Although only one investor can control an investee, more than one entity can share in the returns of an investee. For example, holders of non-controlling interests can share in the profits or distributions of an investee.

Link between power and returns

- 17 A parent must not only have power over an investee and exposure or rights to variable returns from its involvement with the investee, a parent must also have the ability to use its power over the investee to affect its returns from its involvement with the investee.

Accounting requirements

- 18 **A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.**
- 19 Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee.
- 20 Paragraphs B81–B87 set out requirements for the preparation of consolidated financial statements.

Non-controlling interests

- 21 A parent shall present non-controlling interests in its consolidated statement of financial position within equity, separately from the equity of the owners of the parent.
- 22 Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (ie transactions with owners in their capacity as owners).
- 23 Paragraphs B88–B90 set out requirements for the accounting for non-controlling interests in consolidated financial statements.

Loss of control

- 24 If a parent loses control of a subsidiary, the parent:

- (a) derecognises the assets and liabilities of the former subsidiary from the consolidated statement of financial position;
 - (b) recognises the gain or loss associated with the loss of control attributable to the former controlling interest; and
 - (c) recognises any investment retained in the former subsidiary at its fair value when control is lost and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant IFRSs. That fair value shall be regarded as the fair value on initial recognition of a financial asset in accordance with IFRS 9 or, when appropriate, the cost on initial recognition of an investment in an associate or joint venture.
- 25 ParagraphsB91 - B93 set out requirements for the accounting for the loss of control.

Appendix A - Defined terms

This appendix is an integral part of the IFRS.

| | |
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| Consolidated financial statements | The financial statements of a group consolidate the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries and present them as those of a single economic entity. |
| Control | An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee . |
| Decision-maker | An entity with decision-making rights that is either a principal or an agent for other parties. |
| Group | A parent and its subsidiaries . |
| Investee | For the purpose of this IFRS, an investee is an entity that is or may be the subsidiary of the reporting entity. |
| Investor | For the purpose of this IFRS, an investor is a reporting entity that that potentially controls one or more other entities. An investor. An investor may, but is not required to, have an investment in an investee . |
| Non-controlling interest | Equity in a subsidiary not attributable, directly or indirectly, to a parent . |
| Parent | An entity that controls one or more entities. |
| Power | The current ability to direct the relevant activities. |
| Protective rights | Rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate. |
| Relevant activities | Activities of the investee that significantly affect the investee's returns. |
| Removal rights | Rights to deprive the decision-maker of its decision-making authority |
| Subsidiary | An entity that is controlled by another entity. |

Appendix B - Application guidance

This appendix is an integral part of the IFRS.

Assessing control

- B1 An investor must always assess whether it has all of the following elements to determine whether it controls an investee:
- (a) power over the investee;
 - (b) exposure, or rights, to variable returns from its involvement with the investee; and
 - (c) the ability to use its power over the investee to affect the amount of the investor's returns.
- B2 Although an investor must always have the elements set out in paragraph B1 to control an investee, the factors to be considered will depend on how decisions are made about the relevant activities, the rights that an investor has in relation to the investee and the rights held by others.
- B3 When it is clear that an investee is controlled by means of equity instruments, with associated and proportionate voting rights—such as ordinary shares in an investee—, absent any additional arrangements altering decision making, the assessment of control will focus on which party, if any, is able to exercise voting rights sufficient to direct the investee's operating and financing policies (see paragraphs B30–B44)). In the most straightforward case the investor that holds a majority of those voting rights, in the absence of any other factors, controls the investee.
- B4 An investee could be designed so that voting rights are not relevant to deciding who controls the investee, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by contractual arrangements. In such a case, control would be assessed by considering those contractual arrangements to determine who is able to direct the relevant activities, whether an investor with such power is acting as an agent and whether it is exposed, or has rights, to variable returns from its involvement with the investee. For more complex cases, it may be necessary

to consider many or all of the following factors to determine whether an investor controls an investee:

- (a) what the relevant activities are and how decisions about these activities are made (see paragraphs B7-B10);
- (b) whether the rights of the investor give it the current ability to direct those activities (see paragraphs B11-B49);
- (c) whether the investor is exposed, or has rights, to variable returns from its involvement with the investee (see paragraphs B50-B52); and
- (d) whether the investor has the ability to use its power over the investee to affect the amount of the investor's returns (see paragraphs B53-B68).

Power

- B5 To have power over an investee, the investor must have existing rights that give it the current ability to direct the relevant activities. For the purpose of assessing power, only substantive rights and rights that are not protective shall be considered (see paragraphs B18-B21 and paragraphs B22-B24)
- B6 How power is assessed and the factors that should be considered depend on the relevant activities, the way decisions about the relevant activities are made and the rights the investor and other parties have in relation to the investee. Therefore, existing rights that may give an investor power and that therefore need to be considered in assessing whether the investor has power differs between investees.

Relevant activities and direction of relevant activities

- B7 Understanding the purpose and design of an investee may help identify the relevant activities, how decisions about the relevant activities are made, who has the ability to direct those activities and who receives returns from that direction.
- B8 For many investees, a range of operating and financing activities significantly affect their returns. Examples of activities that, depending on the circumstances, can be relevant activities include, but are not limited to:
 - (a) sales and purchases of goods or services;
 - (b) managing financial assets during their life (including upon default);

- (c) selecting, acquiring or disposing of assets;
 - (d) researching and developing new products or processes; or
 - (e) determining a funding structure or obtaining funding.
- B9 Examples of decisions about an investee's activities that, depending on the circumstances, can significantly affect the returns of the investee include but are not limited to:
- (a) establishing operating and capital decisions of the investee, including budgets; or
 - (b) appointing and remunerating an investee's service providers or key management personnel and terminating their services or employment.
- B10 In some situations, activities both before and after a particular set of circumstances arise or event occurs may be relevant activities. When two or more unrelated investor have the current ability to direct activities that significantly affect the investee's returns and those activities occur at different times, they must still determine which investor is able to direct the activities that most significantly affect those returns, consistently with the treatment of concurrent decision-making rights (see paragraph 13). It will be necessary to reconsider this assessment over time if relevant facts or circumstances change.

Application Example

- *Two investors form an investee to develop and market a medical product. One investor is responsible for developing and obtaining regulatory approval of the medical product. Once the regulator has approved the product, the other investor will manufacture and market it. All of the activities—the development, manufacturing and marketing of the medical product—are relevant activities. Each investor will need to determine whether it is able to direct the activities that most significantly affect the investee's returns, including considering the likelihood that the investee will actually reach the manufacturing and marketing phase. The investor responsible for the manufacturing and marketing phase could have power over the investee even before that phase begins.*

Rights that give an investor power over an investee

- B11 Power arises from rights. To have power over an investee an investor must have rights that enable it to direct the relevant activities. Therefore, the rights that may give an investor this ability and that need to be considered in assessing power can

differ between investees. Examples of rights that, either individually or in combination, can give an investor power include but are not limited to :

- (a) rights in the form of voting rights (or potential voting rights) of an investee (see paragraphs B30–B44);
- (b) rights to appoint, reassign or remove members of an investee’s key management personnel who have the ability to significantly affect the investee’s return;
- (c) rights to appoint or remove another entity that participates in decisions about the relevant activities;
- (d) rights to direct the investee to enter into, or veto any changes to, transactions that affect the investor’s returns;
- (e) other rights (such as decision-making rights within a management contract) that significantly affect the investee’s returns.

B12 Generally, when investees have a range of operating and financing activities that significantly affect the returns of the investee and when substantive decision-making in respect to these activities is required on an ongoing basis, it will be voting or similar rights that give an investor power, either individually or in combination with other arrangements.

B13 When voting rights cannot have a significant effect on an investee’s returns, such as when they relate solely to administrative tasks and it is contractual arrangements that determine the direction of most of the activities that significantly affect the return of the investee, an investor needs to assess those contractual arrangements in order to determine whether it has rights sufficient to give it power over the investee. Considering the purpose and design of an investee together with the indicators in paragraphs B15 and B16 may help to determine whether the investor has rights sufficient to give it power.

B14 In some circumstances it may be difficult to determine whether an investor’s rights are sufficient to give it power over an investee. In these cases, to enable the assessment of power to be made the investor should consider evidence of whether it has the ability to direct the relevant activities. Consideration is given, but is not

limited, to the following, which, when considered together with the indicators in paragraphs B15 and B16, may provide evidence that the investor has rights sufficient to give it power over the investee.

- (a) The investor can appoint or approve the investee's key management personnel who direct the relevant activities.
- (b) The investor can direct the investee to enter into, or can veto any changes to, significant transactions that affect the investor's returns.
- (c) The investor can dominate either the nominations process of electing members of the investee's governing body or the obtaining of proxies from other holders of voting rights.
- (d) Its key management personnel or the majority of the members of the investee's governing body are related parties of the investor.

B15 Often, there will be indications that the investor has a special relationship with the investee, suggesting that the investor has more than a passive interest in the investee. The existence of any individual indicator, or a particular combination of indicators, does not necessarily mean that the power criterion is met. However, having more than a passive interest in the investee could indicate that the investor has other, related, rights or provide evidence of existing power over an investee. For example, the following would suggest that the investor has more than a passive interest in the investee:

- (a) The investee's key management personnel who direct the activities that significantly affect the investee's returns are current or previous employees of the investor or of the investor's subsidiaries.
- (b) The investee's operations are dependent on the investor, such as in the following situations:
 - (i) The investee depends on the investor to fund its operations.
 - (ii) The investor guarantees a significant portion of the investee's obligations.

- (iii) The investee depends on the investor for critical services, technology, supplies or raw materials.
 - (iv) The investee depends on the investor for key management personnel, such as when the investor's personnel have specialised knowledge of the investee's operations.
 - (v) The investor controls assets that are critical to the investee's operations.
- (c) A significant portion of the investee's activities either involve or are conducted on behalf of the investor.
- (d) The investor's exposure, or rights, to the returns from its involvement with the investee is disproportionately greater than its voting rights. For example, there may be a situation in which an investor is entitled, or exposed, to more than half of the returns of the investee but holds less than half of the voting rights of the investee.
- B16 The greater an investor's exposure, or rights, to the variability of returns from its involvement with an investee, the greater the incentive for the investor to obtain rights sufficient to give it power. Therefore, having a large exposure to variability of returns is an indicator that the investor may have power. However, the size of the investor's exposure, alone, does not determine whether an investor has power over the investee.
- B17 When considering the factors set out in paragraph B14 and the indicators set out in paragraphs B15 and B16, greater weight should be given to the evidence of power described in paragraph B14.

Substantive rights

- B18 An investor, in assessing whether it has power, considers only substantive rights relating to an investee (held by the investor and others). For a right to be substantive, the holder must have the practical ability to exercise the right. To be substantive, rights also need to give the holder the current ability to direct the relevant activities when decisions about those activities need to be made.

B19 Determining whether rights are substantive requires judgment, taking into account all available facts and circumstances. Factors to consider in making that determination include:

- (a) whether the party or parties that hold the rights would benefit from the exercise of those rights. For example, the holder of potential voting rights in the investee (see paragraphs B42–B44) shall consider the exercise or conversion price of the instrument. The terms and conditions of potential voting rights are more likely to be substantive when the potential voting rights are in the money or the investor would benefit for other reasons (eg by realising synergies between the investor and the investee) from the exercise or conversion of the potential voting rights.
- (b) whether there are any barriers (economic or otherwise) that prevent the holder (or holders) from exercising the rights. Examples of such barriers include:
 - (i) financial penalties and incentives that would prevent the holder from exercising its rights.
 - (ii) terms and conditions that make it unlikely that the rights will be exercised, for example, conditions that narrowly limit the timing of their exercise.
 - (iii) the absence of an explicit, reasonable mechanism in the founding documents of an investee or in applicable laws or regulations that allows the holder to exercise its rights.
 - (iv) the inability of the holders of the rights to obtain the information necessary to exercise their rights.
 - (v) operational barriers or incentives that would prevent (or deter) the holder from exercising its rights (eg the absence of other managers willing or able to provide the specialised services or provide the services or financial support provided by the incumbent manager).
- (c) when the exercise of rights requires the agreement of more than one party, or when the rights are held by more than one party, whether a mechanism is in place that provides those parties with the practical ability to exercise their rights

collectively if they choose to do so. The lack of such a mechanism is an indicator that the rights may be not substantive. The more parties that are required to agree to exercise the rights, the less likely it is that those rights are substantive.

B20 To be substantive, rights need to be exercisable when decisions about the direction of the relevant activities need to be made. Usually, to be substantive, the rights need to be currently exercisable. However, sometimes rights are substantive when they give the holder the current ability to direct the relevant activities, even though the rights are not currently exercisable.

Application examples

- *The investee has annual shareholder meetings at which decisions to direct the relevant activities are made. The next scheduled shareholder meeting is in 8 months time. However, shareholders can call a special meeting to change the existing policies over relevant activities, but a requirement to give notice to the other shareholders means that such a meeting cannot be held for at least 30 days.*

The above fact pattern applies to examples (a)-(d) described below. Each example is considered in isolation.

Example (a)

An investor holds a majority of the voting rights in the investee. The investor's voting rights are substantive because the investor is able to make decisions about the direction of the relevant activities when they need to be made. The fact that it takes 30 days before the investor can exercise its voting rights does not stop the investor having power from the moment the investor acquires the shareholding.

Example (b)

An investor is party to a forward contract to acquire the majority of shares in the investee. The forward contract's settlement date is in 25 days. The investor's forward contract is a substantive right and gives the investor power. The investor has rights that are essentially equivalent to the majority shareholder in example (a) above (i.e. the investor holding the forward contract can make decisions about the direction of the relevant activities when they need to be made).

Example (c)

An investor holds an option to acquire the majority of shares in the investee that is exercisable in 25 days and that is deeply in the money. The same conclusion would be reached as in example (b).

Example (d)

An investor is party to a forward contract to acquire the majority of shares in the investee. The forward contract's settlement date is in 6 months. In contrast to the examples above, the investor does not have a substantive right because the investor does not have the current ability to direct the relevant decisions. The investor does not have this ability because the settlement of the forward contract is in 6 months time - the existing shareholders have the ability to direct the relevant activities.

B21 Substantive rights exercisable by other parties can prevent an investor from controlling the investee to which those rights relate. Such substantive rights do not require the holders to have the ability to initiate decisions. As long as they are not merely protective rights (see paragraphs B22–B24), substantive rights held by other parties may prevent the investor from controlling the investee to which those rights relate even if they only give the holders the current ability to approve or block decisions that relate to the relevant activities.

Protective rights

B22 In evaluating whether rights give an investor power over an investee, the investor shall assess whether its rights, and rights held by others, are protective rights. Protective rights relate to fundamental changes in the activities of an investee or apply only in exceptional circumstances. However, decision-making rights are not protective in nature simply because they are contingent on circumstances or an event arising.

B23 Because protective rights are designed to protect the interest of their holder without giving that party power over the entity to which those rights relate, an investor that holds only protective rights cannot have power or prevent another party from having power over an investee.

B24 Examples of protective rights include, but are not limited to:

- (a) a lender's right to restrict a borrower from undertaking activities that could significantly change the credit risk of the borrower to the detriment of the lender.
- (b) the right of a party holding a non-controlling interest in an investee to approve capital expenditure greater than that required in the ordinary course of business, or to approve the issue of equity or debt instruments.
- (c) the right of a lender to seize the assets of a borrower if the borrower fails to meet specified loan repayment conditions.

Franchises

- B25 A franchise agreement for which the investee is the franchisee will often give the franchisor rights that are designed to protect the franchise brand. Franchise agreements typically give franchisors some decision-making abilities with respect to the operations of the franchise.
- B26 Franchisor rights do not necessarily limit the ability of parties other than the franchisor to make decisions that have a significant effect on the franchisee's returns. Nor do the rights of the franchisor in franchise agreements necessarily give the franchisor the current ability to direct the activities that significantly affect the investee's (franchisee's) returns.
- B27 It is necessary to distinguish between having the current ability to make decisions that significantly affect the returns of the franchisee and having the ability to make decisions that protect the franchise brand. The franchisor does not have power over the franchisee if other parties have existing rights that give them the current ability to direct the activities that significantly affect the franchisee's return.
- B28 By entering into the franchise agreement the franchisee has made a unilateral decision to operate its business in accordance with the terms of the franchise agreement, but for its own account.
- B29 Control over such fundamental decisions as the legal form of the franchisee and its funding structure may be determined by parties other than the franchisor and may significantly affect the returns of the franchisee. The lower the level of financial support provided by the franchisor and the lower the franchisor's exposure to variability of returns from the franchisee the more likely it is that the franchisor will have only protective rights.

Voting rights

- B30 Often an investor will have the right, through voting or similar rights, to direct those activities of an investee that significantly affect the investee's returns. An investor considers the guidance in this section (paragraphs B31–B44) if the activities that significantly affect the investee's returns are directed through voting rights.

Power with a majority of the voting rights

B31 An investor that holds more than half of the voting rights of an investee has power in the following situations, unless paragraph B32 or B33 applies:

- (a) the relevant activities are directed by a vote of the holder of the majority of the voting rights, or
- (b) a majority of the members of the governing body that directs the relevant activities are appointed by a vote of the holder of the majority of the voting rights.

Majority of the voting rights but no power

B32 For an investor that holds more than half of the voting rights of an investee to have power over an investee, the investor's voting rights must be substantive, in accordance with paragraphs B18–B21, and must provide the investor with the current ability to direct the relevant activities which often will be through the direction of operating and financing policies. If another entity has existing rights providing that entity with the right to direct the relevant activities and that entity is not an agent of the investor, the investor does not have power over the investee.

B33 An investor will not have power over an investee, even though the investor holds the majority of the voting rights in the investee, when those voting rights are not substantive. For example, an investor that has more than half of the voting rights in an investee cannot have power if the activities of the investee that significantly affect the investee's returns become subject to direction by a government, court, administrator, receiver, liquidator or regulator.

Power without a majority of the voting rights

B34 An investor can have power even if it holds less than a majority of the voting rights of an investee. An investor can have power with less than a majority of the voting rights of an investee, for example, through:

- (a) a contractual arrangement between the investor and other vote holders (see paragraph B35);
- (b) rights arising from other contractual arrangements (see paragraph B36);

- (c) the investor's voting rights (see paragraphs B37–B41)
- (d) potential voting rights (see paragraphs B42–B44); or
- (e) a combination of (a)–(d).

Contractual arrangement with other vote holders

B35 A contractual arrangement between an investor and other vote holders can give the investor the right to exercise voting rights sufficient to give the investor power, even if the investor itself does not have sufficient voting rights to give it power. Alternatively, a contractual arrangement might ensure that the investor can direct enough other vote holders on how to vote to enable the investor to make decisions about the relevant activities.

Rights from other contractual arrangements

B36 Other decision-making rights, in combination with voting rights, can give an investor the current ability to direct the relevant activities. For example, the rights within a contractual arrangement in combination with voting rights may be sufficient to give an investor the current ability to direct some of the manufacturing processes of an investee or to direct other operating or financing activities of an investee that significantly affect the investee's returns. However, economic dependence of an investee on the investor (such as relations of a supplier with its main customer) does not, alone, lead to the investor having power over the investee.

The investor's voting rights

B37 An investor with less than a majority of the voting rights (considered together with all outstanding substantive potential voting rights, if any) has rights that are sufficient to give it power when the investor can unilaterally direct the relevant activities.

B38 When assessing whether an investor's voting rights are sufficient to give it power, an investor considers all available facts and circumstances, including:

- (a) the size of the investor's holding of voting rights relative to the size and dispersion of holdings of the other vote holders, noting that:
 - (i) the more voting rights an investor holds, the more likely it is to have existing rights to give it the current ability to direct the relevant;

- (ii) the more voting rights an investor holds relative to other vote holders, the more likely it is to have existing rights that give it the current ability to direct the relevant activities;
- (iii) the more parties that would need to act together to outvote the investor, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;
- (b) potential voting rights held by the investor, other vote holders or other parties (see paragraphs B42–B44);
- (c) rights arising from other contractual arrangements; and
- (d) any additional facts and circumstances that indicate that the investor has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

B39 When the direction of relevant activities is determined by majority vote and an investor holds significantly more voting rights than any other vote holder or organised group of vote holders, and the other shareholdings are widely dispersed, the factors listed in paragraphs B38(a) – (c) alone may be sufficient evidence to conclude that the investor has power over the investee.

Application Examples

- *An investor holds 47 per cent of the voting rights of an investee, with the next two largest holdings of voting rights being 10 per cent and 4 per cent. The remaining voting rights are held by thousands of shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has any arrangements to consult each other or make collective decisions. In this case, on the basis of the absolute size of its holding and the relative size of the other shareholdings the investor has a sufficiently dominant voting interest to meet the power criterion without the need to consider any other evidence of power.*
- *Investor A holds 40 per cent of voting rights of an investee and 12 other investors each hold 5 per cent of voting rights in the investee. A shareholder agreement grants investor A the right to appoint, remove and set the compensation of management responsible for directing the relevant activities. In this case, considering the absolute size of the investor's holding and the relative size of the other shareholdings alone is not conclusive to determine the investor has rights sufficient to give it power. However, the fact that investor A has the contractual right to appoint, remove and set the compensation of key management is sufficient to conclude that investor A has power over the investee. The fact that investor A might not have exercised this right yet or the*

likelihood of investor A exercising his right to select, appoint or remove key management should not be considered when assessing if investor A has power.

B40 In other situations, the factors listed in paragraphs B38(a) – (c) alone are sufficient evidence to conclude that an investor does not have power.

Application Example

- *Investor A holds 45 per cent of the voting rights of an investee. Two other investors each hold 26 per cent of the voting rights of the investee. There are no other arrangements that affect decision-making. In this case, considering the size of investor A's voting interest and its relative size to the other shareholdings is sufficient to conclude that investor A does not have power. Only two other investors would need to co-operate to be able to prevent investor A from controlling the investee.*

B41 However, the factors noted in paragraph B38(a) – (c) alone may not be conclusive. If an investor, having considered those factors, is still unclear whether it has power, additional facts and circumstances that indicate that the investor has, or does not have power, should be considered. The voting pattern at previous shareholders' meetings, as well as the factors set out in paragraph B14 and the indicators in paragraph B15 may help with that determination. The fewer voting rights the investor holds, and the fewer parties that would need to act together to outvote the investor, the more reliance would be placed on the additional facts and circumstances in paragraphs B14 and B15 to assess whether the investor has the power to direct the relevant activities. When the factors set out in paragraph B38(a) – (c) are not conclusive and the facts and circumstances in paragraphs B14 and B15 are considered, greater weight should be given to the evidence of power in paragraph B14 than the indicators of power in paragraph B15.

Application example

- *An investor holds 45 per cent of the voting rights of an investee. Eleven other shareholders each hold 5 per cent of the voting rights in the investee. None of shareholders has any contractual arrangements to consult each other or make collective decisions. In this case, considering the absolute size of the investor's holding and the relative size of the other shareholdings alone is not conclusive to determine if the investor has rights sufficient to give it power over the investee. Additional facts and circumstances that indicate that the investor has, or does not have power, should be considered.*

Potential voting rights

- B42 When assessing control, an investor considers its potential voting rights as well as potential voting rights held by other parties, to determine whether the investor has power. Potential voting rights are rights to obtain voting rights of an investee, such as those within an option or convertible instrument. Those potential voting rights are considered only if the rights are substantive (see paragraph B18-B21).
- B43 If the investor also has voting or other decision-making rights relating to the investee's activities, the investor assesses whether those rights, in combination with potential voting rights, give the investor power.
- B44 Substantive potential voting rights alone, or in combination with other rights, can give an investor the current ability to direct the relevant activities. For example, this is likely to be the case when an investor holds 40 per cent of the voting rights of an investee, and in accordance with paragraph B19 also holds substantive rights arising from options to acquire a further 20 per cent of the voting rights.

Application examples

- Investor A holds 70 per cent of the voting rights of an investee. Investor B has 30 per cent of the voting rights of the investee as well as an option to acquire half of the Investor A's voting rights. The option is exercisable for the next two years at a fixed price that is deeply out of the money (and is expected to remain so for that two-year period). Investor A has been exercising its votes and is actively directing the activities of the investee. In such a case, investor A is likely to meet the power criterion because it appears to have the current ability to direct the relevant activities. Although investor B has currently exercisable options to purchase additional voting rights (that, if exercised, would give it a majority of the voting rights in the investee), the terms and conditions associated with those options are such that the options are not considered to be substantive.
- An investee has three shareholders - investor A and two other investors. Each investor holds a third of the voting rights. Investor A also holds debt instruments that are convertible into ordinary shares of the investee at any time for a fixed price that is out of the money (but not deeply out of the money). If the debt were converted, investor A would hold 60 per cent of the voting rights of the investee. In this case, investor A is likely to have power because it holds voting rights in the investee, together with rights to obtain voting rights, to give it the current ability to direct the relevant activities. To determine whether investor A has power over the investee additional evidence as set out in paragraph B14 would need to be considered.

The purpose and design of an investee

- B45 In cases where voting rights or similar rights do not have a significant effect on an investee's return such as when contractual arrangements determine the direction of

the relevant activities, the assessment of its purpose and design includes the consideration of the risks that the investee was designed to create, the risks it was designed to pass on to the parties involved in the transaction and whether the investor is exposed to some or all of those risks. Consideration of the risks includes not only the downside risk but also the potential for upside.

B46 Furthermore, in determining the purpose and design of the investee, the investor should consider the decisions made at the investee's inception as part of its design. In addition, contractual arrangements such as call rights, put rights or liquidation rights established at the investee's inception need to be considered. When these contractual arrangements involve activities that are closely related to the investee, then these activities are, in substance, an integral part of the investee's overall activities, even though they may occur outside the legal boundaries of the investee. Therefore, explicit or implicit decision-making rights embedded in contractual arrangements that are closely related to the investee need to be considered as relevant activities when determining power over the investee.

B47 For some investees, relevant activities occur only when particular circumstances arise or events occur. The investee may be designed so that the direction of its activities and its returns are predetermined unless and until those particular circumstances arise or events occur. In this case, only the decisions about the investee's activities when those circumstances or events occur can significantly affect its returns and thus be relevant activities. The circumstances or events need not have occurred for an investor with the ability to make those decisions to have power. The fact that the right to make decisions is contingent on circumstances or an event arising does not in itself make those rights protective.

Application examples

- *An investee's only business activity, as specified in its founding documents, is to purchase receivables and to service them on a day-to-day basis. Upon default of a receivable the investee automatically puts the receivable to the investor as agreed separately in a put agreement between the investor and the investee. The only activity that significantly affects the returns of the investee is managing the receivables upon default. Therefore, the investor's right to manage the assets upon default should be considered when assessing the overall activities of the investee that significantly affect the returns. In this example, the design of the investee ensures that the investor has decision-making authority over the activities that significantly affect the returns at the only time that such decision-making authority is required. The terms of the put*

agreement are integral to the overall transaction and the establishment of the investee. Therefore, the terms of the put agreement would be considered together with the founding documents of the investee to conclude that the investor has power over the investee even though the investor takes ownership of the receivables upon default and manages the defaulted receivables outside the legal boundaries of the investee.

- *The only assets of an investee are receivables and the only relevant activity is managing the receivables on default. The party that has the ability to manage the defaulting receivables has power over the investee, irrespective of whether any of the borrowers have defaulted.*

B48 Being involved in the design of an investee, alone, is not sufficient to give an investor control. However, involvement in the design may indicate that the investor had the opportunity to obtain rights that are sufficient to give it power over the investee.

B49 An investor may have an explicit or implicit commitment to ensure that an investee continues to operate as designed. Such a commitment may increase the investor's exposure to the variability of returns and, thus, the likelihood that it has power. However, a commitment to ensure that an investee operates as designed does not, alone, give an investor power, nor does it prevent another party from having power.

Exposure, or rights, to variable returns from an investee

B50 When assessing whether an investor has control of an investee, the investor determines whether it is exposed, or has rights, to variable returns from its involvement with the investee.

B51 Returns have the potential to vary as a result of the performance of an investee and can be positive, negative or both (see paragraph 15). An investor assesses whether returns from an investee are variable and how variable those returns are on the basis of the substance of the arrangement and regardless of the legal form of the returns. For example, an investor can hold a bond with fixed interest payments. The fixed interest payments are variable returns for the purpose of this IFRS because they expose the investor to the credit risk of the issuer of the bond and the amount of variability (i.e. how variable those returns are) will depend on the credit risk of the bond. Similarly, fixed performance fees for managing an investee's assets are variable returns because they expose the investor to the performance risk of the investee. The amount of variability will depend on the investee's ability to generate sufficient income.

B52 Examples of returns include:

- (a) dividends, other distributions of economic benefits from an investee (eg interest from debt securities issued by the investee), and changes in the value of the investor's investment in that investee.
- (b) remuneration for servicing an investee's assets or liabilities, fees and exposure to loss from providing credit or liquidity support, residual interests in the investee's assets and liabilities on liquidation of that investee, tax benefits, and access to liquidity that an investor has from its involvement with an investee.
- (c) returns that are not available to other interest holders. For example, an investor might use its assets in combination with the assets of the investee, such as combining operating functions to achieve economies of scale, cost savings, sourcing scarce products, gaining access to proprietary knowledge or limiting some operations or assets, to enhance the value of the investor's other assets.

Delegated power

B53 When assessing whether an investor controls an investee an investor with decision-making rights determines whether it acts as a principal or as an agent of other parties. An investor also should determine whether another entity with decision-making rights is acting as agent for the investor. An agent is a party engaged to act on behalf of another party or parties (the principal(s)). A principal may delegate to the agent decision-making authority on some specific issues or on all relevant activities. Thus, sometimes, an investor's power may be held and exercisable by the agent, but on behalf of the principal. Although decision-making authority is delegated to an agent, an entity does not control an investee when it exercises that decision-making authority in its capacity as an agent.

B54 When assessing whether an investor controls an investee the investor shall treat the decision-making rights of the investor's agent as if they were held by the investor directly. If an investor has rights that enable it to direct the relevant activities but that investor is an agent of another investor (the principal), the principal is the party that has power over the investee. Paragraphs B55–B68 provide guidance on determining

whether an entity with decision-making rights ('decision-maker') is an agent or a principal.

B55 A decision-maker shall consider the overall relationship between itself and other parties involved with the investee, and in particular, all of the factors below in determining whether it is an agent:

- (a) the scope of its decision-making authority over the investee (paragraphs B58 and B59)
- (b) the rights held by other parties (paragraphs B60–B62).
- (c) the remuneration to which it is entitled in accordance with the remuneration agreement (paragraphs B63–B65).
- (d) the decision-maker's exposure to variability of returns from other interests that it holds in the investee (paragraphs B66–B68).

B56 When a single party holds substantive rights to remove the decision-maker ('removal rights') and can remove the decision-maker without cause, this in isolation would be sufficient to conclude that the decision-maker is an agent. In all other cases, to conclude whether a decision-maker is an agent requires an evaluation of all of the factors listed in paragraph B55. However, depending on the particular situation some of the factors may be a stronger indicator of an agency relationship than others. As a consequence, different weightings should be applied to each of the factors on the basis of particular facts and circumstances, taking into account the circumstances specifically mentioned in paragraphs B58–B68.

B57 For example, if a decision-maker has a greater exposure to variable returns compared to others because it holds junior notes, that factor would receive a significant weighting when assessing whether the decision-maker is an agent (increasing the likelihood that the entity is a principal). Similarly, if a small number of parties hold substantive rights to remove a decision-maker, that factor would receive a greater weighting (increasing the likelihood that the decision-maker is an agent) than if a large number of parties hold such rights.

The scope of the decision-making authority

- B58 The scope of an entity's decision-making authority is evaluated by considering:
- (a) the range of activities that it is permitted to direct according to the decision-making agreement(s), including those specified by law, and
 - (b) the discretion that it has when making decisions about those activities.
- B59 Consideration shall be given to the level of influence the decision-maker had in determining the restrictions on its decision-making authority. For example, if the decision-maker (either individually or together with other parties) determined the founding documents of the investee or other documents that determine decision-making rights, the activities that are embedded in those documents that the decision-maker may perform shall be considered part of the decision-maker's authority.

Rights held by other parties

- B60 Even if a decision-maker has the ability to direct the relevant activities, substantive removal rights held by other parties (or similar rights such as some liquidation or redemption rights) may indicate that the decision-maker is an agent.
- B61 Situations in which a single party holds substantive removal rights and can remove the decision-maker without cause, in isolation, would be sufficient to conclude that the decision-maker is an agent. This is the only factor that, in isolation, can result in a conclusion that a decision-maker is an agent. If numerous parties hold such rights (and no individual party can remove the decision-maker without the agreement of other unrelated parties) those rights would not, in isolation, be conclusive in determining whether a decision-maker is an agent.
- B62 Restrictions on a decision-maker's discretion, as a result of rights held by others, shall be considered when evaluating whether the decision-maker is an agent. An investor that is required to obtain approval from other parties for its actions is generally an agent. (See paragraphs B18–B21 for additional guidance on rights and whether they are substantive.)

Remuneration

- B63 The remuneration of the decision-maker shall be considered in determining whether it is an agent. Accordingly, the following should be considered:

- (a) whether the remuneration of the decision-maker, for providing its services, is commensurate with the level of skills needed to provide the services.
- (b) whether the remuneration agreement includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated on an arm's length basis.
- (c) the magnitude of, and variability associated with, the decision-maker's remuneration agreement relative to the investee's returns that are expected of the investee.

B64 A decision-maker cannot be an agent unless the factors set out in paragraphs B63(a) and B63(b) are present. However, those factors, in isolation, are not sufficient to conclude that an entity is an agent.

B65 Remuneration that exposes a decision-maker to variability of returns does not, in isolation, preclude the entity from being an agent if the remuneration aligns the returns of the decision-maker with those of other interest holders. However, remuneration that exposes a decision-maker to returns that vary differently from those of other interest holders may indicate that the decision-maker is not an agent.

Exposure to variability in returns from other interests

B66 When the decision-maker holds other interests in an investee (eg it provides guarantees), the decision-maker's exposure to returns from those interests shall be considered in assessing whether it is an agent.

B67 The fact that a decision-maker holds other interests in an investee may indicate that the decision-maker is not an agent. By virtue of that other interest, the decision-maker may make decisions different from those it might make if it did not hold those other interests. For example, this may be the case when a decision-maker holds subordinated interests in, or provides other forms of credit enhancement to, an investee.

B68 The greater the decision-maker's exposure to variable returns from of its involvement with an investee, considering its remuneration and other interests in aggregate, the greater the weighting that should be placed on this factor and the more likely it is that the decision-maker is not an agent. Although the decision-maker's exposure is

evaluated primarily on the basis of returns that are expected from the activities of an investee, that evaluation should not ignore the maximum exposure of the decision-maker (and its related parties) to variability of returns from the investee through other interests that the decision-maker holds.

Relationship with other parties

- B69 An investor may conclude that the nature of its relationship with other parties is such that those other parties are acting on the investor's behalf (they are 'de facto agents'). Such a relationship need not involve a contractual arrangement. A party is a de facto agent when the investor has, or those that direct the activities of the investor have, the ability to direct that party to act on the investor's behalf.
- B70 The determination of whether other parties are acting as a de facto agent requires judgement, considering the nature of the relationship and how those parties interact with each other and the investor.
- B71 The following are examples of such other parties that, by the nature of their relationship, may act as de facto agents for the investor:
- (a) the investor's related parties as defined in IAS 24 *Related Party Disclosures*.
 - (b) a party that received its interest in the investee as a contribution or loan from the investor.
 - (c) a party that has agreed not to sell, transfer or encumber its interests in the investee without the investor's prior approval, except for situations in which the investor and the other party have the right of prior approval and the rights are based on mutually agreed terms by willing independent parties.
 - (d) a party that cannot finance its operations without subordinated financial support from the investor.
 - (e) an investee for which the majority of the members of its governing body or for which its key management personnel is the same as that of the investor.
 - (f) a party that has a close business relationship with the investor, such as the relationship between a professional service provider and one of its significant clients.

Power over specified assets

- B72 When assessing control, an investor considers whether it has power over specified assets of an investee.
- B73 If an investor has power over specified assets of an investee (i.e. over a 'portion' of an investee), it shall treat the portion of that investee as a separate entity if and only if the following condition is satisfied:

Specified assets of the investee (and related credit enhancements, if any) are the only source of payment for specified liabilities of, or specified other interests in, the investee. Parties other than those with the specified liability do not have rights or obligations related to the specified assets or to residual cash flows from those assets. In substance, none of the returns from the specified assets can be used by the remaining investee and none of the liabilities of the deemed separate entity are payable from the assets of the remaining investee. Thus, in substance all of the assets, liabilities and equity of that deemed separate entity are economically ring-fenced from the overall investee. Such a deemed separate entity is often called a 'silo'.

- B74 If an investor has such an interest in specified assets it must identify the activities that significantly affect the returns of those assets and how those activities are directed in order to assess whether it has power over that portion of the investee.
- B75 If the investor controls and consolidates a portion of an investee as a separate entity in accordance with paragraph B73, other parties exclude that portion of the investee when assessing control of and in consolidating the investee.

Continuous assessment

- B76 An investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 7.
- B77 If there is a change in how power over an investee can be exercised that change must be reflected in how an investor assesses its power over an investee. For example, changes to decision-making rights can mean that the relevant activities are no longer

directed through voting rights, but instead other agreements, such as contracts, give another party or parties the current ability to direct the relevant activities.

- B78 An event can cause an investor to gain or lose power over an investee without the investor being involved in that event. For example, an investor can gain power over an investee because decision-making rights held by another party or parties that previously prevented the investor from controlling an investee have elapsed.
- B79 An investor also considers changes affecting its exposure, or rights, to variable returns from its involvement with an investee. For example, an investor that has power over an investee can lose control of an investee if the investor ceases to be entitled to receive returns or to be exposed to obligations, because it would fail to satisfy paragraph 7(b) (for example, this could occur if a contract to receive performance-related fees is terminated).
- B80 An investor shall consider whether its assessment that it acts as an agent or a principal of another party has changed. Changes in the overall relationship between the investor and other parties can mean that an investor no longer acts as an agent, even though it previously has acted as an agent, and vice versa. For example, if changes in the rights of the investor, or of other parties, occurred, the investor should reconsider its status as principal or agent.

Accounting requirements

Consolidation procedures

- B81 Consolidated financial statements:
- (a) combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.
 - (b) offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary (IFRS 3 explains how to account for any related goodwill).
 - (c) eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or

losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full).

Measurement

B82 A reporting entity includes the income and expenses of a subsidiary in the consolidated financial statements from the date it gains control until the date when the reporting entity ceases to control the subsidiary. Income and expenses of the subsidiary are based on the amounts of the assets and liabilities recognised in the consolidated financial statements at the acquisition date. For example, depreciation expense recognised in the consolidated statement of comprehensive income after the acquisition date is based on the fair values of the related depreciable assets recognised in the consolidated financial statements at the acquisition date.

Potential voting rights

B83 The proportion allocated to the parent and non-controlling interests in preparing consolidated financial statements, and the proportion allocated to an investor that accounts for its investment using the equity method in accordance with IAS 28, are determined 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.

B84 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.

B85 IFRS 9 does not apply to interests in subsidiaries, associates and joint arrangements that are accounted for using IFRS X, IAS 28 and IFRS Z 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 IFRS 9. In all other cases, instruments containing potential voting rights are accounted for in accordance with IFRS 9.

Reporting date

- B86 The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall have the same reporting date. When the end of the reporting period of the parent is different from that of a subsidiary, the parent or the subsidiary prepare, for consolidation purposes, additional financial information to enable the parent to consolidate the financial information of the subsidiary, unless it is impracticable to do so.
- B87 If it is impracticable to do so, the parent shall consolidate the financial information of the subsidiary using the most recent financial statements of the subsidiary adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements. In any case, the difference between the date of the subsidiary's financial statements and that of the parent's financial statements shall be no more than three months, and the length of the reporting periods and any difference between the dates of the financial statements must be the same from period to period.

Non-controlling interests

- B88 A reporting entity shall attribute the profit or loss and each component of other comprehensive income to the owners of the parent and to the non-controlling interests. The reporting entity shall also attribute total comprehensive income to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.
- B89 If a subsidiary has outstanding cumulative preference shares that are classified as equity and are held by non-controlling interests, the reporting entity shall compute its share of profit or loss after adjusting for the dividends on such shares, whether or not such dividends have been declared.

Changes in the proportion held by non-controlling interests

- B90 When the proportion of the equity held by non-controlling interests changes, a reporting entity shall adjust the carrying amounts of the controlling and non-

controlling interests to reflect the changes in their relative interests in the subsidiary. The reporting entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received and attribute it to the owners of the parent.

Loss of control

B91 A parent might lose control of a subsidiary in two or more arrangements (transactions). However, sometimes circumstances indicate that the multiple arrangements should be accounted for as a single transaction. In determining whether to account for the arrangements as a single transaction, a parent shall consider all of the terms and conditions of the arrangements and their economic effects. One or more of the following may indicate that the parent should account for the multiple arrangements as a single transaction:

- (a) they are entered into at the same time or in contemplation of each other.
- (b) they form a single transaction designed to achieve an overall commercial effect.
- (c) the occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.
- (d) one arrangement considered on its own is not economically justified, but it is economically justified when considered together with other arrangements. An example is when one disposal of shares is priced below market and is compensated for by a subsequent disposal priced above market.

B92 If a parent loses control of a subsidiary, it shall:

- (a) derecognise
 - (i) the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost; and
 - (ii) the carrying amount of any non-controlling interests in the former subsidiary at the date when control is lost (including any components of other comprehensive income attributable to them).
- (b) recognise:

- (i) the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control;
 - (ii) if the transaction, event or circumstances that resulted in the loss of control involves a distribution of shares of the subsidiary to owners in their capacity as owners, that distribution; and
 - (iii) any investment retained in the former subsidiary at its fair value at the date when control is lost.
- (c) reclassify to profit or loss, or transfer directly to retained earnings if required in accordance with other IFRSs, the amounts recognised in other comprehensive income in relation to the subsidiary on the basis described in paragraph 24(c).
- (d) recognise any resulting difference as a gain or loss in profit or loss attributable to the parent.

B93 If a reporting entity loses control of a subsidiary, the reporting entity shall account for all amounts previously recognised in other comprehensive income in relation to that subsidiary on the same basis as would be required if the reporting entity had directly disposed of the related assets or liabilities. Therefore, if a gain or loss previously recognised in other comprehensive income would be reclassified to profit or loss on the disposal of the related assets or liabilities, the parent shall reclassify the gain or loss from equity to profit or loss when it loses control of the subsidiary. If a revaluation surplus previously recognised in other comprehensive income would be transferred directly to retained earnings on the disposal of the asset, the reporting entity shall transfer the revaluation surplus directly to retained earnings when it loses control of the subsidiary.

Appendix C - Effective date and transition

This appendix is an integral part of the IFRS.

Effective date

[to be added]

Transition

- C1 A reporting entity shall apply this IFRS retrospectively, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified in paragraphs C2 and C3.
- C2 When application of the requirements of this IFRS for the first time results in an investor consolidating an investee that was not consolidated in accordance with IAS 27 and SIC-12, an investor shall measure the assets, liabilities and non-controlling interests in that previously unconsolidated investee on the date of initial application as if that investee had been consolidated (and thus applied acquisition accounting) from the date when the investor obtained control of that investee on the basis of the requirements of this IFRS. If this is impracticable (as defined in IAS 8) the investor shall apply the requirements of IFRS 3. In this case the deemed acquisition date shall be the beginning of the earliest period for which application of the requirements in IFRS 3 are practicable. The earliest period may be the current period.
- C3 When application of the requirements of this IFRS for the first time results in an investor no longer consolidating an investee that was consolidated in accordance with IAS 27 and SIC-12, an investor shall measure its retained interest in the investee on the date of initial application, at the amount at which it would have been measured if the requirements of this IFRS had been effective when it became involved with, or lost control of, the investee. If measurement of the retained interest is impracticable (as defined in IAS 8), the investor shall apply the requirements in this IFRS for accounting for a loss of control at the start of the reporting period when first applying this IFRS.

Adoption prior to adopting IFRS 9

- C4 If an entity adopts this IFRS but is not yet applying IFRS 9, any reference to IFRS 9 shall be read as a reference to IAS 39 *Financial Instruments: Recognition and Measurement*.

Withdrawal of SIC-12

- C5 This IFRS supersedes SIC-12 *Consolidation—Special Purpose Entities*.

STAFF DRAFT — SUBJECT TO CHANGE

Board Approval

STAFF DRAFT — SUBJECT TO CHANGE

Appendix D - Amendments to other IFRSs

[to be added]

STAFF DRAFT — SUBJECT TO CHANGE

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Basis for Conclusions on IFRS X Consolidated Financial Statements

This Basis for Conclusions accompanies, but is not part of, IFRS X.

Introduction

- BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in developing IFRS X *Consolidated Financial Statements*. Individual Board members gave greater weight to some factors than to others.
- BC2 The Board decided to add a project on consolidation to its agenda because there was divergence in practice in application of the guidance in IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation—Special Purpose Entities*.
- BC3 For example, there is divergence in practice in the application of the control concept
- (a) in circumstances in which an investor controls an investee but the investor has less than a majority of the voting rights of the investee (and voting rights are clearly the basis for control).
 - (b) in circumstances involving special purpose entities (where the the notion of 'economic substance' in SIC-12 applies),
 - (c) in circumstances involving agency relationships; and
 - (d) in circumstances involving protective rights.
- BC4 IAS 27 requires the consolidation of entities that are controlled by a reporting entity, and it defines control as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. SIC-12, which interprets the requirements of IAS 27 in the context of special purpose entities, places greater emphasis on risks and rewards. This perceived conflict of emphasis has led to inconsistent application of the concept of control. This is aggravated by a lack of clear guidance on which investees are within the scope of IAS 27 and which are within the scope of SIC-12. As a result, assessing control sometimes falls back to a

quantitative assessment of whether the investor has a majority of the risks. Such tests based on sharp ‘bright line’ distinctions create structuring opportunities.

- BC5 The financial crisis in 2007/2008 also highlighted a lack of transparency about the risks to which investors were exposed from their involvement with structured vehicles, including those that they had set up or sponsored.
- BC6 In developing IFRS X, the Board considered the responses to its exposure draft, ED 10 *Consolidated Financial Statements*, published in December 2008. Respondents to ED 10 noted that the IASB and the US Financial Accounting Standards Board (FASB), in their Memorandum of Understanding, had agreed to work towards developing common standards on consolidation by 2011. They therefore asked the boards to discuss the consolidation project jointly to ensure that the ensuing standards contained identical, not only similar, requirements. As a result, the Board’s deliberations in developing IFRS X were conducted jointly with the FASB from October 2009. [*to be updated after FASB decision on whether to publish an exposure draft*]
- BC7 ED 10 proposed disclosure requirements for consolidated and unconsolidated investees. During its deliberations on responses to those proposals, the Board decided to combine the disclosure requirements for involvement with subsidiaries, joint arrangements, associates and unconsolidated structured entities within a single comprehensive standard, IFRS Y *Disclosure of an Entity’s Involvement with Other Entities*. IFRS Y sets out disclosure requirements relating to an entity’s involvement with other entities. The Basis for Conclusions accompanying IFRS Y summarises the Board’s considerations in developing IFRS Y, including its considerations of responses to the disclosure proposals in ED 10. Accordingly, IFRS X does not include disclosure requirements and this Basis for Conclusions does not incorporate the Board’s considerations of responses to the proposed disclosure requirements in ED 10.

Control as the basis for consolidation

- BC8 The Board's aim in issuing IFRS X is to improve the understandability of consolidated financial statements, by developing a single basis for consolidation, irrespective of the nature of the investee. That basis is control.
- BC9 Almost all respondents to ED 10 supported control as the basis for consolidation. However, some of the respondents who support using control as the basis for consolidation noted that it can be difficult to identify an investor that has power to direct the activities of some investees that do not require substantive continuous decision-making. They suggested that exposure to risks and rewards should be used as a proxy for control when power is not evident. Some respondents were also concerned that applying the proposed control definition to all investees could lead to more structuring opportunities than could the current requirements in IAS 27 and SIC-12. Other respondents did not think that ED 10 expressed with sufficient clarity the importance of risks and rewards when assessing control.
- BC10 The Board confirmed its view that control should be the only basis for consolidation—and that an investor should consolidate an investee and present in its consolidated financial statements the assets, liabilities, equity, income, expenses and cash flows of an investee, if an investor has the power to direct the activities of the investee that significantly affect the investee's returns and can benefit by using its power. An investor that is exposed, or has rights, to variable returns from its involvement with the investee but does not have the ability to direct the activities of the investee so as to affect the amount of the investor's return from its involvement with the investee does not control the investee.
- BC11 Control as the basis for consolidation does not mean that the consideration of risks and rewards is unimportant when assessing control of an investee. The more an investor is exposed to risks and rewards from its involvement with an investee, the greater the incentive for the investor to obtain contractual decision-making rights that give it the power to direct the activities of the investee. However, risks and rewards

and power are not necessarily directly correlated. Therefore, the Board confirmed that exposure to risks and rewards is an *indicator of control* and an important factor to consider when assessing control but an investor's exposure to risks and rewards alone does not determine that the investor has control over an investee.

BC12 The Board observed that to conclude that exposure to risks and rewards is anything more than an indicator of control would be inconsistent with a control model that contains both a power element and a returns element.

BC13 The Board also confirmed that an investor must have exposure to risks and rewards in order to control an investee—without any exposure to risks and rewards (ie returns), an investor is unable to benefit from any power that it might have and therefore cannot have control.

BC14 In reaching its conclusions regarding control as the basis for consolidation, the Board also noted the following:

(a) One of the main objectives of the consolidation project is to develop a consistent basis for determining when an investor consolidates an investee, irrespective of the nature of the investee. Some respondents to ED 10 suggested including a particular level of exposure to risks and rewards as a presumption of, or proxy for, control, in the context of investees that are not directed through voting or similar rights. The Board concluded that introducing such a presumption for a particular set of investees would contradict the objective of developing a single consistent basis for consolidation that applies to all investees.

(b) Having a different consolidation model for some investees necessitates defining precisely those investees to which that model applies. There have been difficulties, in practice, in identifying which investees are special purpose entities to which SIC-12 applies. A number of respondents to ED 10 noted that any attempt to split the continuum of investee types into distinct populations and to subject the different populations of entities to different

consolidation models would lead to divergence in practice for investees that do not fall clearly in the specified population sets. For that reason, the Board decided not to carry forward the distinction proposed in ED 10 between different types of investee when assessing control (see paragraphs BC48–BC52).

- (c) Including exposure to risks and rewards as a presumption of, or proxy for, control in particular situations puts more pressure on the measurement of that exposure. The Board was particularly concerned that the need to measure risks and rewards might result in the adoption of a consolidation model based on quantitative criteria. Any quantitative analysis of risks and rewards would inevitably be complex and, as a consequence, difficult to understand, apply and audit. The Board noted also that, depending on the specific facts and circumstances, a quantitative model might identify a controlling party that is different from the party that a qualitative analysis of the power over, and returns from, an investee would identify as the controlling party. The Board's analysis is consistent with concerns raised by US GAAP constituents on the quantitative consolidation model in Interpretation 46 (Revised) *Consolidation of Variable Interest Entities*. The FASB has since issued Statement of Financial Accounting Standard No. 167 *Amendments to FIN 46 (Revised) to amend Interpretation 46* to require the consolidation of variable interest entities on the basis of control.
- (d) The Board believes that having a control model that applies to all investees is likely to reduce the opportunities for achieving a particular accounting outcome that is inconsistent with the economics of an investor's relationship with an investee—ie it will reduce *structuring opportunities*.

BC15 The Board does not regard control and risks and rewards as competing models. The exposure to risks and rewards, or returns as it is expressed in IFRS X, is an essential element of control. In the great majority of cases the approaches would lead to the same accounting conclusions. However, a control-based model forces an investor to

consider all of its rights in relation to the investee rather than relying on arbitrary bright lines that are associated with risks and rewards approaches, such as SIC-12, paragraph 10(c) and (d) which refers to control if the investor has rights to obtain the majority of the benefits of the investee or if the investor retains the majority of the risks related to the investee. The Board believes that an investor will, generally, want to control an investee (which includes the ability to direct the activities that significantly affect the investee's returns), when it has significant economic exposure. This should reduce the likelihood of structuring simply to achieve a particular accounting outcome.

Reputational risk

- BC16 During the financial crisis, some financial institutions provided funding or other support to securitisation or investment vehicles because they established or promoted those vehicles. Rather than allowing them to fail and facing a loss of reputation, the financial institutions stepped in, and in some cases took control of the vehicles. ED 10 did not make any explicit reference to reputational risk in relation to control, because the Board decided that having reputational risk in isolation is not an appropriate basis for consolidation. The term 'reputational risk' relates to the risk that failure of an investee would damage an investee's reputation, compelling the investor to provide support to an investee in order to protect the reputation of the investor, even though the investor has no legal or contractual requirement to do so.
- BC17 Respondents to ED 10 agreed, almost unanimously, that reputational risk is not an appropriate basis for consolidation. Some, however, were of the view that reputational risk is part of an investor's exposure to risks and rewards and should be considered when determining control of an investee.
- BC18 The Board believes that reputational risk is part of an investor's exposure to risks and rewards, albeit a risk that arises from non-contractual sources. For that reason, the Board concluded that, when assessing control, reputational risk is a factor to consider along with other facts and circumstances. It is not an indicator of power in its own

right, but may increase an investor's incentive to secure rights that give the investor the power to direct the activities of an investee.

Definition of control

BC19 IFRS X states that an investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

BC20 The definition of control includes three elements, namely an investor's:

- (a) power over the investee;
- (b) exposure, or rights, to variable returns from its involvement with the investee; and
- (c) ability to use its power over the investee to affect the amount of the returns.

Power

BC21 ED 10 proposed that in order to control an investee, an investor must have the power to direct the activities of that investee. IAS 27 defines control as the power to govern the financial and operating policies of an entity. The Board decided to change the definition of control because although power is often obtained by governing the strategic operating and financing policies of an investee, it is only one of the ways in which power to direct the activities of an investee can be achieved. An investor can have the power to direct the activities of an investee through decision-making rights that relate to particular activities of an investee. Indeed, referring to the power to govern the financial and operating policies of an investee would not necessarily apply to investees that are not directed through voting or similar rights.

BC22 Respondents to ED 10 did not object to changing the definition of control to power to direct the activities of an investee. Many were confused, however, about what the Board meant by 'power to direct' and which 'activities' the Board had in mind. They asked for a clear articulation of the principle behind the term 'power to direct'. They

also expressed the view that power should relate to significant activities of an investee, and not those activities that had little effect on the returns.

- BC23 ED 10 described various characteristics of power—power need not be absolute; power need not have been exercised; power precludes others from controlling an investee. ED 10 also implied that power could arise from rights that appeared to be exercisable only at some point in the future when particular circumstances arise or events happen. Respondents to ED 10 were confused about whether power referred to the legal or contractual power to direct, or to the ability to direct, which does not necessarily require the investor to have the legal or contractual right to direct the activities. Some respondents to ED 10 also commented that the statement that power precludes others from controlling an investee was confusing because it implied that an investor with less than a majority of the voting rights in an investee could never have power.
- BC24 In response to the comments from respondents, the Board considered whether power should refer to having the legal or contractual *right* to direct the activities, or the *ability* to direct the activities.
- BC25 According to a legal or contractual right approach, some would suggest that an investor has power only when it has an unassailable legal or contractual right to direct. This means having the right to make decisions about the activities of an investee that could potentially be contrary to the wishes of others in every possible scenario, within the boundaries of protective rights. Therefore, for example, an investor with less than half the voting rights of an investee could not have power unless it had additional legal or contractual rights (see paragraphs BC77). Also, potential voting rights would not affect the assessment of control until exercised or converted because in themselves they do not give the holder the contractual right to direct. A consistent application of this view to ‘kick-out’ (removal) or similar rights would suggest that a decision-maker could never have power when kick-out or similar rights are held by others, as those rights could be exercised to remove the decision-maker.

- BC26 Supporters of the legal or contractual right approach argue that this approach requires less judgement than other approaches and, accordingly, is likely to result in more consistent application of the control definition. They are also concerned that other approaches might result in an investor frequently changing its assessment of control because of changes in circumstances. These changes could be outside the control of the investor (for example, changes in the shareholdings of others or market changes that affect the terms and conditions of potential voting rights).
- BC27 The Board acknowledged that defining power as the legal or contractual right to direct the activities of an investee would require less judgement than other approaches. Nonetheless, the Board rejected that approach because it would create opportunities for an investor to ignore those circumstances in which the Board believes that an investor controls an investee without having the unassailable legal or contractual right to direct the activities of the investee.
- BC28 In addition, the Board concluded that preparers and others should be able to apply the judgement required by an ‘ability’ approach, as long as the principles underlying that approach were articulated clearly and the IFRS included application guidance illustrating how control should be assessed.
- BC29 Consequently, the Board concluded that power should refer to having the *ability* to direct the activities of an investee. The Board observed that the ability to direct the activities of an investee would, in all cases, arise from rights (such as voting rights, potential voting rights, rights within other arrangements, or a combination of these).
- BC30 An investor can have the ability to direct the activities of an investee even if it does not actively direct the activities of the investee. However, an investor is not assumed to have the current ability to direct simply because it is actively directing the activities of an investee. For example, an investor that holds a 70 per cent voting interest in an investee (when no other relevant factors are present) has the current ability to direct the activities of the investee even if it has not exercised its right to vote. Even if the

remaining 30 per cent of voting rights was held by a single party actively exercising its voting rights, that minority shareholder would not have power.

- BC31 The Board decided that to have power an investor must have the *current* ability to make decisions about the activities of an investee. This would be the case if an investor is able to make decisions at the time that those decisions need to be taken.
- BC32 The Board noted that having the current ability to direct the activities of an investee is not limited to being able to act today. There may be steps to be taken in order to act—for example, an investor may need to initiate a meeting before it can exercise its voting or other rights that give it power. However, such a delay would not prevent the investor from having power, assuming that there are no other barriers that would prevent the investor from exercising its rights when it chooses to do so.
- BC33 The Board also noted that for some investees, particularly those with most of their operating and financing decisions predetermined, decisions that significantly affect the returns of the investee are not made on an ongoing basis. Such decisions may be made only if particular events or circumstances arise. For such investees, having the ability to make these decisions if and when they arise is a source of a current ability to direct the activities that significantly affect the returns of the investee.
- BC34 When discussing the principles underlying power, the Board rejected the assertion that an ‘ability’ approach could result in an investee moving frequently in and out of consolidation because of changes that are outside the control of the investor (see paragraph BC26). Changes, as to which party controls an investee, could occur according to any control model, including a ‘contractual rights’ model, when relevant facts and circumstances change.
- BC35 ED 10 did not provide explicit guidance explaining the activities of an investee to which the definition of control referred. In response to comments received from respondents, the Board decided to clarify that, in order to control an investee, an investor must have the power to direct the activities of the investee *that significantly affect the investee’s returns*.

- BC36 The comments on ED 10 suggested that such a clarification would be particularly helpful when assessing control of investees that are not directed through voting or similar rights and for which there are multiple parties with decision-making rights over different activities.
- BC37 If an investor controls such an investee, its power should relate to the activities of the investee that significantly affect the investee's returns, rather than administrative activities that have little or no effect on the investee's returns. For an investee that is not directed through voting or similar rights it can be difficult to determine which investor, if any, meets the power element of the control definition. There is also a risk that, without adding the modifier 'significant', an investor with very little ability to affect the returns could be considered to have the power to direct the activities of that investee. The Board believes it is not appropriate for power to be interpreted as the ability to direct the most significant of a number of insignificant activities that have little effect on the investee's returns.
- BC38 Although the wording proposed in ED 10 is particularly helpful in the context of investees that are not directed through voting or similar rights, the Board concluded that the amended wording would work well for all investees. For an investee that is directed through voting or similar rights, it is generally the case that a range of operating and financing activities are those that significantly affect the investee's returns—for example, the sales of goods or services, purchases, capital expenditure or obtaining finance. In that case, an investor that is able to determine the strategic operating and financing policies of the investee would usually have power.

Returns

- BC39 The definition of control in IFRS X uses the concept of returns in two different ways.
- BC40 In order to have power over an investee an investor must have the current ability to direct the activities that significantly affect the investee's returns. The link to returns was included in this element of control in order to clarify that having the ability to

direct inconsequential activities is not relevant to the assessment of power and control (see BC37).

- BC41 The second element of control requires that the investor's involvement with the investee provides the investor itself with rights or exposures to variable returns. This retains the concept that control conveys the rights to returns from an investee.
- BC42 The revised definition of control retains the concept that control conveys the rights to returns from an investee. To have control an investor must have power over the investee, returns from its involvement with the investee and the ability to use its power to affect the returns. Control is not a synonym of power, because equating power and control would result in incorrect conclusions in situations in which an agent acts on behalf of others. ED 10 used the term 'returns' rather than 'benefits' because 'benefits' are often interpreted to imply only positive returns. The Board believes that using the term 'returns' makes it clear that returns can be positive, negative or both. Further, it makes clear that it is the potential to receive returns that is important.
- BC43 The Board confirmed its intentions to have a broad definition of 'returns' that would include synergistic returns as well as more direct returns, for example, dividends or changes in the value of an investment. In practice, an investor can benefit from controlling an investee in a variety of ways. The Board concluded that to narrow the definition of returns would artificially restrict those ways of benefiting.
- BC44 Although some respondents to ED 10 noted that 'returns' could be interpreted narrowly to refer to financial returns such as dividends only, the Board believed that the broad description of returns included in the IFRS should ensure that the Board's intentions to have a broad definition is clear. The Board also confirmed that an investor's returns could have the potential to be wholly positive, wholly negative, or either positive or negative.

Link between power and returns

BC45 To have control, an investor must have power, exposure to returns and be able to use that power to affect its own returns from its involvement with the investee. Thus, power and the returns to which an investor is exposed, or has rights, must be linked. The link between power and returns does not mean that the proportion of returns accruing to an investor needs to be directly correlated with the amount of power that the investor has. The Board noted that many parties can have the right to receive variable returns from an investee (eg shareholders, debt providers, agents), but only one party can control an investee.

Control is not shared

BC46 ED 10 proposed that only one party, if any, can control an investee (see paragraphs BC35 and BC36). The Board confirmed this in deliberating IFRS X. (See further comments regarding joint arrangements in BC60).

BC47 ED 10 proposed that an investor need not have absolute power to control an investee. Other parties can have protective rights relating to the activities of an investee. For example, limits on power are often imposed by law or regulations. Similarly, other parties—such as non-controlling interests—may hold protective rights that limit the power of the investor. During redeliberations the Board confirmed that an investor can control an investee even if other entities have rights relating to the activities of an investees that significantly affect the investee's returns. Paragraphs BC69 and BC71 discuss rights that give an investor power over an investee.

Assessing control

BC48 In developing IFRS X, the Board, while acknowledging that the factors to be considered in assessing control will vary, had the objective of developing a control model that applies the same notion of control as a basis for consolidation to all investees, irrespective of their nature.

- BC49 In ED 10, the Board set out set out specific factors to consider when assessing control of a structured entity. ED 10 defined a structured entity as an entity whose activities are restricted to the extent that those activities are, in essence, not directed by voting or similar rights.
- BC50 The Board's intention when including the subsection specifically for structured entities was as a convenience for those assessing control of traditional operating entities that are typically controlled through voting rights—the Board did not want to force those assessing control of traditional operating entities to read, and assess whether to apply, all of the guidance relating to structured entities if that guidance was not relevant.
- BC51 However, the vast majority of respondents to ED 10 were opposed to creating a subset of investees for which different guidance would apply when assessing control. In their view, such an approach would perpetuate problems faced in applying the guidance in IAS 27 and SIC-12—two control models leading to inconsistent application and, therefore, potential arbitrage by varying investee-specific characteristics. Respondents also noted that the guidance provided for structured entities should apply generally to all investees. Therefore, they suggested that there should be a single section that combines guidance on assessing control of all investees.
- BC52 The Board was persuaded by these arguments and decided to combine the guidance for assessing control of an investee within a single section, noting that its intention is to have a single basis for consolidation that could be applied to all investees and that that basis is control. However, the Board acknowledged that the way in which control would need to be assessed would vary depending on the nature of investees.

Understanding the purpose and design of an investee

- BC53 Some respondents to ED 10 expressed the view that involvement in the design of an investee (with restricted activities) is a strong indicator of control and, indeed, in some situations, would conclude that involvement in the design alone is sufficient to

meet the power element of the control definition. SIC-12 included this notion as one of its indicators of control and stated the following in its Basis for Conclusions:

SPEs [special purpose entities] frequently operate in a predetermined way so that no entity has explicit decision-making authority over the SPE's ongoing activities after its formation (ie they operate on 'autopilot'). Virtually all rights, obligations, and aspects of activities that could be controlled are predefined and limited by contractual provisions specified or scheduled at inception. In these circumstances, control may exist for the sponsoring party or others with a beneficial interest, even though it may be particularly difficult to assess, because virtually all activities are predetermined. However, the predetermination of the activities of the SPE through an 'autopilot' mechanism often provides evidence that the ability to control has been exercised by the party making the predetermination for its own benefit at the formation of the SPE and is being perpetuated.

- BC54 When developing IFRS X the Board confirmed the position in ED 10, that being involved in setting up an investee was not, in and of itself, sufficient to conclude that an investor has control. Being involved in the design does not necessarily mean that an investor has power to direct the activities of an investee. Often several parties are involved in the design of an investee and the final structure of the investee includes whatever is agreed to by all those parties (including investors, the sponsor of the investee, the transferor(s), and other parties involved in the transaction).
- BC55 Although the success of, for example, a securitisation will depend on the assets that are transferred to the securitisation vehicle, the transferor might not have any further involvement with the vehicle. The benefits from being involved in setting up a vehicle could cease as soon as the vehicle is established. The Board concluded that, in isolation, being involved in setting up an investee would not be an appropriate basis for consolidation.
- BC56 The Board confirmed that considering the purpose and design of an investee is important when assessing control. Understanding the purpose and design of an investee is the means by which an investor identifies the activities that significantly affect the investee's returns, and identifies whether power arises from rights attached to equity interests in an investee, or rights arising from other contracts or instruments. It can also assist in identifying investors that may have sought to secure control and whose position should be understood and analysed when assessing control.

BC57 The Board noted that understanding the purpose and design of an investee also involves consideration of all activities and returns that are closely related to the investee, even though they might occur outside the legal boundaries of the investee. For example, assume that the purpose of a securitisation vehicle is to allocate risks (mainly credit risk) and benefits (cash flows received) of a portfolio of receivables to the parties involved with the vehicle. The vehicle is designed in such a way that the only activity that can be directed, and can affect the returns from the transaction, is managing those receivables when they default. An investor might have the current ability to direct those activities that significantly affect the returns of the transaction by, for example, writing a put on the receivables that is triggered when the receivables default. The design of the vehicle ensures that the investor has decision-making authority over the activities that significantly affect the returns at the only time that such decision-making authority is required. In this situation, the terms of the put agreement are integral to the overall transaction and the establishment of the investee. Therefore, the terms of the put agreement would be considered together with the founding documents of the investee to conclude that the investor has the current ability to direct the activities of the securitisation vehicle that significantly affect the returns of the transaction (even before the default of the receivables).

Different activities significantly affect the returns

BC58 IAS 27, SIC-12 and ED 10 did not specifically address situations in which multiple parties have decision-making authority over the activities of an investee. Some respondents to ED 10 questioned how the control model would be applied in such situations. Respondents were concerned that the absence of specific guidance would create structuring opportunities to avoid the consolidation of structured entities—they asserted that, without any guidance, power could easily be disguised and divided among different parties so that it could be argued that no one would have the power to direct the activities of the investee.

BC59 The Board identified the following situations in which multiple parties may have decision-making authority over the activities of an investee:

- (a) joint control
- (b) shared decision-making that is not joint control
- (c) multiple parties that have each unilateral contractual decision-making rights to direct different activities of an investee that significantly affect the investee's returns.

Joint control

BC60 IFRS Z *Joint Arrangements* defines joint control as the contractually agreed sharing of control over an activity. Joint control exists only when the matters that give the parties, or a group of parties, control over the activity require their unanimous consent **[to be updated when IFRS Z is issued]**. When two or more parties have joint control of an investee, no one party controls that investee and, accordingly, the investee is not consolidated. IFRS Z is applicable to all investees for which two or more parties have joint control. The Board confirmed that the requirements of IFRS X do not change or amend the arrangements that fall within the scope of that guidance.

Shared decision-making that is not joint control

BC61 The power to direct the activities of an investee that significantly affect the returns can be shared by multiple parties but those rights may not meet the definition of joint control. For example, five parties each own 20 per cent of Entity Z, and each has one seat on its board of directors. All strategic operating and financing decisions about the activities of Entity Z require the consent of any four of the five directors. The five parties do not jointly control Entity Z because unanimous consent is not required for all decisions relating to the activities of Entity Z. Nevertheless, it is clear that the power to direct the activities of Entity Z is shared and no single party controls Entity Z. Again, the Board confirmed that the requirements of IFRS X do not change or amend the application of IFRSs to such situations.

Multiple parties with decision-making rights

- BC62 When discussing the sharing of power, the Board noted that for most investees, it will be clear that one party or body has decision-making authority to direct the activities of an investee that significantly affect the investee's returns (see paragraphs BC35 and BC36). For example, for an investee that is directed by voting or similar rights, the governing body or board of directors typically would be responsible for strategic decision-making, so the ability to direct that body would be the basis for power.
- BC63 Nonetheless, it is possible that more than one party might have decision-making authority over different activities of an investee and each such activity may significantly affect the investee's returns—respondents to ED 10 noted the following as examples: multi-seller conduits; multi-seller securitisations; and investees for which the assets are managed by one party and the funding is managed by another party. The Board was persuaded by the comments from respondents that IFRS X should specifically address investees for which multiple parties each have unilateral decision-making rights to direct different activities of the investee.
- BC64 The Board considered whether, for such investees, none of the parties would control the investee because the power to direct the activities is shared. If those different activities do, in fact, significantly affect the returns of the investee, some would argue that it would be artificial to force the parties involved to conclude that one activity is more important than the others. An investee might be required to consolidate an investee when it would not have the power to direct *all* of the activities of the investee that significantly affect the investee's returns.
- BC65 Nonetheless, the Board decided that when two or more unrelated parties each have unilateral decision-making rights over different activities of an investee that significantly affect the investee's returns, the investor that has the current ability to direct the activities of an investee that *most* significantly affect the investee's returns meets the power element of the control definition. In effect, power is attributed to the party that looks most like the controller. However, the Board decided not to prescribe

a specific mechanism how to assess whether the activities of an investee *most* significantly affect the investee's returns.

- BC66 The Board was concerned about creating the potential to avoid consolidation if an investor were to conclude that it has power only when it has the power to direct *all* of the activities that significantly affect the investee's returns. Such a requirement would be open to abuse because an investor could avoid consolidation by involving other parties in an investee's decision-making.
- BC67 The Board's conclusions result in greater potential for an investee to be consolidated because one party would be deemed to have power when multiple parties have unilateral decision-making authority over different activities of an investee.
- BC68 In reaching its conclusions, the Board noted that this situation is not expected to arise frequently as usually one party has overall decision-making responsibility for an investee. The Board believes that its conclusions in this respect will ensure that it does not create an incentive to structure investees to achieve an accounting outcome by involving multiple parties in decision-making when there is no business rationale to do so.

Rights that give an investor power

- BC69 IAS 27 and SIC-12 do not include guidance on rights that give an investor power, other than voting rights and potential voting rights. In addition, neither discusses the effect that such rights held by other parties have on the rights of an investor.
- BC70 The Board addressed this issue to some extent in ED 10 by including guidance on protective rights. However, comments from respondents to ED 10 suggested that the guidance was not sufficient.
- BC71 The Board decided to address those concerns by providing additional guidance about the activities an investor must be able to direct in order to have power (ie those activities that significantly affect the investee's returns) and by providing guidance on when those rights are substantive. The Board believes that including such guidance

should help an investor to determine whether it controls an investee, or whether the rights held by other parties are sufficient to prevent an investor from controlling an investee.

Voting rights

BC72 Similar to IAS 27 and ED 10, the Board decided to include guidance in IFRS X that addresses the assessment of control of investees that are controlled by voting rights.

Majority of voting rights

BC73 The Board carried forward the concept from IAS 27, (with a modification to the words see BC38), that an investor that holds more than half of the voting rights of an investee has power over the investee when those voting rights give the investor the ability to direct the activities that significantly affect the returns of the investee (either directly or by appointing the members of the governing body). The Board concluded that such an investor's voting rights are sufficient to give it power over the investee regardless of whether it has exercised its voting power, unless those rights are not substantive or there are separate arrangements providing another entity with power over the investee (such as through a contractual arrangement over decision making or substantive potential voting rights).

Less than a majority of voting rights

BC74 In October 2005 the Board stated that, in its opinion, IAS 27 contemplates that there are circumstances in which an investor can control an investee without owning more than half the voting rights of that investee. The Board accepted at that time that IAS 27 does not provide clear guidance about the particular circumstances in which this will occur and that, as a consequence, there was likely to be diversity in practice.

BC75 The Board decided that, in ED 10, it would ensure that it explains clearly that an investor can control an investee even if it does not have more than half of the voting rights, as long as its voting rights are sufficient to give the investor the ability to direct the activities of the investee that significantly affect the investee's returns. ED 10 included an example of a situation in which a dominant shareholder holds

voting rights and all other shareholdings are widely dispersed, such that those other shareholders do not actively co-operate when they exercise their votes so as to have more voting power than the dominant shareholder.

BC76 Respondents to ED 10 expressed mixed views about whether an investor could ever control an investee with less than half of the voting rights and without other contractual rights relating to the activities of the investee.

BC77 Some who supported a ‘contractual rights’ control model, believe that an investor with less than half of the voting rights of an investee (and without other contractual rights) cannot control that investee. They reasoned that this is because the investor contractually does not have the right to direct the activities of the other investee in every possible scenario and cannot necessarily block the actions of others.

BC78 Supporters of the ‘contractual rights’ model believe that power should not be defined in a way that relies on the inactivity of other shareholders, as would be the case according to an ‘ability’ model. In addition, they believe that if an investor wishes to control an investee, that investor would need to have a majority of the voting rights, or further contractual rights (in addition to its voting rights if necessary) that guarantee it has the power to direct the activities of the investee.

BC79 Other respondents to ED 10 supported an ‘ability’ model proposed in ED 10. They agreed with the Board that there are situations in which an investor with less than half of the voting rights in an investee can control that investee, even when an investor does not have other contractual rights relating to the activities of the investee. However, those respondents asked the Board to clarify when that would be the case. In particular, they questioned the following:

- (a) The proposals in the exposure draft implied that an investor might have to consolidate an investee simply because the remaining shareholdings are widely dispersed or attendance at shareholder meetings is low, even though the investor might hold only a low percentage of voting rights in that investee (eg 10 per cent or 15 per cent).

(b) The proposals also implied that an investor might be forced to obtain information about the shareholder structure, the degree of organisation and the other shareholders' future intentions. This would be particularly difficult to obtain if the investor owned a low percentage of the voting rights of an investee.

BC80 The Board noted the concerns raised by respondents but concluded that it would be inappropriate to limit power to situations in which an investor would have the contractual right to direct the activities of an investee for the reasons noted in paragraphs BC23–BC34. Specifically in the context of voting rights, the Board believes that there are situations in which an investor can control an investee even though it does not own more than half of the voting rights of an investee.

BC81 The Board also concluded that an 'ability' model would result in more appropriate consolidation conclusions when applied to all investees. This is because the 'ability' model would be applied consistently to all investees by considering the rights held by the investor, as well as the rights held by other parties, when assessing control. For example, in the context of voting rights, an investor would assess whether its voting and any other contractual rights would be sufficient to give the investor the ability to direct the activities of an investee or whether the voting and other rights held by other shareholders can prevent the investor from directing the activities if they choose to act. The model would be applied in a similar way when other parties hold potential voting rights, kick-out rights or similar rights.

BC82 In response to the concerns raised by respondents to ED 10, the Board clarified that its intentions are neither to require the consolidation of all investees, nor to require an investor that owns a low percentage of voting rights of an investee (such as 10 per cent or 15 per cent) to consolidate that investee. An investor should always assess whether its rights, including any voting rights that it owns, are sufficient to give it the current ability to direct the activities of an investee. That assessment requires judgement, considering all available evidence. The Board decided to add application guidance setting out some of the factors to consider when applying that judgement to help in applying the requirements to situations in which no one party holds more than

half of the voting rights of an investee. In particular, the Board decided to clarify that it expects that:

- (a) the more voting rights an investor holds (ie the larger its absolute holding), the more likely it will have the ability to direct the activities of an investee;
- (b) the more voting rights an investor holds relative to other vote holders (ie the larger its relative holding), the more likely the investor will have the ability to direct the activities of an investee; and
- (c) the more parties that would need to act together to outvote the investor, the more likely the investor will have the ability to direct activities of an investee.

BC83 The Board also noted that, in some cases, considering the voting rights and potential voting rights that an investor and others hold, voting patterns at previous shareholder meetings and contractual rights will be sufficient to determine whether the investor has power. However, in other cases these factors may not be sufficient to enable a determination to be made so additional evidence would need to be considered for an investor to determine if it has power. IFRS X sets out additional factors to be considered in these circumstances. In particular, the Board noted that the fewer voting rights that an investor holds and the fewer the parties that would need to act together to outvote the investor the more reliance would need to be placed on additional evidence to determine whether the investor has power.

BC84 It might be the case that when an investor initially acquires voting rights in an investee by considering the size of that holding and the voting rights held by others, sufficient evidence is not available to conclude that the investor has power. However, the assessment must be reconsidered as additional evidence becomes available. For example, the voting rights held by an investor and others may be unchanged but over time the investor may have been able to appoint a majority of the investee's board of directors and have entered into significant transactions with the investee, enabling the overall assessment to be made that the investor now has control and should consolidate the investee.

Potential voting rights

- BC85 An investor might own options, convertible instruments or other instruments that, if exercised, would give the investor voting rights.
- BC86 IAS 27 refers to those instruments as potential voting rights. According to that standard, the existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing control. If the options or convertible instruments that give an investor potential voting rights are currently exercisable, IAS 27 requires the investor to treat those potential voting rights as if they are current voting rights. According to IAS 27, the investor considers all facts and circumstances except the intentions of management and the financial ability to exercise or convert such rights.
- BC87 Because of the revised definition of control, the Board reconsidered potential voting rights in developing this guidance.
- BC88 The questions that the Board considered with respect to potential voting rights were:
- (a) Can potential voting rights give the holder the current ability to direct the activities of an investee to which those potential voting rights relate?
 - (b) If so, in what situations do potential voting rights give the holder the current ability to direct the activities of that investee?
- BC89 The Board proposed in ED 10 that an investor should assess whether its power from holding potential voting rights, considered together with other facts and circumstances, gives it power. In ED 10 the Board proposed that such an investor would have power if the governing body acts in accordance with the wishes of the investor or the counterparty to the instrument acts as an agent for the investor or the investor has particular contractual rights that give it power.
- BC90 Most respondents to ED 10 agreed that unexercised potential voting rights, taken in conjunction with other facts and circumstances, could give an investor power. However, many were confused by the application guidance—how would one know

whether the decisions of the governing body were in accordance with the wishes of the investor? The respondents suggested that the other situations described would lead to power for reasons other than the potential voting rights instrument.

- BC91 The Board concluded that the general guidance in IFRS X that addresses control should apply to potential voting rights, ie when assessing control, an investor should consider all rights that it and other parties hold, including potential voting rights, to determine whether its rights are sufficient to give it power and control.
- BC92 The Board also observed that concluding that such instruments always or never give the holder control would cause inappropriate consolidation decisions in some cases.
- BC93 Accordingly, the Board concluded that potential voting rights can give the holder the current ability to direct the activities of an investee. This will be the case if those instruments are substantive and, on exercise or conversion, (when considered together with any other current rights the holder has) they give the holder the ability to direct the activities of an investee that significantly affect the investee's returns. The holder of such potential voting rights has the contractual right to 'step in', exercise the instruments and subsequently exercise its voting power to direct the activities—thus the holder has the current ability to direct the activities of an investee at the time that decisions need to be taken if those rights are substantive and are exercisable in a time frame that enables the investor to make those decisions when they need to be made.
- BC94 The Board noted that the holder of such potential voting rights is, in effect, in the same position as a passive majority shareholder or the holder of substantive kick-out rights. The control model developed by the Board would conclude that, in the absence of other factors, a majority shareholder controls an investee even though it can take time to organise a meeting and exercise its voting rights. In a similar manner, it can take time for a principal to remove or 'kick out' an agent. The holder of potential voting rights also has steps to take to obtain its voting rights. In each case, the question is whether those steps are so significant that they act as a barrier to

prevent the investor from having the current ability to direct the activities of an investee.

BC95 The Board also observed that if power was characterised as requiring either the contractual right to direct the activities or active direction of the activities, the holder of unexercised potential voting rights would never have power without other contractual rights. However, power is the *ability* to direct the activities of an investee. As such, the Board concluded that there are situations in which substantive potential voting rights can give the holder power before exercise or conversion.

BC96 In response to comments from respondents to add clarity about those situations in which the holder of potential voting rights has power and to ensure that the control model is applied consistently, the Board added guidance to help assess when potential voting rights are substantive. Although that assessment requires judgement, the Board believes that an investor should be able to apply the judgement required. This is because potential voting rights exist for a reason—the terms and conditions of the instruments reflect that reason. Therefore, an assessment of the terms and conditions of the instrument should provide information on whether the instrument is designed to give the holder power before exercise or conversion.

Delegated power (agency relationships)

BC97 IAS 27 and SIC-12 do not contain requirements or guidance to assess whether a decision-maker is an agent or principal. The absence of guidance has allowed divergence to develop in practice. The Board decided to introduce principles that address agency relationships to reduce this divergence.

BC98 ED 10 developed criteria to identify an agency relationship on the basis of the following assumptions:

- (a) Both the principal and the agent will seek to maximise their own benefits. Therefore, the principal is likely to introduce additional measures that are intended to ensure that the agent does not act against the interest of the

principal. For example, the principal may have rights to remove the agent with or without cause.

- (b) A principal has no incentive to remunerate an agent with more than what is commensurate for the services provided. Accordingly, remuneration that is not commensurate with the services provided is an indicator that a decision-maker is not an agent.

BC99 ED 10 also included guidance on dual roles and addressed situations in which an investor holds voting rights, both directly and on behalf of other parties as an agent. The exposure draft proposed that when assessing whether an investor acts as an agent or principal, the investor would exclude the voting rights that it holds as an agent only if it could demonstrate that it is obliged to act in the best interest of other parties or has implemented policies and procedures that ensure the independence of the decision-making in its role as an agent from that as a holder of voting rights directly.

BC100 Most respondents to ED 10 agreed that the consolidation standard should provide application guidance to identify an agency relationship. However, some respondents believed that the exposure draft was not clear on whether the Board intended the proposed application guidance to be limited to legal or contractual agency relationships. Most respondents agreed that the form of remuneration can be an indicator of an agency relationship. However, many found the application guidance, in this respect, confusing. Many respondents did not agree with the dual role guidance that required an investor to assess in aggregate its rights as an agent and a principal. Nor did they believe such an investor should automatically exclude its rights as an agent from the control assessment.

BC101 In response to those comments, the Board decided to base its agent-principal guidance on the thinking developed in agency theory. Jensen and Meckling (1976) define an agency relationship as ‘a contractual relationship in which one or more

persons (the principal) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent.’¹

BC102 The Board clarified that, as defined, an agent is obliged to act in the best interests of the parties that delegated the power (ie the principal or principals) and not other parties by way of a wider fiduciary responsibility. The Board did not think that it would be appropriate to conclude that every party that is obliged, by law or contract, to act in the best interests of other parties would be an agent for the purposes of assessing control. This approach, in effect, assumes that a decision-maker that is legally or contractually obliged to act in the best interests of other parties will always do so, even if that decision-maker receives the vast majority of the returns that are influenced by its decision-making. Although this view might be considered appropriate for some decision-makers, the Board observed that it would not be appropriate for all decision-makers, in particular many investees that are not directed through voting or similar rights. Almost every investment manager could contend that it is contractually obliged to act in the best interests of others. This approach could result in virtually every investee that is not directed through voting or similar rights being unconsolidated.

BC103 The Board observed that the difficulty in developing guidance that addresses agency relationships is that the link between power and returns is often missing. To have control, an investor must have power and be able to use that power for its own benefit.

BC104 If such a decision-maker receives a return that is insignificant or varies insignificantly, most would be comfortable in concluding that the decision-maker uses any decision-making authority delegated to it to generate returns for others—this is because the decision-maker would not have power so as to benefit. Similarly, if the

¹ M C Jensen and W H Meckling, Theory of the Firm: Managerial Behavior Agency Costs and Ownership Structure, Journal of Financial Economics 1976, pp. 305-360

decision-maker held a substantial investment in the investee (say, a 95 per cent investment), most would conclude that the decision-maker uses any decision-making authority delegated to it to generate returns for itself—the decision-maker would have power so as to benefit. But at what point, between insignificant and very significant, does the decision-maker change from using any decision-making authority to generate returns for others to using that authority to generate returns for itself?

- BC105 The Board concluded that the general guidance in IFRS X that addresses control should apply to agency relationships, ie when assessing control, a decision-maker should consider whether it has the power to direct the activities of an investee that it manages to generate returns for itself, or whether it uses the decision-making authority delegated to it for the benefit of other parties.
- BC106 The Board observed that a decision-maker always acts as an agent of another party, when that other party holds a unilateral substantive right to remove the decision-maker. Therefore, a substantive kick-out right that is held by a single party is a conclusive indicator of an agency relationship. In the absence of a substantive kick-out right that is held by a single party, judgement must be applied when assessing whether a decision-maker acts as a principal or an agent.
- BC107 That assessment includes considering the overall relationship between the decision-maker, the entity being managed and the other interest holders. The assessment would take into account all available evidence. With the exception of substantive kick-out or similar rights that are held by one party, no single factor would provide conclusive evidence of an agency relationship. However, the Board observed that depending on the facts and circumstances, a particular factor may be a strong indicator of an agency relationship and would receive a greater weighting than other factors when assessing control. However, the weighting would depend on the relevant facts and circumstances in each case and it would be inappropriate to specify that any factor would always be more important than the others.

- BC108 The Board considered whether to specify that, in the absence of other parties having substantive kick-out or similar rights, a decision-maker that received a particular level of returns or exposure to variability of returns would be deemed to control an investee (for example, exposure to more than half of the variability of returns of an investee). However, the Board rejected developing a model that would specify a particular level of returns that would result in determination of an agency relationship. Rather, the Board concluded that the more a decision-maker is exposed to the variability associated with the returns generated from the activities of an investee, the more likely it is that the decision-maker is a principal.
- BC109 Although specifying a particular level of returns might lead to more consistent application of the requirements by removing some of the judgement required, the Board observed that such an approach was likely to lead to inappropriate consolidation conclusions in some situations. It would create a bright line that might encourage structuring to achieve a particular accounting outcome. The Board also noted that when assessing agency relationships, a decision-maker's exposure to variability of returns is not necessarily correlated with the amount of power that it has, unlike the general assumption when investees are controlled by voting rights. Therefore, a decision-maker does not necessarily have any more power over an investee when it is exposed, for example, to more than half of the variability of an investee's returns than if it is not.

Relationship with other parties

- BC110 An agency relationship does not necessarily need to involve a contractual arrangement. The nature of the relationship between an investor and its related parties might be such that the related party is acting on the investor's behalf in relation to its involvement with an investee, thereby creating a non-contractual agency relationship.

- BC111 ED 10 included a list of examples of parties that often act for the investor. The Board's intention was that an investor would look closely at its relationships with such parties and assess whether the related party is acting for the investor.
- BC112 Some respondents stated that the examples of related parties were not helpful because they could think of circumstances in which it would be appropriate to consider each of the parties to be agents of the investor and other circumstances when it would not. Respondents were unclear about the consequences of concluding that a party was a related party of an investor.
- BC113 The Board decided to clarify its intentions by stating that an investor would consider the interests and involvement of its related parties, together with its own, when the nature of its relationship with a related party is such that the related party is acting on behalf of the investor. The IFRS also includes guidance on the consequences of concluding that a related party acts for the investor when assessing control of an investee.

Interests in specified assets

- BC114 ED 10 introduced the term 'silo'—an investee within a legal structure—without defining it, noting that an investee can comprise more than one entity. This would be the case when the legal and contractual arrangements relating to an investee give one party control over a particular set of assets and liabilities, whereas another party might have control over another set of assets and liabilities within the investee. Respondents to ED 10 requested more guidance in order to apply the concept in practice.
- BC115 In response to those requests, IFRS X includes application guidance regarding interests in specified assets. This guidance is consistent with the current guidance in US GAAP in that it sets out when a portion of an investee is treated as a separate entity for the purposes of consolidation. The Board noted that this situation arises most often in the context of investees that are not directed through voting or similar rights. However, the Board decided that it would be contrary to the objective of

developing a control model that is applied consistently to all investees to restrict the application guidance to investees that are not directed through voting or similar rights. In addition, the Board was not aware of any reason for such a restriction. Therefore, the guidance regarding interests in specified assets should be applied to all investees. This is in contrast with US GAAP, which applies this concept only to portions of variable interest entities.

Continuous assessment

BC116 ED 10 proposed that an investor assess control continuously. This is because the Board believes that the assessment of control requires consideration of all facts and circumstances and it would be impossible to develop reconsideration criteria that would apply to every situation in which an investor obtains or loses control of an investee. Therefore, the reassessment of control only when particular reconsideration criteria are met would lead to inappropriate consolidation decisions in some cases.

BC117 Most respondents to ED 10 did not comment on the requirement to assess control continuously. Some questioned whether the continuous assessment of control could be interpreted to require preparers to reassess control at the end of each reporting period.

BC118 The Board confirmed the proposal in ED 10 to require an investor to assess control continuously, and decided to clarify that this would mean reassessing control when there is a change in relevant facts and circumstances that would suggest that there is a change to one or more of the three elements of control. This would not be restricted to occurring only at each reporting date, nor would it necessarily require the reassessment of all control or potential control relationships at each reporting date.

Consolidation Procedures

BC119 The application guidance to IFRS X explains how potential voting interests should be accounted for in the consolidated financial statements. B83-B86 replaces the

guidance previously included in the Implementation Guidance accompanying IAS 27 but was not intended to result in a change in consolidation procedures.

Effective date and transition

- BC120 [The effective date has not yet been discussed by the Board.]
- BC121 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states that retrospective application results in the most useful information to users because the information presented for all periods is comparable.
- BC122 In reaching its conclusions, the Board observed that IFRS X might result in an investor consolidating investees that were not previously consolidated or not consolidating investees that were previously consolidated. If an investor is required to consolidate a previously unconsolidated investee and has been accounting for its investment in that investee using proportionate consolidation or the equity method, the Board noted that the investor would often have the information available to consolidate the investee retrospectively as if IFRS X had always been in place. This is also likely to be the case if an investor no longer consolidated an investee that it previously consolidated but would now have to account for its investment in the investee using the equity method.
- BC123 However, the Board acknowledged that retrospective application of IFRS X may not be practicable in some circumstances. If an investee on first application consolidates an investee it previously did not consolidate and it is impracticable to apply the provisions of IFRS X retrospectively, the reporting entity should apply the acquisition method in IFRS 3 *Business Combinations* with the acquisition date being the beginning of the earliest period for which application of those requirements are practicable.
- BC124 If an investee on first application of IFRS X ceases to consolidate an investee that was previously consolidated the investor shall measure its retained interest in the investee on the date of initial application, at the amount at which it would have been

measured if the requirements of this IFRS had been effective when it first became involved with, or lost control of, the investee. If measurement of the retained interest is impracticable (as defined in IAS 8), the investor shall apply the requirements in this IFRS for accounting for a loss of control at the start of the reporting period when first applying this IFRS.

BC125 The main changes from the exposure draft are:

- (a) IFRS X includes additional application guidance on all of the following topics:
- (i) the meaning of ‘power’, ‘activities’ and ‘returns’ within the definition of control.
 - (ii) when assessing control of an investee:
 - understanding the purpose and design of an investee.
 - different activities of an investee that significantly affect the investee’s returns.
 - a discussion of rights that give an investor power and protective rights.
 - power to direct the activities of an investee without a majority of the voting rights, including potential voting rights.
 - contractual and non-contractual agency relationships.
- (b) IFRS X requires retrospective application of its requirements in accordance with IAS 8. The exposure draft had proposed prospective application using the requirements of IFRS 3 or the requirements relating to the loss of control on the date of first applying the IFRS.

Withdrawal

BC126 IFRS X, instead of IAS 27 and SIC-12, identifies the principle of control and determines how to identify whether an investor controls an investee and therefore should consolidate the investee. IFRS X also identifies the principles for preparation of consolidated financial statements. However, it does not address the accounting for investments in subsidiary, jointly controlled entities and associates in separate financial statements as specified in IAS 27. Therefore, the parts of IAS 27 that relate to separate financial statements are still unchanged in the amended IAS 27.

Cost-benefit considerations

BC127 The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an investee that is useful to a wide range of users in making economic decisions. To attain this objective, the Board endeavours to ensure that an IFRS will meet a significant need and that the overall benefits of the resulting information justify the costs of providing it. Although the costs to implement a new IFRS might not be borne evenly, users of financial statements benefit from improvements in financial reporting, thereby facilitating the functioning of markets for capital and credit and the efficient allocation of resources in the economy.

BC128 The evaluation of costs and benefits is necessarily subjective. In making its judgement, the Board considered the following:

- (a) the costs incurred by preparers of financial statements;
- (b) the costs incurred by users of financial statements when information is not available;
- (c) the comparative advantage that preparers have in developing information, compared with the costs that users would incur to develop surrogate information;

- (d) the benefit of better economic decision-making as a result of improved financial reporting; and
- (e) the costs of transition for users, preparers and others.

BC129 The Board observed that IFRS X will improve the ability of users to understand the consolidated financial statements by introducing a definition of control of an investee that is applied consistently when assessing whether an investor should consolidate an investee, irrespective of the nature of the investee. IFRS X also requires retrospective application of the requirements subject to the practicability exemptions in IAS 8 that will result in comparable information for all periods presented.

BC130 Users prefer to have information that is comparable, being ability of a user to compare information from reporting period to reporting period for an individual entity and between different entities in a particular reporting period. The Board concluded that IFRS X provides much clearer principles that underlie the definition of control of an investee and providing additional application guidance when assessing control than the requirements they replace. As a consequence, users should have more comparable and more reliable information about the activities controlled by the reporting entity.

BC131 If the requirements in an IFRS are not clear, or there is no guidance, the preparer will often have to seek independent advice and engage with its auditors to resolve the uncertainty about how to account for a particular type of transaction. These costs should decrease if the requirements in the revised IFRS are clearer. Accordingly, because IFRS X addresses the concerns conveyed to the Board about the absence of guidance in IAS 27 and SIC-12, the Board concluded that preparers will benefit from the new requirements in the long term. The Board accepts that any new IFRS will cause preparers to incur one-off costs associated with learning the new requirements and reassessing their accounting. However, the Board assessment is that the benefits from providing clearer principles and more application guidance outweigh those costs.

- BC132 The changes to the definition of control will inevitably lead to some reporting entities consolidating some entities that were previously not consolidated and ceasing consolidation of some entities, or both. The Board does not think it appropriate to consider whether there will be ‘more or less consolidation’ by applying the new proposals. It is clear that the clarifications in relation to less than a majority of the voting rights will lead to more consolidation. In the case of what SIC-12 refers to as special purpose entities, the Board anticipates that the new requirements will result in more appropriate consolidation (such as consolidation of an entity shifting from an agent back to the principal).
- BC133 However, given the benefits for users and preparers noted in paragraphs BC127 to BC132, the Board believes that the benefits of IFRS X outweigh the costs.
- BC134 This project also considered the disclosure requirements in relation to consolidation. Those requirements, and the related costs and benefits, are assessed in the Basis for Conclusions to IFRS Y *Disclosure of an Entity’s Involvement with Other Entities*.