30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410   Fax: +44 (0)20 7246 6411
E-mail: iasb@iasb.org   Website: www.iasb.org

International Accounting Standards Board

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These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: **23 July 2008, London**

Project: **Consolidation**

Subject: **IASB Staff working draft (Agenda paper 14C)**

IASB STAFF DRAFT
This draft ED has not been approved by the Board of the IASB.
COMMENTS WELCOME

[Draft] International Financial Reporting Standard X

Consolidated Financial Statements

Contents

[Draft] International Financial Reporting Standard X *Consolidated Financial Statements*

Core principles

1 **A reporting entity must present financial statements combining its assets, liabilities, revenues and expenses with those of the legal entities it controls. In such circumstances the reporting entity is a parent and the legal entity it controls is its subsidiary.**

2 **These financial statements must use accounting policies and principles that apply to those combined activities as a whole, presenting them as a single economic entity.**

3 **A reporting entity must disclose information that enables users of financial statement to evaluate:**

(a) **the judgements made by management in applying the reporting entity's accounting policies when reaching decisions to consolidate or not and the financial effect of exercising those judgements;**

(b) **the nature and financial effect of restrictions on assets and liabilities resulting from legal entity boundaries that exist within the reporting group; and**

(c) **the nature of and risks associated with, its significant involvement with legal entities that it does not control.**

Scope

4 **This [draft] IFRS applies to the consolidated financial statements for a group of legal entities under the control of a reporting entity.**

5 This [draft] IFRS does not deal with methods of accounting for business combinations and their effects on consolidation, including goodwill arising on a business combination (see IFRS 3 *Business Combinations*).

6 A parent need not present consolidated financial statements if and only if:

(a) the parent is itself 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;
(b) 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);
(c) 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
(d) the ultimate or any intermediate parent of the parent produces consolidated financial statements available for public use that comply with International Financial Reporting Standards.

7 **An entity that elects or is required to prepare separate financial statements applies paragraphs C1 to C8.**

Consolidated financial statements

8 Reporting entities organise their activities in different ways. Some organise their activities or operations into branches or divisions within a single legal entity. Others conduct some of their activities through separate legal entities.

9 The legal structures a reporting entity creates or uses will normally reflect its business objectives. For example, a reporting entity might form a separate legal entity to obtain easier access to financing, to limit its risk exposure or to achieve particular tax objectives.

10 Separate financial statements present the group in accordance with its legal structure by reporting entity's investments in other legal entities on the basis of its interest in the equity instruments of these legal entities. Paragraphs C1 to C8 provide the requirements for separate financial statements.

11 The consolidated financial statements present the assets and liabilities controlled by the parent, whether the reporting entity conducts its activities in a single legal entity or through separate legal entities. This means, that the consolidated financial statements present the assets and liabilities of a reporting entity and its subsidiaries independent of their legal structure. The legal boundaries of the legal entities controlled by the parent are ignored. Users of financial statements are assumed to benefit from financial statements that present the assets and liabilities of the parent and the legal entities that it controls as a single economic entity (the group).

12 The objective of this [draft] IFRS is to:

(a) identify the circumstances in which a reporting entity is a parent and must therefore consolidate the financial statements of another legal entity with its own financial statements; and

(b) to set out the accounting and disclosure requirements for consolidated financial statements.

13 Paragraphs 14 -19 define the legal entity and paragraphs 20 - 44 explain control over a legal entity. Paragraphs 45 to 70 specify the accounting requirements and paragraphs 71 - 73 the disclosure requirements for consolidated financial statements.

Legal entities

14 **Legal entities can assert legal ownership or title to assets and incur liabilities in their own name.**

15 An entity is a legal entity if a reporting entity would account for any interest in such an entity by reporting its interests in the equity instruments of the entity in its separate financial statements. Common examples of legal entities include corporations and cooperatives. However, legal entities can also be unincorporated entities such as partnerships if they can assert legal ownership or title to assets and incur liabilities in their own name.

Restricting the power of a legal entity

16 When a legal entity is created, it potentially has the ability to engage in any legal business activity, giving it the ability to acquire any type of asset and incur any type of liability. The constituting (founding) documents of an entity and the legal framework in which it operates sometimes, however, define a more limited range of transactions and activities in which it can engage or the range of transactions and activities in which it is not permitted to engage. For example, the constituting documents might require that an entity is not able to invest in a new type of business without all of its owners agreeing to such a change.

17 An agreement between the legal entity and the parties that contract with the entity can also restrict its activities. For example, covenants in a debt agreement might limit the entity's ability to invest into a new business, in a manner similar to the aforementioned approval right of the owners of the entity.

18 Restrictions to the power of a legal entity might be established when the entity is formed or by agreement between parties contracting with the entity. Often the conditions for changing or relaxing those restrictions are limited severely.

19 The powers available to the legal entity might be limited to the extent that it is not even necessary for that entity to have a governing body. Or if there is a governing body, its powers are notional and will not be sufficient to affect the performance of the legal entity. The type of legal entity that has such limited powers is often called a special purpose entity, special purpose vehicle, qualifying special purpose entity, variable interest entity or conduit. Sometimes, those legal entities are referred to by reference to the type of transaction in which they are involved, such as securitisation vehicles, structured investment vehicles, lease vehicles and managed funds.

Control of a legal entity

20 **A reporting entity controls a legal entity when it currently has power sufficient to use or manage the assets and liabilities of that entity so as to benefit from them, as if they are its own.**

21 The existence of control is a question of fact. The determination of the fact that control exists, however, often requires judgement. This is because a reporting entity can control an entity in a variety of ways, and the underlying circumstances can vary. Assessing whether a reporting entity controls another entity is a continuous process.

22 Control must be current. The option to achieve control generally does not constitute control before the holder exercises the option. However, an option in combination with other factors might give a reporting entity control over a legal entity.

23 A common way that control over an entity is achieved is by controlling the strategic operating and financing policies of a legal entity. Control over the strategic operating and financing policies can give the controlling party the ability to direct the day-to-day activities of the entity—whether that is achieved by making those decisions directly or by delegating that responsibility to management or others. Control of the strategic operating and financing policies of a legal entity normally gives the controlling party the current power to use or manage the assets and liabilities of that entity so as to benefit from them, as if they are its own.

24 A reporting entity might control a legal entity even though it does not have control over the strategic operating and financing policies of a legal entity. This is the case if the constituting documents or other contractual arrangements of a legal entity restrict the powers available to its governing body to the extent that the powers available to the governing body will not affect the benefits generated by the legal entity. A reporting entity controls such an entity if it:

(a) is exposed to benefits from that entity; and

(b) has the power to make the decisions that affect the benefits generated by that entity.

25 This [draft] IFRS requires that a reporting entity accounts for its assets and liabilities independent of its legal structure. This means, that a reporting entity accounts for its assets and liabilities the same way, regardless of whether it owns those assets and liabilities directly or whether it controls the legal entity that has legal title to those assets or liabilities. Therefore, when a reporting entity assesses whether it has control over a legal entity, it is often helpful to understand how else it could have structured the transaction and why the reporting entity has chosen a particular legal form. If the reporting entity could have undertaken the business activities or transactions within its own legal structure (ie by the parent) with substantially the same economic effect that is achieved by undertaking the business activities or transactions in separate legal entities, this is an indication that the reporting entity controls the legal entity.

Benefits and power

26 The definition of control requires that a reporting entity benefit from a legal entity through the exercise of power over that entity. A reporting entity controls another entity when it has rights that are sufficient to give it the power to be able to use or manage the assets and liabilities of that entity as if they are its own. That power must enable the reporting entity to affect the benefits it receives from the entity. Therefore, benefits and power are related and must be considered together when determining whether a reporting entity controls a legal entity.

Benefits

27 **Benefits are the returns to which a reporting entity is entitled from its involvement with a legal entity, which vary with the performance of the legal entity.**

The benefits must vary

28 The financial returns generated by a legal entity are shared among those who invest in the entity. Some investors will receive a contractually agreed return on an investment, such as a fixed return that corresponds with or reflects the risks assumed. Some investors prefer or accept returns that vary with the performance of the investment. The benefits a reporting entity receives from its control of a legal entity must vary with the financial performance of the legal entity.

Benefits are not limited to returns of the legal entity

29 To determine the variable returns it receives from a legal entity the investor considers all returns to which it is entitled from its involvement with that entity. The returns to

which an investor is entitled are often easy to identify and measure. For example, the benefits a reporting entity receives from controlling a legal entity include the returns from the legal entity by way of dividends and changes in the value of the legal entity. However, the potential returns to an investor from controlling a legal entity are not limited to returns from the performance of the entity itself.

30 Sometimes the returns on an investment are less transparent. For example, an investor's interest in an entity might allow it to generate returns that are not available to other investors. This is the case when it uses the assets of the investee in combination with its other assets, such as combining functions to achieve economies of scale, sourcing scarce products, gaining access to proprietary knowledge or limiting some operations or assets to enhance the value of its other assets.

Benefits from control must have the potential to be favourable

31 In assessing benefits from a relationship of control, it is necessary that a favourable result can be obtained by a parent from its ownership interest. A reporting entity might control a legal entity when it has the ability to share in any surplus and a requirement to bear any loss, but not if it is required only to bear any loss. Having a requirement to bear any loss does not in itself diminish a reorting entity's entitlement to benefits from that other entity at some future point. It is only when the requirement to bear any loss exists on its own, without a corresponding entitlement to share in any gain, that the benefit element of control is not satisfied.

32 Guaranteeing to make up for any lower than expected returns, without any other interest or involvement in the entity, is an example of a requirement to bear any loss without any entitlement to share in any surplus. Although control, and therefore consolidation, will not be applicable in such cases, the obligation to meet any such loss is a financial liability.

33 A reporting entity might reduce its exposure to lower than expected returns by the means of some sort of loss insurance. In such circumstances the reporting entity is exposed to the unfavourable outcomes from the reporting entity but they will have chosen to manage those risks by the means of the loss insurance.

34 The fact that the reporting entity guarantees any lower than expected returns of a legal entity could indicate that the reporting entity has significant involvement with the legal entity so as to manage or protect its exposure to such losses. The reporting entity might also be benefitting from the legal entity through up-front fees, access to cash or by servicing the assets or liabilities of the legal entity. In determining whether the reporting entity controls the legal entity it is necessary to assess all of the reporting entity's benefits from and exposures to the legal entity.

35 Exposure to the legal entity can include implicit support offered by a reporting entity to the legl entity to protect the reputation of the reporting entity. Offering support to a legal entity is not, in itself, sufficient to give the reporting entity control of the legal entity. If such support exists the reporting entity will need to assess whether it is also able to benefit from the legal entity and what powers it has to manage those benefits. The reporting entity would, in any case, need to assess whether the support is such that it meets the denifition of a liability and should be accounted for in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.* .

36 The concepts of expected returns and lower than expected returns are explained in paragraphs B20 to B28.

Receiving a variable return is not a sufficient determinant of control

37 A reporting entity might not control a legal entity even though it receives a variable return from the legal entity. This is because it is also necessary to consider how all parties that contract with a legal entity share the variable returns from that entity.

38 A reporting entity must assess the extent to which it benefits from or is exposed to its involvement with a legal entity. The larger the proportion of variability of the legal entity absorbed by the reporting entity, relative to other parties involved with the legal entity, the more likely it is to control the legal entity.

39 A reporting entity might receive a variable interest because they are acting as an agent of the party that controls the legal entity. In such circumstances the powers available to the reporting entity would be consistent with those available to a party acting as an agent and are likely to be more restricted than those available to the principal.

40 The relationship between a principal and its agent is explained in paragraphs B34 to B42.

Power

41 **Power is the ability of a reporting entity to participate in the management of the assets and liabilities of a legal entity.**

42 A reporting entity has power in a legal entity if it participates in the management of that entity's assets and liabilities. That power must be able to affect the performance of the legal entity.

43 The powers available to a reporting entity might be in place to protect the reporting entity rather or they might be there to allow the reporting entity to participate in the legal entity. Protective powers protect the investment of the reporting entity or limit its exposure to lower than expected returns of the legal entity.

44 When a reporting entity controls a legal entity, the reporting entity will have the ability to manage assets and liabilities as if they are its own and to exclude others from using or managing those assets and liabilities.

45 Although the controlling party does not share its control of a legal entity its power does not need to be absolute. Other parties might have protective rights, through contractual arrangements or through legal protection such as often exists for non-controlling interests, which restrict the power of the controlling party. When this IFRS refers to a reporting entity managing assets and liabilities *as if they are its own* it means that the reporting entity has the same rights as the legal entity. Accordingly any protective rights that restrict the powers of the legal entity will also restrict the rights of the reporting entity.

46 Investors are assumed to require power that is proportionate to their entitlement to the benefits from a legal entity. Accordingly, they require powers that are sufficient to allow them to participate in an entity to ensure that they are compensated for, or benefit from, their investment.

47 A reporting entity can have power in a legal entity by participating in the governing body of the legal entity such as by appointing, or having sufficient voting rights to appoint, directors to the governing body. Power could also be achieved by having a contract to service or administer the assets or liabilities, or both, of the entity. The ability to appoint management personnel or dominate the major contracts of the legal entity might also give the reporting entity power.

Summary

48 Benefits and power are presumed to be related. The party that benefits more than any other party from the variable returns of a legal entity is also the party most likely to have power sufficient to allow it to control that entity. To maximise its positive variable returns and to protect its exposure to negative variable returns the investor will require power to affect the performance of the entity. An investor will normally require more power over a legal entity the higher its ability to maximise returns or its exposure to negative variable returns is. The power to affect the performance of a legal entity might give the investor control over that entity.

49 Although the party that has the greatest exposure to variable returns is likely to have the greatest incentive to control the legal entity this is not always the case. For example, another party might have particular business knowledge or expertise that is of importance for the legal entity. A reporting entity that has the greatest exposure to variable returns might allow that party to control the legal entity because of the advantages it brings to the reporting entity.

50 Additional guidance about how to assess benefits and power is explained in paragraphs B4 to B19.

Presentation of consolidated financial statements

51 **A reporting entity, other than one described in paragraph 6, must present financial statements combining its assets, liabilities, revenues and expenses with those of all legal entities it controls.**

52 **A reporting entity consolidates the financial statements of another entity with its own financial statements from the date that it achieves control and ceases consolidation when it loses control.**

53 When a reporting entity achieves control over another entity this will be the first consolidation of the other entity. If the entity achieves control by way of a business combination, it accounts for that initial recognition in accordance with IFRS 3 *Business Combinations*.

54 If an entity ceases to be a subsidiary its assets and liabilities are derecognised from the group. Any gain or loss on derecognition that is attributable to the controlling equity interest is recognised in profit or loss in the period derecognition occurs.

Accounting requirements

Consolidation procedures

55 **In preparing consolidated financial statements, an entity combines the financial statements of the parent and its subsidiaries line by line by adding together like items of assets, liabilities, equity, income and expenses using accounting policies and principles that apply to the group as a whole.**

56 In order that the consolidated financial statements present financial information about the group as that of a single economic entity, the following steps are then taken:

(a) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary are eliminated (see IFRS 3, which describes the treatment of any resultant goodwill);

(b) non-controlling interests in the profit or loss of consolidated subsidiaries for the reporting period are identified; and

(c) non-controlling interests in the net assets of consolidated subsidiaries are identified separately from the parent's ownership interests in them.

57 Non-controlling interests in the net assets comprise:

(a) the amount of those non-controlling interests at the date of the original combination calculated in accordance with IFRS 3; and

(b) the non-controlling interests' share of changes in equity since the date of the combination.

Potential voting rights

58 When potential voting rights exist, the proportions of profit or loss and changes in equity allocated to the parent and non-controlling interests are determined on the basis of present ownership interests and do not reflect the possible exercise or conversion of potential voting rights.

Intragroup balances and transactions

59 Intragroup balances and transactions, including income, expenses and dividends, are eliminated in full. Profits and losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full. Intragroup losses may indicate an impairment that requires recognition in the consolidated financial statements. IAS 12 *Income Taxes* applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.

Reporting date

60 The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements must have the same reporting date. When the end of the reporting period of the parent is different from that of a subsidiary, the subsidiary prepares, for consolidation purposes, additional financial statements as of the same date as the financial statements of the parent unless it is impracticable to do so.

61 When, in accordance with paragraph 60, the financial statements of a subsidiary used in the preparation of consolidated financial statements are prepared as of a date different from that of the parent's financial statements the reporting entity adjusts for the effects of significant transactions or events that occur between that date and the date of the parent's financial statements. In any case, the difference between the end of the reporting period of the subsidiary and that of the parent can be no more than three months and the length of the reporting periods and any difference between the ends of the reporting periods must be the same from period to period.

Income and expenses

62 The income and expenses of a subsidiary are included in the consolidated financial statements from the acquisition date as defined in IFRS 3. Income and expenses of the subsidiary are based on the values of the assets and liabilities recognised in the parent's consolidated financial statements at the acquisition date. For example, depreciation expense recognised in the consolidated statement of comprehensive income after the acquisition date are based on the fair values of the related depreciable assets recognised in the consolidated financial statements at the acquisition date. The income and expenses of a subsidiary are included in the consolidated financial statements until the date when the parent ceases to control the subsidiary.

Non-controlling interests

63 Non-controlling interests are presented in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent.

64 Profit or loss and each component of other comprehensive income are attributed to the owners of the parent and to the non-controlling interests. Total comprehensive income is attributed 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.

65 If a subsidiary has outstanding cumulative preference shares that are classified as equity and are held by non-controlling interests, the parent computes its share of profit or loss after adjusting for the dividends on such shares, whether or not dividends have been declared.

Changes in the proportion held by non-controlling interests

66 Changes in a parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions (ie transactions with owners in their capacity as owners). In such circumstances the carrying amounts of the controlling and non-controlling interests shall be adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the parent.

Loss of control

67 A parent can lose control of a subsidiary with or without a change in absolute or relative ownership levels. This could occur, for example, when a subsidiary becomes subject to the control of a government, court, administrator or regulator. It could also occur as a result of a contractual agreement.

Linked transactions

68 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 must 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.

69 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.

Recognition

70 If a parent loses control of a subsidiary, it:

(a) derecognises the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost;

(b) derecognises 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);

(c) recognises:

(i) the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control; and

(ii) if the transaction that resulted in the loss of control involves a distribution of shares of the subsidiary to owners in their capacity as owners, that distribution;

(d) recognises any investment retained in the former subsidiary at its fair value at the date when control is lost;

(e) reclassifies to profit or loss, or transfers directly to retained earnings if required in accordance with other IFRSs, the amounts identified in paragraph 50; and

(f) recognises any resulting difference as a gain or loss in profit or loss attributable to the parent.

Other comprehensive income

71 If a parent loses control of a subsidiary, the parent shall account for all amounts recognised in other comprehensive income in relation to that subsidiary on the same basis as would be required if the parent 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 reclassifies the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses control of the subsidiary. For example, if a subsidiary has available-for-sale financial assets and the parent loses control of the subsidiary, the parent shall reclassify to profit or loss the gain or loss previously recognised in other comprehensive income in relation to those assets. Similarly, if a revaluation surplus previously recognised in other comprehensive income would be transferred directly to retained earnings on the disposal of the asset, the parent transfers the revaluation surplus directly to retained earnings when it loses control of the subsidiary.

72 On the loss of control of a subsidiary, any investment retained in the former subsidiary and any amounts owed by or to the former subsidiary shall be accounted for in accordance with other IFRSs from the date when control is lost.

Initial recognition of the investment in the former subsidiary

73 The fair value of any investment retained in the former subsidiary at the date when control is lost shall be regarded as the fair value on initial recognition of a financial asset in accordance with IAS 39 Financial *Instruments: Recognition and Measurement* or, when appropriate, the cost on initial recognition of an investment in an associate or jointly controlled entity.

Disclosure

74 **A reporting entity must disclose information that enables users of its financial statement to evaluate:**

(a) **the judgements that management has made in the process of applying the reporting entity's accounting policies when reaching decisions to consolidate or not and the financial effects of those judgements.**

(b) **the nature and financial effects of restrictions on assets and liabilities resulting from legal entity boundaries that exist within its group.**

(c) **the financial effects of changes in a parent's ownership interest or the loss of control of a subsidiary.**

(d) **the nature of, and risks associated with, its significant involvement with legal entities that it does not control.**

75 To meet the objectives in paragraph 74, the reporting entity shall disclose the information specified in paragraphs B43 to B55.

76 If the requirements in paragraphs B43 to B55 do not meet the objectives in paragraph 69, the reporting entity shall disclose whatever additional information is necessary to meet those objectives.

Effective date

77 An entity shall apply this [draft] IFRS in its annual financial statements for periods beginning on or after [Date to be inserted after exposure]. Earlier application is

permitted. If an entity applies this [draft] IFRS in its financial statements for a period before [Date to be inserted after exposure], it shall disclose that fact.

Withdrawal of IAS 27 and SIC-12

78 This [draft] IFRS supersedes IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation—Special Purpose Entities.*

Appendix A - Defined terms

Benefits are the returns to which a reporting entity is entitled from its involvement with a legal entity, which vary with the performance of the legal entity.

Consolidated financial statements are the financial statements of a group presented as a single economic entity.

Control of a legal entity is the current power of the reporting entity sufficient for it to use or manage the assets and liabilities of that legal entity so as to benefit from them, as if they are its own.

A **group** is a parent and all its subsidiaries.

A **legal entity** is an entity that can assert legal ownership or title to assets and incur liabilities in its own name.

Non-controlling interest is the equity in a subsidiary not attributable, directly or indirectly, to a parent.

A **parent** is an entity that has one or more subsidiaries.

Power is the ability of a reporting entity to participate in the management of the assets and liabilities of a legal entity.

Separate financial statements are those presented by the parent, an investor in an associate or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct equity interests rather than on the basis of reported results and net assets of the investees.

Significant involvement in a legal entity is the current power of a party to participate in the decisions of how to use or manage the assets and liabilities of an entity so as to benefit from them, but such power is not sufficient to give the party control of that entity.

A **subsidiary** is a legal entity, including an unincorporated entity such as a partnership that is controlled by another entity (known as the parent).

Appendix B - Application Guidance

Consolidation of all subsidiaries (paragraph 1)

B1 The consolidated financial statements include the parent and all of its subsidiaries. The parent does not exclude a subsidiary from consolidation simply because:

(a) the parent is a venture capital organisation, mutual fund, unit trust or similar entity;

(b) its business activities are dissimilar from those of the other entities within the group; or

(c) control over the subsidiary is temporary.

B2 Relevant information is provided by consolidating such subsidiaries and disclosing additional information in the consolidated financial statements about the different business activities of subsidiaries. For example, the disclosures required by IFRS 8 *Operating Segments* help to explain the significance of different business activities within the group.

B3 However, a subsidiary is excluded from consolidation if the subsidiary meets at the acquisition date the criteria to be classified as held-for-sale in accordance with IFRS 5 *Non-current Assets held for Sale and Discontinued Operations*. In such circumstances the subsidiary is accounted for in accordance with that standard.

Control without a majority of the voting rights (paragraphs 20 to 50)

B4 A common way to achieve control over the strategic operating and financing policies of a legal entity is by having a majority of the voting rights of that entity. A reporting entity that controls more than half of the voting rights of a legal entity is presumed to control that legal entity. However, an entity does not need to have the majority of the voting rights to control a legal entity.

B5 A reporting entity can have control over a legal entity with less than half the voting rights in circumstances in which there are no other dominant voting interests in the entity. This could include circumstances in which the other owners have not organised their interests in such a way that they actively cooperate when they exercise their votes so as to have more dominant voting power than the holder of the single largest ownership interest.

B6 A reporting entity does not control a legal entity if another owner has the right to exercise a more dominant number of votes, whether or not that other owner has previously exercised that right.

Conditions that lead to a presumption of control

B7 The holder of less than a majority voting interest in a legal entity is presumed to control that entity if the holder satisfies any one or more of the following conditions:

(a) it has the ability to exercise more than half of the entity's voting rights by virtue of an agreement with other investors.

(b) it has the ability under a statute or an agreement to determine the entity's strategic operating and financing policies.

(c) it has the ability to appoint or remove the majority of the members of the entity's board of directors or equivalent governing body and control of the entity is by that board or body.

(d) the right to cast votes sufficient to constitute a majority of the votes cast at meetings of the entity's governing body.

Indicators of control

B8 Often, although not always, there will be other factors that combine to indicate that a dominant shareholder, or the holder of an option to acquire an interest that gives it the majority of the voting rights, has control over a legal entity even though it holds less than the majority of the voting interests in that entity. The existence of any of the following factors might indicate that the holder of less than a majority voting interest in an entity controls that entity, although each factor taken on its own would not be sufficient to conclude that control exists.

(a) The ability to dominate the governing body, and therefore the strategic policy decision process. Examples of indicators of this nature are:

(i) the ability to dominate the process of nominating members of that entity's governing body and/or solicit proxies from other holders of voting interests;

(ii) the right to appoint members to fill vacancies of an entity's governing body until the next election;

(b) The ability to participate in the management of an entity, such as:

(i) the right to appoint, hire, reassign or dismiss an entity's key management personnel; or

(ii) sharing of resources between the reporting entity and the legal entity. For example, the reporting entity and the legal entity might have the same members of their governing bodies, share key management personnel or other staff or use the same suppliers or service providers.

(c) The ability to access the residual assets of an entity, such as:

(i) the right to dissolve an entity and redirect the use of its assets; or

(ii) the right under a statute or an agreement to access or use an entity's resources.

B9 The existence of material transactions in conjunction with these participatory indicators is consistent with that participation being for the benefit of the majority holder.

Previous voting interests

B10 In assessing whether a reporting entity controls a legal entity, it does not matter how the reporting entity was able achieve power over the legal entity. What matters is that the reporting entity has power and is able to use that power for its benefit.

B11 A reporting entity might have less than a majority voting interest in a legal entity having controlled the legal entity previously by having a majority voting interest. The fact that the reporting entity has controlled the legal entity before reducing its interest to less than half of the voting rights is not of itself an indicator of power. However, having controlled the legal entity previously by way of the voting interests, the reporting entity will have had the opportunity and ability to establish policies or contractual relationships that allow it to continue to control the legal entity without having a majority of the voting interests. In that respect, the circumstances in which the current interests have been established might affect the likelihood that the reporting entity has established factors that are indicators of control.

Majority of the voting rights but no control

B12 In exceptional circumstances, the entity that has a majority of the voting rights will be able to demonstrate that it is not the controlling party. This is the case when legal requirements, the constituting documents or other contractual arrangements of the legal entity restrict the power of the party that holds the majority of the voting rights to the extent that it does not have the power to direct the strategic operating and financing policies.

Control without power over the strategic operating or financing policies

B13 The constituting documents or other contractual arrangements of a legal entity might restrict the power available to the governing body of that entity to the extent that the powers available to the governing body will not affect the benefits generated by the legal entity. In such cases the reporting entity assesses whether it is exposed to benefits from that entity and has the power to make the decisions that affect the benefits generated by that entity.

B14 For example a reporting entity might sell receivables to a separate legal entity. The legal entity finances the acquisition of the receivables by issuing senior bond notes to third party investors and junior bond notes to the reporting entity. The legal entity pays interest on the junior bonds only after it has paid principal and interest to the senior bond holders. To protect the interests of all bond holders, the powers available to the legal entity have been restricted severely. The only powers available to the legal entity are those that allow it to manage the receivables. It is the collection and the default management of those receivables that affects the performance of the legal entity.

B15 In this example the reporting entity is likely to control the legal entity because it benefits from funding through the entity (ie the structure allows it to use the receivables as a source of funding) and it is exposed to variable returns from the junior bond notes. In addition, the reporting entity has the power to manage the receivables and is therefore able to affect the performance of the legal entity so to maximise its benefits and minimise its exposure to variability caused by the receivables.

Significant involvement

B16 A reporting entity has significant involvement in a legal entity, when it has the ability to participate in the decisions of how to use or manage the assets and liabilities of that entity so as to benefit from them, but does not have sufficient power to control that entity.

B17 Assessing whether a reporting entity has significant involvement in a legal entity involves the same decision process as is undertaken in assessing whether the reporting entity controls the legal entity. The difference is that the reporting entity will have concluded that the powers and related benefits are not sufficient to give it control over the legal entity. The factors described in paragraphs B4 to B15 are relevant in assessing whether the reporting entity has significant involvement in a legal entity.

B18 Accordingly, a reporting entity can have significant involvement in a legal entity by:

(a) participating in the governing body of the legal entity such as by having the ability to appoint, or having sufficient voting rights to appoint, directors to the governing body;

(b) having a contract to service or administer the assets or liabilities, or both, of the entity;

(c) having the ability to appoint management personnel;

(d) dominating the major contracts of the legal entity.

B19 A legal entity is likely to have had its available powers restricted if its purpose is to facilitate a securitisation arrangement, managed fund, other investment vehicle and other arrangements that have a narrower purpose than operating a business. In such circumstances, if the reporting entity is a sponsor of that legal entity or manages its assets or liabilities it is likely that the reporting entity has, at a minimum, significant involvement in the legal entity and might control the legal entity. This is particularly so if the reporting entity also provides credit enhancement or liquidity support to the legal entity.

Expected returns (paragraph 31)

B20 An *expected return* is an estimate of the returns an investor expects to receive from its investment. It reflects the distribution (range) of the different returns that are possible and the likelihood of each of those possibilities occurring.

B21 To illustrate this concept, suppose an investor made an investment in the equity of a legal entity. The investor might assess that likely outcomes range from a positive return of 20 per cent return to a negative return of 20 per cent. The investor assesses the likelihood of each of the outcomes as follows:

***(a)* Likely return**	***(b)* Likelihood**	***(a) x (b)***
20%	0.100	2.00%
15%	0.200	3.00%
10%	0.250	2.50%
5%	0.200	1.00%
0%	0.150	0.00%
-10%	0.075	-0.75%
-20%	0.025	-0.50%
	Expected return	**7.25%**

B22 The actual returns an investor receives might differ from the expected outcome. Any difference between the expected returns of 7.25 per cent and the actual returns will cause the investor to receive higher or lower than expected returns.[1] For example, a return of 10 per cent is a higher than the expected return and a realised return of 5 per cent would be a lower than the expected return.

B23 This concept applies broadly to the benefits a reporting entity might expect to generate from its involvement with a legal entity. For example, a reporting entity might generate higher (lower) than expected returns from more (fewer) synergies than they initially anticipated when it acquired a controlling interest in a subsidiary.

Thin capitalisation

B24 Returns can vary with the performance of a legal entity regardless of their form. For example, a creditor might have agreed to a fixed interest rate, when borrowing funds to a legal entity. In this case, the contractual returns of the creditor depend on the ability of the legal entity to meet its contractual obligations. If the legal entity has only nominal equity and the creditor is the only borrower to the legal entity, the creditor's contractual returns depend on the legal entity's performance. This means that the creditor has variable returns from its loan to the legal entity.

Expected returns and power

B25 Likely returns are often a subset of the range of possible returns. For example, investors in aggregate might assess the range of likely returns on a property portfolio to be between negative 15 per cent and positive 25 per cent over the next year. It is possible that the property portfolio could suffer a loss greater than 15 per cent, but this has been assessed by the investors as being unlikely. Similarly, the returns could exceed 25 per cent, but that possibility has also been assessed by the investors as being unlikely.

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[1] The US FIN 46(R) labels lower than expected returns as *expeced losses* and higher than expected returns as *expected residual returns*.

B26 By understanding the likely range of outcomes it can help a reporting entity assess the nature of any powers it has in relation to a legal entity. Its powers might be conditional in that they only take effect if specified conditions occur. In the example, some powers such as being able to seize assets, might take effect if the property portfolio suffers a fall in excess of, say, 12 per cent. In some cases those powers might give the reporting entity the ability to control the legal entity, but only if the conditions that cause their powers to become effective occur. If this happens the control of the legal entity will have changed. The disclosure requirements of this IFRS require a reporting entity to provide information that helps a user of its financial statements assess the likelihood and financial effect of such a change in control occurring.

B27 If the powers enable the reporting entity to affect the financial performance of the entity within the range of likely outcomes those powers are likely to indicate that the reporting entity controls the legal entity.

B28 In some circumstances the likely returns are not distributed normally. For example, the expected outcome of a research and development venture could be binary—with the research activity likely to lead to a complete loss of the investment or a very high return.

Protective rights

B29 A reporting entity rarely has unlimited power over a legal entity. Most legal entities contract with many parties that are exposed to variable returns of the legal entity and the contracting parties will demand rights to protect their exposure. Those rights are often referred to as protective rights. When assessing power over a legal entity, the reporting entity assesses the protective rights of other parties that contract with the legal entity.

B30 Protective rights often relate to fundamental changes only in the activities of an entity or might apply only in exceptional circumstances. For example, those rights might include:

(a) the approval of capital expenditure, over a particular threshold, that is not undertaken in the ordinary course of business;

(b) the approval of the issue of equity or debt capital, beyond normal operating requirements; or

(c) the ability to remove a fund manager or servicer in exceptional circumstances only (eg on bankruptcy of the manager or on breach of contract).

B31 Protective rights do not normally affect a reporting entity's ability to manage the assets and liabilities of a legal entity as if they are its own. A reporting entity can therefore have power over a legal entity even though other parties have protective rights in that entity.

B32 However, some contracting parties might have rights in a legal entity that hinder the reporting entity from managing the assets and liabilities of that entity as if they are its own. Those rights enable often their holder to participate in the day-to-day activities of an entity, rather than being limited to fundamental changes in the activities of the entity. As a consequence, the reporting entity does not have power over the legal entity. For example a contracting party might have the right to:

(a) select, terminate and set the compensation of key management; or

(b) set or change the operating and financing decisions of the entity, including budgets, in the ordinary course of business.

B33 In assessing whether rights of other parties affect the power of the reporting entity over a legal entity, the reporting entity considers all rights of other contracting parties, both individually and in aggregate.

Agency relationships

B34 A reporting entity must assess whether it is acting in its own interests or as an agent for other parties.

B35 When an investor engages another party to act on its behalf, such as making investment decisions, the investor will have delegated some decision-making authority to that party. This establishes a principal-agency relationship, with the investor being the principal and the other party being the agent. The agent will be required, either by agreement or law, to act in the best interests of the principal. This means that the agent must use the decision-making ability delegated to it primarily for the benefit of the principal.

B36 An agent is unlikely to be able to establish or change any strategic policies of an entity. What powers they have will be within the limits in which the entity operates, whether established by the principal or by the governing documents of the entity (such as incorporation documents). For example, the agent might make decisions about the timing and nature of assets to be purchased or sold by an entity. However the power an agent has will not be sufficient to use or manage the assets as if they are its own—such as using sale proceeds within its business or using the assets as security for its own borrowings.

B37 When assessing control over a legal entity, a reporting entity considers also the rights of agents. A reporting entity might have power over a legal entity because:

(a) an agent of the reporting entity has power over that entity; or

(b) the rights of the reporting entity combined with the rights of its agents give it power over that entity.

B38 The following parties might act as agents of the reporting entity:

(a) a related party of the reporting entity as defined in IAS 24 *Related Parties*;

(b) a party that received its interest in the legal entity as a contribution or loan from the reporting entity;

(c) a party that has an agreement that it cannot sell, transfer or encumber its interests in the legal entity without the prior approval of the reporting entity;

(d) a party that cannot finance its operations without financial support from the reporting entity;

(e) senior management of the reporting entity;

(f) a party that has a close business relationship with the reporting entity, such as the relationship between a professional service provider and one of its significant clients; and

(g) a legal entity with the same board of director's as the reporting entity.

B39 Similarly, a reporting entity might act as an agent on behalf of another party. A reporting entity does not control a legal entity, if it must use its rights in that entity for the benefit of another party.

B40 A fiduciary relationship, such as one involving trustees and beneficiaries of trusts, is an example where the trustee might appear to be the controlling party but the trustee is acting as an agent of the beneficiaries. Although a trustee might have the ability to make decisions concerning the financing and operating activities of the trust, this ability is governed by the trustee's fiduciary responsibility at law to act in the best interests of the beneficiaries of the trust.

B41 An agent is rewarded for the services it performs. This might be a fixed or performance-related fee. If the agent receives a performance related fee, the agency relationship might be difficult to distinguish from control over the legal entity. This is because the agent benefits from its ability to use or manage the assets and liabilities of the legal entity. However, this ability is limited by its fiduciary responsibility to act in the best interest of its principal. The performance related fee that the agent receives is compensation for the services it performs for the principal.

B42 Sometimes, a reporting entity might act simultaneously in the role of the principal and agent. For example, a group of investors might choose one investor to use or manage the assets and liabilities of a legal entity on behalf of all investors.

Disclosures (paragraphs 74 to 76)

B43 To meet the disclosure objectives in paragraph 69, a reporting entity shall disclose the information set out in paragraphs B44 to B55.

Judgement in the decision to consolidate (paragraph 74(a))

B44 To enable users of its financial statements to evaluate the judgements that management has made when reaching decisions to consolidate, or not, the reporting entity must describe the basis for its decision:

(a) to consolidate a legal entity in which it does not currently have more than half of the voting interest; and

(b) not to consolidate a legal entity in which it has significant involvement.

Financial effects of the decision to consolidate a legal entity (paragraph 74(b))

B45 To enable users of its financial statements to evaluate the financial effects of the those judgements used in reaching a decision to consolidate or not that have the most significant effect on the amount recognised in the financial statements, the reporting entity shall disclose for each subsidiary identified in B44 (a) the following amounts that have been included in the group financial statements:

(a) total assets;

(b) total liabilities;

(c) revenue; and

(d) net income.

B46 The reporting entity must also disclose any other factors in relation to these subsidiaries, such as concentrations of assets or liabilities, which are likely to be relevant to the users of its financial statements.

B47 The reporting entity is also required to disclose information in relation to the legal entities identified in B44 (b) because they are legal entities in which the reporting entity has significant involvement. Those requirements are outlined in paragraphs B51 to B55.

Restrictions on assets and liabilities of subsidiaries (paragraph 74(c))

B48 The consolidated financial statements present the assets, liabilities, equity, revenues and expenses of the parent combined with those of the legal entities it controls. The legal structures used by the parent can affect its ability to access assets and its exposure to liabilities. Accordingly, the ability to compare the group financial statements of two or more reporting entities is enhanced when users of those financial statements have information about the extent to which assets, liabilities, equity, revenues and expenses are managed within subsidiaries of the group.

B49 To enable users of its financial statements to evaluate the nature and financial effect of restrictions on assets and liabilities resulting from legal boundaries that exist within its group, a reporting entity must disclose:

(a) the number of subsidiaries that have been consolidated with the financial statements of the parent;

(b) for each individually material subsidiary (with materiality assessed on the basis of the subsidiaries relative to each other):

(i) its name;

(ii) its main activities; and

(iii) its region of operations

(c) the number of subsidiaries in which there are non-controlling interests;

(d) In aggregate, for subsidiaries in which there is a non-controlling interest, total:

(i) assets;

(ii) liabilities;

(iii) operating cash flows;

(iv) investing cash flows;

(v) financing cash flows;

(vi) dividends paid, distinguishing between dividends paid to the parent and to non-controlling interests.

(e) An explanation of the extent to which non-controlling interests are able to restrict the activities of subsidiaries such as being able to restrict cash flows or investment and financing decisions.

Financial effects of changes in a parent's ownership interest or the loss of control of a subsidiary (paragraph 74(d))

B50 To enable users of its financial statements to evaluate the financial effects of changes in a parent's ownership interest or the loss of control of a subsidiary, the reporting entity shall disclose:

(a) a schedule that shows the effects of any changes in a parent's ownership interest in a subsidiary that do not result in a loss of control on the equity attributable to owners of the parent.

(b) If control of a subsidiary is lost, the parent shall disclose the gain or loss, if any, recognised in accordance with paragraph 70, and:

(i) the portion of that gain or loss attributable to recognising any investment retained in the former subsidiary at its fair value at the date when control is lost; and

(ii) the line item(s) in the statement of comprehensive income in which the gain or loss is recognised (if not presented separately in the statement of comprehensive income).

Significant involvement with other legal entities (paragraph 74(e))

B51 To enable users of its financial statements to evaluate the nature of, and risks associated with, its significant involvement with legal entities that it does not control, the reporting entity shall disclose:

(a) the assets and liabilities of legal entities with which the reporting entity has significant involvement, aggregated so that entities with similar economic characteristics are aggregated into a single category;

(b) for each category of such entities, any concentrations of assets or liability maturities that help users of the financial statements assess the risks to which the reporting entity is exposed as a result of its involvement with these entities; and

(c) the conditions or circumstances related to the reporting entity's significant involvement that would cause the reporting entity to have control of the legal entities and whether the reporting entity has any discretion or ability to avoid being given control of the legal entities.

B52 The categories must be appropriate to the reporting entity but might include securitisation or investment entities. If the reporting entity has different types of, for example, investment entities that have different economic characteristics those differences should cause the reporting entity to disclose these in separate categories.

B53 The assets and liabilities must be presented with the same level of disaggregation that the reporting entity uses in its statement of financial position.

B54 The information must be presented and summarised so that a user of the financial statements of the reporting entity can identify the total assets and liabilities for each category of legal entity in which the reporting entity has significant involvement without having to perform their own aggregations for each category.

B55 In addition to the disclosure requirements in this IFRS, the reporting entity is also required to comply with IFRS 7 *Financial Instruments: Disclosures* in relation to any financial instruments to which it and the entities with which it has significant involvement are a party.

Appendix C - Separate Financial Statements

C1 This Standard does not mandate which entities produce separate financial statements available for public use. Paragraphs C2 to C9 apply when a reporting entity prepares separate financial statements that comply with International Financial Reporting Standards. The reporting entity also produces consolidated financial statements available for public use as required by paragraph 1, unless the exemption provided in paragraph 6 is applicable.

C2 **When separate financial statements are prepared, investments in subsidiaries, jointly controlled entities and associates that are not classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with *IFRS 5 Non-current Assets Held for Sale and Discontinued Operations* shall be accounted for either:**

(a) **at cost, or**

(b) **in accordance with IAS 39.**

C3 **The same accounting shall be applied for each category of investments. Investments in subsidiaries, jointly controlled entities and associates that are classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 shall be accounted for in accordance with that IFRS.**

C4 **A reporting entity shall recognise a dividend from a subsidiary, jointly controlled entity or associate in profit or loss in its separate financial statements when its right to receive the dividend is established.**

C5 When a parent reorganises the structure of its group by establishing a new legal entity as its parent in a manner that satisfies the following criteria:

(a) the new parent obtains control of the original parent by issuing equity instruments in exchange for existing equity instruments of the original parent;

(b) the assets and liabilities of the new group and the original group are the same immediately before and after the reorganisation; and

(c) the owners of the original parent before the reorganisation have the same absolute and relative interests in the net assets of the original group and the new group immediately before and after the reorganization and the new parent accounts for its investment in the original parent in accordance with paragraph C2(a) in its separate financial statements, the new parent shall measure cost at the carrying amount of its share of the equity items shown in the separate financial statements of the original parent at the date of the reorganisation.

C6 Similarly, an entity that is not a parent might establish a new entity as its parent in a manner that satisfies the criteria in paragraph C5. The requirements in paragraph C5 apply equally to such reorganisations. In such cases, references to ’original parent’ and ‘original group’ are to the ‘original entity’.

C7 **Investments in jointly controlled entities and associates that are accounted for in accordance with IAS 39 in the consolidated financial statements shall be accounted for in the same way in the investor's separate financial statements.**

C8 **When separate financial statements are prepared for a parent that, in accordance with paragraph 6, elects not to prepare consolidated financial statements, those separate financial statements shall disclose:**

(a) **the fact that the financial statements are separate financial statements;**

(b) **that the exemption from consolidation has been used;**

(c) **the name of the entity whose consolidated financial statements that comply with International Financial Reporting Standards have been produced for public use;**

(d) **the country of incorporation or residence of that entity;**

(e) **the address where those consolidated financial statements are obtainable**

(f) **a list of significant investments in subsidiaries, jointly controlled entities and associates, including the:**

(i) **name,**

(ii) **country of incorporation or residence,**

(iii) **proportion of ownership interest and, if different, proportion of voting power held; and**

(iv) **a description of the method used to account for each investment.**

C9 **When a parent (other than a parent covered by paragraph C8), venturer with an interest in a jointly controlled entity or an investor in an associate prepares separate financial statements, those separate financial statements shall disclose:**

(a) **the fact that the statements are separate financial statements and the reasons why those statements are prepared if not required by law;**

(b) **a list of significant investments in subsidiaries, jointly controlled entities and associates, including:**

(i) **the name of each investee;**

(ii) **its country of incorporation or residence,**

(iii) **the proportion of ownership interest held by the reporting entity;**

(iv) **the proportion of voting power held by the reporting entity, if it is not the same as its ownership interest; and**

(v) **a description of the method used to account for the investment;**

(c) **the identity of the financial statements prepared in accordance with paragraph 1 of this Standard or IAS 28 and IAS 31 to which they relate.**