30 Cannon Street, London EC4M 6XH, England
Phone: +44 (0)20 7246 6410, Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: http://www.iasb.org

International
Accounting Standards
Board

This document is provided as a convenience to observers at the World Standard Setters meeting, to assist them in following the discussions. It does not represent an official position of the IASB. Board positions are set out in Standards.

Note: These notes are based on the staff papers prepared for the WSS meeting. Paragraph numbers correspond to paragraph numbers used in the WSS agenda paper.

INFORMATION FOR OBSERVERS

WSS Meeting:	**September 2008, London**
Project:	**[Draft] International Financial Reporting Standard X Consolidated Financial Statements**
	Agenda paper 1A

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 **An entity must present financial statements that consolidate its assets, liabilities, equity, revenues and expenses with those of the entities it controls, presenting them as a single economic entity.**

2 **The controlling entity is the parent, the entities it controls are its subsidiaries and the economic entity is a group.**

3 **The financial statements must use accounting policies and principles that apply to the group as a whole on a consistent basis.**

4 **An entity must disclose information that enables users of financial statements to evaluate:**

(a) **the judgements made by management in applying this IFRS when reaching decisions to consolidate or not and the financial reporting effect of exercising those judgements;**

(b) **the nature and financial effect of restrictions on assets and liabilities that are a consequence of the use of subsidiaries to structure the activities of the group; and**

(c) **the nature of, and risks and benefits associated with entities that it does not control but with which it has significant involvement.**

Scope

5 **This [*draft*] IFRS applies to all entities.**

6 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*).

7 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.

Consolidated financial statements

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

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

10 The structures an entity can use to manage its activities include incorporated entities such as companies, corporations and cooperatives. They also include unincorporated entities such as partnerships and trusts.

11 Separate financial statements present the group in accordance with its legal structure by presenting the entity's investments in other legal structures on the basis of its interest in the equity instruments of these entities.

12 The consolidated financial statements present the assets and liabilities controlled by the parent, whether it conducts its activities in a single legal structure or through separate legal structures. This means, that the consolidated financial statements present the assets and liabilities of a parent and its subsidiaries independent of their legal structure. The legal boundaries of the 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 its subsidiaries as a single economic entity (the group).

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

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

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

14 Paragraphs 15 - 55 explain control of an entity. Paragraphs 56 to 78 specify the accounting requirements and paragraphs 79 - 81 the disclosure requirements for consolidated financial statements.

Control of an entity

15 **A party controls an entity when it currently has power sufficient to enable it to use or manage the individual assets and liabilities of that entity so as to benefit from them.**

16 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 party can control an entity in a variety of ways, and the underlying circumstances can vary.

17 When a party controls an entity, it will have the ability to use or manage the entity's individual assets and liabilities and to exclude others from using or managing those assets and liabilities.

18 This [*draft*] IFRS requires that a party accounts for its assets and liabilities independent of its legal structure. This means, that a party accounts for its assets and liabilities the same way, regardless of whether it owns those assets and liabilities directly or whether it controls the entity that has legal title to those assets or liabilities. Therefore, when a party assesses whether it has control over another entity, it is often helpful to understand how else it could have structured the transaction and why it chose a particular legal form. If the party 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 a separate legal structure, this is an indication that it controls that other entity.

Control is not shared

19 Although the controlling party does not share its control of an entity, its power does not need to be absolute. Other parties might have protective rights, through contractual arrangements or through legal protection, which, for example, often exists for non-controlling interests. Protective rights restrict the power of the controlling party.

Control must be current

20 Control must be current. Having the ability to obtain control is not the same as having current control. For example, a currently exercisable option is not in itself sufficient to give its holder current control of an entity. However, an option in combination with other factors might give the option holder control of an entity.

Assessment is continuous

21 The power a party has to use or manage the assets and liabilities of an entity might change as a consequence of actions by that party or changes in facts or circumstances. Assessing whether a party has power sufficient to be able to control an entity is, therefore, a continuous process.

Benefits and power

22 The definition of control requires that the controlling party benefit from an entity and be able to affect the benefits from its power over that entity. Therefore, benefits and power are related and must be considered together when determining whether a party controls an entity.

Benefits

23 A party that controls an entity will be entitled to benefits from its involvement with an entity that vary with the performance of that entity. Therefore, benefits can be positive or negative.

Benefits are not limited to returns from the entity

24 The term ‘benefit’ has a wide meaning in this [*draft*] IFRS. It includes returns from the entity as well as other economic benefits.

25 The benefits a party receives from controlling an entity include returns, such as dividends and changes in the value of the entity. However, the potential returns to a party from controlling an entity are not limited to returns from the performance of the entity itself.

26 For example, a party’s interest in an entity might allow that party to generate benefits that are not available to others. This is the case when the party uses the assets of the entity 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.

27 To determine the benefits it receives from an entity a party considers all returns to which it is entitled from its involvement with that entity.

The benefits must vary

28 The benefits a party receives from its control of an entity must vary with the performance of that entity. The returns generated by an entity are shared among those who invest in it. Similarly, more than one party might derive other economic benefits from an entity. Some parties will receive contractually agreed benefits, such as a fixed return that corresponds with or reflects the risks assumed. Some parties receive benefits that vary with the performance of the entity.

29 Returns can vary with the performance of an entity, regardless of their form. For example, a creditor might have agreed to a fixed interest rate, when lending funds to a legal entity. In this case, the contractual returns of the creditor depend on the ability of the entity to meet its contractual obligations. If the entity has only nominal equity and the creditor is the only lender to the entity, the creditor’s realised returns depend on the entity’s performance. In this case the creditor has variable returns from its loan to the entity.

Exposure to losses

30 An entity cannot avoid consolidating an entity by reducing its exposure to lower than expected returns.

31 A party might reduce its exposure to lower than expected returns from an entity by the means of some sort of loss insurance. In such circumstances the party is exposed to the unfavourable outcomes from that other entity but they might choose to manage those risks by the means of the loss insurance.

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 The fact that a party guarantees any lower than expected returns of an entity could indicate that the party has significant involvement with the entity so as to manage

or protect its exposure to such losses. The party might also be benefitting from the entity through up-front fees, access to cash or by servicing its assets or liabilities. In determining whether a party controls an entityit is necessary to consider and assess all of the party's benefits from and exposures to the legal entity.

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

35 The concepts of expected returns and lower than expected returns are explained in paragraphs B21 to B27.

Receiving a variable return is not a sufficient determinant of control

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

37 A party 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 party 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.

38 The relationship between a principal and its agent is explained in paragraphs B33 to B41.

39 The party that is exposed to more benefits from an entity than any other party is the party most likely to have power sufficient to allow it to control that entity.

40 To maximise its positive benefits and to protect its exposure to negative benefits a party will require power to affect the performance of the entity. A party will normally require more power over an entity the higher its ability to maximise returns or its exposure to negative variable returns is. The power to affect the performance of an entity might give that party control over that entity.

41 Although the party that has the greatest exposure to variable returns is likely to have the greatest incentive to control an entity this is not always the case. In some circumstances a party might control an entity even though it does not have the greatest exposure to variable returns. For example, the other parties might be willing to cede control to that party to benefit from the particular business knowledge or expertise it will provide to the entity.

Power

42 A party that controls an entity will have the ability to participate in the management of the assets and liabilities of that entity.

43 A common way that control over an entity is achieved is by controlling its strategic operating and financing policies. 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 an entity normally gives the controlling party the current power to use or manage the individual assets and liabilities of that entity so as to benefit from them.

44 An entity might control another entity without having have control over its strategic operating and financing policies. This is the case if the constituting documents or other contractual arrangements of an 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. Such an entity is controlled by the party when it has the power to make the decisions that affect the benefits generated by that entity and is exposed to those benefits.

Restricting the power of an entity

45 The constituting (founding) documents of an entity, and the legal framework in which it operates, sometimes define the range of transactions and activities in which it can engage or expressly prohibit some types of transaction or activities. 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.

46 An agreement between the entity and the parties that contract with it 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.

47 Accordingly, restrictions to the power of an 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.

48 The powers available to the 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 entity. The type of 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 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.

49 Such an entity can be controlled by a party that has power that is sufficient to allow it to participate in an entity to ensure that it is compensated for, or benefits from, its investment.

50 Power could be achieved by having a contract to service or administer the assets or liabilities, or both, of the entity. The ability of a party to appoint management personnel or dominate the major contracts of an entity might also give it power.

51 Additional guidance about how to assess benefits and power is explained in paragraphs B4 to B20.

Protective powers

52 The powers available to a party might be in place to protect that party or they might be in place to allow it to participate in decisions about using or managing the assets or liabilities of the entity. Protective powers protect the investment of the party or limit its exposure to lower than expected returns of the entity.

53 A party can control an entity even if another party has protective powers in that entity.

54 Additional guidance about protective power is explained in paragraphs B28 to B32.

Presentation of consolidated financial statements

55 **An entity, other than one described in paragraph 7, must present financial statements consolidating its assets, liabilities, equity, revenues and expenses with those of all the entities it controls.**

56 **An 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.**

57 When an 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*.

58 If an entity loses control over another entity, the assets and liabilities of that entity are derecognised from the consolidated financial statements. Any gain or loss on loss of control that is attributable to the controlling equity interest is recognised in profit or loss in the period the loss of control occurs.

Accounting requirements

Consolidation procedures

59 **In preparing consolidated financial statements, a parent combines its financial statements and those of 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.**

60 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.

61 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

62 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

63 Intragroup balances and transactions, including income, expenses and dividends, are eliminated in full. Profits or 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 or losses resulting from intragroup transactions.

Reporting date

64 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.

65 When, in accordance with paragraph 64, 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 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

66 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 amounts 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

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

68 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.

69 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

70 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

71 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.

Related transactions

72 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.

73 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.

Derecognition

74 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 76; and

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

Other comprehensive income

75 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.

76 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

77 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

78 **An entity must disclose information that enables users of its financial statement to evaluate:**

(a) **the judgements that management has made in applying this IFRS 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 a parent's use of subsidiaries to manage 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 and benefits associated with entities that it does not control but with which it has significant involvement.**

79 To meet the objectives in paragraph 78, an entity shall disclose the information specified in paragraphs B42 to B54.

80 If the requirements in paragraphs B42 to B54 do not meet the objectives in paragraph 69, an entity shall disclose whatever additional information is necessary to meet those objectives.

Effective date

81 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

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

Appendix A - Defined terms

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

Control of an entity is the current power of a party sufficient to enable it to use or manage the individual assets and liabilities of that entity so as to benefit from them.

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

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.

Significant involvement in an 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 an entity, including an unincorporated entity such as a partnership or trust, that is controlled by another entity (known as the parent).

Appendix B - Application Guidance

Consolidation of all subsidiaries (paragraph 5)

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 15 to 54)

B4 A party is presumed to control an entity if it controls more than half of the voting rights of the entity. Having the rights to a majority of the voting rights of an entity is a common way of having power over the strategic operating and financing policies of an entity. However, a party does not need to have the majority of the voting rights to control a legal entity.

Dominant shareholder

B5 A party can have control over an entity with less than half the voting rights when there are no other dominant voting interests in the entity. This could occur when the other parties with voting interests 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 party does not control a legal entity if another party has the right to exercise a larger number of votes, whether or not that other owner has previously exercised that right.

Conditions that lead to a presumption of control

B7 A party is presumed to control an entity it holds less than a majority of the entity's voting interests in an holder and satisfies any 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 the party with the most dominant voting interest, or 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.

B9 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 party and the entity. For example, the party and the 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.

B10 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

B11 In assessing whether a party controls an entity, it does not matter how the party was able achieve power over the entity. What matters is that the party has power and is able to use that power for its benefit.

B12 A party might have less than a majority voting interest in an entity having controlled the entity previously by having a majority voting interest. The fact that the party has controlled the 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 entity previously by way of the voting interests, the party will have had the opportunity and ability to establish policies or contractual relationships that allow it to continue to control the 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 party has established factors that are indicators of control.

Majority of the voting rights but no control

B13 In exceptional circumstances, the party 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 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 (paragraphs 45 to 51)

B14 The constituting documents or other contractual arrangements of an entity might restrict the power available to its governing body to the extent that those powers will not affect the benefits generated by the entity. In such cases the party assesses whether it is exposed to benefits from that entity and has the power to make the decisions that affect those benefits.

B15 For example a party, the originator, might sell receivables to an entity. That entity finances the acquisition of the receivables by issuing senior bond notes to third party investors and junior bond notes to the originator. The 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 entity have been restricted severely. The only powers available to the 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 entity.

B16 In this example the party is likely to control the 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 party has the power to manage the receivables and therefore is able to affect the performance of the entity so to maximise its positive benefits and to protect its exposure to negative benefits caused by the receivables.

Significant involvement

B17 A party has significant involvement in an entity, when it has the ability to participate in the decisions of how to use or manage the assets and liabilities of the entity so as to benefit from them but not sufficient to control the entity.

B18 Assessing whether a party has significant involvement in an entity involves the same decision process as is undertaken in assessing whether the party controls the entity. The difference is that the party will have concluded that the powers available to it are not sufficient to give it control over the entity. The factors described in paragraphs B4 to B16 are relevant in assessing whether a party has significant involvement in an entity.

B19 Accordingly, a party can have significant involvement in an entity by:

(a) participating in its governing body, 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.

B20 An 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, a party that is a sponsor of the entity or manages its assets or liabilities is likely, at a minimum, to have significant involvement in the entity and might control the legal entity. This is particularly so if the party also provides credit enhancement or liquidity support to the entity.

Expected returns (paragraphs 23 to 42)

B21 An *expected return* is an estimate of the return an investor expects to receive from its investment. It reflects the distribution of the returns that are possible and the likelihood of each of those possibilities occurring.

B22 The actual returns an investor receives might differ from the expected return. Any difference between the expected return and the actual return will cause the investor to receive a higher or lower than expected returns.[1]

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

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

Expected returns and power

B24 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.

B25 Understanding the likely range of outcomes can help a party assess the nature of any powers it has in relation to an entity. Its powers might be conditional in that they only take effect if specified conditions occur. In the example, some powers, such as the ability to seize assets, might take effect if the value of the property portfolio suffers a decline in excess of, say, 12 per cent. In some cases those powers might give the party the ability to control the entity, but only if the conditions that cause their powers to become effective occur. If this happens control of the entity will change. The requirements of this IFRS require an entity to disclose information that helps a user of its financial statements assess the likelihood and financial effect of such a change in control.

B26 If the powers enable a party to affect the financial performance of the entity within the range of likely outcomes, those powers are likely to indicate that the party controls the entity.

B27 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 power (paragraph 52 to 54)

B28 A party rarely has unlimited power over an entity. Most entities contract with many parties that are exposed to its variable returns and the contracting parties demand rights to protect their exposure. Those rights are often referred to as protective rights. When assessing power over an entity, a party assesses the protective rights of other parties that contract with the entity.

B29 Protective rights often relate to fundamental changes 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).

B30 Protective rights do not normally affect a party's ability to use or manage the individual assets and liabilities of an entity. A party can therefore have power over an entity even though other parties have protective rights in that entity.

B31 However, some contracting parties might have rights in an entity that hinder the party from using or managing the individual assets and liabilities of that entity. Those rights enable often their holder to participate in the day-to-day activities of the entity, rather than being limited to fundamental changes in its activities. As a consequence, the party does not have power over the 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.

B32 In assessing whether rights of other parties affect the power of the party over an entity, the party considers all rights of other contracting parties, both individually and in aggregate.

Agency relationships (paragraphs 22 to 54)

B33 An entity must assess whether it is acting in its own interests or as an agent for other parties.

B34 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.

B35 An agent is unlikely to be able to establish or change any strategic policies of an entity. What powers it has 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 individual assets—such as using sale proceeds within its business or using the assets as security for its own borrowings.

A party acting as an agent of the entity

B36 When assessing control, a party considers also the rights of agents. A party might have control of an entity because:

(a) its agent has power over that entity; or

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

B37 The following parties might act as agents of a reporting entity:

(a) Its related parties as defined in IAS 24 *Related Parties*;

(b) a party that received its interest in an 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 an 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) an entity with the same board of director's as the reporting entity.

The entity acting as an agent

B38 An entity might act as an agent on behalf of another party. An entity does not control another entity if it must use its rights in that entity for the benefit of another party.

B39 A fiduciary relationship, such as one involving trustees and beneficiaries of trusts, is an example of when 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.

B40 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 interests of its principal. The performance-related fee that the agent receives is compensation for the services it performs for the principal.

B41 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 78 to 80)

B42 To meet the disclosure objectives in paragraph 78, an entity must disclose the information set out in paragraphs B43 to B54.

Judgment in the decision to consolidate (paragraph 78(a))

B43 To enable users of its financial statements to evaluate the judgements that management has made when reaching decisions to consolidate, or not, the entity shall describe the basis for its decision:

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

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

Financial effects of the decision to consolidate an entity (paragraph 78(b))

B44 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, a parent shall disclose for each subsidiary identified in B43 (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.

B45 The 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.

B46 The entity is also required to disclose information in relation to the entities identified in B43 (b) because they are entities in which it has significant involvement. Those requirements are outlined in paragraphs B50 to B54.

Restrictions on assets and liabilities of subsidiaries (paragraph 78(c))

B47 The consolidated financial statements present the assets, liabilities, equity, revenues and expenses of the parent combined with those of the 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 its assets, liabilities, equity, revenues and expenses are managed within subsidiaries of the group.

B48 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, an 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 78(d))

B49 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 parent must 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 74, 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 78(e))

B50 To enable users of its financial statements to evaluate the nature of, and risks associated with, its significant involvement with entities that it does not control, an entity shall disclose:

(a) the assets and liabilities of entities with which it 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 entity is exposed as a result of its involvement with these entities; and

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

B51 The categories shall be appropriate to the entity but might include securitisation or investment entities. If the entity has different types of, for example, investment entities that have different economic characteristics those differences should cause the entity to disclose these in separate categories.

B52 The assets and liabilities shall be presented with the same level of disaggregation that the entity uses in its statement of financial position.

B53 The information shall be presented and summarised so that a user of the financial statements of the entity can identify the total assets and liabilities for each category of entity in which it has significant involvement without having to perform their own aggregations for each category.

B54 In addition to the disclosure requirements in this IFRS, the entity shall also 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.