

STAFF PAPER

10 – 11 September 2013

IFRS Interpretations Committee Meeting

Project	IFRS 10 <i>Consolidated Financial Statements</i> Effect of protective rights on an assessment of control		
Paper topic	Review of the tentative agenda decision		
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Introduction

1. In August 2012, the IFRS Interpretations Committee (‘the Interpretations Committee’) received a request for clarification about IFRS 10 *Consolidated Financial Statements*. IFRS 10 defines the principle of control and establishes control as the basis for determining which entities are consolidated in the consolidated financial statements. An important element of control in IFRS 10 is power. The submission related to protective rights, and the effect of those rights on an entity’s power over the investee, as outlined in a simple example of when a borrowing covenant is breached.
2. Our analysis of this issue was discussed in Agenda Paper 11 of the March 2013 meeting and Agenda Paper 19 of the May 2013 meeting. Both papers were entitled *IFRS 10 Consolidated Financial Statements: Effect of protective rights on an assessment of control*. A link to these papers is included in the footnote below.¹

¹ Agenda Paper 11, March 2013

<http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2013/March/111303AP11%20-%20IFRS%2010%20Protective%20rights.pdf>

Agenda Paper 19, May 2013

<http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2013/May/AP19-IFRS-10-Protective-rights.pdf>

3. The Interpretations Committee tentatively decided that they would not add this topic to the agenda because they think that the Standard requires an investor to reassess whether it controls an investee if facts and circumstances change and that the breach did constitute such a change. They also do not expect significant diversity in practice to arise when the Standard is applied. The tentative agenda decision, in the form of an extract from *IFRIC Update* May 2013, is included as Appendix A for convenience.

Comment letter summary

4. The comment period for the tentative agenda decision ended on 29 July 2013. We received three responses. These comment letters are attached as Appendices B–D.
5. Two respondents, the Canadian and Italian standard-setters, agree with the tentative agenda decision for the reasons provided in the agenda decision.
6. The third respondent, Deloitte, agrees with the tentative agenda decision for the reasons provided in the agenda decision, but thinks that the agenda decision should not refer to the IASB’s redeliberations, because the agenda paper that is referred to in the decision does not form part of the IASB’s authoritative literature. This respondent also suggests that the agenda decision should make it clear that a reassessment may, or may not, result in a conclusion that control has changed.

Staff analysis

7. The staff considered the two suggestions made by the third respondent.

Suggestion 1: remove reference to IASB redeliberations

8. The respondent suggests that reference to an agenda paper that was discussed by the IASB during its redeliberations of this topic should not be referred to in the agenda decision. We do not agree with this recommendation because we think

that the clarification of the IASB's intention, as contained in that agenda paper, is useful. We also note that the Interpretations Committee considered the IASB's intention in assessing this issue.

Suggestion 2: reassessment may not result in a changed assessment

9. The same respondent also suggests that the agenda decision should make it clear that a reassessment of control does not necessarily change the conclusion about control. We agree that it would be helpful to avoid any misconception that reassessment necessarily results in such a change.
10. When this was discussed by the Interpretations Committee they accepted that the control assessment might be the same or differ on reassessment, but they thought that they had insufficient facts to assess what the outcome of that reassessment would be in the example given. We note the following from the March 2013 *IFRIC Update*:

The Interpretations Committee did not think that they had enough information about the rights of the investor, banks and others to come to a conclusion about the outcome of that control assessment in the submitted example.

11. To clarify this point, we recommend including the following sentence in the tentative agenda decision:

It also noted that the reassessment may or may not result in a change to the control assessment, depending on the individual facts and circumstances.

Staff recommendation

12. We recommend confirming the tentative agenda decision as worded in the May 2013 *IFRIC Update*, but with the inclusion of the additional sentence referred to in paragraph 11. The full text of the tentative agenda decision is included as Appendix A, with the proposed additional sentence inserted in mark-up for convenience.

Question for the Interpretations Committee

Do you agree with the staff recommendation to confirm the original wording and include the additional sentence referred to in paragraph 11?

Appendix A

Finalisation of agenda decision

We recommend confirming the original agenda decision, with the inclusion of the additional sentence noted in red typeface and underlined:

IFRS 10 Consolidated Financial Statements—Effect of protective rights on an assessment of control

The Interpretations Committee received a request for clarification about IFRS 10. The query relates to protective rights and the effect of those rights on the power over the investee. More specifically, the submitter asked whether the control assessment should be reassessed when facts and circumstances change such that rights, previously determined to be protective, change (for example upon the breach of a covenant in a borrowing arrangement that causes the borrower to be in default) or whether, instead, such rights are never included in the reassessment of control upon a change in facts and circumstances.

The Interpretations Committee observed that paragraph 8 of IFRS 10 requires an investor to reassess all rights to establish whether it controls an investee whenever facts and circumstances change. The Interpretations Committee also observed that if the breach of a covenant resulted in the rights becoming exercisable, that did constitute such a change. It noted that the Standard does not include an exemption for any rights from this need for reassessment. The Interpretations Committee also discussed the IASB's redeliberations of this topic during the development of IFRS 10 and concluded that the IASB's intention was that protective rights should be included in a reassessment of control when facts and circumstances change. Accordingly, the Interpretations Committee noted that the conclusion about who controlled the investee would need to be reassessed after the breach occurred. It also noted that the reassessment may or may not result in a change to the control assessment, depending on the individual facts and circumstances.

The Interpretations Committee also concluded that it did not expect significant diversity in practice to develop following the implementation of the Standard. Consequently, the Interpretations Committee [decided] not to add this issue to its agenda.

July 26, 2013

(By e-mail to ifric@ifrs.org)

IFRS Interpretations Committee

30 Cannon Street,
London EC4M 6XH
United Kingdom

Dear Sirs,

Re: Tentative agenda decision on IFRS 10 Consolidated Financial Statements – Effect of protective rights on an assessment of control

This letter is the response of the staff of the Canadian Accounting Standards Board (AcSB) to the IFRS Interpretations Committee's tentative agenda decision regarding the effect of protective rights on an assessment of control. This tentative agenda decision was published in the May 2013 IFRIC Update.

The views expressed in this letter take into account comments from individual members of the AcSB staff but do not necessarily represent a common view of the AcSB or its staff. Views of the AcSB are developed only through due process. We agree with the Committee's decision not to add this item to its agenda for the reasons provided in the tentative agenda decision.

We would be pleased to provide more detail if you require. If so, please contact me at +1 416 204-3276 (e-mail pmartin@cpacanada.ca), or Kathryn Ingram, Principal, Accounting Standards at +1 416 204-3475 (e-mail kingram@cpacanada.ca).

Yours truly,



Peter Martin, CPA, CA Director,
Accounting Standards

Wayne Upton
Chairman
IFRS Interpretations Committee
30 Cannon Street
London
EC4M 6XH

Email: ifric@ifrs.org

29 July 2013

Dear Mr. Upton

Tentative Agenda Decision - IFRS 10 Consolidated Financial Statements: Effect of protective rights on an assessment of control

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the May IFRIC Update of the tentative decision not to take onto the Committee's agenda a request for clarification on whether a control assessment should be reassessed when facts and circumstances change such that rights previously determined to be protective change (for example, upon the breach of a covenant in a borrowing arrangement that causes the borrower to be in default).

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision, but would make the following points of detail:

- we suggest that the agenda decision include a statement that the reassessment may, or may not, result in a conclusion that control has been obtained to avoid any misconception that reassessment necessarily results in a change; and
- we recommend that the reference to the IASB's redeliberations of IFRS 10 be removed as this statement is made principally on the basis of an agenda paper for the IASB's October 2009 meeting that does not form part of the IASB's authoritative literature.

Yours sincerely



Veronica Poole
Global IFRS Leader

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IFRS Interpretations Committee

30 Cannon Street

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26 July 2013

Re: Interpretation Committee tentative agenda decisions

Dear Wayne,

We are pleased to have the opportunity to provide our comments in order to contribute to the IFRS IC agenda decision (issued in May 2013) on IFRS 10 – “Consolidated Financial Statements— Effect of protective rights on an assessment of control”.

We are writing to communicate our agreement with regard to the tentative decisions reached on the above-mentioned issues.

IFRS 10 – Consolidated Financial Statements — Effect of protective rights on an assessment of control

The issue relates to protective rights and the effect of those rights on the power over the investee when there is a change in the facts and circumstances that affect them (for example a breach of a covenant in a borrowing arrangement that causes the borrower to be in default).

The IFRS IC noted that IFRS 10.8 requires an investor to reassess all rights to establish whether it controls an investee whenever facts and circumstances change. Therefore, protective rights should be included in a reassessment of control when facts and circumstances change. The IFRS IC also observed that if the breach of a covenant resulted in the rights becoming exercisable, that did constitute such a change.

The IFRS IC decided not to add this issue to its agenda because it does not expect significant diversity in practice to develop following the implementation of the Standard.

The protective rights ensure that at the occurrence of pre-defined conditions the payee may exercise the rights to the underlying shares. The protective rights remain “protective” until facts occur (for example, the breaking of covenants) that make them exercisable so as to allow the payee to exercise influence on the significant activities of the entity. We think that the breaking of a covenant represents a change in the "Facts and Circumstances" that may change the nature of the protective rights, making them substantial. So, in line with IFRS 10 (paragraphs B22 et seq.), such a change imposes a reassessment of the control including the protective rights within the assessment of the control.

We think that IFRS 10 is clear on this point and, therefore, we agree with the IFRS IC tentative decision not to add this issue to its agenda.

Should you need any further information, please do not hesitate to contact us.

Yours sincerely,

Angelo Casò

(Chairman)