IFRS

STAFF PAPER

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IASB® Meeting

Project	**Post-implementation Review of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities***
Paper topic	Findings from the first phase and determining the next step

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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB® *Update*.

Purpose of the paper

1. In this paper, the staff:
   (a) present the findings from the first phase of the Post-implementation Review (PIR) of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities* (the Standards); and
   (b) ask the Board to approve the next step of the PIR.
2. The findings are presented to help the Board identify areas (requirements) in the Standards on which further information is needed for the second phase of the PIR.
3. The Board is asked to approve the next step of the PIR, ie the development of a request for further information on the areas (requirements) the Board identifies. Based on the Board's decision, the staff will develop a request for information that includes questions for stakeholders.
4. If the Board approves the next step and areas for further information, the staff does not plan to discuss the questions at a future Board meeting; the staff will bring a paper to a future Board meeting for the Board to confirm that it is satisfied that it has complied with the applicable due process requirements.

5. This Agenda Paper is supplemented by:

   (a) Agenda Paper 7B—which provides additional background on the Standards and the due process related to PIRs; and

   (b) Agenda Paper 7C—which provides a summary of the outreach conducted in the first phase of the PIR and the academic review undertaken.

   The staff do not intend to discuss Agenda Papers 7B and 7C unless Board members have questions.

Structure of the paper

6. The paper sets out:

   (a) staff recommendations in paragraphs 10–13; and

   (b) a summary of the findings from the first phase of the PIR in paragraphs 14–143.

7. To assist the Board, the findings from the first phase of the PIR are grouped by Standard, and then by requirement within each Standard.

8. When applicable, the staff has presented feedback supporting further investigation. The staff has also provided reasons for not recommending that the Board seek further information on particular areas (requirements).

9. The following table summarises the contents of this agenda paper:

Standards	Requirements	Feedbacks	Paragraphs
IFRS 10	Elements of control—power over an investee	Identifying the relevant activities	20–23
		Control without the majority of voting rights	24–26
		Assessing *de facto* control on a continuous basis	27–28
		Assessing whether rights are protective	29–30
		Rights that are conditional on future events	31–35
		Assessing whether potential voting rights are substantive	36–38
		Practical ability to unilaterally direct the relevant activities	39–42
	Elements of control—exposure and rights to variable returns		43–48

<table>
<tr><th>Standards</th><th>Requirements</th><th>Feedbacks</th><th>Paragraphs</th></tr>
<tr><td rowspan="8"></td><td rowspan="3">Elements of control—the link between power and returns</td><td>Exposure to variability of returns from other interests</td><td>50–54</td></tr>
<tr><td>Non-contractual agency relationships</td><td>55–57</td></tr>
<tr><td>Assessing whether removal rights are substantive</td><td>58–61</td></tr>
<tr><td rowspan="5">Accounting requirements</td><td>Changes in ownership interests</td><td>64–66</td></tr>
<tr><td>Partial acquisition of a subsidiary that does not constitute a business</td><td>67–70</td></tr>
<tr><td>Options that give access to the returns associated with an ownership interest</td><td>71–74</td></tr>
<tr><td>Subsidiary partially held by an associate</td><td>75</td></tr>
<tr><td>Initial measurement of a retained interest after loss of control</td><td>76–79</td></tr>
<tr><td rowspan="2"></td><td rowspan="2">Investment entity consolidation exception</td><td>Criteria for identifying an investment entity</td><td>82–84</td></tr>
<tr><td>Accounting requirements for an investment entity subsidiary</td><td>85–90</td></tr>
<tr><td rowspan="7">IFRS 11</td><td colspan="2">Collaboration arrangements outside the scope of IFRS 11</td><td>94–97</td></tr>
<tr><td colspan="2">Assessing joint control</td><td>98–101</td></tr>
<tr><td colspan="2">Classifying joint arrangements</td><td>102–104</td></tr>
<tr><td colspan="2">Accounting requirements for joint ventures</td><td>105–108</td></tr>
<tr><td rowspan="3">Accounting requirements for joint operations</td><td>Disproportion between share of output and share of economic interest</td><td>113–115</td></tr>
<tr><td>Liabilities in relation to a joint operator’s interest in a joint operation</td><td>116–119</td></tr>
<tr><td>Parties to a joint operation that do not share joint control</td><td>120–124</td></tr>
<tr><td rowspan="2">IFRS 12</td><td colspan="2">Completeness of the requirements</td><td>127–130</td></tr>
<tr><td colspan="2">Applying the requirements</td><td>131–136</td></tr>
<tr><td colspan="3">Interaction with other Standards</td><td>137–143</td></tr>
</table>

Staff recommendation for the next step in the PIR

10. The *Due Process Handbook* states that ‘the initial review should draw on the broad network of IFRS-related bodies and interested parties’ and that ‘the purpose of these consultations is to inform the IASB so that it can establish an appropriate scope for the review’.[1]

11. The staff’s view is that the findings from the first phase of the PIR provide sufficient information to help the Board establish the scope of the review.

[1] Paragraph 6.56 of the *Due Process Handbook*.

12. Based on these findings, the staff recommends that:

    (a) the Board proceed with the PIR and publish a request for information (RFI). The objective of the RFI would be to gather evidence on the requirements identified in the first phase of the review from a broader group of stakeholders. Publication of an RFI does not imply that any standard-setting is required.

    (b) the RFI include questions on:

        (i) IFRS 10, relating to:

            1. power over an investee.

            2. the link between power and returns, with a focus on identifying agency relationships.

            3. accounting requirements in IFRS 10, with a focus on changes in ownership interests.

            4. the investment entity consolidation exception.

        (ii) IFRS 11, relating to:

            1. collaboration arrangements outside the scope of IFRS 11.

            2. classifying joint arrangements as joint operations based on other facts and circumstances.

            3. accounting requirements in IFRS 11, with a focus on joint operations.

        (iii) IFRS 12, relating to the quality of information and whether and how well the disclosure objectives are met by an entity applying the requirements.

    (c) the RFI does not include questions on the interaction of IFRS 10, IFRS 11 and IFRS 12 with other IFRS Standards.

13. The questions for the Board are set out at paragraph 144 of this Agenda Paper.

Summary of findings from the first phase of the PIR

IFRS 10 *Consolidated Financial Statements*

Overview of findings

14. IFRS 10 establishes control as the single basis for consolidation and sets out principles for presenting and preparing consolidated financial statements when an entity controls one or more other entities.

15. IFRS 10 was developed to provide a model that can be used in a broad range of fact patterns and governance structures to determine whether an investor has control of an investee. IFRS 10 requires a holistic and qualitative assessment of all legal, contractual and other facts and circumstances before such a determination is made.

16. During outreach in the first phase of the PIR, stakeholders expressed support for the principles of IFRS 10. However, some stakeholders said that applying the requirements to complex fact patterns requires significant judgement and may not result in consistent outcomes.

17. The IFRS 10 control model requires a holistic assessment that avoids 'bright lines', therefore, the use of judgement in complex situations is unavoidable.

Elements of control—power over an investee

18. Paragraph 7 of IFRS 10 states:

> … an investor controls an investee if and only if the investor has all the following:
>
> (a) power over the investee … [paragraphs 10–14, B9–B54 and BC42–BC59];
>
> (b) exposure, or rights, to variable returns from its involvement with the investee … [paragraphs 15–16, B55–B57 and BC60–BC67]; and
>
> (c) the ability to use its power over the investee to affect the amount of the investor's returns … [paragraphs 17–18, B58 and BC68].

19. The first element of control is power over an investee. Paragraphs 20–42 set out the requirements of IFRS 10 and the findings from the first phase of the PIR in relation to this element.

Identifying the relevant activities—requirements

20. IFRS 10 states an investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities of the investee.

21. Contractual agreements can grant different investors power over different activities of an investee, for example, one investor has rights over research and development activities and another investor has rights over manufacturing and marketing activities. Paragraphs 13 and B13 of IFRS 10 state that where investors have rights over different activities, the investor with the current ability to direct the activities that most significantly affect the returns of the investee, has power over the investee.

22. Example 1 of the Application Guidance on IFRS 10 illustrates that when an investor is deciding which activity most significantly affects the investee's returns, the investor shall consider the profit margin, revenue and value of the investee, as well as any uncertainties about future developments.

Identifying the relevant activities—findings

23. Stakeholders said that the contribution of each activity to the investee's performance can change over time. Applying IFRS 10 requirements and the application guidance in these circumstances requires projections over the lifetime of the investee, which involve a high level of uncertainty.

Control without the majority of voting rights—requirements

24. Paragraph B16 of IFRS 10 states that power over an investee can be obtained directly from voting rights. However, paragraph B38 states that an investor can have power even if it holds less than a majority of voting rights. An investor could have control because of a contractual agreement with other vote holders.[2] An investor could also have control

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[2] Paragraphs B39–B40 of IFRS 10.

because that the investor has the practical ability to direct the investees' relevant activities due to its share of voting rights and the dispersion of the other shareholders, a situation referred to in this Agenda Paper as *de facto* control.[3]

Control without the majority of voting rights—findings

25. Stakeholders said assessing whether an investor has *de facto* control involves significant judgement, which can lead to inconsistent outcomes. In addition, views diverge on whether there is a minimum level of voting rights required to establish *de facto* control, and if so, what that minimum level is.

26. One example provided to demonstrate the above point was: an investor has a significant share but less than a majority of voting rights, and the remaining shareholding is dispersed. However, some of the investor's voting rights are held by a subsidiary trust fund operated by an independent asset manager. The assessment as to whether the investor has *de facto* control depends on whether the investor considers the voting rights held by the subsidiary trust fund as part of its own voting rights.

Assessing de facto control on a continuous basis—requirements

27. The IFRS 10 requirements include:

    (a) paragraph 8, which requires an investor to reassess whether it controls an investee if facts or circumstances indicate a change to one or more of the elements of control;

    (b) paragraph B82, which states that an event can cause an investor to gain or lose power over an investee without the investor being involved in the event; and

    (c) paragraph 8 of IFRS 3 *Business Combinations*, which requires an investor to identify the acquisition date—the date on which the entity obtains control.

[3] Paragraphs B41–B43 of IFRS 10.

Assessing de facto control on a continuous basis—findings

28. Stakeholders said it is difficult and burdensome to assess *de facto* control on a continuous basis because doing so requires an investor to continuously monitor transactions between third parties to ascertain whether it has gained or lost *de facto* control.

Assessing whether rights are protective—requirements

29. Paragraph B26 of IFRS 10 requires when evaluating whether rights give power over an investee that an investor assess whether its rights, and rights held by other parties, are substantive or protective. Paragraph B26 specifies that protective rights relate to fundamental changes to the activities of an investee or apply in exceptional circumstances.

Assessing whether rights are protective—findings

30. Stakeholders said that in some circumstances, assessing whether a right is protective is complex, for example, in circumstances in which:

    (a) the investor has the right to appoint different members of the investee's key management personnel;

    (b) veto powers apply;

    (c) rights under a franchise agreement substantially restrict the ability of other parties to direct relevant activities; and

    (d) deadlock clauses affect the nature of the rights held by the entity or other parties.

Rights that are conditional on future events—requirements

31. Paragraph B24 of IFRS 10 states that to be substantive, rights also need to be exercisable when decisions about the direction of the relevant activities need to be made. The paragraph adds that *usually* the rights need to be currently exercisable to be substantive.

Rights that are conditional on future events—findings

32. Some rights are contingent on future events that are outside the control of the holder of those rights, for example a breach of a covenant. Stakeholders questioned whether the conditionality of a right affects the assessment of whether the right is substantive.

33. In September 2013, the IFRS Interpretations Committee (Committee) issued Agenda Decision *IFRS 10 Consolidated Financial Statements—Effect of protective rights on an assessment of control.* The Committee concluded that, if a change in facts and circumstances results in a change in rights previously determined to be protective, the entity should reassess control.

34. Paragraph B53 of IFRS 10 states that an investee may be designed so that the direction of its activities and its returns are predetermined unless and until particular circumstances arise or events occur. In cases involving such investees, only the decisions about the investee's activities when those circumstances or events occur can significantly affect the investee's returns and thus be relevant activities. The events need not have occurred for the investor with the ability to make those decisions to have power.

35. Outside paragraph B53, IFRS 10 does not indicate explicitly how an entity considers the likelihood of future events when assessing if potential voting rights are substantive.

Assessing whether potential voting rights are substantive—requirements

36. When assessing control, an investor considers potential voting rights such as those arising from convertible instruments or options.[4] In relation to potential voting rights, paragraph B23 of IFRS 10 requires an investor to consider whether the price creates a financial barrier to the exercise of the option.

Assessing whether potential voting rights are substantive—findings

37. Concerns were raised when IFRS 10 was developed that this requirement could lead to frequent changes in control due to changes in market prices of an equity instrument. However, the Board concluded that determining whether a potential voting right is substantive is a holistic assessment based on a variety of factors. The Board considered that a change in market conditions, in isolation, would typically not lead to a change in the control.[5]

[4] Paragraph B47 of IFRS 10.

[5] Paragraph 124 of the Basis for Conclusions on IFRS 10.

38. Some stakeholders asked if the reference to market conditions implies that the investor should assess whether the change in the current price is attributable to events specific to the investee rather than to general changes in financial markets.

Practical ability to unilaterally direct the relevant activities—requirements

39. When it is unclear whether the investor's voting and contractual rights are sufficient to give it power, paragraph 18 of IFRS 10 requires the investor to assess if it has the practical ability to unilaterally direct the relevant activities. In doing so, an investor considers the evidence set out in paragraphs B18 and B19 of IFRS 10.

40. The factors in B18 and B19 need not be considered in all cases, but must be considered if:

    (a) an investee is not governed via voting or contractual rights; and

    (b) an investee is governed via voting or contractual rights but based on the analysis it is unclear if any investor has power over the investee.

41. Paragraph B46 also indicates that if after considering all factors, including those in paragraphs B18 and B19, it is still unclear if the investor has power, the investor concludes that it does not control the investee.

Practical ability to unilaterally direct the relevant activities—findings

42. Stakeholders said that it is difficult to prove or disprove the presence of non-enforceable rights (that is, the practical ability to unilaterally direct the relevant activities), and that the presence or absence of non-enforceable rights can be used to justify different conclusions in similar circumstances.

Elements of control—exposure and rights to variable returns

43. The second element of control (see paragraph 18) is the investor's exposure or rights to variable returns due to the involvement with the investee.

Exposure and rights to variable returns—requirements

44. The nature of possible returns is broad and paragraph B57 of IFRS 10 indicates that it is not limited to dividends.

45. There were relatively few comments on the second element of control, except on the inclusion of synergistic returns. Paragraph B57 of IFRS 10 lists as one example:

> … returns that are not available to other interest holders. For example, an investor might use its assets in combination with the assets of the investee, such as combining operating functions to achieve economies of scale, cost savings, sourcing scarce products, gaining access to proprietary knowledge or limiting some operations or assets, to enhance the value of the investor's other assets.

Exposure and rights to variable returns—findings

46. Some stakeholders said a controlling entity does not have the right to prevent other investors from accessing their share of returns, therefore, it is unclear when the example set out in paragraph B57 of IFRS 10 would apply in practice.

Exposure and rights to variable returns—recommendation not to ask for further information

47. In the staff's view, the objective of the paragraph is to clarify that variable returns arise not only from the investor's direct economic interest, such as equity instruments or loans, but also from the broader economic relationship with the investee. This does not imply that the investor should be able to use its power to curtail the other parties' returns to its own advantage.

48. The staff take the view that in most situations assessing whether an investor meets the requirement is straightforward and that there is no need to request further information on this area in the second phase of the PIR.

Elements of control—the link between power and returns

49. The third element of control (see paragraph 18) is the link between power and returns—illustrated by an investor's ability to use its power over an investee to affect the amount of the investor's returns. This involves assessing whether an investor acts as a principal or an agent.

Exposure to variability of returns from other interests (agent or principal)—requirements

50. Paragraph B60 of IFRS 10 includes the following factors to be considered in assessing if an investor acts as a principal or an agent:

    (a) the scope of the decision maker's authority over the investee;

    (b) the rights held by other parties, including substantive removal rights;

    (c) the remuneration to which the decision maker is entitled; and

    (d) the decision maker's *exposure to variability of returns from other interests* it holds in the investee.

51. Paragraph B72 of IFRS 10 states that in evaluating exposure to variability of returns, an investor shall consider that the greater the magnitude of, and variability associated with, its economic interests, the greater the likelihood that the decision maker is a principal.

Exposure to variability of returns from other interests (agent or principal)—findings

52. Stakeholders had diverging views on whether a minimum level of economic interest is required for the decision maker to be a principal, and if so, what that level is.

53. Although paragraph B72 of IFRS 10 notes that a greater magnitude of economic interest is associated with a greater likelihood of the investor acting as a principal, IFRS 10 is clear that no quantitative threshold exists. Examples 13–15 of the Application Guidance on IFRS 10 indicate that the decision maker needs to consider all relevant factors and that different factors may receive more or less emphasis in different scenarios. Example 14B of the Application Guidance concludes that:

    > For example, having considered its remuneration and the other factors, the fund manager might consider a 20 per cent investment to be sufficient to conclude that it controls the funds. However, in different circumstances (ie if the remuneration or other factors are different), control may arise when the level of investment is different.

54. In developing IFRS 10, the Board considered specifying a level of returns that would result in the determination of an agency relationship. The Board acknowledged that setting a quantitative threshold might lead to a more consistent application, but concluded

that it would create a bright line and encourage structuring. Also, the Board was not persuaded that the exposure to variability was necessarily correlated to the amount of power.[6]

Non-contractual agency relationships—requirements

55. Paragraph B73 of IFRS 10 states that agency relationships may not involve a contractual arrangement. Paragraph B75 of IFRS 10 includes examples of non-contractual agency relationships that may arise between an investor and its related parties.

Non-contractual agency relationships—findings

56. Stakeholders said non-contractual agency relationships are difficult to prove or disprove. Regulators identified cases where two entities under common control own interests in an investee that, when considered together, convey control via voting rights. In the absence of a contractual agreement, it is possible to claim that either party acts as an agent for the other, or even that they both act as agents for the ultimate parent, which is the real controlling party.

57. In developing IFRS 10, the Board noted that it would be inappropriate to assume that the parties indicated in paragraph B75, including related parties like entities under common control, would always or never act on behalf of the investor.[7]

Assessing whether removal rights are substantive—requirements

58. As noted in paragraph 50 above, one of the relevant factors when assessing whether a decision maker is an agent is the rights held by other parties. A right to remove a decision maker without cause is, in isolation, sufficient to result in a conclusion that the decision maker is an agent. However, other rights (such as redemption rights) may achieve an outcome similar to removal rights.

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[6] Paragraphs 142 and 143 of the Basis for Conclusions on IFRS 10.

[7] Paragraph 146 of the Basis for Conclusions on IFRS 10.

59. These rights may be subject to conditions or limitations—for instance, investors may be allowed to close a fund earlier than its contracted life if the fund's performance is below target or investors may have redemption rights subject to gating provisions.

Assessing whether removal rights are substantive—findings

60. In the cases described in paragraphs 58–59 above, the assessment of whether these rights are substantive is considered by stakeholders to involve a significant degree of judgement.

61. In developing IFRS 10, the Board observed that removal rights are defined as 'rights to deprive the decision maker of its decision-making authority' and that other rights, such as some liquidation rights, could meet the definition. The Board concluded that there was no need to add guidance on this issue.[8]

Accounting requirements

62. When an entity holds an interest in a business, the entity applies the relevant IFRS Standard to the interest. IFRS 9 *Financial Instruments,* IAS 28 *Investments in Associates and Joint Ventures*, IFRS 10 and IFRS 11 may apply to an interest in a business.

63. Changes in the ownership interest may result in a change in the relationship between an investor and an investee, for example a transaction in which an investor acquires control of a current associate. IFRS Standards address some of these transactions, including requirements to account for previously held interests or retained interests.

Changes in ownership interests—findings

64. Stakeholders said IFRS Standards do not provide comprehensive requirements on how to account for changes in ownership interest that modify the relationship between an investor and an investee, for example, a transaction in which a parent loses control of a subsidiary but retains an interest in a joint operation.

65. In July 2015, the Committee discussed an analysis of other transactions involving changes of interests in a business for which there is a lack of guidance. The analysis identified 14

[8] Paragraph 140 of the Basis for Conclusions on IFRS 10.

such transactions and indicated that several of these transactions were either not widespread, did not cause diversity in practice or were the subject of another project.

66. In December 2017 the Board published *Annual Improvements to IFRS Standards 2015–2017 Cycle* to address transactions in which:

    (a) an entity with an interest in a joint operation acquires control of the joint operation; and

    (b) an entity that is a party to a joint operation becomes a joint operator.

Partial acquisition of a subsidiary that does not constitute a business—findings

67. IFRS 10 is silent on how to account for a partial acquisition of an entity that does not constitute a business. The findings indicate there are two accepted practices:

    (a) the method described in paragraph 2 of IFRS 3 which involves allocating the consideration paid to the identifiable assets and liabilities acquired based on their relative fair values; or

    (b) the acquisition method in IFRS 3, including recognition of non-controlling interests (NCIs).

68. The two different accounting practices arise from the fact that the initial recognition of an NCI is addressed by IFRS 3; the relevant requirements in IFRS 3 apply to acquirees, defined as the business or businesses over which the acquirer obtains control in a business combination. However, IFRS 10 requires a parent to consolidate all its subsidiaries and define NCIs as equity in a subsidiary not attributable, directly or indirectly, to a parent. A subsidiary need not constitute a business.

69. This issue can be linked to a more general discussion on whether the existence of a legal vehicle should affect the accounting for a transaction. In the example above, if the legal form of the transaction was the purchase of a portion of an asset, the entity would apply IAS 16 *Property, Plant and Equipment* and initially recognise the asset at cost. There would be no basis to recognise NCIs.

70. In October 2019, the Board discussed the accounting for a transaction in which an entity, as part of its ordinary activities, enters into a contract with a customer to sell real estate by selling its equity interest in a single asset entity that is a subsidiary. In that case also, the involvement of a legal vehicle affects the choice of the relevant IFRS Standard to apply, and results in a different accounting outcome. The Board instructed the staff to investigate the feasibility of a narrow-scope project.

Options that give access to the returns associated with an ownership interest—requirements

71. Paragraph B90 of IFRS 10 states:

> In some circumstances, an entity has in substance an existing ownership interest as a result of a transaction that currently gives the entity access to the returns associated with an ownership interest. In such circumstances, the proportion allocated to the parent and the non-controlling interest in preparing consolidated financial statements is determined by taking into account the eventual exercise of those potential voting rights and other derivatives that currently give the entity access to the returns.

Options that give access to the returns associated with an ownership interest—findings

72. Some stakeholders have noted there may be divergence in practice on assessing whether an option gives access to the returns associated with the shares.

73. The staff examined the material from the accounting firms and found that there is a commonly held view that the option holder would need to have access to substantially all the benefits of the shares, including dividends and changes in fair value. The entity would need to consider the option price formula and assess:

    (a) whether the parties have agreed that there will be no distributions, or the parent has the power to unilaterally decide the dividend policy;

    (b) whether distributions to the current owner are deducted from the option strike price;

    (c) whether the strike price is fixed or offers substantially only a lender’s return to the current owner; and

(d) whether the strike price does not vary with changes in the fair value of the underlying shares or to reflect the share of profit or losses attributable to the shares.

74. One audit firm also mentioned that it is unclear if an entity should recognise a liability in relation to a purchased call option on NCI that gives access to the returns associated with that interest, before the option is exercised and an obligation arises.

Subsidiary partially held by an associate—findings

75. IFRS 10 is silent on how to determine whether an interest is an NCI when the subsidiary is partly owned by an associate of the parent. Based on the staff's research, there are two accepted practices:

(a) treating the part of the interest in a subsidiary held by an associate as an NCI in full; or

(b) treating the part of interest in a subsidiary held by an associate as an NCI to the extent of the third parties' interest in the associate.

Initial measurement of a retained interest after loss of control—requirements

76. When a parent loses control of a subsidiary and retains an interest, paragraph B98 of IFRS 10 requires an entity to measure any interest retained at its fair value at the date control is lost.

Initial measurement of a retained interest after loss of control—findings

77. The requirement to remeasure the retained interest was introduced when the Board issued IFRS 3 and revised IAS 27 *Consolidated and Separate Financial Statements*[9]. The introduction of the requirement was not widely supported when the Board developed these Standards. Some stakeholders still maintain the view that remeasuring the retained interest is not appropriate because no significant changes have occurred to the retained interest.

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[9] IAS 27 *Separate Financial Statements* was issued in May 2011 together with IFRS 10 to supersede IAS 27 *Consolidated and Separate Financial Statements.*

78. A stakeholder suggested that if a parent loses control and retains an interest that qualifies as an associate, the initial measurement should be based on the value of the equity of the former subsidiary.

79. There is a conceptual link between the requirement to remeasure a retained interest and the accounting requirements for business combinations achieved in stages. Consequently if this matter is to be examined further it should not be considered in isolation.

Investment entity consolidation exception

80. Paragraph 31 of IFRS 10 requires an investment entity to measure interests in subsidiaries, including those that are investment entities themselves, at fair value with the changes recognised in profit or loss. The consolidation exception is based on the conclusion that for these entities, fair value provides the most relevant information.

81. In general, stakeholders, and in particular, preparers in the financial services industry, support the consolidation exception. However, stakeholders provided comments in relation to:

    (a) the criteria for identifying an investment entity; and

    (b) the accounting requirements for an investment entity subsidiary.

Criteria for identifying an investment entity—requirements

82. Paragraphs 27–28 of IFRS 10 define ‘investment entity’ and set out the typical characteristics of such entities.

Criteria for identifying an investment entity—findings

83. Stakeholders said the criteria may not be sufficiently specified, and commented on topics including:

    (a) business purpose—paragraph B85B of IFRS 10 states that the definition of an investment entity requires that the purpose of the entity is to invest solely for capital appreciation, investment income or both. Paragraph B85D states that an investment entity may provide management services and strategic advice to an

investee, to the extent these activities do not represent a separate substantial business activity. Stakeholders have enquired as to the level of active management of the investee that is consistent with investment entity status.

(b) exit strategy—paragraph B85F of IFRS 10 states that since an investment entity does not plan to hold its investments indefinitely, it should have an exit strategy documenting how the entity plans to realise capital appreciation from substantially all of its equity investments and non-financial asset investments. Stakeholders have enquired as to the level of formal documentation needed to prove an exit strategy exists.

(c) fair value measurement—paragraph B85K of IFRS 10 states that an essential element of the definition of an investment entity is that it measures and evaluates the performance of substantially all its investments on a fair value basis, because using fair value results in more relevant information than for example, consolidating its subsidiaries or using the equity method for its interests in associates or joint ventures. Stakeholders have enquired as to the conditions that need to be fulfilled to prove that fair value information is used for internal reporting and decision-making purposes.

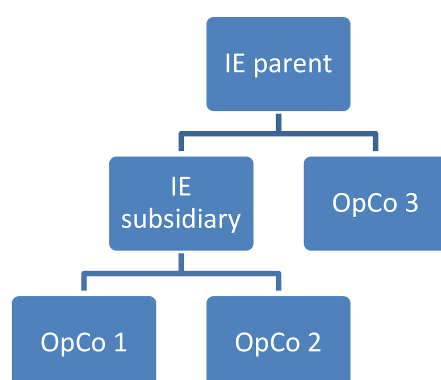
84. Some stakeholders opine that this lack of rigour may enable entities to achieve preferred outcomes.

Accounting requirements for an investment entity subsidiary—requirements

85. Paragraph 31 of IFRS 10 requires an investment entity to measure its interest in a subsidiary at fair value. This requirement also applies to interests in subsidiaries that are themselves investment entities.

Accounting requirements for an investment entity subsidiary—findings

86. As a consequence, investments held by and financial liabilities incurred by an investment entity subsidiary are not separately presented in the financial statements of a parent investment entity but are subsumed in the fair value of the investment entity subsidiary. The following diagram illustrates the scenario:



87. In the structure above, the consolidated financial statements would present the investment in the investment entity subsidiary and OpCo 3, but not the investments in OpCo 1 and 2. Likewise, the consolidated financial statements would present the financial liabilities directly incurred for the acquisition of OpCo 3, but not the financial liabilities incurred by the investment entity subsidiary to acquire OpCo 1 and 2.

88. Some stakeholders said there is a loss of information and they would support requiring full consolidation of an investment entity subsidiary, at least in some circumstances. Others suggested that IFRS 12 should require disclosure of this information in the notes.

89. The Board discussed this aspect when developing of the exemption and considered a proposal to consolidate fully owned investment entity subsidiaries formed for legal, tax or regulatory purposes. The Board eventually rejected the proposal.

90. Some investment entities voluntarily disclose information about the fair value of the investments held by subsidiaries in the notes to the consolidated financial statements.

IFRS 11 Joint Arrangements

Overview of findings

91. IFRS 11 establishes principles for financial reporting by entities that have an interest in arrangements that are controlled jointly.

92. IFRS 11's predecessor Standard IAS 31 *Joint Arrangements* established different accounting requirements depending on whether the arrangements were structured through an entity. IFRS 11 requires classifying joint arrangements as either joint ventures or joint operations, based on the nature of the rights and obligations of the parties sharing control.

93. Stakeholders pointed out several application issues relating to the accounting for interests in joint operations. This feedback is consistent with the number of submissions the Committee has received since IFRS 11 was issued.

Collaboration arrangements outside the scope of IFRS 11—requirements

94. Paragraph 4 of IFRS 11 defines a joint arrangement as an arrangement in which two or more parties have joint control. Paragraph 5 of IFRS 11 indicates that in a joint arrangement:

    (a) the parties are bound by a contractual arrangement; and

    (b) the contractual arrangement gives two or more parties joint control of the arrangement.

Collaboration arrangements outside the scope of IFRS 11—findings

95. Some stakeholders noted that arrangements exist whereby two or more parties manage activities together, but that these arrangements do not qualify as joint arrangements as defined in IFRS 11. These stakeholders further commented that IFRS Standards do not provide guidance for collaborative arrangements that fall outside the scope of IFRS 11.

96. Some stakeholders noted that Accounting Standards Codification 808 addresses this category of arrangements. ASC 808 defines a collaborative arrangement as a contractual arrangement that involves a joint operating activity. These arrangements involve two (or more) parties that:

    (a) are active participants in the activity; and

    (b) are exposed to significant risks and rewards depending on the commercial success of the activity.

97. The staff have considered whether other IFRS Standards could provide relevant requirements, for example:

(a) participants that hold an equity interest would account for that interest using either IAS 28 *Investments in Associates and Joint Ventures* or IFRS 9 *Financial Instruments*.

(b) participants that do not hold an equity interest, shall apply the relevant IFRS Standards to assets and liabilities. For example, if a participant provides an item of equipment, it assesses whether the arrangement is or includes a lease as defined in IFRS 16 *Leases.*

Assessing joint control—requirements

98. The following requirements apply in assessing joint control:

(a) paragraph B47 of IFRS 10 states that, when assessing control, an investor considers its potential voting rights as well as the potential voting rights held by third parties, but only if the rights are substantive.

(b) paragraph B23 of IFRS 10 lists the factors an investor should consider when determining if potential voting rights are substantive.

(c) paragraph B9 of IFRS 11 states that, if the unanimous consent relates only to the decisions that give a party protective rights, that party is not a party with joint control of the arrangement.

(d) paragraph B10 of IFRS 11 states that a contractual arrangement might include clauses on the resolution of disputes, such as arbitration. The existence of these clauses does not prevent the arrangement from being jointly controlled, and therefore from being a joint arrangement.

Assessing joint control—findings

99. Some stakeholders said there is uncertainty in assessing how deadlock clauses affect joint control. In some cases, the joint arrangement may include a range of resolution clauses, such as:

(a) escalation to senior management; and

(b) arbitration by independent experts or third parties.

100. If the disagreement is not resolved, the joint arrangement may result in a call option being granted to one of the partners or a similar right, for example, a right of first refusal. Regulators have noted it can be difficult to assess if and when these clauses prevent joint control.

Assessing joint control—staff recommendation not to ask for further information

101. The staff note that IFRS 10 and IFRS 11 apply the same notion of control and that questions should be included on the assessment of control in the public consultation. The staff take the view that stakeholders can comment on the assessment of joint control when replying to those questions and, therefore, that there is no need for specific questions on assessing joint control in the RFI.

Classifying joint arrangements—requirements

102. IFRS 11 requires an entity to classify interests in joint arrangements as either joint operations or joint ventures. The classification is based on the rights held and obligations incurred by the parties sharing joint control.

103. A joint arrangement that does not involve a separate vehicle is a joint operation. A joint arrangement that involves a separate vehicle may be classified as a joint operation based on 'other facts and circumstances', such as when the activities of the joint arrangement are designed primarily to provide output to the parties. Paragraphs B29–B32 of IFRS 11 and Example 3 of the Application Guidance on IFRS 11 illustrate how an entity considers other facts and circumstances in the assessment.

Classifying joint arrangements—findings

104. Some preparers have commented that this part of the guidance is too complex; in their view, the requirements should be simpler and allow a classification based on the commercial purpose of the joint arrangement.

Accounting requirements for joint ventures—requirements

105. IFRS 11 requires a joint venturer to account for its interests in a joint venture using the equity method. The Board eliminated proportionate consolidation which was permitted by IAS 31 because the Board concluded it is not an appropriate method to account for interests in joint arrangements when the parties have the rights to the net assets.

106. IFRS 12 requires a joint venturer to disclose information that enable users of the financial statement to evaluate the nature of and changes in the risks associated with its interests in joint venture or associate, including summarised financial information about the joint venture or associate.

Accounting requirements for joint ventures—findings

107. Some stakeholders said the elimination of proportionate consolidation give rise to the questions about the information for joint ventures.

Accounting requirements for joint ventures —staff recommendation not to ask for further information

108. The staff recommend that the RFI should include a question relating to the quality of information and whether and how well the disclosure objectives are met by an entity applying the requirements. Stakeholders would be able to express views on the quality of information for interests in joint ventures. Therefore, the staff does not recommend including a specific question on accounting for joint ventures.

Accounting requirements for joint operations—requirements

109. When a joint arrangement is classified as a joint operation, paragraph 20 of IFRS 11 requires a joint operator to recognise its assets, liabilities, revenues and expenses including the share of assets, liabilities, revenues and expenses arising from the joint operation.

110. The Committee has received several submissions relating to the accounting for interests in joint operations. The submissions discussed were on topics including:[10]

    (a) the disproportion between the share of output and the share of economic interest;

[10] For a full list of the submissions see Agenda Paper 7B

(b) the recognition of revenue from sales to the joint operation;

(c) the sale of output by a joint operator; and

(d) liabilities in relation to a joint operator's interest in a joint operation.

111. The Committee finalised agenda decisions in relation to all these issues.

112. Regardless of their views on the issues, some stakeholders do not share the Committee's conclusion that sufficient guidance exists in IFRS Standards. They encouraged the Board to add requirements to comprehensively address the issues raised with the Committee.

Disproportion between share of output and share of economic interest—requirements

113. Paragraph B20 of IFRS 11 states that when the joint arrangement is structured via a separate vehicle, the joint arrangement between the parties may confer rights to the assets and obligations to the liabilities of the arrangement. This could be the case when the parties have a contractual arrangement to purchase all the output produced.

Disproportion between share of output and share of economic interest—findings

114. Stakeholders have raised the following questions in relation to cases where the share of output the parties are committed to buy differs from their share of ownership in the vehicle:

(a) on which basis do the parties determine their share of jointly held assets and jointly incurred liabilities?

(b) if there is a difference between the amount of assets and liabilities initially recognised and the initially contributed equity, how is this difference accounted for?

115. IFRS 11 does not provide requirements on these questions. The agenda decision noted that judgement is needed to understand what the reason is for the difference and determine the appropriate accounting.

Liabilities in relation to a joint operator's interest in a joint operation—requirements

116. In March 2019, the Committee published an agenda decision addressing the recognition by a joint operator of lease liabilities relating to its interest in a joint operation.

117. In the fact pattern, the joint operator enters into a lease, as sole signatory, for an item of property, plant and equipment to be used by the joint operation. The joint operator has the right to recover a share of the lease costs from the other joint operators. The joint arrangement is not structured through a legal vehicle.

118. The agenda decision stated that identifying the liabilities that a joint operator incurs and those incurred jointly requires an assessment of the terms and conditions in all contractual agreements that relate to the joint operation, including consideration of the laws pertaining to those agreements. The Committee observed that the liabilities a joint operator recognises include those for which it has primary responsibility.

Liabilities in relation to a joint operator's interest in a joint operation—findings

119. There were mixed views expressed on the tentative agenda decision. Some stakeholders have expressed these concerns on more than one occasion.

Parties to a joint operation that do not share joint control—requirements

120. Paragraph 23 of IFRS 11 requires a party that participates in but does not have joint control of a joint operation, to apply the same accounting requirements as a joint operator if the party has rights to the assets and obligations for the liabilities of the joint operation. Otherwise, the party shall account for its interest in accordance with the IFRS Standard applicable to that interest.

Parties to a joint operation that do not share joint control—findings

121. Stakeholders noted that if the party applied joint operation accounting and the vehicle ceased to be a joint arrangement (for instance because one of the joint operators acquired control), the party would then be obliged to discontinue joint operation accounting and start applying the applicable Standard to its interest—either IFRS 9 or IAS 28. This is because the party can apply joint operation accounting only as long as the vehicle is a joint operation.

122. Stakeholders asked why the party should change its accounting if termination of the joint arrangement has not affected its rights and obligations.

123. The staff notes that while a change in an entity's economic position usually results from the entity's own actions, a change can also arise from transactions between third parties. For example, an investor may have significant influence over an investee that has a dispersed shareholding; if another shareholder acquires a large share of voting rights combing the dispersed shareholding, the investor could lose its significant influence and be required to discontinue the equity method of accounting.

124. While IFRS 11 requires an entity to assess whether the parties have used the contractual arrangements to reverse or modify the rights and obligations conferred by the legal form of the separate vehicle, IAS 28 and IFRS 9 do not impose a similar requirement and the investor accounts for the investment.

IFRS 12 Disclosure of Interests in Other Entities

Overview of findings

125. IFRS 12 sets out disclosure requirements in relation to an entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities and the risks associated with these interests.

126. There were relatively few comments on the requirements in IFRS 12 during the first phase of the PIR.

Completeness of requirements—findings

127. Stakeholders called for additional information on material NCIs and their proportionate share of profits and cash flows and sought:

    (a) information on the composition of NCIs (such as, to which subsidiaries an NCI relates);

(b) information on the proportionate share of operating cash flows associated with material NCIs; and

(c) more detailed information on the assets and liabilities held by subsidiaries with material NCIs, as well as associates and joint ventures.

128. Stakeholders also called for more information on restrictions on paying dividends, dividend traps, the tax consequences of distributions and subordination of debt in subsidiaries.

129. In contrast, other stakeholders viewed some requirements in IFRS 12 as excessive. For example, some questioned the need to provide information on subsidiaries with significant NCIs, because the group controls all assets and is responsible for all liabilities.

Completeness of requirements—requirements

130. Staff have considered the request from stakeholders in relation to disclosure requirements in IFRS Standards and posit that:

(a) paragraph 82A of IAS 12 *Income Taxes* requires disclosing the potential income tax consequences of a distribution to shareholders.

(b) paragraph 48 of IAS 7 *Statement of Cash Flows* requires disclosing the amount of significant cash and cash equivalent balances that are not available for use by the group.

(c) paragraph 12 of IFRS 12 requires disclosing for each subsidiary with NCIs that are material to the reporting entity:

(i) the share of ownership interest and, if different, the share of voting rights held by the NCI;

(ii) the profit or loss allocated to the NCIs during the period and the accumulated NCIs at the end of the period; and

(iii) summarised financial information on the subsidiary.

(d) paragraph 13 of IFRS 12 requires disclosing:

(i) significant restrictions on the ability of a parent or its subsidiaries to transfer cash or other assets to (or from) other entities in the group; and

(ii) the nature and extent to which protective rights belonging to NCIs can significantly restrict the entity's ability to access or use the assets and settle the liabilities of the group.

Applying IFRS 12—requirements

131. IFRS 12 requires entities to disclose information about the nature and extent of their interests in unconsolidated structured entities and any associated risks. A structured entity is defined as an entity that has been designed so voting or similar rights are not the dominant factor in deciding which party controls the entity.

132. IFRS 12 requires entities to disclose information about interests in joint arrangements and associates. Financial information should be disclosed separately for each joint arrangement and associate that is individually material, and in aggregate for joint arrangements and associates that are not individually material.

133. Guidance on the level of aggregation and detail is available in paragraphs B2–B6 of the Standard and in IFRS Practice Statement 2 *Making Materiality Judgements.*

Applying IFRS 12—findings

134. Stakeholders said entities may experience difficulty:

(a) applying the definition of structured entities and identifying unconsolidated structured entities; or

(b) obtaining timely information needed to provide the disclosure required.

135. The staff note that the disclosure requirements are related to assets and liabilities recognised in the financial statements of the entity, or risks and commitments arising from arrangements to which the reporting entity is party.

136. The feedback indicated that the basis for assessing materiality, in the context of applying IFRS 12, needs clarification.

Interaction with other IFRS Standards

Findings

137. Some stakeholders asked that the next phase of the PIR investigate aspects the Standards do not address, such as:

    (a) the accounting for interests in subsidiaries, associates and joint ventures in the investor's separate financial statements;

    (b) conceptual and application issues relating to the equity method of accounting in IAS 28; and

    (c) the initial and subsequent accounting for put options on NCIs (in particular, whether the remeasurement of put options should be recognised in profit or loss or in equity).

Analysis of the findings

138. In relation to the request in paragraph 137(a), some stakeholders have expressed the view that some of the measurement options in IAS 27 for interest in subsidiaries, associates and joint ventures in the separate financial statements are unnecessary or seldom used.

139. Some stakeholders also noted that entities may set up not-for-profit entities or trusts to manage certain corporate social obligations, that from a legal perspective the investor may not have an equity interest and that IAS 27 does not address contributions to entities such as trusts.

140. The staff takes the position that the request in paragraph 130(a) falls outside the scope of the PIR.

141. In relation to the request in paragraph 137(b), in September 2019 the Board received an update on the Board's research programme, which includes a project on the equity method of accounting. The aim of the project is to determine whether practice problems can be addressed by amending the equity method or whether a more fundamental review is needed.

142. In relation to the request in paragraph 137(c), in October 2019 the Board discussed a plan for the project on Financial Instruments with Characteristics of Equity. The plan, which the Board expects to discuss in H1 2020, addressed obligations to redeem own equity instruments.

Staff recommendation not to seek further information

143. For the reasons explained above, the staff recommends that the public consultation does not include questions on the requirements for separate financial statements, the equity method of accounting and put options on NCIs.

Questions for the Board

144. The staff recommends that:

   (a) the Board proceed with the PIR and publish a request for information (RFI). The objective of the RFI would be to gather evidence on the requirements identified in the first phase of the review from a broader group of stakeholders. Publication of an RFI does not imply that any standard-setting is required.

   (b) the RFI include questions on:

      (i) IFRS 10, relating to:

         1. power over an investee.

         2. the link between power and returns, with a focus on identifying agency relationships.

         3. accounting requirements in IFRS 10, with a focus on changes in ownership interests.

         4. the investment entity consolidation exception.

      (ii) IFRS 11, relating to:

         1. collaboration arrangements outside the scope of IFRS 11.

2. classifying joint arrangements as joint operations based on other facts and circumstances.

3. accounting requirements in IFRS 11, with a focus on joint operations.

(iii) IFRS 12, relating to the quality of information and whether and how well the disclosure objectives are met by an entity applying the requirements.

(c) the RFI does not include questions on the interaction of IFRS 10, IFRS 11 and IFRS 12 with other IFRS Standards.

Questions for Board members
1 Do you agree with the staff recommendation that the Board publish an RFI?
2 Do you agree with the staff recommendation to address in the RFI the areas described in paragraph 144?