

Review of IFRS 10 *Consolidated Financial Statements*

Objective: To review IFRS 10 *Consolidated Financial Statements* to consider whether the concerns raised by the AASB in response to IASB ED 10 (AASB ED 171) *Consolidated Financial Statements* have been appropriately addressed and whether there are outstanding issues.

Issue Raised in AASB Submission	IASB ED 10 Proposals	IASB Approach in IFRS 10
Definition of control		
<p>The Board expressed concern that the proposed definition of control could not be applied to all entities within the scope of IAS 27 and SIC-12, and provided an example of a situation in which an entity would find it difficult to determine whether it controls an entity under the proposals (in contrast with SIC-12, under which the need to consolidate would be clear) – the reporting entity has 80% of the returns from another entity but only 50% of the voting rights in that entity.</p> <p>The Board does not believe the IASB achieved its goal of having a single basis of consolidation that can be applied to all circumstances since the ED proposes two sets of guidance on assessing the existence of control: one for control of non-structured entities and the other for control of structured entities.</p>	<p>Paragraph 10, definition of control: “A reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity to generate returns for the reporting entity.”</p>	<p>The new definition of control in IFRS 10 (para 6): “An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.”</p> <p>The revised definition encompasses three elements of control: power, rights to variable returns (both positive and negative), and the ability to use the power to affect the returns. An entity can have power over another entity without necessarily having to direct all the activities of the investee – it need have only the ability to direct those activities that significantly affect the investor’s returns.</p> <p>The IASB noted in para BC32 that variable returns encompass exposure to risks and rewards, which is an indicator of control. Hence the revised definition is broader and does incorporate risks and rewards, which are addressed explicitly in SIC-12. However, the outcome re control may differ under IFRS 10, because the three elements of control need to be qualitatively assessed rather than applying the majority of risks or benefits criteria in SIC-12.</p> <p>The IASB combined the guidance for assessing control of an investee into a single set, deciding not to attempt to define different subsets of entities for different consolidation models.</p> <p><u>Staff view</u> – issue resolved – the same guidance applies to all cases in applying the definition of control.</p>

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<p>Correlation between power and returns</p> <p>The Board did not agree with the proposal that the reporting entity that receives the greatest level of returns from another entity is likely to have the greatest power over the entity. The Board stated that the reference to ‘likely’ may be misused in the absence of judgement: power may not be correlated with returns.</p> <p>The Board queried whether a structured entity would be controlled by the entity that receives the largest fixed returns or the entity that would receive the variable residual returns.</p> <p>In addition, the Board expressed concern regarding the interaction between ‘power to direct activities’ and ‘returns’ and believes the IASB should be clear about which element takes precedence in such circumstances.</p>	<p>Paragraph 33:</p> <p>“Generally, the more a reporting entity is exposed to the variability of returns from its involvement with an entity, the more power the reporting entity is likely to have to direct the activities of that entity that cause the returns to vary. A reporting entity is likely to have power to direct the activities of a structured entity if it is exposed to the variability of returns that are potentially significant to the structured entity and the reporting entity’s exposure is more than that of any other party.”</p>	<p>The notion that the more a reporting entity is exposed to variability of returns the more power it is likely to hold has been deleted. Application guidance para B20 does state that the greater an investor’s exposure/rights to variability of returns, the greater its incentive to obtain rights sufficient to give it power over the investee, which is sensible.</p> <p>Paragraph B19(d) indicates that disproportionate returns for an investor is one factor to consider in assessing power over an investee.</p> <p>IFRS 10 is clear that an investor without exposure to variable returns cannot control an investee. Paragraph BC34 notes that the investor cannot benefit from any power that it may have.</p> <p>The three elements of control are required to be assessed together.</p> <p><u>Staff view</u> – issue resolved – the Board’s concerns have been addressed.</p>
<p>Use of the term ‘returns’</p> <p>The Board did not agree with replacing the term ‘benefits’ with ‘returns’. The Board believes the term may still result in confusion and believes the economic context of the term indicates an entity’s exposure to financial returns, whereas ‘benefits’ has broadly been interpreted to capture both financial and non-financial exposures. In addition, the Board noted that ‘benefits’ remains more suitable for both for-profit entities and not-for-profit entities.</p>	<p>Paragraph 10:</p> <p>“Returns from involvement with an entity vary with that entity’s activities and can be positive or negative.”</p>	<p>The IASB has retained the use of the term ‘returns’ in the new definition of control. The IASB states in paragraph BC62 that the term ‘benefits’ often is interpreted as implying only positive returns.</p> <p>Paragraph BC63 goes on to state that the IASB confirmed its intention to have a broad definition of ‘returns’ that would include synergistic returns as well as more direct returns.</p> <p><u>Staff view</u> – issue remains – the term is suitable for for-profit entities, however the need for an Aus paragraph in AASB 10 to interpret the term for not-for-profit entities will be considered under the Board’s project on control in the NFP sector.</p>

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<p>Control principle for consolidation The Board agreed with the proposal to adopt the controlling entity model as the basis for consolidation.</p>		<p>This is the basis in IFRS 10. <u>Staff view</u> – issue resolved.</p>
<p>Assessing control</p>		
<p>Split between structured and non-structured entities The Board stated that the guidance regarding the assessment of control should be the same for all entities.</p>	<p>Assessing the power to direct activities was divided into paragraphs 23-29 in relation to voting rights or other arrangements, and paragraphs 30-38 for structured entities.</p>	<p>The guidance for assessing control of an investee is no longer split between structured and other entities. <u>Staff view</u> – issue resolved.</p>
<p>Inconsistent application of the control definition – power to direct the activities with a majority of the voting rights The Board did not consider that it was appropriate to assume that having more than half of the voting rights will necessarily give the reporting entity the power to determine the policies of the entity. Furthermore, the Board suggested rewording paragraph 23 and provided proposed wording based on paragraph 27(b).</p>	<p>Paragraph 23: “A reporting entity can have the power to direct the activities of another entity by having the power to appoint or remove the members of that entity’s governing body that have more than half of the voting rights within that body, if the determination of strategic operating and financing policies is by that body.”</p>	<p>The IASB has amended the wording concerning the effect of holding a majority of voting rights. Paragraph B35 states: “An investor that holds more than half of the voting rights of an investee has power in the following situations, unless paragraph B36 or paragraph B37 applies: (a) the relevant activities are directed by a vote of the holder of the majority of the voting rights, or (b) a majority of the members of the governing body that directs the relevant activities are appointed by a vote of the holder of the majority of the voting rights.” Paragraphs B36 and B37 address circumstances in which the holder of a majority of voting rights does not have power over the investee. In addition, the IASB stated in paragraph BC110 that ‘The Board’s intention was not to create a presumption that in the absence of evidence to the contrary the shareholder with the largest proportion of voting rights controls an investee.’ <u>Staff view</u> – issue resolved.</p>

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<p>Inconsistent application of the control definition – power to direct the activities without a majority of the voting rights</p> <p>The Board stated that the guidance regarding power without a majority of voting rights could be improved.</p> <p>Some Board members did not agree with the proposal that ‘de facto’ control is an appropriate basis for consolidation and believed that the IASB should clearly articulate how ‘de facto’ controls fits into the controlling entity model.</p> <p>Other Board members agreed with the ‘de facto’ control approach, but proposed that the example in paragraph 28 be amended to refer to a sufficient number of the other shareholders being unlikely to vote at meetings where policy decisions are made. The actions of the other shareholders at past meetings should be considered in assessing the likelihood of their voting at future meetings.</p>	<p>Paragraph 28:</p> <p>“For example, a reporting entity can have the power to direct the activities of another entity if the reporting entity is the dominant shareholder that holds voting rights and all the other shareholders with voting rights are widely dispersed and are not organised in such a way that they actively co-operate when they exercise their votes so as to have more voting power than the reporting entity.”</p>	<p>IFRS 10 requires consolidation where there is de facto control. The application guidance is now extensive (para’s B38-B50) and does not rely upon the other parties not being organised. Contractual arrangements and potential voting rights also need to be considered, not just the existing voting rights.</p> <p>Numerous factors for consideration are noted in para B42, including voting patterns at previous shareholder meetings. Para B43 retains the reference to wide dispersion of the other shareholdings, but as one factor to take into account, and para B45 addresses the passivity of the other shareholders. A range of illustrative examples are included.</p> <p><u>Staff view</u> – issue resolved – judgement is required in determining whether an investor without a majority of voting rights has power over an investee.</p>
<p>Options and convertible instruments</p> <p>The Board disagreed with the proposals on the basis that the requirements would be difficult to make operational and lead to diversity of interpretation in assessing control through holding options or convertible instruments. The wide dispersion of the guidance in the ED also added to the difficulties.</p> <p>The Board also noted that options are discussed under the section of ‘power to direct activities’ in the body of the ED and the only consideration of the returns element of control is in the Basis for Conclusions and hence there is a tendency to focus</p>	<p>Paragraph B13:</p> <p>“When assessing control, a reporting entity considers whether its power from holding options or convertible instruments to obtain voting rights, taken in conjunction with other relevant facts and circumstances, gives it the power to direct the activities of another entity. A reporting entity that holds options or convertible instruments has power to direct the activities of another entity if (a), (b) or (c) applies:</p> <p>(a) ... might be the case if, for example, the reporting entity holds voting rights together with options or convertible instruments to obtain voting rights that,</p>	<p>The content in IFRS 10 concerning options and convertible shares has been amended. Potential voting rights are now dealt with only in the application guidance concerning an investor’s current ability to direct relevant activities (para’s B47-B50).</p> <p>The guidance clarifies that potential voting rights are considered in assessing control only if they are substantive, i.e. if the holder has the practical ability to exercise the rights (para B22). Para B24 notes that to be substantive, rights also need to be exercisable when the decisions directing the relevant activities need to be made. Therefore, sometimes rights can be substantive even though they are not currently exercisable (but are exercisable in time). This is illustrated in</p>

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<p>on meeting the power element of the control definition.</p> <p>In addition, the Board believes the following are relevant in assessing whether the instrument contributes to the holder having control:</p> <ul style="list-style-type: none"> ▪ whether the instrument is currently exercisable; ▪ the financial ability of management to exercise; ▪ all relevant facts and circumstances. <p>Furthermore, the Board suggested that the guidance in paragraph B13 should be rephrased to address currently commercially exercisable instruments and those not currently exercisable or subject to restrictions.</p> <p>Finally, the Board characterised the examples in para B13(a)-(c) as unlikely examples of options that are not currently exercisable, and that they should be retained.</p>	<p>if exercised or converted, would give the reporting entity voting rights sufficient to determine the entity’s strategic operating and financing policies</p> <p>(b) any party with voting rights that is the counterparty to an option agreement acts as an agent for the reporting entity ...</p> <p>(c) the option or conversion agreement gives the reporting entity particular rights relating to the strategic operating and financing policies that enable the reporting entity to have the power to direct the activities of the entity.”</p>	<p>Examples 3-3D, where a general meeting requires 30 days’ notice.</p> <p>Para B48 requires an investor to consider the purpose and design of the potential voting rights instrument as well as any other involvement the investor has with the investee.</p> <p>The examples in paragraphs B13(a)-(c) in the ED have not been retained. However, para B50 includes two examples (examples 9 and 10) of assessing whether potential voting rights are substantive.</p> <p><u>Staff view</u> – issue resolved – the guidance is sufficient to enable a reporting entity to assess potential voting rights in combination with other factors in considering whether the entity has control over an investee.</p>
<p>Voting rights held both directly and on behalf of other parties as agents</p> <p>The Board disagreed with the rebuttable presumption, considering that it is likely to be interpreted by some as always being rebuttable and by others as never rebuttable.</p> <p>The Board supported the inclusion of guidance to help identify whether the reporting entity is acting as a principal or an agent, but disagreed with providing a potential list of agents.</p>	<p>Paragraph B11:</p> <p>“Sometimes it can be difficult to identify whether a reporting entity that holds voting rights, both directly and on behalf of other parties as an agent, uses the voting rights of the other parties for its own benefit or for the benefit of those other parties. In such circumstances, in assessing whether it has voting rights sufficient to control another entity, the reporting entity excludes the voting rights it holds as an agent only if the reporting entity can demonstrate that it is obliged to act in the best interests of those other</p>	<p>The principles concerning delegated power and agency rights have been amended and clarified in IFRS 10. There is no longer a rebuttable presumption that an entity may be able to use rights that it holds as an agent for its own benefit.</p> <p>IFRS 10 provides guidance addressing delegated power in para’s B58-B72. Included in this guidance (paragraph B60) is a list of factors that a decision maker should consider in determining whether it is an agent. Furthermore, the guidance (at para B72) also includes seven examples concerning whether an entity is acting as an agent or otherwise. Several of these examples concern fund managers.</p> <p><u>Staff view</u> – issue resolved – IFRS 10 appropriately addresses delegated power and provides sufficient guidance to avoid differing interpretations of the requirements.</p>

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	parties or has implemented policies and procedures that ensure the independence of the decision-making in its role as an agent from that as a holder of voting rights directly.”	
Structured entities		
ED questions 6 to 8 addressed structured entities.		These questions are no longer relevant as IFRS 10 does not divide investees into structured and other entities.
Disclosures		
Proposed disclosures The Board’s comments on the disclosures proposed in ED 10 are addressed in the review of IFRS 12 <i>Disclosure of Interests in Other Entities</i> (see agenda paper 8.4.1).		