

Compiled AASB Standard

AASB 10

Consolidated Financial Statements

This compiled Standard applies to annual reporting periods beginning on or after 1 January 2014. Early application is permitted. It incorporates relevant amendments made up to and including 30 September 2014.

Prepared on 1 October 2014 by the staff of the Australian Accounting Standards Board.



Australian Government

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Australian Accounting Standard AASB 10 *Consolidated Financial Statements* (as amended) is set out in paragraphs 1 – 33 and Appendices A – C and E. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the Standard. AASB 10 is to be read in the context of other Australian Accounting Standards, including AASB 1048 *Interpretation of Standards*, which identifies the Australian Accounting Interpretations. In the absence of explicit guidance, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies.

COMPILATION DETAILS

Accounting Standard AASB 10 Consolidated Financial Statements as amended

This compiled Standard applies to annual reporting periods beginning on or after 1 January 2014. It takes into account amendments up to and including 30 September 2014 and was prepared on 1 October 2014 by the staff of the Australian Accounting Standards Board (AASB).

This compilation is not a separate Accounting Standard made by the AASB. Instead, it is a representation of AASB 10 (August 2011) as amended by other Accounting Standards, which are listed in the Table below.

Table of Standards

Standard	Date made	Application date (annual reporting periods ... on or after ...)	Application, saving or transitional provisions
AASB 10	29 Aug 2011	(beginning) 1 Jan 2013	see (a) below
AASB 2012-10	18 Dec 2012	(beginning) 1 Jan 2013	see (b) below
AASB 2012-11	18 Dec 2012	(beginning) 1 Jul 2013	see (c) below
AASB 2013-5	14 Aug 2013	(beginning) 1 Jan 2014	see (d) below
AASB 2013-8	31 Oct 2013	(beginning) 1 Jan 2014	see (e) below
Erratum	30 Sep 2014	(beginning) 1 Jan 2014	see (f) below

- (a) For-profit entities (but not not-for-profit entities) may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2013, provided that certain related Standards are also applied to such periods. This early application provision was subsequently amended by AASB 2012-10.
- (b) For-profit entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2013. Not-for-profit entities may elect to apply the amendments to AASB 10 in this Standard to annual reporting periods beginning on or after 1 January 2013 but before 1 January 2014.
- (c) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 July 2009 but before 1 July 2013, provided that AASB 1053 *Application of Tiers of Australian Accounting Standards* is also applied to such periods.
- (d) For-profit entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2014. Not-for-profit entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2013 but before 1 January 2014. If an entity elects to apply this Standard to such annual

reporting periods, it shall also apply AASB 10 *Consolidated Financial Statements* and associated Standards to such periods.

- (e) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2013 but before 1 January 2014, provided that AASB 10 *Consolidated Financial Statements* and AASB 12 *Disclosure of Interests in Other Entities* are also applied to such periods.
- (f) For-profit entities may elect to apply this Erratum to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2014. Not-for-profit entities may elect to apply this Erratum to annual reporting periods beginning on or after 1 January 2013 but before 1 January 2014. If an entity elects to apply this Erratum to such annual reporting periods, it shall also apply AASB 10 *Consolidated Financial Statements* and associated Standards to such periods.

Table of Amendments to Standard

Paragraph affected	How affected	By ... [paragraph]
2	amended	AASB 2013-5 [7]
Aus3.2-Aus3.3	amended	AASB 2012-10 [25]
Aus3.6	added	AASB 2013-8 [7]
4	amended	AASB 2013-5 [7]
Aus4.1	amended	AASB 2012-11 [14]
Aus4.2	amended	Erratum, Sep 2014
27-33 (and preceding headings)	added	AASB 2013-5 [8]
Appendix A	amended	AASB 2013-5 [9]
B13	amended	AASB 2012-10 [26]
B43	amended	AASB 2012-10 [27]
B82	amended	AASB 2012-10 [28]
B85A-B85W (and preceding headings)	added	AASB 2013-5 [10]
B100-B101 (and preceding heading)	added	AASB 2013-5 [11]
C1A	added	AASB 2012-10 [29]
C1B	added	AASB 2013-5 [12]
C2	amended	AASB 2012-10 [30]
C2A	added amended	AASB 2012-10 [31] AASB 2013-5 [13]
C2B	added	AASB 2012-10 [31]
C3	amended	AASB 2012-10 [32]
C3A-C3F	added	AASB 2013-5 [14]
C4	amended	AASB 2012-10 [32]
C4A	added	AASB 2012-10 [32]
C4B-C4C	added	AASB 2012-10 [33]
C5	amended	AASB 2012-10 [34]

Paragraph affected	How affected	By ... [paragraph]
C5A	added	AASB 2012-10 [34]
C6	amended	AASB 2012-10 [34]
C6A (preceding heading)	added	AASB 2012-10 [35]
C6A	added amended	AASB 2012-10 [35] AASB 2013-5 [15]
C6B	added	AASB 2012-10 [35]
Appendix E	added	AASB 2013-8 [8]

Table of Amendments to Australian Application Guidance

Paragraph affected	How affected	By ... [paragraph]
AG1	amended	AASB 2012-11 [15]

COMPARISON WITH IFRS 10

AASB 10 *Consolidated Financial Statements* as amended incorporates IFRS 10 *Consolidated Financial Statements* as issued and amended by the International Accounting Standards Board (IASB). Paragraphs that have been added to this Standard (and do not appear in the text of IFRS 10) are identified with the prefix “Aus”, followed by the number of the preceding IASB paragraph and decimal numbering.

For-profit entities that comply with AASB 10 as amended will simultaneously be in compliance with IFRS 10 as amended.

Not-for-profit entities using the added “Aus” paragraphs in the Standard that specifically apply to not-for-profit entities may not be simultaneously complying with IFRS 10.

ACCOUNTING STANDARD AASB 10

The Australian Accounting Standards Board made Accounting Standard AASB 10 *Consolidated Financial Statements* under section 334 of the *Corporations Act 2001* on 29 August 2011.

This compiled version of AASB 10 applies to annual reporting periods beginning on or after 1 January 2014. It incorporates relevant amendments contained in other AASB Standards made by the AASB up to and including 30 September 2014 (see Compilation Details).

ACCOUNTING STANDARD AASB 10

CONSOLIDATED FINANCIAL STATEMENTS

Objective

- 1 The objective of this Standard is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

Meeting the objective

- 2 To meet the objective in paragraph 1, this Standard:
 - (a) requires an entity (the *parent*) that controls one or more other entities (*subsidiaries*) to present consolidated financial statements;
 - (b) defines the principle of *control*, and establishes control as the basis for consolidation;
 - (c) sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee;
 - (d) sets out the accounting requirements for the preparation of consolidated financial statements; and
 - (e) defines an investment entity and sets out an exception to consolidating particular subsidiaries of an investment entity.

- 3 This Standard does not deal with the accounting requirements for business combinations and their effect on consolidation, including goodwill arising on a business combination (see AASB 3 *Business Combinations*).

Application

Aus3.1 This Standard applies to:

- (a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act and that is a reporting entity;
- (b) general purpose financial statements of each other reporting entity; and
- (c) financial statements that are, or are held out to be, general purpose financial statements.

Aus3.2 This Standard applies to annual reporting periods beginning on or after 1 January 2013, except that for not-for-profit entities it applies to annual reporting periods beginning on or after 1 January 2014.

[Note: For application dates of paragraphs changed or added by an amending Standard, see Compilation Details.]

Aus3.3 This Standard may be applied by:

- (a) for-profit entities to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2013; and
- (b) not-for-profit entities to annual reporting periods beginning on or after 1 January 2013 but before 1 January 2014.

If an entity applies this Standard to such an annual reporting period in accordance with paragraph (a) or (b), it shall disclose that fact and apply AASB 11 *Joint Arrangements*, AASB 12 *Disclosure of Interests in Other Entities*, AASB 127 *Separate Financial Statements* (August 2011) and AASB 128 *Investments in Associates and Joint Ventures* (August 2011), at the same time.

Aus3.4 The requirements specified in this Standard apply to the financial statements where information resulting from their

**application is material in accordance with AASB 1031
Materiality.**

- Aus3.5 When applied or operative, this Standard supersedes:
- (a) the requirements relating to consolidated financial statements in AASB 127 *Consolidated and Separate Financial Statements* (March 2008, as amended); and
 - (b) Interpretation 112 *Consolidation – Special Purpose Entities* (December 2004, as amended).
- Aus3.6 Appendix E *Australian Implementation Guidance for Not-for-Profit Entities* explains and illustrates the principles in this Standard from the perspective of not-for-profit entities in the private and public sectors, particularly in circumstances where the for-profit perspective reflected in the body of the Standard and the other appendices does not readily translate to a not-for-profit perspective.

Scope

- 4 An entity that is a parent shall present consolidated financial statements. This Standard applies to all entities, except as follows:
- (a) a parent need not present consolidated financial statements if it meets all the following conditions:
 - (i) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all 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;
 - (ii) its 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);
 - (iii) it 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
 - (iv) its ultimate or any intermediate parent produces consolidated financial statements that are available for

public use and comply with International Financial Reporting Standards (IFRSs).

- (b) post-employment benefit plans or other long-term employee benefit plans to which AASB 119 *Employee Benefits* applies.
- (c) an investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of this Standard, to measure all of its subsidiaries at fair value through profit or loss.

Aus4.1 Notwithstanding paragraph 4(a)(iv), a parent that meets the criteria in paragraphs 4(a)(i), 4(a)(ii) and 4(a)(iii) need not present consolidated financial statements if its ultimate or any intermediate parent produces consolidated financial statements available for public use and:

- (a) the parent and its ultimate or intermediate parent are:
 - (i) both not-for-profit entities complying with Australian Accounting Standards; or
 - (ii) both entities complying with Australian Accounting Standards – Reduced Disclosure Requirements; or
- (b) the parent is an entity complying with Australian Accounting Standards – Reduced Disclosure Requirements and its ultimate or intermediate parent is a not-for-profit entity complying with Australian Accounting Standards.

Aus4.2 Notwithstanding paragraphs 4(a) and Aus4.1, the ultimate Australian parent shall present consolidated financial statements that consolidate its investments in subsidiaries in accordance with this Standard when either the parent or the group is a reporting entity or both the parent and the group are reporting entities.

Control

- 5 An investor, regardless of the nature of its involvement with an entity (the investee), shall determine whether it is a parent by assessing whether it controls the investee.**
- 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.

- 7 Thus, an investor controls an investee if and only if the investor has all the following:**
- (a) power over the investee (see paragraphs 10–14);**
 - (b) exposure, or rights, to variable returns from its involvement with the investee (see paragraphs 15 and 16); and**
 - (c) the ability to use its power over the investee to affect the amount of the investor’s returns (see paragraphs 17 and 18).**
- 8** An investor shall consider all facts and circumstances when assessing whether it controls an investee. The investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 7 (see paragraphs B80–B85).
- 9** Two or more investors collectively control an investee when they must act together to direct the relevant activities. In such cases, because no investor can direct the activities without the co-operation of the others, no investor individually controls the investee. Each investor would account for its interest in the investee in accordance with the relevant Standards, such as AASB 11 *Joint Arrangements*, AASB 128 *Investments in Associates and Joint Ventures* or AASB 9 *Financial Instruments*.

Power

- 10** An investor has power over an investee when the investor has existing rights that give it the current ability to direct the *relevant activities*, ie the activities that significantly affect the investee’s returns.
- 11** Power arises from rights. Sometimes assessing power is straightforward, such as when power over an investee is obtained directly and solely from the voting rights granted by equity instruments such as shares, and can be assessed by considering the voting rights from those shareholdings. In other cases, the assessment will be more complex and require more than one factor to be considered, for example when power results from one or more contractual arrangements.
- 12** An investor with the current ability to direct the relevant activities has power even if its rights to direct have yet to be exercised. Evidence that the investor has been directing relevant activities can help

determine whether the investor has power, but such evidence is not, in itself, conclusive in determining whether the investor has power over an investee.

- 13 If two or more investors each have existing rights that give them the unilateral ability to direct different relevant activities, the investor that has the current ability to direct the activities that most significantly affect the returns of the investee has power over the investee.
- 14 An investor can have power over an investee even if other entities have existing rights that give them the current ability to participate in the direction of the relevant activities, for example when another entity has *significant influence*. However, an investor that holds only protective rights does not have power over an investee (see paragraphs B26–B28), and consequently does not control the investee.

Returns

- 15 An investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance. The investor's returns can be only positive, only negative or both positive and negative.
- 16 Although only one investor can control an investee, more than one party can share in the returns of an investee. For example, holders of non-controlling interests can share in the profits or distributions of an investee.

Link between power and returns

- 17 An investor controls an investee if the investor not only has power over the investee and exposure or rights to variable returns from its involvement with the investee, but also has the ability to use its power to affect the investor's returns from its involvement with the investee.
- 18 Thus, an investor with decision-making rights shall determine whether it is a principal or an agent. An investor that is an agent in accordance with paragraphs B58–B72 does not control an investee when it exercises decision-making rights delegated to it.

Accounting requirements

- 19 **A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.**

- 20 Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee.
- 21 Paragraphs B86–B93 set out guidance for the preparation of consolidated financial statements.

Non-controlling interests

- 22 A parent shall present non-controlling interests in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent.
- 23 Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (ie transactions with owners in their capacity as owners).
- 24 Paragraphs B94–B96 set out guidance for the accounting for non-controlling interests in consolidated financial statements.

Loss of control

- 25 If a parent loses control of a subsidiary, the parent:
 - (a) derecognises the assets and liabilities of the former subsidiary from the consolidated statement of financial position.
 - (b) recognises any investment retained in the former subsidiary at its fair value when control is lost and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant Standards. That fair value shall be regarded as the fair value on initial recognition of a financial asset in accordance with AASB 9 or, when appropriate, the cost on initial recognition of an investment in an associate or joint venture.
 - (c) recognises the gain or loss associated with the loss of control attributable to the former controlling interest.
- 26 Paragraphs B97–B99 set out guidance for the accounting for the loss of control.

Determining whether an entity is an investment entity

- 27 A parent shall determine whether it is an investment entity. An investment entity is an entity that:**
- (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;**
 - (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and**
 - (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.**

Paragraphs B85A–B85M provide related application guidance.

- 28 In assessing whether it meets the definition described in paragraph 27, an entity shall consider whether it has the following typical characteristics of an investment entity:**
- (a) it has more than one investment (see paragraphs B85O–B85P);**
 - (b) it has more than one investor (see paragraphs B85Q–B85S);**
 - (c) it has investors that are not related parties of the entity (see paragraphs B85T–B85U); and**
 - (d) it has ownership interests in the form of equity or similar interests (see paragraphs B85V–B85W).**

The absence of any of these typical characteristics does not necessarily disqualify an entity from being classified as an investment entity. An investment entity that does not have all of these typical characteristics provides additional disclosure required by paragraph 9A of AASB 12.

- 29 If facts and circumstances indicate that there are changes to one or more of the three elements that make up the definition of an investment entity, as described in paragraph 27, or the typical characteristics of an investment entity, as described in paragraph 28, a parent shall reassess whether it is an investment entity.**
- 30 A parent that either ceases to be an investment entity or becomes an investment entity shall account for the change in its status**

prospectively from the date at which the change in status occurred (see paragraphs B100–B101).

Investment entities: exception to consolidation

- 31 Except as described in paragraph 32, an investment entity shall not consolidate its subsidiaries or apply AASB 3 when it obtains control of another entity. Instead, an investment entity shall measure an investment in a subsidiary at fair value through profit or loss in accordance with AASB 9¹.**
- 32 Notwithstanding the requirement in paragraph 31, if an investment entity has a subsidiary that provides services that relate to the investment entity's investment activities (see paragraphs B85C–B85E), it shall consolidate that subsidiary in accordance with paragraphs 19–26 of this Standard and apply the requirements of AASB 3 to the acquisition of any such subsidiary.
- 33 A parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

¹ Paragraph C7 of AASB 10 *Consolidated Financial Statements* states “If an entity applies this Standard but does not yet apply AASB 9, any reference in this Standard to AASB 9 shall be read as a reference to AASB 139 *Financial Instruments: Recognition and Measurement*.”

APPENDIX A

DEFINED TERMS

This appendix is an integral part of AASB 10.

consolidated financial statements	The financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.
control of an investee	An investor controls an investee when the investor 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.
decision maker	An entity with decision-making rights that is either a principal or an agent for other parties.
group	A parent and its subsidiaries .
investment entity	An entity that: <ul style="list-style-type: none"> (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services; (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.
non-controlling interest	Equity in a subsidiary not attributable, directly or indirectly, to a parent .
parent	An entity that controls one or more entities.

power	Existing rights that give the current ability to direct the relevant activities .
protective rights	Rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.
relevant activities	For the purpose of this Standard, relevant activities are activities of the investee that significantly affect the investee's returns.
removal rights	Rights to deprive the decision maker of its decision-making authority.
subsidiary	An entity that is controlled by another entity.

The following terms are defined in AASB 11, AASB 12 *Disclosure of Interests in Other Entities*, AASB 128 (August 2011) or AASB 124 *Related Party Disclosures* and are used in this Standard with the meanings specified in those Standards:

- associate
- interest in another entity
- joint venture
- key management personnel
- related party
- significant influence.

APPENDIX B

APPLICATION GUIDANCE

This appendix is an integral part of AASB 10. It describes the application of paragraphs 1–33 and has the same authority as the other parts of the Standard.

- B1 The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual fact patterns, all facts and circumstances of a particular fact pattern would need to be evaluated when applying AASB 10.

Assessing control

- B2 To determine whether it controls an investee an investor shall assess whether it has all the following:
- (a) power over the investee;
 - (b) exposure, or rights, to variable returns from its involvement with the investee; and
 - (c) the ability to use its power over the investee to affect the amount of the investor's returns.
- B3 Consideration of the following factors may assist in making that determination:
- (a) the purpose and design of the investee (see paragraphs B5–B8);
 - (b) what the relevant activities are and how decisions about those activities are made (see paragraphs B11–B13);
 - (c) whether the rights of the investor give it the current ability to direct the relevant activities (see paragraphs B14–B54);
 - (d) whether the investor is exposed, or has rights, to variable returns from its involvement with the investee (see paragraphs B55–B57); and
 - (e) whether the investor has the ability to use its power over the investee to affect the amount of the investor's returns (see paragraphs B58–B72).

- B4 When assessing control of an investee, an investor shall consider the nature of its relationship with other parties (see paragraphs B73–B75).

Purpose and design of an investee

- B5 When assessing control of an investee, an investor shall consider the purpose and design of the investee in order to identify the relevant activities, how decisions about the relevant activities are made, who has the current ability to direct those activities and who receives returns from those activities.
- B6 When an investee's purpose and design are considered, it may be clear that an investee is controlled by means of equity instruments that give the holder proportionate voting rights, such as ordinary shares in the investee. In this case, in the absence of any additional arrangements that alter decision-making, the assessment of control focuses on which party, if any, is able to exercise voting rights sufficient to determine the investee's operating and financing policies (see paragraphs B34–B50). In the most straightforward case, the investor that holds a majority of those voting rights, in the absence of any other factors, controls the investee.
- B7 To determine whether an investor controls an investee in more complex cases, it may be necessary to consider some or all of the other factors in paragraph B3.
- B8 An investee may be designed so that voting rights are not the dominant factor in deciding who controls the investee, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. In such cases, an investor's consideration of the purpose and design of the investee shall also include consideration of the risks to which the investee was designed to be exposed, the risks it was designed to pass on to the parties involved with the investee and whether the investor is exposed to some or all of those risks. Consideration of the risks includes not only the downside risk, but also the potential for upside.

Power

- B9 To have power over an investee, an investor must have existing rights that give it the current ability to direct the relevant activities. For the purpose of assessing power, only substantive rights and rights that are not protective shall be considered (see paragraphs B22–B28).
- B10 The determination about whether an investor has power depends on the relevant activities, the way decisions about the relevant activities are

made and the rights the investor and other parties have in relation to the investee.

Relevant activities and direction of relevant activities

B11 For many investees, a range of operating and financing activities significantly affect their returns. Examples of activities that, depending on the circumstances, can be relevant activities include, but are not limited to:

- (a) selling and purchasing of goods or services;
- (b) managing financial assets during their life (including upon default);
- (c) selecting, acquiring or disposing of assets;
- (d) researching and developing new products or processes; and
- (e) determining a funding structure or obtaining funding.

B12 Examples of decisions about relevant activities include but are not limited to:

- (a) establishing operating and capital decisions of the investee, including budgets; and
- (b) appointing and remunerating an investee's key management personnel or service providers and terminating their services or employment.

B13 In some situations, activities both before and after a particular set of circumstances arises or event occurs may be relevant activities. When two or more investors have the current ability to direct relevant activities and those activities occur at different times, the investors shall determine which investor is able to direct the activities that most significantly affect those returns consistently with the treatment of concurrent decision-making rights (see paragraph 13). The investors shall reconsider this assessment over time if relevant facts or circumstances change.

Application examples
<p>Example 1</p> <p>Two investors form an investee to develop and market a medical product. One investor is responsible for developing and obtaining regulatory approval of the medical product—that responsibility includes having the unilateral ability to make all decisions relating to the development of the product and to obtaining regulatory approval. Once the regulator has approved the product, the other investor will manufacture and market it—this investor has the unilateral ability to make all decisions about the manufacture and marketing of the product. If all the activities—developing and obtaining regulatory approval as well as manufacturing and marketing of the medical product—are relevant activities, each investor needs to determine whether it is able to direct the activities that <i>most</i> significantly affect the investee’s returns. Accordingly, each investor needs to consider whether developing and obtaining regulatory approval or the manufacturing and marketing of the medical product is the activity that <i>most</i> significantly affects the investee’s returns and whether it is able to direct that activity. In determining which investor has power, the investors would consider:</p> <ul style="list-style-type: none"> (a) the purpose and design of the investee; (b) the factors that determine the profit margin, revenue and value of the investee as well as the value of the medical product; (c) the effect on the investee’s returns resulting from each investor’s decision-making authority with respect to the factors in (b); and (d) the investors’ exposure to variability of returns. <p>In this particular example, the investors would also consider:</p> <ul style="list-style-type: none"> (e) the uncertainty of, and effort required in, obtaining regulatory approval (considering the investor’s record of successfully developing and obtaining regulatory approval of medical products); and (f) which investor controls the medical product once the development phase is successful.

Example 2

An investment vehicle (the investee) is created and financed with a debt instrument held by an investor (the debt investor) and equity instruments held by a number of other investors. The equity tranche is designed to absorb the first losses and to receive any residual return from the investee. One of the equity investors who holds 30 per cent of the equity is also the asset manager. The investee uses its proceeds to purchase a portfolio of financial assets, exposing the investee to the credit risk associated with the possible default of principal and interest payments of the assets. The transaction is marketed to the debt investor as an investment with minimal exposure to the credit risk associated with the possible default of the assets in the portfolio because of the nature of these assets and because the equity tranche is designed to absorb the first losses of the investee. The returns of the investee are significantly affected by the management of the investee's asset portfolio, which includes decisions about the selection, acquisition and disposal of the assets within portfolio guidelines and the management upon default of any portfolio assets. All those activities are managed by the asset manager until defaults reach a specified proportion of the portfolio value (ie when the value of the portfolio is such that the equity tranche of the investee has been consumed). From that time, a third-party trustee manages the assets according to the instructions of the debt investor. Managing the investee's asset portfolio is the relevant activity of the investee. The asset manager has the ability to direct the relevant activities until defaulted assets reach the specified proportion of the portfolio value; the debt investor has the ability to direct the relevant activities when the value of defaulted assets surpasses that specified proportion of the portfolio value. The asset manager and the debt investor each need to determine whether they are able to direct the activities that *most* significantly affect the investee's returns, including considering the purpose and design of the investee as well as each party's exposure to variability of returns.

Rights that give an investor power over an investee

- B14 Power arises from rights. To have power over an investee, an investor must have existing rights that give the investor the current ability to direct the relevant activities. The rights that may give an investor power can differ between investees.
- B15 Examples of rights that, either individually or in combination, can give an investor power include but are not limited to:

- (a) rights in the form of voting rights (or potential voting rights) of an investee (see paragraphs B34–B50);
- (b) rights to appoint, reassign or remove members of an investee’s key management personnel who have the ability to direct the relevant activities;
- (c) rights to appoint or remove another entity that directs the relevant activities;
- (d) rights to direct the investee to enter into, or veto any changes to, transactions for the benefit of the investor; and
- (e) other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities.

B16 Generally, when an investee has a range of operating and financing activities that significantly affect the investee’s returns and when substantive decision-making with respect to these activities is required continuously, it will be voting or similar rights that give an investor power, either individually or in combination with other arrangements.

B17 When voting rights cannot have a significant effect on an investee’s returns, such as when voting rights relate to administrative tasks only and contractual arrangements determine the direction of the relevant activities, the investor needs to assess those contractual arrangements in order to determine whether it has rights sufficient to give it power over the investee. To determine whether an investor has rights sufficient to give it power, the investor shall consider the purpose and design of the investee (see paragraphs B5–B8) and the requirements in paragraphs B51–B54 together with paragraphs B18–B20.

B18 In some circumstances it may be difficult to determine whether an investor’s rights are sufficient to give it power over an investee. In such cases, to enable the assessment of power to be made, the investor shall consider evidence of whether it has the practical ability to direct the relevant activities unilaterally. Consideration is given, but is not limited, to the following, which, when considered together with its rights and the indicators in paragraphs B19 and B20, may provide evidence that the investor’s rights are sufficient to give it power over the investee:

- (a) The investor can, without having the contractual right to do so, appoint or approve the investee’s key management personnel who have the ability to direct the relevant activities.

- (b) The investor can, without having the contractual right to do so, direct the investee to enter into, or can veto any changes to, significant transactions for the benefit of the investor.
- (c) The investor can dominate either the nominations process for electing members of the investee's governing body or the obtaining of proxies from other holders of voting rights.
- (d) The investee's key management personnel are related parties of the investor (for example, the chief executive officer of the investee and the chief executive officer of the investor are the same person).
- (e) The majority of the members of the investee's governing body are related parties of the investor.

B19 Sometimes there will be indications that the investor has a special relationship with the investee, which suggests that the investor has more than a passive interest in the investee. The existence of any individual indicator, or a particular combination of indicators, does not necessarily mean that the power criterion is met. However, having more than a passive interest in the investee may indicate that the investor has other related rights sufficient to give it power or provide evidence of existing power over an investee. For example, the following suggests that the investor has more than a passive interest in the investee and, in combination with other rights, may indicate power:

- (a) The investee's key management personnel who have the ability to direct the relevant activities are current or previous employees of the investor.
- (b) The investee's operations are dependent on the investor, such as in the following situations:
 - (i) The investee depends on the investor to fund a significant portion of its operations.
 - (ii) The investor guarantees a significant portion of the investee's obligations.
 - (iii) The investee depends on the investor for critical services, technology, supplies or raw materials.
 - (iv) The investor controls assets such as licences or trademarks that are critical to the investee's operations.

- (v) The investee depends on the investor for key management personnel, such as when the investor's personnel have specialised knowledge of the investee's operations.
 - (c) A significant portion of the investee's activities either involve or are conducted on behalf of the investor.
 - (d) The investor's exposure, or rights, to returns from its involvement with the investee is disproportionately greater than its voting or other similar rights. For example, there may be a situation in which an investor is entitled, or exposed, to more than half of the returns of the investee but holds less than half of the voting rights of the investee.
- B20 The greater an investor's exposure, or rights, to variability of returns from its involvement with an investee, the greater is the incentive for the investor to obtain rights sufficient to give it power. Therefore, having a large exposure to variability of returns is an indicator that the investor may have power. However, the extent of the investor's exposure does not, in itself, determine whether an investor has power over the investee.
- B21 When the factors set out in paragraph B18 and the indicators set out in paragraphs B19 and B20 are considered together with an investor's rights, greater weight shall be given to the evidence of power described in paragraph B18.

Substantive rights

- B22 An investor, in assessing whether it has power, considers only substantive rights relating to an investee (held by the investor and others). For a right to be substantive, the holder must have the practical ability to exercise that right.
- B23 Determining whether rights are substantive requires judgement, taking into account all facts and circumstances. Factors to consider in making that determination include but are not limited to:
- (a) Whether there are any barriers (economic or otherwise) that prevent the holder (or holders) from exercising the rights. Examples of such barriers include but are not limited to:
 - (i) financial penalties and incentives that would prevent (or deter) the holder from exercising its rights.

- (ii) an exercise or conversion price that creates a financial barrier that would prevent (or deter) the holder from exercising its rights.
 - (iii) terms and conditions that make it unlikely that the rights would be exercised, for example, conditions that narrowly limit the timing of their exercise.
 - (iv) the absence of an explicit, reasonable mechanism in the founding documents of an investee or in applicable laws or regulations that would allow the holder to exercise its rights.
 - (v) the inability of the holder of the rights to obtain the information necessary to exercise its rights.
 - (vi) operational barriers or incentives that would prevent (or deter) the holder from exercising its rights (eg the absence of other managers willing or able to provide specialised services or provide the services and take on other interests held by the incumbent manager).
 - (vii) legal or regulatory requirements that prevent the holder from exercising its rights (eg where a foreign investor is prohibited from exercising its rights).
- (b) When the exercise of rights requires the agreement of more than one party, or when the rights are held by more than one party, whether a mechanism is in place that provides those parties with the practical ability to exercise their rights collectively if they choose to do so. The lack of such a mechanism is an indicator that the rights may not be substantive. The more parties that are required to agree to exercise the rights, the less likely it is that those rights are substantive. However, a board of directors whose members are independent of the decision maker may serve as a mechanism for numerous investors to act collectively in exercising their rights. Therefore, removal rights exercisable by an independent board of directors are more likely to be substantive than if the same rights were exercisable individually by a large number of investors.
- (c) Whether the party or parties that hold the rights would benefit from the exercise of those rights. For example, the holder of potential voting rights in an investee (see paragraphs B47–B50) shall consider the exercise or conversion price of the instrument. The terms and conditions of potential voting rights are more likely to be substantive when the instrument is in the money or

the investor would benefit for other reasons (eg by realising synergies between the investor and the investee) from the exercise or conversion of the instrument.

- B24 To be substantive, rights also need to be exercisable when decisions about the direction of the relevant activities need to be made. Usually, to be substantive, the rights need to be currently exercisable. However, sometimes rights can be substantive, even though the rights are not currently exercisable.

Application examples
<p>Example 3</p> <p>The investee has annual shareholder meetings at which decisions to direct the relevant activities are made. The next scheduled shareholders' meeting is in eight months. However, shareholders that individually or collectively hold at least 5 per cent of the voting rights can call a special meeting to change the existing policies over the relevant activities, but a requirement to give notice to the other shareholders means that such a meeting cannot be held for at least 30 days. Policies over the relevant activities can be changed only at special or scheduled shareholders' meetings. This includes the approval of material sales of assets as well as the making or disposing of significant investments.</p> <p>The above fact pattern applies to examples 3A–3D described below. Each example is considered in isolation.</p> <p>Example 3A</p> <p>An investor holds a majority of the voting rights in the investee. The investor's voting rights are substantive because the investor is able to make decisions about the direction of the relevant activities when they need to be made. The fact that it takes 30 days before the investor can exercise its voting rights does not stop the investor from having the current ability to direct the relevant activities from the moment the investor acquires the shareholding.</p> <p>Example 3B</p> <p>An investor is party to a forward contract to acquire the majority of shares in the investee. The forward contract's settlement date is in 25 days. The existing shareholders are unable to change the existing policies over the relevant activities because a special meeting cannot be held for at least 30 days, at which point the forward contract will have been settled. Thus, the investor has</p>

rights that are essentially equivalent to the majority shareholder in example 3A above (ie the investor holding the forward contract can make decisions about the direction of the relevant activities when they need to be made). The investor's forward contract is a substantive right that gives the investor the current ability to direct the relevant activities even before the forward contract is settled.

Example 3C

An investor holds a substantive option to acquire the majority of shares in the investee that is exercisable in 25 days and is deeply in the money. The same conclusion would be reached as in example 3B.

Example 3D

An investor is party to a forward contract to acquire the majority of shares in the investee, with no other related rights over the investee. The forward contract's settlement date is in six months. In contrast to the examples above, the investor does not have the current ability to direct the relevant activities. The existing shareholders have the current ability to direct the relevant activities because they can change the existing policies over the relevant activities before the forward contract is settled.

- B25 Substantive rights exercisable by other parties can prevent an investor from controlling the investee to which those rights relate. Such substantive rights do not require the holders to have the ability to initiate decisions. As long as the rights are not merely protective (see paragraphs B26–B28), substantive rights held by other parties may prevent the investor from controlling the investee even if the rights give the holders only the current ability to approve or block decisions that relate to the relevant activities.

Protective rights

- B26 In evaluating whether rights give an investor power over an investee, the investor shall assess whether its rights, and rights held by others, are protective rights. Protective rights relate to fundamental changes to the activities of an investee or apply in exceptional circumstances. However, not all rights that apply in exceptional circumstances or are contingent on events are protective (see paragraphs B13 and B53).
- B27 Because protective rights are designed to protect the interests of their holder without giving that party power over the investee to which those rights relate, an investor that holds only protective rights cannot have

power or prevent another party from having power over an investee (see paragraph 14).

B28 Examples of protective rights include but are not limited to:

- (a) a lender's right to restrict a borrower from undertaking activities that could significantly change the credit risk of the borrower to the detriment of the lender.
- (b) the right of a party holding a non-controlling interest in an investee to approve capital expenditure greater than that required in the ordinary course of business, or to approve the issue of equity or debt instruments.
- (c) the right of a lender to seize the assets of a borrower if the borrower fails to meet specified loan repayment conditions.

Franchises

- B29 A franchise agreement for which the investee is the franchisee often gives the franchisor rights that are designed to protect the franchise brand. Franchise agreements typically give franchisors some decision-making rights with respect to the operations of the franchisee.
- B30 Generally, franchisors' rights do not restrict the ability of parties other than the franchisor to make decisions that have a significant effect on the franchisee's returns. Nor do the rights of the franchisor in franchise agreements necessarily give the franchisor the current ability to direct the activities that significantly affect the franchisee's returns.
- B31 It is necessary to distinguish between having the current ability to make decisions that significantly affect the franchisee's returns and having the ability to make decisions that protect the franchise brand. The franchisor does not have power over the franchisee if other parties have existing rights that give them the current ability to direct the relevant activities of the franchisee.
- B32 By entering into the franchise agreement the franchisee has made a unilateral decision to operate its business in accordance with the terms of the franchise agreement, but for its own account.
- B33 Control over such fundamental decisions as the legal form of the franchisee and its funding structure may be determined by parties other than the franchisor and may significantly affect the returns of the franchisee. The lower the level of financial support provided by the franchisor and the lower the franchisor's exposure to variability of

returns from the franchisee the more likely it is that the franchisor has only protective rights.

Voting rights

- B34 Often an investor has the current ability, through voting or similar rights, to direct the relevant activities. An investor considers the requirements in this section (paragraphs B35–B50) if the relevant activities of an investee are directed through voting rights.

Power with a majority of the voting rights

- B35 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.

Majority of the voting rights but no power

- B36 For an investor that holds more than half of the voting rights of an investee, to have power over an investee, the investor's voting rights must be substantive, in accordance with paragraphs B22–B25, and must provide the investor with the current ability to direct the relevant activities, which often will be through determining operating and financing policies. If another entity has existing rights that provide that entity with the right to direct the relevant activities and that entity is not an agent of the investor, the investor does not have power over the investee.
- B37 An investor does not have power over an investee, even though the investor holds the majority of the voting rights in the investee, when those voting rights are not substantive. For example, an investor that has more than half of the voting rights in an investee cannot have power if the relevant activities are subject to direction by a government, court, administrator, receiver, liquidator or regulator.

Power without a majority of the voting rights

- B38 An investor can have power even if it holds less than a majority of the voting rights of an investee. An investor can have power with less than a majority of the voting rights of an investee, for example, through:

- (a) a contractual arrangement between the investor and other vote holders (see paragraph B39);
- (b) rights arising from other contractual arrangements (see paragraph B40);
- (c) the investor's voting rights (see paragraphs B41–B45);
- (d) potential voting rights (see paragraphs B47–B50); or
- (e) a combination of (a)–(d).

Contractual arrangement with other vote holders

B39 A contractual arrangement between an investor and other vote holders can give the investor the right to exercise voting rights sufficient to give the investor power, even if the investor does not have voting rights sufficient to give it power without the contractual arrangement. However, a contractual arrangement might ensure that the investor can direct enough other vote holders on how to vote to enable the investor to make decisions about the relevant activities.

Rights from other contractual arrangements

B40 Other decision-making rights, in combination with voting rights, can give an investor the current ability to direct the relevant activities. For example, the rights specified in a contractual arrangement in combination with voting rights may be sufficient to give an investor the current ability to direct the manufacturing processes of an investee or to direct other operating or financing activities of an investee that significantly affect the investee's returns. However, in the absence of any other rights, economic dependence of an investee on the investor (such as relations of a supplier with its main customer) does not lead to the investor having power over the investee.

The investor's voting rights

- B41 An investor with less than a majority of the voting rights has rights that are sufficient to give it power when the investor has the practical ability to direct the relevant activities unilaterally.
- B42 When assessing whether an investor's voting rights are sufficient to give it power, an investor considers all facts and circumstances, including:

- (a) the size of the investor's holding of voting rights relative to the size and dispersion of holdings of the other vote holders, noting that:
 - (i) the more voting rights an investor holds, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;
 - (ii) the more voting rights an investor holds relative to other vote holders, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;
 - (iii) the more parties that would need to act together to outvote the investor, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;
- (b) potential voting rights held by the investor, other vote holders or other parties (see paragraphs B47–B50);
- (c) rights arising from other contractual arrangements (see paragraph B40); and
- (d) any additional facts and circumstances that indicate the investor has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

B43 When the direction of relevant activities is determined by majority vote and an investor holds significantly more voting rights than any other vote holder or organised group of vote holders, and the other shareholdings are widely dispersed, it may be clear, after considering the factors listed in paragraph B42(a)–(c) alone, that the investor has power over the investee.

Application examples
<p>Example 4</p> <p>An investor acquires 48 per cent of the voting rights of an investee. The remaining voting rights are held by thousands of shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has any arrangements to consult any of the others or make collective decisions. When assessing the proportion of voting rights to acquire, on the basis of the relative</p>

size of the other shareholdings, the investor determined that a 48 per cent interest would be sufficient to give it control. In this case, on the basis of the absolute size of its holding and the relative size of the other shareholdings, the investor concludes that it has a sufficiently dominant voting interest to meet the power criterion without the need to consider any other evidence of power.

Example 5

Investor A holds 40 per cent of the voting rights of an investee and twelve other investors each hold 5 per cent of the voting rights of the investee. A shareholder agreement grants investor A the right to appoint, remove and set the remuneration of management responsible for directing the relevant activities. To change the agreement, a two-thirds majority vote of the shareholders is required. In this case, investor A concludes that the absolute size of the investor's holding and the relative size of the other shareholdings alone are not conclusive in determining whether the investor has rights sufficient to give it power. However, investor A determines that its contractual right to appoint, remove and set the remuneration of management is sufficient to conclude that it has power over the investee. The fact that investor A might not have exercised this right or the likelihood of investor A exercising its right to select, appoint or remove management shall not be considered when assessing whether investor A has power.

- B44 In other situations, it may be clear after considering the factors listed in paragraph B42(a)–(c) alone that an investor does not have power.

Application example

Example 6

Investor A holds 45 per cent of the voting rights of an investee. Two other investors each hold 26 per cent of the voting rights of the investee. The remaining voting rights are held by three other shareholders, each holding 1 per cent. There are no other arrangements that affect decision-making. In this case, the size of investor A's voting interest and its size relative to the other shareholdings are sufficient to conclude that investor A does not have power. Only two other investors would need to co-operate to be able to prevent investor A from directing the relevant activities of the investee.

- B45 However, the factors listed in paragraph B42(a)–(c) alone may not be conclusive. If an investor, having considered those factors, is unclear whether it has power, it shall consider additional facts and circumstances, such as whether other shareholders are passive in nature as demonstrated by voting patterns at previous shareholders’ meetings. This includes the assessment of the factors set out in paragraph B18 and the indicators in paragraphs B19 and B20. The fewer voting rights the investor holds, and the fewer parties that would need to act together to outvote the investor, the more reliance would be placed on the additional facts and circumstances to assess whether the investor’s rights are sufficient to give it power. When the facts and circumstances in paragraphs B18–B20 are considered together with the investor’s rights, greater weight shall be given to the evidence of power in paragraph B18 than to the indicators of power in paragraphs B19 and B20.

Application examples

Example 7

An investor holds 45 per cent of the voting rights of an investee. Eleven other shareholders each hold 5 per cent of the voting rights of the investee. None of the shareholders has contractual arrangements to consult any of the others or make collective decisions. In this case, the absolute size of the investor’s holding and the relative size of the other shareholdings alone are not conclusive in determining whether the investor has rights sufficient to give it power over the investee. Additional facts and circumstances that may provide evidence that the investor has, or does not have, power shall be considered.

Example 8

An investor holds 35 per cent of the voting rights of an investee. Three other shareholders each hold 5 per cent of the voting rights of the investee. The remaining voting rights are held by numerous other shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has arrangements to consult any of the others or make collective decisions. Decisions about the relevant activities of the investee require the approval of a majority of votes cast at relevant shareholders’ meetings—75 per cent of the voting rights of the investee have been cast at recent relevant shareholders’ meetings. In this case, the active participation of the other shareholders at recent shareholders’ meetings indicates that the investor would not have the practical

<p>ability to direct the relevant activities unilaterally, regardless of whether the investor has directed the relevant activities because a sufficient number of other shareholders voted in the same way as the investor.</p>

- B46 If it is not clear, having considered the factors listed in paragraph B42(a)–(d), that the investor has power, the investor does not control the investee.

Potential voting rights

- B47 When assessing control, an investor considers its potential voting rights as well as potential voting rights held by other parties, to determine whether it has power. Potential voting rights are rights to obtain voting rights of an investee, such as those arising from convertible instruments or options, including forward contracts. Those potential voting rights are considered only if the rights are substantive (see paragraphs B22–B25).
- B48 When considering potential voting rights, an investor shall consider the purpose and design of the instrument, as well as the purpose and design of any other involvement the investor has with the investee. This includes an assessment of the various terms and conditions of the instrument as well as the investor’s apparent expectations, motives and reasons for agreeing to those terms and conditions.
- B49 If the investor also has voting or other decision-making rights relating to the investee’s activities, the investor assesses whether those rights, in combination with potential voting rights, give the investor power.
- B50 Substantive potential voting rights alone, or in combination with other rights, can give an investor the current ability to direct the relevant activities. For example, this is likely to be the case when an investor holds 40 per cent of the voting rights of an investee and, in accordance with paragraph B23, holds substantive rights arising from options to acquire a further 20 per cent of the voting rights.

Application examples

Example 9

<p>Investor A holds 70 per cent of the voting rights of an investee. Investor B has 30 per cent of the voting rights of the investee as well as an option to acquire half of investor A’s voting rights. The option is exercisable for the next two years at a fixed price that is</p>
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deeply out of the money (and is expected to remain so for that two-year period). Investor A has been exercising its votes and is actively directing the relevant activities of the investee. In such a case, investor A is likely to meet the power criterion because it appears to have the current ability to direct the relevant activities. Although investor B has currently exercisable options to purchase additional voting rights (that, if exercised, would give it a majority of the voting rights in the investee), the terms and conditions associated with those options are such that the options are not considered substantive.

Example 10

Investor A and two other investors each hold a third of the voting rights of an investee. The investee's business activity is closely related to investor A. In addition to its equity instruments, investor A also holds debt instruments that are convertible into ordinary shares of the investee at any time for a fixed price that is out of the money (but not deeply out of the money). If the debt were converted, investor A would hold 60 per cent of the voting rights of the investee. Investor A would benefit from realising synergies if the debt instruments were converted into ordinary shares. Investor A has power over the investee because it holds voting rights of the investee together with substantive potential voting rights that give it the current ability to direct the relevant activities.

Power when voting or similar rights do not have a significant effect on the investee's returns

- B51 In assessing the purpose and design of an investee (see paragraphs B5–B8), an investor shall consider the involvement and decisions made at the investee's inception as part of its design and evaluate whether the transaction terms and features of the involvement provide the investor with rights that are sufficient to give it power. Being involved in the design of an investee alone is not sufficient to give an investor control. However, involvement in the design may indicate that the investor had the opportunity to obtain rights that are sufficient to give it power over the investee.
- B52 In addition, an investor shall consider contractual arrangements such as call rights, put rights and liquidation rights established at the investee's inception. When these contractual arrangements involve activities that are closely related to the investee, then these activities are, in substance, an integral part of the investee's overall activities, even though they may occur outside the legal boundaries of the investee. Therefore, explicit or implicit decision-making rights embedded in

contractual arrangements that are closely related to the investee need to be considered as relevant activities when determining power over the investee.

- B53** For some investees, relevant activities occur only when particular circumstances arise or events occur. The investee may be designed so that the direction of its activities and its returns are predetermined unless and until those particular circumstances arise or events occur. In this case, only the decisions about the investee's activities when those circumstances or events occur can significantly affect its returns and thus be relevant activities. The circumstances or events need not have occurred for an investor with the ability to make those decisions to have power. The fact that the right to make decisions is contingent on circumstances arising or an event occurring does not, in itself, make those rights protective.

Application examples
<p>Example 11</p> <p>An investee's only business activity, as specified in its founding documents, is to purchase receivables and service them on a day-to-day basis for its investors. The servicing on a day-to-day basis includes the collection and passing on of principal and interest payments as they fall due. Upon default of a receivable the investee automatically puts the receivable to an investor as agreed separately in a put agreement between the investor and the investee. The only relevant activity is managing the receivables upon default because it is the only activity that can significantly affect the investee's returns. Managing the receivables before default is not a relevant activity because it does not require substantive decisions to be made that could significantly affect the investee's returns – the activities before default are predetermined and amount only to collecting cash flows as they fall due and passing them on to investors. Therefore, only the investor's right to manage the assets upon default should be considered when assessing the overall activities of the investee that significantly affect the investee's returns. In this example, the design of the investee ensures that the investor has decision-making authority over the activities that significantly affect the returns at the only time that such decision-making authority is required. The terms of the put agreement are integral to the overall transaction and the establishment of the investee. Therefore, the terms of the put agreement together with the founding documents of the investee lead to the conclusion that the investor has power over the investee even though the investor takes ownership of the receivables only upon default and manages</p>

the defaulted receivables outside the legal boundaries of the investee.

Example 12

The only assets of an investee are receivables. When the purpose and design of the investee are considered, it is determined that the only relevant activity is managing the receivables upon default. The party that has the ability to manage the defaulting receivables has power over the investee, irrespective of whether any of the borrowers have defaulted.

- B54 An investor may have an explicit or implicit commitment to ensure that an investee continues to operate as designed. Such a commitment may increase the investor's exposure to variability of returns and thus increase the incentive for the investor to obtain rights sufficient to give it power. Therefore a commitment to ensure that an investee operates as designed may be an indicator that the investor has power, but does not, by itself, give an investor power, nor does it prevent another party from having power.

Exposure, or rights, to variable returns from an investee

- B55 When assessing whether an investor has control of an investee, the investor determines whether it is exposed, or has rights, to variable returns from its involvement with the investee.
- B56 Variable returns are returns that are not fixed and have the potential to vary as a result of the performance of an investee. Variable returns can be only positive, only negative or both positive and negative (see paragraph 15). An investor assesses whether returns from an investee are variable and how variable those returns are on the basis of the substance of the arrangement and regardless of the legal form of the returns. For example, an investor can hold a bond with fixed interest payments. The fixed interest payments are variable returns for the purpose of this Standard because they are subject to default risk and they expose the investor to the credit risk of the issuer of the bond. The amount of variability (ie how variable those returns are) depends on the credit risk of the bond. Similarly, fixed performance fees for managing an investee's assets are variable returns because they expose the investor to the performance risk of the investee. The amount of variability depends on the investee's ability to generate sufficient income to pay the fee.

B57 Examples of returns include:

- (a) dividends, other distributions of economic benefits from an investee (eg interest from debt securities issued by the investee) and changes in the value of the investor's investment in that investee.
- (b) remuneration for servicing an investee's assets or liabilities, fees and exposure to loss from providing credit or liquidity support, residual interests in the investee's assets and liabilities on liquidation of that investee, tax benefits, and access to future liquidity that an investor has from its involvement with an investee.
- (c) 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.

Link between power and returns

Delegated power

B58 When an investor with decision-making rights (a decision maker) assesses whether it controls an investee, it shall determine whether it is a principal or an agent. An investor shall also determine whether another entity with decision-making rights is acting as an agent for the investor. An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)) and therefore does not control the investee when it exercises its decision-making authority (see paragraphs 17 and 18). Thus, sometimes a principal's power may be held and exercisable by an agent, but on behalf of the principal. A decision maker is not an agent simply because other parties can benefit from the decisions that it makes.

B59 An investor may delegate its decision-making authority to an agent on some specific issues or on all relevant activities. When assessing whether it controls an investee, the investor shall treat the decision-making rights delegated to its agent as held by the investor directly. In situations where there is more than one principal, each of the principals shall assess whether it has power over the investee by considering the requirements in paragraphs B5–B54. Paragraphs B60–B72 provide guidance on determining whether a decision maker is an agent or a principal.

B60 A decision maker shall consider the overall relationship between itself, the investee being managed and other parties involved with the investee, in particular all the factors below, in determining whether it is an agent:

- (a) the scope of its decision-making authority over the investee (paragraphs B62 and B63).
- (b) the rights held by other parties (paragraphs B64–B67).
- (c) the remuneration to which it is entitled in accordance with the remuneration agreement(s) (paragraphs B68–B70).
- (d) the decision maker’s exposure to variability of returns from other interests that it holds in the investee (paragraphs B71 and B72).

Different weightings shall be applied to each of the factors on the basis of particular facts and circumstances.

B61 Determining whether a decision maker is an agent requires an evaluation of all the factors listed in paragraph B60 unless a single party holds substantive rights to remove the decision maker (removal rights) and can remove the decision maker without cause (see paragraph B65).

The scope of the decision-making authority

B62 The scope of a decision maker’s decision-making authority is evaluated by considering:

- (a) the activities that are permitted according to the decision-making agreement(s) and specified by law, and
- (b) the discretion that the decision maker has when making decisions about those activities.

B63 A decision maker shall consider the purpose and design of the investee, the risks to which the investee was designed to be exposed, the risks it was designed to pass on to the parties involved and the level of involvement the decision maker had in the design of an investee. For example, if a decision maker is significantly involved in the design of the investee (including in determining the scope of decision-making authority), that involvement may indicate that the decision maker had the opportunity and incentive to obtain rights that result in the decision maker having the ability to direct the relevant activities.

Rights held by other parties

- B64 Substantive rights held by other parties may affect the decision maker's ability to direct the relevant activities of an investee. Substantive removal or other rights may indicate that the decision maker is an agent.
- B65 When a single party holds substantive removal rights and can remove the decision maker without cause, this, in isolation, is sufficient to conclude that the decision maker is an agent. If more than one party holds such rights (and no individual party can remove the decision maker without the agreement of other parties) those rights are not, in isolation, conclusive in determining that a decision maker acts primarily on behalf and for the benefit of others. In addition, the greater the number of parties required to act together to exercise rights to remove a decision maker and the greater the magnitude of, and variability associated with, the decision maker's other economic interests (ie remuneration and other interests), the less the weighting that shall be placed on this factor.
- B66 Substantive rights held by other parties that restrict a decision maker's discretion shall be considered in a similar manner to removal rights when evaluating whether the decision maker is an agent. For example, a decision maker that is required to obtain approval from a small number of other parties for its actions is generally an agent. (See paragraphs B22–B25 for additional guidance on rights and whether they are substantive.)
- B67 Consideration of the rights held by other parties shall include an assessment of any rights exercisable by an investee's board of directors (or other governing body) and their effect on the decision-making authority (see paragraph B23(b)).

Remuneration

- B68 The greater the magnitude of, and variability associated with, the decision maker's remuneration relative to the returns expected from the activities of the investee, the more likely the decision maker is a principal.
- B69 In determining whether it is a principal or an agent the decision maker shall also consider whether the following conditions exist:
- (a) The remuneration of the decision maker is commensurate with the services provided.

- (b) The remuneration agreement includes only terms, conditions or amounts that are customarily present in arrangements for similar services and level of skills negotiated on an arm's length basis.

B70 A decision maker cannot be an agent unless the conditions set out in paragraph B69(a) and (b) are present. However, meeting those conditions in isolation is not sufficient to conclude that a decision maker is an agent.

Exposure to variability of returns from other interests

B71 A decision maker that holds other interests in an investee (eg investments in the investee or provides guarantees with respect to the performance of the investee), shall consider its exposure to variability of returns from those interests in assessing whether it is an agent. Holding other interests in an investee indicates that the decision maker may be a principal.

B72 In evaluating its exposure to variability of returns from other interests in the investee a decision maker shall consider the following:

- (a) the greater the magnitude of, and variability associated with, its economic interests, considering its remuneration and other interests in aggregate, the more likely the decision maker is a principal.
- (b) whether its exposure to variability of returns is different from that of the other investors and, if so, whether this might influence its actions. For example, this might be the case when a decision maker holds subordinated interests in, or provides other forms of credit enhancement to, an investee.

The decision maker shall evaluate its exposure relative to the total variability of returns of the investee. This evaluation is made primarily on the basis of returns expected from the activities of the investee but shall not ignore the decision maker's maximum exposure to variability of returns of the investee through other interests that the decision maker holds.

Application examples

Example 13

A decision maker (fund manager) establishes, markets and manages a publicly traded, regulated fund according to narrowly defined parameters set out in the investment mandate as required by its local
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laws and regulations. The fund was marketed to investors as an investment in a diversified portfolio of equity securities of publicly traded entities. Within the defined parameters, the fund manager has discretion about the assets in which to invest. The fund manager has made a 10 per cent pro rata investment in the fund and receives a market-based fee for its services equal to 1 per cent of the net asset value of the fund. The fees are commensurate with the services provided. The fund manager does not have any obligation to fund losses beyond its 10 per cent investment. The fund is not required to establish, and has not established, an independent board of directors. The investors do not hold any substantive rights that would affect the decision-making authority of the fund manager, but can redeem their interests within particular limits set by the fund. Although operating within the parameters set out in the investment mandate and in accordance with the regulatory requirements, the fund manager has decision-making rights that give it the current ability to direct the relevant activities of the fund—the investors do not hold substantive rights that could affect the fund manager’s decision-making authority.

The fund manager receives a market-based fee for its services that is commensurate with the services provided and has also made a pro rata investment in the fund. The remuneration and its investment expose the fund manager to variability of returns from the activities of the fund without creating exposure that is of such significance that it indicates that the fund manager is a principal.

In this example, consideration of the fund manager’s exposure to variability of returns from the fund together with its decision-making authority within restricted parameters indicates that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Example 14

A decision maker establishes, markets and manages a fund that provides investment opportunities to a number of investors. The decision maker (fund manager) must make decisions in the best interests of all investors and in accordance with the fund’s governing agreements. Nonetheless, the fund manager has wide decision-making discretion. The fund manager receives a market-based fee for its services equal to 1 per cent of assets under management and 20 per cent of all the fund’s profits if a specified profit level is achieved. The fees are commensurate with the services provided.

Although it must make decisions in the best interests of all investors, the fund manager has extensive decision-making authority to direct the relevant activities of the fund. The fund manager is paid fixed and performance-related fees that are commensurate with the services provided. In addition, the remuneration aligns the interests of the fund manager with those of the other investors to increase the value of the fund, without creating exposure to variability of returns from the activities of the fund that is of such significance that the remuneration, when considered in isolation, indicates that the fund manager is a principal.

The above fact pattern and analysis applies to examples 14A–14C described below. Each example is considered in isolation.

Example 14A

The fund manager also has a 2 per cent investment in the fund that aligns its interests with those of the other investors. The fund manager does not have any obligation to fund losses beyond its 2 per cent investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract.

The fund manager's 2 per cent investment increases its exposure to variability of returns from the activities of the fund without creating exposure that is of such significance that it indicates that the fund manager is a principal. The other investors' rights to remove the fund manager are considered to be protective rights because they are exercisable only for breach of contract. In this example, although the fund manager has extensive decision-making authority and is exposed to variability of returns from its interest and remuneration, the fund manager's exposure indicates that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Example 14B

The fund manager has a more substantial pro rata investment in the fund, but does not have any obligation to fund losses beyond that investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract.

In this example, the other investors' rights to remove the fund manager are considered to be protective rights because they are exercisable only for breach of contract. Although the fund manager is paid fixed and performance-related fees that are commensurate with the services provided, the combination of the fund manager's investment together with its remuneration could create exposure to variability of returns from the activities of the fund that is of such significance that it indicates that the fund manager is a principal. The greater the magnitude of, and variability associated with, the fund manager's economic interests (considering its remuneration and other interests in aggregate), the more emphasis the fund manager would place on those economic interests in the analysis, and the more likely the fund manager is a principal.

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 fund. However, in different circumstances (ie if the remuneration or other factors are different), control may arise when the level of investment is different.

Example 14C

The fund manager has a 20 per cent pro rata investment in the fund, but does not have any obligation to fund losses beyond its 20 per cent investment. The fund has a board of directors, all of whose members are independent of the fund manager and are appointed by the other investors. The board appoints the fund manager annually. If the board decided not to renew the fund manager's contract, the services performed by the fund manager could be performed by other managers in the industry.

Although the fund manager is paid fixed and performance-related fees that are commensurate with the services provided, the combination of the fund manager's 20 per cent investment together with its remuneration creates exposure to variability of returns from the activities of the fund that is of such significance that it indicates that the fund manager is a principal. However, the investors have substantive rights to remove the fund manager—the board of directors provides a mechanism to ensure that the investors can remove the fund manager if they decide to do so.

In this example, the fund manager places greater emphasis on the substantive removal rights in the analysis. Thus, although the fund manager has extensive decision-making authority and is exposed to variability of returns of the fund from its remuneration and

investment, the substantive rights held by the other investors indicate that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Example 15

An investee is created to purchase a portfolio of fixed rate asset-backed securities, funded by fixed rate debt instruments and equity instruments. The equity instruments are designed to provide first loss protection to the debt investors and receive any residual returns of the investee. The transaction was marketed to potential debt investors as an investment in a portfolio of asset-backed securities with exposure to the credit risk associated with the possible default of the issuers of the asset-backed securities in the portfolio and to the interest rate risk associated with the management of the portfolio. On formation, the equity instruments represent 10 per cent of the value of the assets purchased. A decision maker (the asset manager) manages the active asset portfolio by making investment decisions within the parameters set out in the investee's prospectus. For those services, the asset manager receives a market-based fixed fee (ie 1 per cent of assets under management) and performance-related fees (ie 10 per cent of profits) if the investee's profits exceed a specified level. The fees are commensurate with the services provided. The asset manager holds 35 per cent of the equity in the investee.

The remaining 65 per cent of the equity, and all the debt instruments, are held by a large number of widely dispersed unrelated third party investors. The asset manager can be removed, without cause, by a simple majority decision of the other investors.

The asset manager is paid fixed and performance-related fees that are commensurate with the services provided. The remuneration aligns the interests of the fund manager with those of the other investors to increase the value of the fund. The asset manager has exposure to variability of returns from the activities of the fund because it holds 35 per cent of the equity and from its remuneration. Although operating within the parameters set out in the investee's prospectus, the asset manager has the current ability to make investment decisions that significantly affect the investee's returns—the removal rights held by the other investors receive little weighting in the analysis because those rights are held by a large number of widely dispersed investors. In this example, the asset manager places greater emphasis on its exposure to variability of returns of the fund from its equity interest, which is subordinate to the debt instruments. Holding 35 per cent of the equity creates subordinated exposure to losses and rights to returns of the investee,

which are of such significance that it indicates that the asset manager is a principal. Thus, the asset manager concludes that it controls the investee.

Example 16

A decision maker (the sponsor) sponsors a multi-seller conduit, which issues short-term debt instruments to unrelated third party investors. The transaction was marketed to potential investors as an investment in a portfolio of highly rated medium-term assets with minimal exposure to the credit risk associated with the possible default by the issuers of the assets in the portfolio. Various transferors sell high quality medium-term asset portfolios to the conduit. Each transferor services the portfolio of assets that it sells to the conduit and manages receivables on default for a market-based servicing fee. Each transferor also provides first loss protection against credit losses from its asset portfolio through over-collateralisation of the assets transferred to the conduit. The sponsor establishes the terms of the conduit and manages the operations of the conduit for a market-based fee. The fee is commensurate with the services provided. The sponsor approves the sellers permitted to sell to the conduit, approves the assets to be purchased by the conduit and makes decisions about the funding of the conduit. The sponsor must act in the best interests of all investors.

The sponsor is entitled to any residual return of the conduit and also provides credit enhancement and liquidity facilities to the conduit. The credit enhancement provided by the sponsor absorbs losses of up to 5 per cent of all of the conduit's assets, after losses are absorbed by the transferors. The liquidity facilities are not advanced against defaulted assets. The investors do not hold substantive rights that could affect the decision-making authority of the sponsor.

Even though the sponsor is paid a market-based fee for its services that is commensurate with the services provided, the sponsor has exposure to variability of returns from the activities of the conduit because of its rights to any residual returns of the conduit and the provision of credit enhancement and liquidity facilities (ie the conduit is exposed to liquidity risk by using short-term debt instruments to fund medium-term assets).

Even though each of the transferors has decision-making rights that affect the value of the assets of the conduit, the sponsor has extensive decision-making authority that gives it the current ability to direct the activities that *most* significantly affect the conduit's returns (ie the sponsor established the terms of the conduit, has the right to make decisions about the assets (approving the assets purchased and the transferors of those assets) and the funding of the conduit (for which new investment must be found on a regular basis)). The right to residual returns of the conduit and the provision of credit enhancement and liquidity facilities expose the sponsor to variability of returns from the activities of the conduit that is different from that of the other investors. Accordingly, that exposure indicates that the sponsor is a principal and thus the sponsor concludes that it controls the conduit. The sponsor's obligation to act in the best interest of all investors does not prevent the sponsor from being a principal.

Relationship with other parties

- B73 When assessing control, an investor shall consider the nature of its relationship with other parties and whether those other parties are acting on the investor's behalf (ie they are 'de facto agents'). The determination of whether other parties are acting as de facto agents requires judgement, considering not only the nature of the relationship but also how those parties interact with each other and the investor.
- B74 Such a relationship need not involve a contractual arrangement. A party is a de facto agent when the investor has, or those that direct the activities of the investor have, the ability to direct that party to act on the investor's behalf. In these circumstances, the investor shall consider its de facto agent's decision-making rights and its indirect exposure, or rights, to variable returns through the de facto agent together with its own when assessing control of an investee.
- B75 The following are examples of such other parties that, by the nature of their relationship, might act as de facto agents for the investor:
- (a) the investor's related parties.
 - (b) a party that received its interest in the investee as a contribution or loan from the investor.
 - (c) a party that has agreed not to sell, transfer or encumber its interests in the investee without the investor's prior approval (except for situations in which the investor and the other party

have the right of prior approval and the rights are based on mutually agreed terms by willing independent parties).

- (d) a party that cannot finance its operations without subordinated financial support from the investor.
- (e) an investee for which the majority of the members of its governing body or for which its key management personnel are the same as those of the investor.
- (f) a party that has a close business relationship with the investor, such as the relationship between a professional service provider and one of its significant clients.

Control of specified assets

B76 An investor shall consider whether it treats a portion of an investee as a deemed separate entity and, if so, whether it controls the deemed separate entity.

B77 An investor shall treat a portion of an investee as a deemed separate entity if and only if the following condition is satisfied:

Specified assets of the investee (and related credit enhancements, if any) are the only source of payment for specified liabilities of, or specified other interests in, the investee. Parties other than those with the specified liability do not have rights or obligations related to the specified assets or to residual cash flows from those assets. In substance, none of the returns from the specified assets can be used by the remaining investee and none of the liabilities of the deemed separate entity are payable from the assets of the remaining investee. Thus, in substance, all the assets, liabilities and equity of that deemed separate entity are ring-fenced from the overall investee. Such a deemed separate entity is often called a 'silo'.

B78 When the condition in paragraph B77 is satisfied, an investor shall identify the activities that significantly affect the returns of the deemed separate entity and how those activities are directed in order to assess whether it has power over that portion of the investee. When assessing control of the deemed separate entity, the investor shall also consider whether it has exposure or rights to variable returns from its involvement with that deemed separate entity and the ability to use its power over that portion of the investee to affect the amount of the investor's returns.

- B79 If the investor controls the deemed separate entity, the investor shall consolidate that portion of the investee. In that case, other parties exclude that portion of the investee when assessing control of, and in consolidating, the investee.

Continuous assessment

- B80 An investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 7.
- B81 If there is a change in how power over an investee can be exercised, that change must be reflected in how an investor assesses its power over an investee. For example, changes to decision-making rights can mean that the relevant activities are no longer directed through voting rights, but instead other agreements, such as contracts, give another party or parties the current ability to direct the relevant activities.
- B82 An event can cause an investor to gain or lose power over an investee without the investor being involved in that event. For example, an investor can gain power over an investee because decision-making rights held by another party or parties that previously prevented the investor from controlling an investee have lapsed.
- B83 An investor also considers changes affecting its exposure, or rights, to variable returns from its involvement with an investee. For example, an investor that has power over an investee can lose control of an investee if the investor ceases to be entitled to receive returns or to be exposed to obligations, because the investor would fail to satisfy paragraph 7(b) (eg if a contract to receive performance-related fees is terminated).
- B84 An investor shall consider whether its assessment that it acts as an agent or a principal has changed. Changes in the overall relationship between the investor and other parties can mean that an investor no longer acts as an agent, even though it has previously acted as an agent, and vice versa. For example, if changes to the rights of the investor, or of other parties, occur, the investor shall reconsider its status as a principal or an agent.
- B85 An investor's initial assessment of control or its status as a principal or an agent would not change simply because of a change in market conditions (eg a change in the investee's returns driven by market conditions), unless the change in market conditions changes one or more of the three elements of control listed in paragraph 7 or changes the overall relationship between a principal and an agent.

Determining whether an entity is an investment entity

B85A An entity shall consider all facts and circumstances when assessing whether it is an investment entity, including its purpose and design. An entity that possesses the three elements of the definition of an investment entity set out in paragraph 27 is an investment entity. Paragraphs B85B–B85M describe the elements of the definition in more detail.

Business purpose

B85B The definition of an investment entity requires that the purpose of the entity is to invest solely for capital appreciation, investment income (such as dividends, interest or rental income), or both. Documents that indicate what the entity's investment objectives are, such as the entity's offering memorandum, publications distributed by the entity and other corporate or partnership documents, will typically provide evidence of an investment entity's business purpose. Further evidence may include the manner in which the entity presents itself to other parties (such as potential investors or potential investees); for example, an entity may present its business as providing medium-term investment for capital appreciation. In contrast, an entity that presents itself as an investor whose objective is to jointly develop, produce or market products with its investees has a business purpose that is inconsistent with the business purpose of an investment entity, because the entity will earn returns from the development, production or marketing activity as well as from its investments (see paragraph B85I).

B85C An investment entity may provide investment-related services (eg investment advisory services, investment management, investment support and administrative services), either directly or through a subsidiary, to third parties as well as to its investors, even if those activities are substantial to the entity.

B85D An investment entity may also participate in the following investment-related activities, either directly or through a subsidiary, if these activities are undertaken to maximise the investment return (capital appreciation or investment income) from its investees and do not represent a separate substantial business activity or a separate substantial source of income to the investment entity:

- (a) providing management services and strategic advice to an investee; and

- (b) providing financial support to an investee, such as a loan, capital commitment or guarantee.

B85E If an investment entity has a subsidiary that provides investment-related services or activities, such as those described in paragraphs B85C–B85D, to the entity or other parties, it shall consolidate that subsidiary in accordance with paragraph 32.

Exit strategies

B85F An entity's investment plans also provide evidence of its business purpose. One feature that differentiates an investment entity from other entities is that an investment entity does not plan to hold its investments indefinitely; it holds them for a limited period. Because equity investments and non-financial asset investments have the potential to be held indefinitely, an investment entity shall 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. An investment entity shall also have an exit strategy for any debt instruments that have the potential to be held indefinitely, for example perpetual debt investments. The entity need not document specific exit strategies for each individual investment but shall identify different potential strategies for different types or portfolios of investments, including a substantive time frame for exiting the investments. Exit mechanisms that are only put in place for default events, such as a breach of contract or non-performance, are not considered exit strategies for the purpose of this assessment.

B85G Exit strategies can vary by type of investment. For investments in private equity securities, examples of exit strategies include an initial public offering, a private placement, a trade sale of a business, distributions (to investors) of ownership interests in investees and sales of assets (including the sale of an investee's assets followed by a liquidation of the investee). For equity investments that are traded in a public market, examples of exit strategies include selling the investment in a private placement or in a public market. For real estate investments, an example of an exit strategy includes the sale of the real estate through specialised property dealers or the open market.

B85H An investment entity may have an investment in another investment entity that is formed in connection with the entity for legal, regulatory, tax or similar business reasons. In this case, the investment entity investor need not have an exit strategy for that investment, provided that the investment entity investee has appropriate exit strategies for its investments.

Earnings from investments

B85I An entity is not investing solely for capital appreciation, investment income, or both, if the entity or another member of the group containing the entity (ie the group that is controlled by the investment entity's ultimate parent) obtains, or has the objective of obtaining, other benefits from the entity's investments that are not available to other parties that are not related to the investee. Such benefits include:

- (a) the acquisition, use, exchange or exploitation of the processes, assets or technology of an investee. This would include the entity or another group member having disproportionate, or exclusive, rights to acquire assets, technology, products or services of any investee; for example, by holding an option to purchase an asset from an investee if the asset's development is deemed successful;
- (b) joint arrangements (as defined in AASB 11) or other agreements between the entity or another group member and an investee to develop, produce, market or provide products or services;
- (c) financial guarantees or assets provided by an investee to serve as collateral for borrowing arrangements of the entity or another group member (however, an investment entity would still be able to use an investment in an investee as collateral for any of its borrowings);
- (d) an option held by a related party of the entity to purchase, from that entity or another group member, an ownership interest in an investee of the entity;
- (e) except as described in paragraph B85J, transactions between the entity or another group member and an investee that:
 - (i) are on terms that are unavailable to entities that are not related parties of either the entity, another group member or the investee;
 - (ii) are not at fair value; or
 - (iii) represent a substantial portion of the investee's or the entity's business activity, including business activities of other group entities.

B85J An investment entity may have a strategy to invest in more than one investee in the same industry, market or geographical area in order to benefit from synergies that increase the capital appreciation and

investment income from those investees. Notwithstanding paragraph B85I(e), an entity is not disqualified from being classified as an investment entity merely because such investees trade with each other.

Fair value measurement

B85K An essential element of the definition of an investment entity is that it measures and evaluates the performance of substantially all of 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. In order to demonstrate that it meets this element of the definition, an investment entity:

- (a) provides investors with fair value information and measures substantially all of its investments at fair value in its financial statements whenever fair value is required or permitted in accordance with Australian Accounting Standards; and
- (b) reports fair value information internally to the entity's key management personnel (as defined in AASB 124), who use fair value as the primary measurement attribute to evaluate the performance of substantially all of its investments and to make investment decisions.

B85L In order to meet the requirement in B85K(a), an investment entity would:

- (a) elect to account for any investment property using the fair value model in AASB 140 *Investment Property*;
- (b) elect the exemption from applying the equity method in AASB 128 for its investments in associates and joint ventures; and
- (c) measure its financial assets at fair value using the requirements in AASB 9.

B85M An investment entity may have some non-investment assets, such as a head office property and related equipment, and may also have financial liabilities. The fair value measurement element of the definition of an investment entity in paragraph 27(c) applies to an investment entity's investments. Accordingly, an investment entity need not measure its non-investment assets or its liabilities at fair value.

Typical characteristics of an investment entity

B85N In determining whether it meets the definition of an investment entity, an entity shall consider whether it displays the typical characteristics of one (see paragraph 28). The absence of one or more of these typical characteristics does not necessarily disqualify an entity from being classified as an investment entity but indicates that additional judgement is required in determining whether the entity is an investment entity.

More than one investment

B85O An investment entity typically holds several investments to diversify its risk and maximise its returns. An entity may hold a portfolio of investments directly or indirectly, for example by holding a single investment in another investment entity that itself holds several investments.

B85P There may be times when the entity holds a single investment. However, holding a single investment does not necessarily prevent an entity from meeting the definition of an investment entity. For example, an investment entity may hold only a single investment when the entity:

- (a) is in its start-up period and has not yet identified suitable investments and, therefore, has not yet executed its investment plan to acquire several investments;
- (b) has not yet made other investments to replace those it has disposed of;
- (c) is established to pool investors' funds to invest in a single investment when that investment is unobtainable by individual investors (eg when the required minimum investment is too high for an individual investor); or
- (d) is in the process of liquidation.

More than one investor

B85Q Typically, an investment entity would have several investors who pool their funds to gain access to investment management services and investment opportunities that they might not have had access to individually. Having several investors would make it less likely that the entity, or other members of the group containing the entity, would obtain benefits other than capital appreciation or investment income (see paragraph B85I).

B85R Alternatively, an investment entity may be formed by, or for, a single investor that represents or supports the interests of a wider group of investors (eg a pension fund, government investment fund or family trust).

B85S There may also be times when the entity temporarily has a single investor. For example, an investment entity may have only a single investor when the entity:

- (a) is within its initial offering period, which has not expired and the entity is actively identifying suitable investors;
- (b) has not yet identified suitable investors to replace ownership interests that have been redeemed; or
- (c) is in the process of liquidation.

Unrelated investors

B85T Typically, an investment entity has several investors that are not related parties (as defined in AASB 124) of the entity or other members of the group containing the entity. Having unrelated investors would make it less likely that the entity, or other members of the group containing the entity, would obtain benefits other than capital appreciation or investment income (see paragraph B85I).

B85U However, an entity may still qualify as an investment entity even though its investors are related to the entity. For example, an investment entity may set up a separate 'parallel' fund for a group of its employees (such as key management personnel) or other related party investor(s), which mirrors the investments of the entity's main investment fund. This 'parallel' fund may qualify as an investment entity even though all of its investors are related parties.

Ownership interests

B85V An investment entity is typically, but is not required to be, a separate legal entity. Ownership interests in an investment entity are typically in the form of equity or similar interests (eg partnership interests), to which proportionate shares of the net assets of the investment entity are attributed. However, having different classes of investors, some of which have rights only to a specific investment or groups of investments or which have different proportionate shares of the net assets, does not preclude an entity from being an investment entity.

B85W In addition, an entity that has significant ownership interests in the form of debt that, in accordance with other applicable Australian

Accounting Standards, does not meet the definition of equity, may still qualify as an investment entity, provided that the debt holders are exposed to variable returns from changes in the fair value of the entity's net assets.

Accounting requirements

Consolidation procedures

B86 Consolidated financial statements:

- (a) combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.
- (b) offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary (AASB 3 explains how to account for any related goodwill).
- (c) eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (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. AASB 112 *Income Taxes* applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.

Uniform accounting policies

B87 If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies.

Measurement

B88 An entity includes the income and expenses of a subsidiary in the consolidated financial statements from the date it gains control until the date when the entity ceases to control the subsidiary. Income and expenses of the subsidiary are based on the amounts of the assets and liabilities recognised in the consolidated financial statements at the acquisition date. For example, depreciation expense recognised in the

consolidated statement of comprehensive income after the acquisition date is based on the fair values of the related depreciable assets recognised in the consolidated financial statements at the acquisition date.

Potential voting rights

- B89 When potential voting rights, or other derivatives containing potential voting rights, exist, the proportion of profit or loss and changes in equity allocated to the parent and non-controlling interests in preparing consolidated financial statements is determined solely on the basis of existing ownership interests and does not reflect the possible exercise or conversion of potential voting rights and other derivatives, unless paragraph B90 applies.
- B90 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 non-controlling interests 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.
- B91 AASB 9 does not apply to interests in subsidiaries that are consolidated. When instruments containing potential voting rights in substance currently give access to the returns associated with an ownership interest in a subsidiary, the instruments are not subject to the requirements of AASB 9. In all other cases, instruments containing potential voting rights in a subsidiary are accounted for in accordance with AASB 9.

Reporting date

- B92 The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall 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 information as of the same date as the financial statements of the parent to enable the parent to consolidate the financial information of the subsidiary, unless it is impracticable to do so.
- B93 If it is impracticable to do so, the parent shall consolidate the financial information of the subsidiary using the most recent financial statements of the subsidiary adjusted for the effects of significant transactions or

events that occur between the date of those financial statements and the date of the consolidated financial statements. In any case, the difference between the date of the subsidiary's financial statements and that of the consolidated financial statements shall be no more than three months, and the length of the reporting periods and any difference between the dates of the financial statements shall be the same from period to period.

Non-controlling interests

- B94 An entity shall attribute the profit or loss and each component of other comprehensive income to the owners of the parent and to the non-controlling interests. The entity shall also attribute total comprehensive income 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.
- B95 If a subsidiary has outstanding cumulative preference shares that are classified as equity and are held by non-controlling interests, the entity shall compute its share of profit or loss after adjusting for the dividends on such shares, whether or not such dividends have been declared.

Changes in the proportion held by non-controlling interests

- B96 When the proportion of the equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent.

Loss of control

- B97 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 shall consider all the terms and conditions of the arrangements and their economic effects. One or more of the following 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.
- (d) 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 a disposal of shares is priced below market and is compensated for by a subsequent disposal priced above market.

B98 If a parent loses control of a subsidiary, it shall:

- (a) derecognise:
 - (i) the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost; and
 - (ii) 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).
- (b) recognise:
 - (i) the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control;
 - (ii) if the transaction, event or circumstances that resulted in the loss of control involves a distribution of shares of the subsidiary to owners in their capacity as owners, that distribution; and
 - (iii) any investment retained in the former subsidiary at its fair value at the date when control is lost.
- (c) reclassify to profit or loss, or transfer directly to retained earnings if required by other Standards, the amounts recognised in other comprehensive income in relation to the subsidiary on the basis described in paragraph B99.
- (d) recognise any resulting difference as a gain or loss in profit or loss attributable to the parent.

- B99 If a parent loses control of a subsidiary, the parent shall account for all amounts previously 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 shall reclassify the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses control of the subsidiary. 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 shall transfer the revaluation surplus directly to retained earnings when it loses control of the subsidiary.

Accounting for a change in investment entity status

- B100 When an entity ceases to be an investment entity, it shall apply AASB 3 to any subsidiary that was previously measured at fair value through profit or loss in accordance with paragraph 31. The date of the change of status shall be the deemed acquisition date. The fair value of the subsidiary at the deemed acquisition date shall represent the transferred deemed consideration when measuring any goodwill or gain from a bargain purchase that arises from the deemed acquisition. All subsidiaries shall be consolidated in accordance with paragraphs 19–24 of this Standard from the date of change of status.
- B101 When an entity becomes an investment entity, it shall cease to consolidate its subsidiaries at the date of the change in status, except for any subsidiary that shall continue to be consolidated in accordance with paragraph 32. The investment entity shall apply the requirements of paragraphs 25 and 26 to those subsidiaries that it ceases to consolidate as though the investment entity had lost control of those subsidiaries at that date.

APPENDIX C

EFFECTIVE DATE AND TRANSITION

This appendix is an integral part of AASB 10 and has the same authority as the other parts of the Standard.

Effective date

- C1 [Deleted by the AASB – see paragraphs Aus3.2 and Aus3.3]
- C1A AASB 2012-10 *Amendments to Australian Accounting Standards – Transition Guidance and Other Amendments*, issued in December 2012, amended paragraphs C2–C6 and added paragraphs C2A–C2B, C4A–C4C, C5A and C6A–C6B. An entity shall apply those amendments for annual reporting periods beginning on or after 1 January 2013, except that a not-for-profit entity shall apply the amendments for annual reporting periods beginning on or after 1 January 2014. If an entity applies AASB 10 for an earlier period, it shall apply those amendments for that earlier period.
- C1B AASB 2013-5 *Amendments to Australian Accounting Standards – Investment Entities*, issued in August 2013, amended paragraphs 2, 4, C2A, C6A and Appendix A and added paragraphs 27–33, B85A–B85W, B100–B101 and C3A–C3F. An entity shall apply those amendments for annual reporting periods beginning on or after 1 January 2014. Early application is permitted. If an entity applies those amendments earlier, it shall disclose that fact and apply all amendments included in AASB 2013-5 at the same time.

Transition

- C2 An entity shall apply this Standard retrospectively, in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified in paragraphs C2A–C6.
- C2A Notwithstanding the requirements of paragraph 28 of AASB 108, when this Standard is first applied, and, if later, when AASB 2013-5 is first applied, an entity need only present the quantitative information required by paragraph 28(f) of AASB 108 for the annual reporting period immediately preceding the date of initial application of this Standard (the ‘immediately preceding period’). An entity may also present this information for the current period or for earlier comparative periods, but is not required to do so.

- C2B For the purposes of this Standard, the date of initial application is the beginning of the annual reporting period for which this Standard is applied for the first time.
- C3 At the date of initial application, an entity is not required to make adjustments to the previous accounting for its involvement with either:
- (a) entities that would be consolidated at that date in accordance with AASB 127 *Consolidated and Separate Financial Statements* and Interpretation 112 *Consolidation – Special Purpose Entities* and are still consolidated in accordance with this Standard; or
 - (b) entities that would not be consolidated at that date in accordance with AASB 127 and Interpretation 112 and are not consolidated in accordance with this Standard.
- C3A At the date of initial application, an entity shall assess whether it is an investment entity on the basis of the facts and circumstances that exist at that date. If, at the date of initial application, an entity concludes that it is an investment entity, it shall apply the requirements of paragraphs C3B–C3F instead of paragraphs C5–C5A.
- C3B Except for any subsidiary that is consolidated in accordance with paragraph 32 (to which paragraphs C3 and C6 or paragraphs C4–C4C, whichever is relevant, apply), an investment entity shall measure its investment in each subsidiary at fair value through profit or loss as if the requirements of this Standard had always been effective. The investment entity shall retrospectively adjust both the annual reporting period that immediately precedes the date of initial application and equity at the beginning of the immediately preceding reporting period for any difference between:
- (a) the previous carrying amount of the subsidiary; and
 - (b) the fair value of the investment entity’s investment in the subsidiary.
- The cumulative amount of any fair value adjustments previously recognised in other comprehensive income shall be transferred to retained earnings at the beginning of the annual period immediately preceding the date of initial application.
- C3C Before the date that AASB 13 *Fair Value Measurement* is adopted, an investment entity shall use the fair value amounts that were previously reported to investors or to management, if those amounts represent the amount for which the investment could have been exchanged between

knowledgeable, willing parties in an arm's length transaction at the date of the valuation.

- C3D If measuring an investment in a subsidiary in accordance with paragraphs C3B–C3C is impracticable (as defined in AASB 108), an investment entity shall apply the requirements of this Standard at the beginning of the earliest period for which application of paragraphs C3B–C3C is practicable, which may be the current period. The investor shall retrospectively adjust the annual period that immediately precedes the date of initial application, unless the beginning of the earliest period for which application of this paragraph is practicable is the current period. If this is the case, the adjustment to equity shall be recognised at the beginning of the current period.
- C3E If an investment entity has disposed of, or has lost control of, an investment in a subsidiary before the date of initial application of this Standard, the investment entity is not required to make adjustments to the previous accounting for that subsidiary.
- C3F If an entity applies AASB 2013-5 for a period later than when it applies AASB 10 for the first time, references to 'the date of initial application' in paragraphs C3A–C3E shall be read as 'the beginning of the annual reporting period for which AASB 2013-5 *Amendments to Australian Accounting Standards – Investment Entities*, is applied for the first time.'
- C4 If, at the date of initial application, an investor concludes that it shall consolidate an investee that was not consolidated in accordance with AASB 127 and Interpretation 112, the investor shall:
- (a) if the investee is a business (as defined in AASB 3 *Business Combinations*), measure the assets, liabilities and non-controlling interests in that previously unconsolidated investee as if that investee had been consolidated (and thus had applied acquisition accounting in accordance with AASB 3) from the date when the investor obtained control of that investee on the basis of the requirements of this Standard. The investor shall adjust retrospectively the annual reporting period immediately preceding the date of initial application. When the date that control was obtained is earlier than the beginning of the immediately preceding period, the investor shall recognise, as an adjustment to equity at the beginning of the immediately preceding period, any difference between:
 - (i) the amount of assets, liabilities and non-controlling interests recognised; and

- (ii) the previous carrying amount of the investor's involvement with the investee.
- (b) if the investee is not a business (as defined in AASB 3), measure the assets, liabilities and non-controlling interests in that previously unconsolidated investee as if that investee had been consolidated (applying the acquisition method as described in AASB 3 but without recognising any goodwill for the investee) from the date when the investor obtained control of that investee on the basis of the requirements of this Standard. The investor shall adjust retrospectively the annual reporting period immediately preceding the date of initial application. When the date that control was obtained is earlier than the beginning of the immediately preceding period, the investor shall recognise, as an adjustment to equity at the beginning of the immediately preceding period, any difference between:
 - (i) the amount of assets, liabilities and non-controlling interests recognised; and
 - (ii) the previous carrying amount of the investor's involvement with the investee.

C4A If measuring an investee's assets, liabilities and non-controlling interests in accordance with paragraph C4(a) or (b) is impracticable (as defined in AASB 108), an investor shall:

- (a) if the investee is a business, apply the requirements of AASB 3 as of the deemed acquisition date. The deemed acquisition date shall be the beginning of the earliest period for which application of paragraph C4(a) is practicable, which may be the current period.
- (b) if the investee is not a business, apply the acquisition method as described in AASB 3 but without recognising any goodwill for the investee as of the deemed acquisition date. The deemed acquisition date shall be the beginning of the earliest period for which the application of paragraph C4(b) is practicable, which may be the current period.

The investor shall adjust retrospectively the annual reporting period immediately preceding the date of initial application, unless the beginning of the earliest period for which application of this paragraph is practicable is the current period. When the deemed acquisition date is earlier than the beginning of the immediately preceding period, the investor shall recognise, as an adjustment to equity at the beginning of the immediately preceding period, any difference between:

- (c) the amount of assets, liabilities and non-controlling interests recognised; and
- (d) the previous carrying amount of the investor's involvement with the investee.

If the earliest period for which application of this paragraph is practicable is the current period, the adjustment to equity shall be recognised at the beginning of the current period.

C4B When an investor applies paragraphs C4–C4A and the date that control was obtained in accordance with this Standard is later than the effective date of AASB 3 as revised in 2008 (AASB 3 (March 2008)), the reference to AASB 3 in paragraphs C4 and C4A shall be to AASB 3 (March 2008). If control was obtained before the effective date of AASB 3 (March 2008), an investor shall apply either AASB 3 (March 2008) or AASB 3 (July 2004).

C4C When an investor applies paragraphs C4–C4A and the date that control was obtained in accordance with this Standard is later than the effective date of AASB 127 as revised in 2008 (AASB 127 (March 2008)), an investor shall apply the requirements of this Standard for all periods that the investee is retrospectively consolidated in accordance with paragraphs C4–C4A. If control was obtained before the effective date of AASB 127 (March 2008), an investor shall apply either:

- (a) the requirements of this Standard for all periods that the investee is retrospectively consolidated in accordance with paragraphs C4–C4A; or
- (b) the requirements of the version of AASB 127 issued in 2004 (AASB 127 (July 2004)) for those periods prior to the effective date of AASB 127 (March 2008) and thereafter the requirements of this Standard for subsequent periods.

C5 If, at the date of initial application, an investor concludes that it will no longer consolidate an investee that was consolidated in accordance with AASB 127 and Interpretation 112, the investor shall measure its interest in the investee at the amount at which it would have been measured if the requirements of this Standard had been effective when the investor became involved with (but did not obtain control in accordance with this Standard), or lost control of, the investee. The investor shall adjust retrospectively the annual reporting period immediately preceding the date of initial application. When the date that the investor became involved with (but did not obtain control in accordance with this Standard), or lost control of, the investee is earlier than the beginning of the immediately preceding period, the investor

shall recognise, as an adjustment to equity at the beginning of the immediately preceding period, any difference between:

- (a) the previous carrying amount of the assets, liabilities and non-controlling interests; and
- (b) the recognised amount of the investor's interest in the investee.

C5A If measuring the interest in the investee in accordance with paragraph C5 is impracticable (as defined in AASB 108), an investor shall apply the requirements of this Standard at the beginning of the earliest period for which application of paragraph C5 is practicable, which may be the current period. The investor shall adjust retrospectively the annual reporting period immediately preceding the date of initial application, unless the beginning of the earliest period for which application of this paragraph is practicable is the current period. When the date that the investor became involved with (but did not obtain control in accordance with this Standard), or lost control of, the investee is earlier than the beginning of the immediately preceding period, the investor shall recognise, as an adjustment to equity at the beginning of the immediately preceding period, any difference between:

- (a) the previous carrying amount of the assets, liabilities and non-controlling interests; and
- (b) the recognised amount of the investor's interest in the investee.

If the earliest period for which application of this paragraph is practicable is the current period, the adjustment to equity shall be recognised at the beginning of the current period.

C6 Paragraphs 23, 25, B94 and B96–B99 were amendments to AASB 127 made in 2008 that were carried forward into AASB 10. Except when an entity applies paragraph C3, or is required to apply paragraphs C4–C5A, the entity shall apply the requirements in those paragraphs as follows:

- (a) An entity shall not restate any profit or loss attribution for reporting periods before it applied the amendment in paragraph B94 for the first time.
- (b) The requirements in paragraphs 23 and B96 for accounting for changes in ownership interests in a subsidiary after control is obtained do not apply to changes that occurred before an entity applied these amendments for the first time.

- (c) An entity shall not restate the carrying amount of an investment in a former subsidiary if control was lost before it applied the amendments in paragraphs 25 and B97–B99 for the first time. In addition, an entity shall not recalculate any gain or loss on the loss of control of a subsidiary that occurred before the amendments in paragraphs 25 and B97–B99 were applied for the first time.

References to the ‘immediately preceding period’

- C6A Notwithstanding the references to the annual reporting period immediately preceding the date of initial application (the ‘immediately preceding period’) in paragraphs C3B–C5A, an entity may also present adjusted comparative information for any earlier periods presented, but is not required to do so. If an entity does present adjusted comparative information for any earlier periods, all references to the ‘immediately preceding period’ in paragraphs C3B–C5A shall be read as the ‘earliest adjusted comparative period presented’.
- C6B If an entity presents unadjusted comparative information for any earlier periods, it shall clearly identify the information that has not been adjusted, state that it has been prepared on a different basis, and explain that basis.

References to AASB 9

- C7 If an entity applies this Standard but does not yet apply AASB 9, any reference in this Standard to AASB 9 shall be read as a reference to AASB 139 *Financial Instruments: Recognition and Measurement*.

Withdrawal of other IFRSs

- C8 [Deleted by the AASB – see paragraph Aus3.5(a)]
- C9 [Deleted by the AASB – see paragraph Aus3.5(b)]

APPENDIX E

AUSTRALIAN IMPLEMENTATION GUIDANCE FOR NOT-FOR-PROFIT ENTITIES

This appendix is an integral part of AASB 10 and has the same authority as the other parts of the Standard. The appendix applies only to not-for-profit entities. The appendix does not apply to for-profit entities or affect their application of AASB 10.

- IG1 AASB 10 incorporates International Financial Reporting Standard IFRS 10 *Consolidated Financial Statements*, issued by the International Accounting Standards Board. Consequently, much of the text of the body of this Standard and Appendices A–C is expressed from the perspective of for-profit entities. The AASB has prepared this appendix to explain and illustrate the principles in the Standard for not-for-profit entities in the private and public sectors, particularly to address circumstances where a for-profit perspective does not readily translate to a not-for-profit perspective.
- IG2 This appendix addresses a range of matters affecting not-for-profit entities broadly in the order in which the related paragraphs appear in the body of the Standard and in Appendix B. The appendix paragraphs are arranged under the same headings as in the body of the Standard or Appendix B. Cross-references to the paragraphs in the body of the Standard and to the other appendices are included to assist in relating the paragraphs in this appendix to the requirements of the Standard.
- IG3 Illustrative examples are provided in the implementation guidance both within implementation guidance paragraphs and as discrete examples. The examples apply by analogy to types of not-for-profit entities other than those identified in the examples and similar circumstances. It is the facts and circumstances in any case, not simply the type of not-for-profit entity, that need to be assessed in determining whether one entity controls another entity.

Control

- IG4 Paragraph 5 of AASB 10 sets out the fundamental requirement that an investor shall determine whether it controls an investee. As indicated by the reference in paragraph 11 to assessing power arising from contractual arrangements, the investor need not have a financial investment in the investee. In general terms, an investor and an

investee are merely entities that have a relationship in which control of one entity (the investee) by the other (the investor) might arise.

Power

- IG5 One of the criteria set out in paragraph 7 for control of an investee is that the investor has power over the investee. Paragraph 10 states that an investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities, that is, the activities that significantly affect the investee's returns. As an example, a not-for-profit investor would have power over an investee when the investor can require the investee to deploy its assets or incur liabilities in a way that affects the investee's returns (for example, in providing goods or services to the investor or other parties that assist in achieving or furthering the investee's objectives).
- IG6 Paragraph 11 states that power arises from rights, and refers to voting rights granted by equity instruments and rights arising from contractual arrangements. While these rights will often be the source of power for for-profit entities, power will frequently arise through different sources for not-for-profit entities. For many not-for-profit entities, rights arising from administrative arrangements or statutory provisions will often be the source of power. Assessing the purpose and design of an investee will assist an investor to identify who has power over the investee, ie the current ability to direct the relevant activities (paragraph B5).
- IG7 As an example of contractual or statutory arrangements, a not-for-profit investor often will have power over an investee that it has established when the constituting document or enabling legislation for the investee specifies the investor's rights to direct the operating and financing activities that may be carried out by the investee. However, the impact of the constituting document or legislation is evaluated in the context of the prevailing circumstances, as all facts and circumstances need to be considered in assessing whether an investor has power over an investee. For example, the purpose and design of an investee may point to the relevant activities of the investee and how decisions about the relevant activities are made. To illustrate, a government may not have power over a research and development corporation that operates under a mandate created, and limited, by that government's legislation if that or other legislation means that the power to direct the relevant activities is held by other entities that are not controlled by the government, such as participants in the research and development activities.
- IG8 The research and development corporation example in the previous paragraph illustrates that an investor might not have power over an

investee due to the rights of other parties in relation to the investee, as indicated in paragraph B10. As another example, subject to consideration of all the facts and circumstances, a State or Territory government normally would not have power to direct the relevant activities (ie the activities that significantly affect the returns) of a local government that determines through the council elected periodically by the local community how to deploy the local government's resources in the interests of the local community (even though those interests might coincide with or overlap the interests of the State or Territory government).

Rights that give an investor power over an investee

IG9 Paragraph B15 provides examples of rights that, either individually or in combination, can give an investor power in respect of an investee. In relation to not-for-profit investors, additional examples of such rights include:

- (a) rights to give policy directions to the governing body of the investee that give the holder the ability to direct the relevant activities of the investee; and
- (b) rights to approve or veto operating and capital budgets relating to the relevant activities of the investee.

IG10 A not-for-profit investor can have power over an investee even if it does not have responsibility for the day-to-day operation of the investee or the specific manner in which prescribed functions are performed by the investee. For example, legislation governing the establishment and operation of an independent statutory office (such as an auditor-general or the judiciary) sets out the broad parameters within which the office holder is required to operate, and results in the office holder operating in a manner consistent with the objectives set by the legislation. Whilst the holders of an independent statutory office are to act independently in discharging their responsibilities, the government typically provides the organisations that assist the statutory office holders in fulfilling their responsibilities. In such cases, the resources of those organisations remain government resources albeit that they are placed at the disposal of the office holders, subject to the office holders acting in accordance with their enabling legislation. Furthermore, the relevant activities of the organisations, including providing technical services to the statutory office holders, are generally subject to the same financial management, employment and administrative frameworks and policies as would apply to government-controlled entities such as government departments. Therefore, subject to other facts and circumstances, assuming the other control criteria are also satisfied,

the organisations assisting the independent statutory office holders would be controlled by the government and would be consolidated into the whole of government general purpose financial statements.

- IG11 Paragraph B19 lists a range of indicators that suggest that an investor has more than a passive interest in an investee, but notes that the existence of such indicators does not necessarily mean that the power criterion is met. The indicators listed include the investee's operations being dependent on the investor, such as dependence on the investor to fund a significant portion of its operations, guarantee a significant portion of its obligations or provide critical goods or services. Paragraph B40 also states that, in the absence of other rights, the economic dependence of an investee on the investor does not lead to the investor having power over the investee.
- IG12 An example of the circumstances contemplated in paragraphs B19 and B40 is that a government may not have the current ability to direct the relevant activities of entities (such as private schools, private hospitals, private aged-care providers and universities) that are financially dependent on government funding, where the governing bodies of those entities have discretion with respect to whether they will accept resources from the government, or the manner in which their resources are to be deployed. This may be so even if government grants provided to such entities require them to comply with specified conditions. Although these entities might receive government grants for capital construction and operating costs subject to specified service standards or restrictions on user fees, their independent governing body may have ultimate discretion about how assets are deployed.

Substantive rights

- IG13 Barriers that prevent a holder of rights from exercising them are considered in determining whether the rights are substantive, that is, whether the holder has the practical ability to exercise the rights (paragraph B22). Paragraph B23 provides examples of such barriers. For some not-for-profit investors, political, cultural, social or similar types of barriers might make it difficult for the investor to exercise rights held in relation to an investee. However, the investor's rights would be substantive, despite such barriers, if the investor can still choose to exercise those rights. For example, a government may have the power to appoint and remove the majority of members of the governing body of a railway authority without cause but may be reluctant to remove members because of sensitivity in the electorate regarding the previous government's involvement in the operation of the rail network. In this case, the government has substantive rights, irrespective of whether it chooses to exercise them.

- IG14 Paragraph B24 states that to be substantive, rights need to be exercisable when decisions about the direction of the relevant activities need to be made. Usually this means that the rights need to be currently exercisable. However, paragraph B24 also notes that sometimes rights can be substantive even though they are not currently exercisable. For many not-for-profit investors, power over an investee may be obtained from existing statutory arrangements. Rights specified in substantively enacted legislation would be substantive rights that need to be considered by the investor in assessing control of an investee if it is assessed that the rights will be exercisable when decisions about the direction of the relevant activities need to be made. However, the power to enact or change legislation does not give the investor the current ability to direct relevant activities of the investee. Depending on circumstances, statutory arrangements may be in the nature of protective rights rather than substantive rights – see paragraphs IG15–IG17.

Protective rights

- IG15 Protective rights are defined in Appendix A as rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate. Applying this principle to not-for-profit entities, protective rights include rights held by a government or other entity in order to protect, as distinct from enhance, the interests of the government, the beneficiaries of an entity or the public at large. In accordance with paragraph B27, such rights do not result in the investor (the government or other entity) having power over an investee or restricting another entity from having power over the investee.
- IG16 Not-for-profit entities might hold regulatory powers that restrict the way in which regulated entities operate. The regulatory powers may be exercisable through an established framework within which entities are required to operate, including the ability to impose conditions or sanctions on their operations. Regulatory powers may represent protective rights, which do not give power (as defined in the Standard) over an investee, or substantive rights that need to be considered in determining control. For example, regulatory powers may represent substantive rights when they would have the effect of giving the regulator the ability to direct the relevant activities of an investee in particular circumstances. Not-for-profit investors are required by paragraph B26 to assess whether their rights (and rights held by others) are protective or substantive rights.
- IG17 In addition to the examples in paragraph B28, examples of protective rights in relation to not-for-profit entities include:

- (a) the right of a regulator to curtail or close the operations of entities that are not complying with regulations or other requirements. For example, a pollution control authority may be able to close down an entity's activities that breach environmental regulations.
- (b) the right to remove members of the governing body of another entity under certain restricted circumstances. For example, for reasons relating to a lack of probity, a State government may be able to remove or suspend the councillors of a local government and appoint an administrator who is not directed by the State government in carrying out the functions of the local government.
- (c) the right to appoint additional members to the governing body of another entity under certain restricted circumstances. For example, when the entity has failed to comply with performance standards, a regulator may be able to appoint appropriately qualified members who are in the same position as other members – they do not report to and are not directed by the regulator.
- (d) the right of the government to remove tax deductibility for contributions to a not-for-profit entity if the entity significantly changes its objectives or activities.
- (e) a philanthropic trust providing resources to a charity on condition that the net assets of the charity would be distributed to a similar organisation undertaking similar activities if the charity is liquidated.

Returns

Exposure, or rights, to variable returns from an investee

IG18 One of the criteria set out in paragraph 7 for control of an investee is that the investor has exposure, or rights, to variable returns from its involvement with the investee. The examples of returns in paragraph B57, particularly those in paragraph B57(c), indicate that the scope of the nature of returns is broad. In application to not-for-profit entities, the broad scope of the nature of returns encompasses financial, non-financial, direct and indirect benefits, whether positive or negative, including the achievement or furtherance of the investor's objectives.

IG19 An investor's exposure, or rights, to variable returns from its involvement with an investee may give rise to indirect, non-financial

returns, such as when achieving or furthering the objectives of the investee contributes to the objectives of the investor. For example, the provision of goods and services by the investee to its beneficiaries may affect the extent to which the investor's social policy objectives are furthered. These returns to the investor would reflect factors such as the efficiency and effectiveness of delivery of the goods and services and changes in the outcomes for the beneficiaries.

Link between power and returns

IG20 The third criterion set out in paragraph 7 for control of an investee is that the investor has the ability to use its power over the investee to affect the amount of the investor's returns. As an example, the investor would have the ability to use its power over the investee when it can direct the investee to work with the investor to further the investor's objectives. However, the existence of congruent objectives alone is insufficient for a not-for-profit investor to conclude that it controls an investee.

Delegated power

IG21 An investor with decision-making rights (a decision maker) is required by paragraph B58 to determine whether it is a principal or an agent. Paragraphs B60 and B61 summarise factors to be taken into account in making that determination, such as the scope of the decision-making authority and the rights of other parties. The following examples illustrate these paragraphs in relation to not-for-profit entities.

IG22 A charity establishes a trust to fund and construct village dams, bores and other water infrastructure in several provinces of a developing country. The trustee is appointed by the charity to oversee the work of the trust. The trustee receives remuneration from the trust commensurate with the services provided and the skills applied, plus a performance bonus upon the successful completion of individual projects. The charity can replace the trustee at its discretion. The trustee therefore is an agent of the charity and cannot control the trust in its own right. In this case, the charity then needs to assess whether it controls the trust through the trustee. For example:

- (a) the trustee may have power over the trust in having the current ability to direct its relevant activities, whether through a broad decision-making authority or as determined by the charity in respect of major aspects, such as project selection. Even if the trustee does not have exposure or rights to variable returns from the trust, the charity does so in terms of the extent to which its overseas aid objectives are achieved or furthered

through the activities of the trust. Since the trustee (as an agent of the charity) can use its powers to affect the trust's non-financial returns, the three control criteria are satisfied in respect of the charity and the charity would control the trust; or

- (b) the trustee may be permitted by development regulations of the provincial governments to provide only oversight of the trust's activities, which are carried out in general by management committees appointed by the relevant provincial government. In this case, the trustee does not have the power to direct the relevant activities of the trust, and accordingly the charity would not control the trust.

IG23 A government department acts in relation to an investee only as an agent of the responsible Minister when the department or an official of the department is merely authorised by the Minister to act on the Minister's behalf (in which case the department's activities in relation to the investee would be reflected in its reporting under AASB 1050 *Administered Items*).

IG24 Alternatively, a department acts as a principal under a delegation of powers from the Minister as the department or an official of the department exercises their own discretion, not subject to specific direction by the Minister. In this case, the department would report its activities in relation to the investee as its own transactions. The department would need to assess whether the delegated powers give it the current ability to direct the relevant activities of the investee and whether the other control criteria are satisfied in deciding whether the department controls the investee and should consolidate it.

Implementation Examples

IG25 Examples IG1–IG5 illustrate the application of the three criteria for control (power over an investee, variable returns from involvement with the investee, and link between power and the investor's returns) in a range of circumstances. Example IG5 also illustrates the effect of delegated powers in the public sector.

IG26 Each example provides detailed information about the purpose and design of the investee, as a basis for assessing control of the investee. The sub-examples address the initial circumstances, and then vary the design of the investee, with the control assessment then reconsidered in each case. Examples IG3 and IG4 particularly distinguish substantive and protective rights held by an investor in relation to the investee. In any specific case, distinguishing substantive and protective rights requires analysis of the circumstances, including

considering the reasons for different investors holding various rights in relation to the investee.

Implementation examples
<p>Example IG1</p> <p>A religious organisation ABC established a community housing program that provides low-cost housing. The program is operated by an incorporated association. The association's constitution states that its objective is to manage the community housing facility to meet the need for low-cost housing. The association has not issued any equity instruments.</p> <p>The relevant activities of the association comprise:</p> <ul style="list-style-type: none"> • reviewing and selecting applicants for housing; • the day-to-day operation of the housing program; • maintaining the houses and common facilities; and • improving and extending the housing facilities. <p>The board of governors of the association has 16 members, with eight appointed by (and subject to removal by) the religious organisation. The chair is appointed by the board from amongst the appointees of the religious organisation, and has a casting vote that is rarely exercised. The board meets regularly and reviews reports received from the association's management. Based on these reports, the board may confirm or override management decisions. In addition, the board makes decisions on major issues such as significant maintenance and investing further capital to build additional housing, after reviewing vacancy levels and the demand for housing.</p> <p>The religious organisation owns the land on which the housing facilities stand and has contributed capital and operating funds to the association since it was established. The association owns the housing facilities.</p> <p>The association retains any surplus resulting from the operation of the facilities and under its constitution is unable to provide a direct financial return to the religious organisation.</p> <p>Example IG1A</p> <p>Based on the facts and circumstances outlined above, the religious organisation controls the association.</p>

The religious organisation appoints eight members of the board of governors, one of whom will become the chair, who has a casting vote. As a result, the religious organisation has power over the association through substantive rights that give it the current ability to direct the relevant activities of the association, regardless of whether the religious organisation chooses to exercise those substantive rights.

The religious organisation also has exposure or rights to variable returns from its involvement with the association. The religious organisation obtains non-financial returns through the association furthering its social objective of meeting the need for low-cost community housing. Although not able to receive direct financial returns, the religious organisation obtains indirect returns through its ability to direct how the financial returns are to be employed in the community housing program.

The religious organisation also satisfies the final control criterion. Through its appointees on the board, the religious organisation has the ability to use its power to affect the nature and amount of its returns from the association.

The religious organisation satisfies all three criteria for control and therefore the religious organisation controls the association.

Example IG1B

In this example, the facts of Example IG1A apply, except that:

- the association's board of governors is elected through a public nomination and voting process that does not give rights to the religious organisation to appoint board members; and
- decisions made by the association's board are reviewed by the religious organisation, which may offer advice to the association.

Based on the revised facts and circumstances outlined above, the religious organisation does not have substantive rights relating to the association and therefore does not have power over the association.

The religious organisation's social objectives in relation to low-cost community housing are still being achieved and therefore it will still obtain indirect non-financial returns. However, congruence of objectives alone is insufficient to conclude that one entity controls another (see paragraph IG20).

The religious organisation does not have power and consequently does not have the ability to use power to affect the amount of the

organisation's returns. The religious organisation is unable to satisfy two of the three control criteria and therefore the religious organisation does not control the association.

Example IG1C

In this example, the facts of Example IG1B apply, except that the association's constitution allows the religious organisation to change the manner in which the board of governors is determined, as it sees fit.

For example, the religious organisation has the unilateral ability to amend the constitution of the association to enable the religious organisation to appoint a majority of the board of governors, thus giving the religious organisation substantive rights that give it the current ability to direct the relevant activities of the association. Therefore, the religious organisation has power over the association through those substantive rights, regardless of whether the religious organisation chooses to exercise those rights.

Since the religious organisation has the ability to determine the composition of the board of governors and thus direct the relevant activities of the association, the religious organisation has exposure or rights to the same variable returns from its involvement with the association as set out for Example IG1A.

The religious organisation also satisfies the final control criterion. Through its ability to determine the composition of the board of governors, the religious organisation can use its power to affect the amount of its returns from the activities of the association.

The religious organisation satisfies all three of the control criteria and therefore the religious organisation controls the association. In this example, the design of the association as set out in its constitution indicates that the religious organisation has the ability to direct the relevant activities of the association even though a publicly elected board of governors has been established. This design reflects the special relationship between the religious organisation and the association.

Implementation examples

Example IG2

FGH Charity is a private sector not-for-profit organisation. Its objectives are to protect and serve the community by providing

emergency first aid and increasing the first aid skills of the community. The charity provides first aid at sporting events and when natural disasters occur. The charity is funded via donations and the sale of first aid supplies (bandages, first aid kits, etc.). The board of the charity has 10 members.

The charity established TUV First Aid Training Ltd (TUV or the company) some years ago. The purpose of TUV is to provide first aid training courses to the general public for a fee. TUV has an eight-member board, with all members appointed by the board of FGH Charity.

The charity has the right to receive distributions of profits made by TUV.

The management of TUV is responsible for the day-to-day operations of the company. TUV's management is also responsible for developing the company's policies, including:

- the scope of the training courses, such as the type of courses and the maximum number of participants for each course;
- marketing plans for the courses, including the fee structure;
- the frequency and location of courses; and
- the use of in-house or off-the-shelf training materials.

These policies address the relevant activities of TUV, ie the activities that significantly affect the company's returns.

The board of TUV meets regularly to review reports from TUV management in order to assess the performance of the company. The board makes decisions about the company's activities and policies so as to optimise its outcomes. For example, the board might modify the scope or frequency of courses or revise the fee structure.

The TUV board also considers whether any profits should be distributed to the charity (FGH) as a financial return or used to improve or expand the company's activities.

Example IG2A

Based on the facts and circumstances outlined above, the charity controls TUV. The charity has power over TUV because its board appoints the board members of TUV, thus giving the charity the

current ability to direct the relevant activities of the company. The charity is exposed to variable returns from its involvement with TUV, both financial returns (the right to receive distributions of profits from TUV) and non-financial returns (the furtherance of its objective of improving community first aid skills). Finally, the charity can use its power over TUV (via the board) to affect the nature and amount of returns it obtains through TUV.

Example IG2B

In this example, the facts of Example IG2A apply, except that:

- the charity does not have the right to receive distributions of profits from TUV since the constitution of the company prohibits distributions to its members; and
- all profits of TUV are to be reinvested into first aid training programs.

Based on the revised facts and circumstances, the charity controls TUV. The charity has power over TUV because it appoints the board of the company. Although it does not receive any financial returns, the charity obtains non-financial returns because TUV is fulfilling one of its objectives by increasing the first aid skills of the community. The charity is able to use its power over TUV to affect the nature and amount of its returns. Therefore, the three control criteria are satisfied.

Example IG2C

This example has the same facts as Example IG2B, except that:

- the charity cannot appoint the board members of TUV, except for the Chair, who must be a board member of the charity; and
- the charity has the right to veto appointments to the board of TUV, but only in exceptional circumstances – that is, when a potential board member is deemed unsuitable. This right has only been enforced once, when a proposed board member was found to have a history of fraudulent activities.

Based on these facts and circumstances, the charity does not control TUV. This is because the charity does not have the requisite power to direct the relevant activities of TUV – it appoints only one of the eight members of the board of TUV. Even though the charity has the right of veto over TUV board appointments, this is only a protective right because it is a safeguard against having board

members who could potentially interfere with the operations of the company and adversely affect its outcomes.

The charity had the opportunity and incentive when establishing TUV to obtain rights that would give it the ability to direct the relevant activities of TUV, but it did not do so. Being involved in the design of an investee is not sufficient to give an investor control (see paragraph B51 of the Standard).

Example IG2D

In this example, the facts of Example IG2C apply, except that:

- TUV's constitution permits its board to make financial distributions to other parties as decided by the board; and
- although the charity does not have any right to distributions of profits from TUV, to date TUV has always distributed its profits to the charity.

Based on these facts and circumstances, the charity does not control TUV because, as in Example IG2C, the charity does not have power over TUV to direct the relevant activities.

Even though TUV was established by the charity in order to further its objective regarding community first aid skills, and despite the charity historically receiving financial returns from TUV, the design of TUV does not give the charity power over TUV. The board of TUV is independent of the charity, there is no requirement for TUV to make distributions to the charity (or to any other party), and the charity has no right to demand financial returns.

Implementation example

Example IG3

The LMN local government (the Council) is created under a State's Local Government Act to operate for the peace, order and good government of its municipal district. The Council is administered by the councillors, who are elected directly by the local community in periodic elections. General requirements for the elections are set out in the Act.

Objectives of the Council

The Act specifies that the Council's primary objective is to achieve the best outcomes for the local community over the long term. In working to achieve this objective, the Council must have regard to:

- promoting the social, economic and environmental viability and sustainability of the municipal district;
- ensuring that resources are used efficiently and effectively and that services provided are accessible and equitable;
- the equitable imposition of rates and charges; and
- transparency and accountability in Council decision making.

Powers and Functions of the Council

The Council is empowered by the Act to do all things necessary and convenient for the achievement of its objectives and the performance of its functions, subject to any limitations under the Act or any other legislation (see the sections on the State Government's protective and substantive rights later in this example).

The Council's functions include:

- raising revenue to fund its functions and activities;
- planning for and providing services and facilities (including infrastructure) for the local community;
- strategic and land-use planning;
- making and enforcing local laws; and
- advocating proposals that are in the best interests of the district.

Activities of the Council

In carrying out its functions, the Council undertakes a wide range of activities, including the employment of staff, the imposition of rates and charges upon constituents, the establishment and implementation of policies and procedures, the purchase or sale of goods or services from or to constituents or other parties, the provision without charge of services such as parks and roads, transactions under financial contracts and prosecuting legal actions.

State Government Involvement with the Council

The State Government's objectives for the government of the municipal district are consistent with the objectives of the Council, since the State Government set out the Council's objectives in the State's Local Government Act.

Consequently, the Council is subject to a wide range of State Government regulatory powers, even though its day-to-day operations are carried out by the Council's staff under the direction of its elected councillors. The State Government's rights in respect of the Council are held primarily by the Minister for Local Government, but other Ministers also hold some additional powers, such as land-use planning powers held by the Minister for Planning.

The interest of the State Government in the activities of the Council is to ensure that the general objectives set out in the Act are being achieved or furthered. To that end, the State Government has an extensive range of rights (through its Ministers) to advise or guide the Council in its activities or, under particular circumstances, to intervene in the activities of the Council. The principal rights of the State Government are described in the following sections.

Protective rights of the State Government

Some of the State Government's rights are protective rights, as described in paragraph B26: rights that relate to fundamental changes to the activities of the Council (the investee) or that apply in exceptional circumstances. For example, the Minister has the following rights that are regarded as protective rights for the purpose of this example:

- restructure the municipal district through boundary changes;
- abolish the existing Council and constitute a new Council or Councils, with the Minister able to direct the transfer of property, income, assets, rights, liabilities, expenses and staff among Councils as part of the process;
- suspend all the councillors of the Council if the Minister is satisfied that there has been a serious failure to provide good government or serious unlawful acts by the Council – in which case an administrator is appointed to act as the Council and to perform its functions, powers and duties;
- appoint inspectors of municipal administration to examine any particular Council matter and make recommendations to the Council, and enforce those recommendations if the Council

does not adopt them;

- revoke local laws passed by the Council where, in the Minister's opinion, the laws substantially restrict competition without appropriate justification;
- approve (or veto) Council entering into an entrepreneurial endeavour that exceeds 5% of the Council's revenue from rates and charges;
- approve (or veto) investment by the Council in types of financial instruments not already approved under the Act; and
- make guidelines concerning the Council's procurement policy or the provision of services by the Council so as to best meet the needs of the local community.

Substantive rights of the State Government

The State Government also has a range of rights that do not fall into the category of protective rights. For example, Ministers have the following rights that, for the purpose of this example, are classified as substantive rights:

- give directions concerning rates and charges to limit the rate of change in the Council's general income for a financial year;
- review the allowance category annually for the Council, including the limits and ranges of councillor allowances; and
- prepare a planning scheme for the district or authorise an amendment subject to any conditions that the Minister wishes to impose.

Control of the Council

Based on the facts and circumstances outlined above, does the State Government control the Council in accordance with the definition of control in the Standard? If not, who controls the Council?

Relevant activities

The State Government has numerous rights in relation to the Council. Whereas the State Government's protective rights cannot give power over the Council, the substantive rights do give the State Government the current ability to direct some activities of the Council.

However, paragraph 10 of the Standard states that an investor has

power over an investee when the investor has the current ability to direct the *relevant activities*, ie the activities that *significantly affect* the investee's returns. Therefore, it is necessary to identify the relevant activities of the Council, and then assess the State Government's substantive rights in respect of those activities relative to the rights of other parties.

Judgement is required in identifying the relevant activities, as this requires identifying both the Council's returns and the activities of the Council that significantly affect those returns. As a not-for-profit entity, the Council's non-financial returns for the community are considered to be of primary importance, even though its objectives also include financial aspects, such as the efficient use of resources and equitable rates and charges. The objectives do not include the raising of revenue per se.

All of the Council's activities and functions contribute (whether positively or negatively) to the Council achieving or furthering its objectives. Thus they are activities that affect the financial and non-financial returns of the Council. But which activities *significantly affect* the Council's returns? Given the significance of non-financial returns for the Council, it is considered that the provision of services and facilities for the community and regulating other parties' activities in the community (eg property development, health services and shopping centres) are the activities that most significantly affect the Council's returns. Consequently, these are likely to be the *relevant activities* of the Council.

Power

Paragraph B10 states that whether an investor has power over an investee depends on, for example, the rights the investor and other parties have in relation to the investee. When two or more parties each have existing rights that give them the unilateral ability to direct different relevant activities, the party that has the current ability to direct the activities that most significantly affect the investee's returns has power over the investee (paragraph 13 of the Standard). Does the State Government have the power, the current ability, to direct the relevant activities of the Council?

The substantive rights of the State Government do give it the current ability to direct *some* of the activities of the Council, such as amending or replacing planning schemes. However, the State Government is unable to direct the major part of the activities that *significantly affect* the Council's returns. Therefore, the State Government does not hold power over the Council as described in

the Standard.

The power to direct the relevant activities is held by the councillors of the Council, who direct, within the framework established by the State Government, the vast majority of the Council's activities that affect the returns from its operations.

The State Government's right to give directions to limit the rate of change in the Council's general income (rates and charges) is in the nature of price regulation rather than directing relevant activities. The raising of revenue itself is not a relevant activity, as identified above, because revenue by itself is not one of the Council's returns or objectives.

Returns

The State Government is exposed, or has rights, to variable returns from its involvement with the Council since the activities of the Council contribute to the achievement or furtherance of the State Government's objectives for the good government and appropriate development of the municipal district.

Ability to use power to affect returns

Since it was concluded above that in the circumstances presented the State Government does not have power (as described in the Standard) over the Council, then the third control criterion linking power and returns is also not satisfied. The State Government is able to affect the Council's returns, and thus its own indirect returns, through exercising its substantive rights. However, the State Government is unable to direct the activities that most significantly affect the Council's returns.

Control conclusion

The conclusion from the above assessment is that the State Government does not have power over the Council and therefore does not control the Council.

In this case, the Council would not be consolidated by any other entity. The councillors of the Council as a group are not investors as contemplated by the Standard. They are akin to the board of directors of a company, that is, the councillors are a part of the Council itself.

Alternative Outcome

The distinction between protective and substantive rights and the significance of the substantive rights to the Council's returns are matters for judgement in view of all the facts and circumstances in any particular situation. A different list or classification of relevant activities, protective rights and substantive rights from that presented in this example might change the conclusion on control of the Council.

Implementation examples

Example IG4

XYZ University was established under an Act of the State Government. The University receives approximately 40% of its total revenue in the form of grants for various purposes, comprising 30% from the Australian Government and 10% from the State Government. The University is required by the Act to submit an annual report to the State Minister for Education.

Objectives of the University

The Act specifies that the University's objects include:

- to provide higher education at an international standard;
- to undertake scholarship and research for the advancement of knowledge and the benefit of the well-being of the State, Australian and international communities;
- to equip graduates to excel in their careers and contribute to the life of the community; and
- to serve the State, Australian and international communities and the public interest by enriching cultural and community life and promoting critical and free inquiry and public debate.

Management of the University

The governing body of the University is the University Council. The Council consists of 17 members, five of whom were appointed directly or indirectly by the State Minister. Four members were elected by the staff and students of the University. The remaining eight members were appointed by the Council itself, comprising the

three official members (the Chancellor, the Vice-Chancellor and the President of the Academic Board) and five other (non-official) members.

The Act specifies that the number of Minister-appointed members (five members in this case) must be equal to or greater than the number of non-official Council-appointed members (also five).

The Act specifies that the University Council's responsibilities, powers and functions include:

- approving the mission, strategic direction and annual budget and business plan of the University;
- establishing policies ('university statutes and regulations') relating to the governance and operation of the University, including trusts and endowments, and research, development, consultancy, commercial activities and other services undertaken for commercial organisations or public bodies;
- developing guidelines (if any) concerning the carrying out of commercial activities, finance and property matters, or any other related matter;
- overseeing the management of the property, finances and business affairs of the University, such as risk management across the University, including its commercial activities;
- any other powers and functions conferred on it by or under legislation or any university statute or regulation; and
- the power to do anything else necessary or convenient to be done for or in connection with its powers and functions.

Activities of the University

In carrying out its functions, the University undertakes a wide range of activities, including employing academic, teaching and administrative staff, determining fees and charges for courses provided to students and for commercial activities, entering into contracts, and forming or becoming a member of other entities.

State Government Involvement with the University

The State Government's objectives for the University are consistent with, but not limited to, those specified in the Act for the University. For example, the State Government anticipates State economic development as a result of the University's activities, such as the provision of housing and tourism services to

international students.

The State Minister has the following powers and functions, which are classified in this example as substantive rights under the Standard:

- fix the remuneration and fees to be paid to Council members who are not full-time staff of the University or holders of statutory office;
- approve (or veto) University statutes and guidelines made by the Council;
- declare an activity to be a university commercial activity;
- make interim guidelines concerning university commercial activities and finance and property matters – these apply unless replaced by University-submitted guidelines approved by the Minister;
- certain rights specified in State Government grants provided to the University – some of the grants detail the education or research activities to be carried out under the grant;
- in conjunction with the State Treasurer, approve the limits and conditions (eg security) for University borrowings; and
- approve (or veto) the disposal of land that was previously Crown land granted to the University.

The Minister also has the following powers, which are classified as protective rights for the purpose of this example:

- request commercial and financial reports from the University;
- refer a university commercial activity or any aspect thereof to the auditor-general for investigation and report to the Minister; and
- certain rights specified in State Government grants provided to the University – some of the grants are required to be repaid if not applied as specified.

Australian Government Involvement with the University

The Australian Government's objectives for the University are consistent with, but not limited to, those specified in the State Act for the University. For example, the Australian Government anticipates national economic development as a result of the University's activities and may seek to advance foreign policy

objectives through universities attracting international students.

The Australian Minister for Education also has the rights specified in Australian Government grants provided to the University. Some of these grants specify how they are to be applied to education or research activities (which are substantive rights for the purpose of this example) and some require their repayment if not applied as specified (protective rights for the purpose of this example).

The Minister can also request reports from the University.

University Council-directed Activities

As indicated above, the University's commercial activities and finance and property matters are subject to various State Government Ministerial powers, and government grants may be conditional. However, the University Council also has a range of powers and functions that it can exercise directly, such as the following:

- appoint the Vice-Chancellor, who is the chief executive officer of the University and responsible for the conduct of the University's affairs in all matters;
- determine the composition of borrowings within the parameters set by the State Government;
- approve the University's budget for a financial year, incorporating total revenue and the planned revenue sources, including planning the mix between teaching, research and commercial activities, the fees and charges to apply to those activities, and the type and value of government grants desired;
- determine the course mix and target student mix, such as vocational, undergraduate, graduate and executive courses, on-campus or distance learning, and local and international students;
- appoint staff and determine their terms and conditions;
- decide whether to operate through multiple campuses and how to utilise the University's infrastructure; and
- make university regulations with respect to any matter relating to the University.

Example IG4A

Control of the University

Based on the facts and circumstances outlined above, does the State Government or the Australian Government control the University in accordance with the definition of control in the Standard? If not, who controls the University?

Economic dependence

The State and Australian Governments each has a range of rights in relation to the University. The University may be economically dependent on the grants from those Governments in order to carry out its activities at their present scope and scale, but paragraphs B19 and B40 of the Standard make clear that economic dependence alone does not lead to the investor having power (as that term is used in AASB 10) over the investee. The State Government and Australian Government rights under some of their grants to the University to recover misapplied funds amount to protective rights. The repayment of such grants, potentially coupled with a reduction of Government grants in the future given the lack of compliance with grant conditions, may require the University to curtail its activities due to the reduction in funding. However, such a curtailment does not involve either Government in directing activities of the University, since it is the University that would determine which activities would be curtailed.

Relevant activities

Judgement is required to identify the University's *relevant activities*, that is, the activities that *significantly affect* the University's returns. All of the University's activities and functions contribute in some way (positive or negative) to the University achieving or furthering its objectives. Thus they are activities that affect the financial and non-financial returns of the University. However, as the University has fairly limited commercial activities in this example, the activities that most significantly affect the University's returns are the education and research activities.

Power

Protective rights held by the State and Australian Governments cannot give them power over the University. Instead, their substantive rights concerning the University's education and research activities (the relevant activities) need to be weighed

against the rights of the University Council itself, in order to assess which party has the current ability to direct the activities that most significantly affect the University's returns (or outcomes).

It is the University Council that generally directs the education and research activities. For example, the Council decides the mix between education, research and commercial activities, the courses to be offered, the target student mix, the fee structure and how to use the University's infrastructure for the activities. Some grants from the State and Australian Governments direct how they are to be applied, but these affect only a relatively small proportion of the education and research activities overall. On balance, the University Council itself appears to have the current ability to direct the relevant activities of the University.

Since the State Minister is able to appoint members of the University Council, it is necessary to consider whether the State Minister has power over the University through substantive rights to appoint a majority of the members of the University Council. In this example, the State Minister can appoint only five of the 17 members of the University Council. Therefore, the State Government is unable to direct the relevant activities of the University through appointments to the University Council.

The State Government's substantive rights in relation to the University's commercial activities or business operations are not considered in this assessment of control, since they do not relate to the relevant activities.

Neither the State Government nor the Australian Government would have power (as described in the Standard) over the University.

Returns

The State and Australian Governments are exposed, or have rights, to variable returns from their involvement with the University since the activities of the University contribute to the achievement or furtherance of the State Government's and the Australian Government's objectives for higher education. The Governments have additional objectives regarding the activities of the University, but there is no need for a direct alignment between the Governments' objectives and the University's objectives.

Ability to use power to affect returns

Since it was concluded above that in the circumstances presented

neither the State Government nor the Australian Government has power (as described in the Standard) over the University, then the third control criterion linking power and returns is also not satisfied. The Governments are able to affect the returns of the University, and thus their own indirect returns, through exercising their substantive rights. However, the Governments are unable to direct the activities that most significantly affect the University's returns.

Control conclusion

The conclusion from the above assessment is that neither the State Government nor the Australian Government has power over the University and therefore neither Government controls the University.

In this case, the University would not be consolidated by any other entity. The University Council as a group is not an investor as contemplated by the Standard. It is akin to the board of directors of a company, that is, the Council is a part of the University itself.

Example IG4B

In this example, the facts are the same as in Example IG4A except that:

- XYZ University is a research university with extensive commercial activities, and teaching activities that are limited to a small range of graduate and executive courses;
- the University receives approximately 30% of its total revenue in the form of grants for various purposes, comprising 10% from the Australian Government and 20% from the State Government;
- 50% of the total revenue is derived from commercial activities, and the balance of 20% from industry funding and course fees; and
- the State Government requires all significant commercial activities and finance and property decisions of the University to be approved by the Minister.

Based on these revised facts and circumstances, the State Government's substantive rights in respect of the University's commercial activities and its finance and property matters have a much more significant role in the operations of the University than in Example IG4A. The substantive rights may now be of such

effect that the State Government has the current ability to direct the activities that significantly affect the University's returns. In that case, the State Government would have power over the University as described in the Standard, satisfying the first control criterion.

As explained in Example IG4A, the State Government is exposed or has rights to variable returns from its involvement with the University, thus satisfying the second control criterion.

Finally, the State Government is able to use its power over the University's commercial activities to affect its returns from the University, thus meeting the third control criterion.

Control Conclusion

The conclusion from the above assessment is that in this case the State Government controls the University, assuming that the State Government's substantive rights give it the ability to direct the relevant activities of the University.

Implementation examples

Example IG5

A statutory authority SHS is established under State health services legislation to deliver services to the community. The statutory authority has a governing council that oversees the authority's operations and is responsible for its day-to-day operations. The State Health Minister appoints the authority's governing council and, subject to the Minister's approval, the authority's governing council appoints the chief executive of the authority.

The State Health Department acts as the 'system manager' for the State public health system. This role includes:

- strategic leadership, such as the development of State-wide health service plans;
- directions for the delivery of health services, such as entering into service agreements, capital works approval and management of State-wide industrial relations, including employment terms and conditions for the authority's employees; and
- monitoring of performance (eg quality of health services and

financial data) of the authority and taking remedial action when performance does not meet specified performance measures.

The Minister's approval is specifically required for the following major decisions:

- entering into service agreements with the authority;
- issuing binding health service directives;
- finalisation of State-wide health service plans and capital works planning; and
- employment and remuneration of the authority's executive staff.

Example IG5A

Based on the facts and circumstances outlined above, the Department generally acts as an agent of the State Health Minister in relation to the statutory authority. This is evident from the restricted decision-making authority held by the Department. The Department does not control the statutory authority.

As the State Health Minister appoints the statutory authority's governing council and approves the major decisions affecting the authority's activities, the Minister has the power to direct the relevant activities of the authority. Assuming that the other control criteria (variable returns and link between power and returns) are satisfied, as would be expected, then the Minister would control the statutory authority. As a result, the statutory authority would not be consolidated by the Department, but would be consolidated directly into the whole of government general purpose financial statements.

Example IG5B

The facts are the same as in Example IG5A except that:

- the Minister has delegated the power to appoint members of the statutory authority's governing council to the Department head;
- the appointment of the authority's chief executive by the governing council does not require Ministerial approval;
- the Minister has delegated the power to approve the major decisions to the Department head; and
- assessments of the Department's performance encompass the performance of the statutory authority.

In this example, the scope of the decision-making authority held by the Department has increased significantly as a result of the delegations by the Minister to the Department head. As the Department acts as a principal under the delegations, the Department has the current ability to direct the relevant activities of the authority so as to achieve the health service objectives of the Department. As the Department also has the ability to use its power over the authority to affect the nature and amount of the Department's returns, the Department controls the statutory authority.

The Department would consolidate the statutory authority into its consolidated financial statements. The Department's consolidated financial statements would then be consolidated into the whole of government financial statements.

AUSTRALIAN APPLICATION GUIDANCE

This guidance accompanies, but is not part of, AASB 10.

Exemption from Presenting Consolidated Financial Statements

AG1 The following table summarises the circumstances in which the exemption from presenting consolidated financial statements set out in paragraphs 4-Aus4.2 of this Standard may be available to a parent entity. The exemption is available only if the requirements of those paragraphs are satisfied. For example, the exemption is not available to a parent entity if it is a disclosing entity.

Same type of entity – same tier				
Ultimate or Intermediate Parent	FP – Tier 1	FP – Tier 2	NFP – Tier 1	NFP – Tier 2
Parent	FP – Tier 1	FP – Tier 2	NFP – Tier 1	NFP – Tier 2
Exemption	Available*	Available	Available	Available

Same type of entity – different tier				
Ultimate or Intermediate Parent	FP – Tier 1	FP – Tier 2	NFP – Tier 1	NFP – Tier 2
Parent	FP – Tier 2	FP – Tier 1	NFP – Tier 2	NFP – Tier 1
Exemption	Available*	Not available	Available	Not available

Different type of entity – same tier				
Ultimate or Intermediate Parent	FP – Tier 1	FP – Tier 2	NFP – Tier 1	NFP – Tier 2
Parent	NFP – Tier 1	NFP – Tier 2	FP – Tier 1	FP – Tier 2
Exemption	Available*	Available	Not available^	Available

Different type of entity – different tier				
Ultimate or Intermediate Parent	FP – Tier 1	FP – Tier 2	NFP – Tier 1	NFP – Tier 2
Parent	NFP – Tier 2	NFP – Tier 1	FP – Tier 2	FP – Tier 1
Exemption	Available*	Not available	Available	Not available

FP = For-profit entity

NFP = Not-for-profit entity

- * The exemption would not be available by reference to the intermediate parent when it is a for-profit public sector entity unable to claim compliance with IFRSs – see paragraph Aus16.2 of AASB 101 *Presentation of Financial Statements*.
- ^ When the parent entity's NFP ultimate or intermediate parent is able to claim compliance with IFRSs, the exemption is available.

Australian Accounting Standards consist of two tiers of reporting requirements for preparing general purpose financial statements:

- (a) Tier 1: Australian Accounting Standards; and
- (b) Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements.

DELETED IFRS 10 TEXT

Deleted IFRS 10 text is not part of AASB 10.

Paragraph C1

An entity shall apply this IFRS for annual periods beginning on or after 1 January 2013. Earlier application is permitted. If an entity applies this IFRS earlier, it shall disclose that fact and apply IFRS 11, IFRS 12, IAS 27 *Separate Financial Statements* and IAS 28 (as amended in 2011) at the same time.

Paragraph C8

This IFRS supersedes the requirements relating to consolidated financial statements in IAS 27 (as amended in 2008).

Paragraph C9

This IFRS also supersedes SIC-12 *Consolidation – Special Purpose Entities*.