Compiled AASB Standard **AASB 10**

Consolidated Financial Statements

This compiled Standard applies to annual periods beginning on or after 1 July 2016 but before 1 January 2022. Earlier application is permitted for annual periods beginning on or after 1 January 2014 but before 1 July 2016. It incorporates relevant amendments made up to and including 12 December 2017.

Prepared on 20 April 2018 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 – Aus33.2 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, and AASB 1057 *Application of Australian Accounting Standards*. 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.

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). Australian-specific paragraphs (which are not included in IFRS 10) are identified with the prefix "Aus". Paragraphs that apply only to not-for-profit entities begin by identifying their limited applicability.

Tier 1

For-profit entities complying with AASB 10 also comply with IFRS 10.

Not-for-profit entities' compliance with IFRS 10 will depend on whether any "Aus" paragraphs that specifically apply to not-for-profit entities provide additional guidance or contain applicable requirements that are inconsistent with IFRS 10.

AASB 1053 *Application of Tiers of Australian Accounting Standards* explains the two tiers of reporting requirements.

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 24 July 2015.

This compiled version of AASB 10 applies to annual periods beginning on or after 1 July 2016 but before 1 January 2022. It incorporates relevant amendments contained in other AASB Standards made by the AASB up to and including 12 December 2017 (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*).

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 financial statements that are available for public use and comply with IFRSs, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with this Standard.

(b) [deleted]

(c) [deleted]

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 financial statements that are available for public use in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with this Standard 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, except if the ultimate Australian parent is required, in accordance with paragraph 31 of this Standard, to measure all of its subsidiaries at fair value through profit or loss.

4A This Standard does not apply to post-employment benefit plans or other long-term employee benefit plans to which AASB 119 *Employee Benefits* applies.

4B A parent that is an investment entity shall 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.

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 Australian Accounting 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 *Disclosure of Interests in Other Entities*.

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 9.[1]

32 Notwithstanding the requirement in paragraph 31, if an investment entity has a subsidiary that is not itself an investment entity and whose main purpose and activities are providing 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*."

Commencement of the legislative instrument

Aus33.1 For legal purposes, this legislative instrument commences on 30 June 2016.

Withdrawal of AASB pronouncements

Aus33.2 This Standard repeals AASB 10 *Consolidated Financial Statements* issued in August 2011. Despite the repeal, after the time this Standard starts to apply under section 334 of the Corporations Act (either generally or in relation to an individual entity), the repealed Standard continues to apply in relation to any period ending before that time as if the repeal had not occurred.

[Note: When this Standard applies under section 334 of the Corporations Act (either generally or in relation to an individual entity), it supersedes the application of the repealed Standard.]

Appendix A
Defined terms

This appendix is an integral part of the Standard.

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: (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 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 the Standard. 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

Example 1

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 *most* 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 most 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:

(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.

Application examples
In this particular example, the investors would also consider: (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

Example 3

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.

The above fact pattern applies to examples 3A–3D described below. Each example is considered in isolation.

Example 3A

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.

Example 3B

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 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
Example 4 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 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 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.

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 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 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.

Application examples

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

Example 11

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 the defaulted receivables outside the legal boundaries of the investee.

Application examples
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 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.

Application examples

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.

Application examples

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.

Application examples
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, subject to the entity continuing to meet the definition of an investment 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 is not itself an investment entity and whose main purpose and activities are providing investment-related services or activities that relate to the investment entity's investment 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. If the subsidiary that provides the investment-related services or activities is itself an investment entity, the investment entity parent shall measure that subsidiary at fair value through profit or loss in accordance with paragraph 31.

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 the Standard and has the same authority as the other parts of the Standard.

Effective date

C1 An entity shall apply this Standard for annual periods beginning on or after 1 July 2016. Earlier application is permitted for annual periods beginning on or after 1 January 2014 but before 1 July 2016. If an entity applies this Standard earlier, it shall disclose that fact and apply AASB 11, AASB 12, AASB 127 *Separate Financial Statements* and AASB 128 at the same time.

AusC1.1 AASB 2015-6 *Amendments to Australian Accounting Standards – Extending Related Party Disclosures to Not-for-Profit Public Sector Entities* amended Example IG5 in Appendix E in the previous version of this Standard. An entity shall apply those amendments for annual periods beginning on or after 1 July 2016. Earlier application is permitted. Those amendments shall be applied prospectively as at the beginning of the annual period in which this Standard is initially applied.

C1A–
C1B [Deleted by the AASB]

C1D AASB 2015-5 *Amendments to Australian Accounting Standards – Investment Entities: Applying the Consolidation Exception*, issued in January 2015, amended the previous version of the Standard as follows: amended paragraphs 4, Aus4.1, Aus4.2, 32, B85C, B85E and C2A and added paragraphs 4A–4B. An entity shall apply those amendments for annual periods beginning on or after 1 January 2016. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

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 *Amendments to Australian Accounting Standards – Investment Entities* and AASB 2015-5 are first applied, an entity need only present the quantitative information required by paragraph 28(f) of AASB 108 for the annual 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 period that immediately precedes the date of initial application and equity at the beginning of the immediately preceding 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 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 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 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 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 (2008)), the reference to AASB 3 in paragraphs C4 and C4A shall be to AASB 3 (2008). If control was obtained before the effective date of AASB 3 (2008), an investor shall apply either AASB 3 (2008) or AASB 3 (issued in 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 (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 (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 (2004)) for those periods prior to the effective date of AASB 127 (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 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 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 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–C9 [Deleted by the AASB]

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

Example IG1

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.

The relevant activities of the association comprise:

- 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.

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.

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.

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.

Example IG1A

Based on the facts and circumstances outlined above, the religious organisation controls the association.

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.

<u>Protective rights of the State Government</u>

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.

<u>Substantive rights of the State Government</u>

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?

<u>Economic dependence</u>

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.

<u>Relevant activities</u>

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, as part of their role in the State Government, 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, given on behalf of the State Government, 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 Government 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 Government appoints the statutory authority's governing council and approves the major decisions affecting the authority's activities, the State Government 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 State Government 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 State Government 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 State Government 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 State Government 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 Australian application 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.

Compilation details
Accounting Standard AASB 10 *Consolidated Financial Statements* as amended

Compilation details are not part of AASB 10.

This compiled Standard applies to annual periods beginning on or after 1 July 2016 but before 1 January 2022. It takes into account amendments up to and including 12 December 2017 and was prepared on 20 April 2018 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 (July 2015) as amended by other Accounting Standards, which are listed in the Table below.

Table of Standards

Standard	Date made	FRLI identifier	Commence-ment date	Effective date *(annual periods … on or after …)*	Application, saving or transitional provisions
AASB 10	24 July 2015	F2015L01617	30 Jun 2016	*(beginning)* 1 Jul 2016	see (a) below
AASB 2015-10	22 Dec 2015	F2016L00035	31 Dec 2015	*(beginning)* 1 Jan 2016	see (b) below
AASB 2017-5	12 Dec 2017	F2018L00067	31 Dec 2017	*(beginning)* 1 Jan 2018	see (c) below

(a) Entities may elect to apply this Standard to annual periods beginning on or after 1 January 2014 but before 1 July 2016, provided that AASB 11 *Joint Arrangements*, AASB 12 *Disclosure of Interests in Other Entities*, AASB 127 *Separate Financial Statements* and AASB 128 *Investments in Associates and Joint Ventures* are also applied to such periods.

(b) AASB 2015-10 deferred the effective date of certain requirements included in AASB 10 to annual periods beginning on or after 1 January 2018 instead of 1 July 2016. The amendments originally set out in AASB 2014-10 (which were reversed by AASB 2015-10 from this version of AASB 10) nevertheless may be applied to annual periods beginning on or after 1 January 2014 but before 1 January 2018.

(c) AASB 2017-5 deferred the effective date of certain requirements included in AASB 10 to annual periods beginning on or after 1 January 2022 instead of 1 January 2018. The amendments originally set out in AASB 2014-10 (which were reversed by AASB 2015-10 and AASB 2017-5 from this version of AASB 10) nevertheless may be applied to annual periods beginning on or after 1 January 2014 but before 1 January 2022.

Table of amendments

Paragraph affected	How affected	By … [paragraph]
25-26	amended (for certain periods) amended (for certain periods)	AASB 2015-10 [8] AASB 2017-5 [6]
B99A	deleted (for certain periods) deleted (for certain periods)	AASB 2015-10 [8] AASB 2017-5 [6]
C1C	deleted (for certain periods) deleted (for certain periods)	AASB 2015-10 [8] AASB 2017-5 [6]

Deleted IFRS 10 text

Deleted IFRS 10 text is not part of AASB 10.

C1A *Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance* (Amendments to IFRS 10, IFRS 11 and IFRS 12), issued in June 2012, amended paragraphs C2–C6 and added paragraphs C2A–C2B, C4A–C4C, C5A and C6A–C6B. An entity shall apply those amendments for annual periods beginning on or after 1 January 2013. If an entity applies IFRS 10 for an earlier period, it shall apply those amendments for that earlier period.

C1B *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), issued in October 2012, 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 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 *Investment Entities* at the same time.

C8 This IFRS supersedes the requirements relating to consolidated financial statements in IAS 27 (as amended in 2008).

C9 This IFRS also supersedes SIC-12 *Consolidation—Special Purpose Entities*.

Basis for Conclusions on AASB 2011-5 and AASB 2011-6

This Basis for Conclusions accompanies, but is not part of, AASB 10. The Basis for Conclusions was originally published with AASB 2011-6 Amendments to Australian Accounting Standards – Extending Relief from Consolidation, the Equity Method and Proportionate Consolidation – Reduced Disclosure Requirements.

Introduction

BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's considerations in reaching the conclusions in AASB 2011-5 *Amendments to Australian Accounting Standards – Extending Relief from Consolidation, the Equity Method and Proportionate Consolidation* and AASB 2011-6 *Amendments to Australian Accounting Standards – Extending Relief from Consolidation, the Equity Method and Proportionate Consolidation – Reduced Disclosure Requirements*. Individual Board members gave greater weight to some factors than to others.

Background

BC2 Paragraph 10 of AASB 127 *Consolidated and Separate Financial Statements* (in common with IAS 27 *Consolidated and Separate Financial Statements*) provides relief from preparing consolidated financial statements for parents that meet four criteria, including having an ultimate parent or an intermediate parent that prepares IFRS-compliant consolidated financial statements (paragraph 10(d)).

BC3 Due to the addition of Aus paragraphs in IFRSs as adopted in Australia, the financial statements of some entities applying Australian Accounting Standards are not IFRS compliant. This means that a parent that has an ultimate parent or other intermediate parent that prepares non-IFRS-compliant consolidated financial statements does not have access to the exemption from consolidation provided in paragraph 10 of AASB 127, even if the criteria in paragraphs 10(a) to 10(c) are met.

BC4 Similarly, investors need not apply the equity method when they meet the four criteria in paragraph 13(c) of AASB 128 *Investments in Associates* and venturers need not apply proportionate consolidation or the equity method when they meet the four criteria in paragraph 2(c) of AASB 131 *Interests in Joint Ventures*. The criteria in paragraph 10 of AASB 127, paragraph 13(c) of AASB 128 and paragraph 2(c) of AASB 131 are similar.

BC5 Consequently, the exemptions from the equity method and proportionate consolidation are also not available under those paragraphs to an investor or a venturer when its ultimate parent or intermediate parent prepares non-IFRS-compliant consolidated financial statements.

BC6 The AASB issued Exposure Draft ED 205 *Extending Relief from Consolidation, the Equity Method and Proportionate Consolidation* in September 2010. The AASB considered the submissions received from constituents and confirmed the principal approach proposed in the Exposure Draft.

New Zealand approach

BC7 During its development of ED 205, the AASB noted that a related issue was considered by the Financial Reporting Standards Board (FRSB) of the New Zealand Institute of Chartered Accountants in December 2008. This concerned the requirement in paragraph 10(d) of NZ IAS 27 *Consolidated and Separate Financial Statements* that the parent's financial statements must be 'available for public use'. Due to the reporting requirements in New Zealand, not all entities are required to file their financial statements with the Companies Office. Hence, when a parent of a group is not required to submit its financial statements, any intermediate subsidiaries were unable to use the paragraph 10 exemption. As a result, the FRSB inserted paragraph NZ 3.1 into NZ IAS 27 so that entities that qualify for differential reporting concessions were not required to comply with paragraph 10(d). In order to qualify for the exemption not to present consolidated financial statements, qualifying entities were still required to comply with all the other conditions in paragraph 10.

BC8 In addition, the AASB noted that the FRSB had inserted a similar exemption into NZ IAS 28 *Investments in Associates* (paragraph NZ 1.2) and NZ IAS 31 *Interests in Joint Ventures* (paragraph NZ 1.1), extending the relief from application of the equity method by investors and proportionate consolidation or the equity method by venturers.

BC9 The AASB did not follow the FRSB's specific approach for qualifying entities, given the different issues faced by the two Boards and the different financial reporting framework in New Zealand, including its differential reporting framework that involves modifications to the recognition and measurement requirements of IFRSs.

Extending the exemptions

BC10 The AASB considered the limitations on the exemptions and developed a view that relief from consolidation, the equity method and proportionate consolidation should be extended to a not-for-profit or Tier 2 parent, investor or venturer if it:

(a) has a parent higher up in the group that prepares consolidated financial statements (whether or not IFRS-compliant) that are available for public use and:

(i) those consolidated financial statements incorporate the information that would otherwise have been presented in the parent's consolidated financial statements or the investor's or venturer's financial statements; or

(ii) the parent, investor or venturer is an entity complying with Australian Accounting Standards – Reduced Disclosure Requirements ('Tier 2'); and

(b) meets the criteria in paragraphs 10(a) to 10(c) of AASB 127, paragraphs 13(c)(i) to 13(c)(iii) of AASB 128 or paragraphs 2(c)(i) to 2(c)(iii) of AASB 131, as relevant.

BC11 This view is based on the principle that financial statement users would be able to satisfy their information needs through the consolidated financial statements prepared by the parent higher up in the group. However, the AASB decided that such relief should not be available in relation to the General Government Sector (GGS) of each Federal, State and Territory Government due to the unique circumstances related to the GGS, its relationship to the whole of government and its macro-economic significance. The AASB also decided that the partial consolidation basis for GGS financial statements required by AASB 1049 *Whole of Government and General Government Sector Financial Reporting* would not be amended.

BC12 Consistent with IAS 27, IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures*, the AASB decided that the existing relief provided under paragraph 10 of AASB 127, paragraph 13(c) of AASB 128 and paragraph 2(c) of AASB 131 should be retained. The extension of relief on the basis set out in paragraph BC10 does not change the present requirements for relief when the ultimate or intermediate parent is a for-profit Tier 1 entity – that entity is still required to prepare IFRS-compliant consolidated financial statements.

Not-for-profit ultimate or intermediate parent

BC13 When the ultimate or intermediate parent is a not-for-profit Tier 1 entity, and the parent, investor or venturer is a for-profit Tier 1 entity, the relief is not available where there are differences in the basis of accounting between the not-for-profit and for-profit entities as a result of the not-for-profit entity applying Standards or Aus paragraphs that contain requirements that are inconsistent with IFRS requirements. Extending relief to the for-profit Tier 1 parent, investor or venturer in this case would be beyond the scope of the relief available under IFRSs. However, the relief is available when the not-for-profit entity is not required to apply such inconsistent requirements. This is indicated by footnote to the table in paragraph AG1 of the Australian application guidance added to AASB 127. In this case, the for-profit Tier 1 entity would be able to claim compliance with IFRSs in that the relief is within the scope of the relief available under IFRSs.

BC14 The AASB considered the extension of relief to a for-profit Tier 2 parent, investor or venturer that has a not-for-profit ultimate or intermediate parent. The table in the Basis for Conclusions in ED 205 proposed that relief should be available to a parent, investor or venturer in these circumstances, which appears to be inconsistent with the circumstances addressed in paragraph BC13. The AASB considered three approaches to addressing the apparent inconsistency:

(a) amend the table proposed in ED 205 to indicate that the relief would not be available;

(b) retain the approach proposed in ED 205, that the relief would be available, and extend the justification in the Basis for Conclusions for this position; or

(c) retain the approach proposed in ED 205 with no amendment to the justification.

BC15 The AASB adopted the approach in paragraph BC14(b), extending the relief, based on its judgement that the relief would be reasonable for Tier 2 parents, investors or venturers despite any differences in the basis of accounting in the consolidated financial statements of the ultimate or intermediate parent that are publicly available. Typically, the not-for-profit ultimate or intermediate parent would not be able to claim compliance with IFRSs, and the Tier 2 parent, investor or venturer could not do so.

For-profit public sector entities

BC16 The AASB decided that relief would not be available to a parent entity merely because the intermediate parent preparing consolidated financial statements is a for-profit Tier 1 public sector entity unable to claim compliance with IFRSs. This decision was made on the basis that a for-profit public sector entity may apply requirements in particular Standards, such as AASB 1004 Contributions, and Aus paragraphs in other Australian Accounting Standards that are inconsistent with an IFRS requirement. However, relief may be available to the parent entity on another basis permitted by the Standard.

BC17 Relief is (or is not) available to a for-profit public sector entity as the parent, investor or venturer on the same basis as for any other for-profit parent, investor or venturer.

Other changes

BC18 The AASB also decided that, consistent with paragraph 10(d) of AASB 127, the references to 'Australian equivalents to IFRSs' in paragraph 13(c)(iv) of AASB 128 and paragraph 2(c)(iv) of AASB 131 should be amended to 'International Financial Reporting Standards'.

BC19 The AASB decided to include the summary table set out in the Basis for Conclusions in the Exposure Draft as Australian application guidance accompanying, but not part of, the amended AASB 127. Whereas the table in the Exposure Draft addressed relief in relation to both not-for-profit entities and entities applying reduced disclosure requirements under AASB 1053 *Application of Tiers of Australian Accounting Standards*, the table added to the AASB 127 guidance by AASB 2011-5 addresses not-for-profit entities but not reduced disclosure requirements.

Reduced disclosure requirements

BC20 Exposure Draft ED 205, in addition to addressing relief for not-for-profit entities, also proposed the extension of relief to entities applying Australian Accounting Standards – Reduced Disclosure Requirements under AASB 1053. The AASB decided that relief should be extended to Tier 2 entities, either on the same basis as for not-for-profit entities or as addressed in paragraphs BC14 and BC15. Accounting Standard AASB 2011-6 provides this relief. That Standard also expands the table in the Australian application guidance accompanying AASB 127 to address entities applying reduced disclosure requirements.

BC21 Whereas AASB 2011-5 applies to annual reporting periods beginning on or after 1 July 2011, AASB 2011-6 applies to annual reporting periods beginning on or after 1 July 2013, being the application date of the reduced disclosure requirements under AASB 1053. Accordingly, two amending Standards were prepared to reflect the different application dates. Early application of each Standard is permitted. Early application of AASB 2011-6 requires early application of AASB 1053.

Basis for Conclusions on AASB 2013-5 and dissenting views

This Basis for Conclusions accompanies, but is not part of, AASB 10. The Basis for Conclusions was originally published with AASB 2013-5 Amendments to Australian Accounting Standards – Investment Entities.

BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's (AASB) considerations in issuing AASB 2013-5 *Amendments to Australian Accounting Standard – Investment Entities*. Individual Board members gave greater weight to some factors than to others.

Background

BC2 AASB 2013-5 is the result of the AASB's due process, which began when the AASB issued Exposure Draft ED 220 *Investment Entities* (AASB ED 220) in September 2011 (incorporating International Accounting Standards Board [IASB] ED/2011/4 *Investment Entities*). That Exposure Draft proposed that an investment entity be required to account for investees that it controls at fair value through profit or loss, rather than consolidate them.

BC3 In the material accompanying ED 220, AASB members expressed concerns with the ED/2011/4 proposals, including:

(a) the exception to consolidation goes against the application of the well-established accounting concept of control, which is designed to result in the presentation of all the assets, liabilities, income and expenses of the group, and the amendments would result in a loss of relevant information for users of financial statements;

(b) the basis of the exception to consolidation is the type of entity, rather than the underlying relationship between investors and investees; and

(c) there are no clear principles underpinning the classification of entities as investment entities and the criteria for identifying investment entities are rule-based and open to opportunistic behaviour.

BC4 As evident from the responses to ED 220, views were divided among Australian constituents. Some expressed concerns similar to those of the AASB members. However, others expressed broad support for requiring some types of entities to account for controlled investees at fair value through profit or loss, rather than having them consolidate such entities.

BC5 The AASB expressed its concerns in its submission to the IASB on IASB ED/2011/4.

BC6 In October 2012, the IASB amended IFRS 10 *Consolidated Financial Statements*, IFRS 12 *Disclosures of Interest in Other Entities* and IAS 27 *Separate Financial Statements* for investment entities to provide an exception to consolidating particular subsidiaries for investment entities, requiring them instead to measure their investments in unconsolidated subsidiaries at fair value through profit or loss.

BC7 The AASB noted that its concerns with the ED/2011/4 proposals were not adequately addressed in the IASB amendments. The AASB also considered the disclosures required by the IASB amendments and noted that they require an investment entity to provide information about the exception to consolidation rather than addressing the loss of consolidation information that preparing a complete set of consolidated general purpose financial statements would provide.

BC8 Because of its concerns with the IASB amendments, the AASB decided to undertake further due process. After considering a number of different possible approaches to the recognition and measurement of controlled investees of investment entities, including (i) consolidation and (ii) fair value measurement with compensating disclosures, the AASB issued ED 233 *Australian Additional Disclosures – Investment Entities* in December 2012. It proposed to introduce the exception to consolidation for investment entities (as per the IASB amendments) and to require Australian additional disclosures for Australian entities that meet the IASB's investment entity criteria. The Australian additional disclosures proposed in ED 233 were in the form of:

- consolidated financial statements prepared in a manner consistent with the definition of consolidated financial statements in Appendix A of AASB 10 *Consolidated Financial Statements*; and
- a summary of the significant accounting policies used in preparing those consolidated financial statements that are not otherwise disclosed in accordance with AASB 101 *Presentation of Financial Statements*.

BC9 ED 233 also specifically asked respondents whether they have any alternative approaches/disclosure strategies that can be employed to minimise the adverse impact on the decision-making of the loss of consolidation information.

BC10 The AASB received 29 submissions on ED 233. The vast majority of respondents did not support the proposed Australian additional disclosures. These respondents expressed support for introducing the IASB amendments without Australian additional disclosures.

BC11 The AASB staff also conducted targeted outreach with users of financial statements and the limited feedback received indicated that if there were to be Australian additional disclosures required, an example of the information that would be relevant is information about the earnings and liabilities of subsidiaries of investment entities.

AASB deliberations on adopting the IASB amendments in Australia without Australian additional disclosures

BC12 The AASB considered three main approaches to introducing the IASB amendments for investment entities in Australia:

A. issue the IASB amendments without Australian additional disclosures;

B. issue the IASB amendments with Australian additional disclosures as proposed in AASB ED 233; and

C. issue the IASB amendments with Australian additional disclosures that are reduced compared with the ED 233 proposals, in particular, disclosures about an unconsolidated subsidiary's total assets, total liabilities and total comprehensive income.

BC13 The AASB considered and rejected the approach of not adopting the IASB's amendments for Australian investment entities as this would result in Australian investment entities not being able to assert IFRS compliance, an outcome that would be contrary to the AASB's policy of having "… Tier 1 for-profit entities being IFRS compliant"[2].

BC14 The majority of AASB members expressed a preference for, or could at least accept, Approach A, consistent with the AASB's policy of IFRS adoption. Some members consider that the fair value of controlled entities can arguably be regarded as more relevant for users of financial statements of investment entities than consolidation information. Some other members consider that the IASB's criteria for determining investment entities lack rigour and could lead to inconsistent application. However, on balance, the majority of members are willing to accept, in the absence of evidence to the contrary, that the IASB amendments, including the disclosures required of investment entities in accordance with IFRS 12, would be sufficient to meet the needs of users of financial statements of investment entities, consistent with the feedback received from the vast majority of the respondents to ED 233.

BC15 This majority of AASB members could not accept Approach C as there was insufficient feedback from users to suggest that the reduced disclosures proposed in Approach C would be useful. Those AASB members did not think it appropriate to delay adoption while further input from users is sought.

BC16 The AASB noted the wide range of arguments put forward by respondents to ED 233 for favouring Approach A including the view that fair value information is most relevant for investors of investment entities in many circumstances; and the cost to Australian preparers of financial statements compared with other jurisdictions of providing Australian additional disclosures . However, despite accepting Approach A, the AASB did not accept all of those arguments. In particular, the AASB did not accept the arguments that requiring Australian additional disclosures would reduce comparability (as distinct from uniformity) between Australian investment entities and their international counterparts or would lead to the perception that Australian investment entities are not IFRS compliant.

BC17 On balance, the AASB decided to adopt Approach A. This was on the basis that the AASB would monitor the implementation of the IASB amendments for Australian investment entities. This would include monitoring the disclosures made in accordance with AASB 12 *Disclosure of Interests in Other Entities* and AASB 101 *Presentation of Financial Statements* paragraph 17(c)[3]. Such monitoring, which may be via a post-implementation review, would be undertaken with a view to potentially adding Australian additional disclosure requirements at a later stage, if it were to become evident that additional disclosures are warranted, noting that such disclosures might be different from those proposed in ED 233 or Approach C.

2 AASB Policy Statement *Policies and Processes* March 2011, paragraph 7

3 AASB 101 paragraph 17(c) requires an entity to provide additional disclosures when compliance with the specific requirements in Australian Accounting Standards is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

Monitoring might also lead to the AASB deciding to write to the IASB, informing it of the findings and concerns arising from the Australian experience.

GAAP/GFS Harmonisation

BC18 In adopting Approach A, the AASB considered whether there would be any GAAP/GFS harmonisation implications that it would need to address in the context of AASB 1049 *Whole of Government and General Government Sector Financial Reporting*. The AASB noted that no such implications are expected to arise because, although the whole of government or general government sector might be a parent of an investment entity, the whole of government and general government sector would not themselves be investment entities.

Application to Tier 2

BC19 The AASB noted that the way in which the IASB has defined an investment entity (including that such an entity need not have more than one investor) could result in there being investment entities that do not have public accountability as defined in Appendix A of AASB 1053 *Application of Tiers of Australian Accounting Standards* and are therefore eligible to present Tier 2 general purpose financial statements.

BC20 In addition, the AASB considered the entities listed in Appendix B of AASB 1053 that are deemed to have public accountability. Whilst many investment entities would fall within the list of deemed entities, there could be a number of investment entities that would not be captured – for example, managed investment schemes that are investment entities but are not registered and therefore, again potentially eligible to present Tier 2 general purpose financial statements.

BC21 The AASB conducted due process on whether Tier 2 investment entities should be provided with any relief from the disclosures required by the IASB amendments through ED 220.

BC22 After considering constituent feedback, the AASB decided the disclosures in the IASB amendments for investment entities should be applied to both Tier 1 and Tier 2 investment entities as it considers those disclosures to be fundamental to the needs of users in decision-making. Accordingly, the AASB decided that it would not be appropriate to exempt those investment entities from any of the disclosures in the IASB amendments.

Dissenting views

Dissent of Peter Gibson, Jayne Godfrey, John O'Grady and Kevin M. Stevenson

DO1 In our opinion the exception to consolidation for investment entities that requires controlled investees to be measured at fair value through profit or loss rather than being consolidated is a violation of the basic principle that an entity should account for all of its assets, liabilities, income and expenses.

DO2 At the most fundamental level we do not see the provision of fair value information for investments as a substitute for, or an alternative to, consolidated information. Without the detailed consideration of that part of the financial position and financial performance of an entity represented by its controlled entities, fair value movements would not be sufficient for decision-making and offset too much information into a single line item.

DO3 We regard the exception as fundamentally based on a view that an entity's business model should determine accounting treatments. However, we do not believe that an entity's business model should drive how it accounts for its controlled investees. In our opinion, the business model approach and the IASB's criteria for determining investment entities, which we believe lack rigour, will lead to uncertainty in application and inconsistency of reporting between similar entities. This approach also has the potential to promote structuring opportunities to avoid consolidation. In turn, this would be to the detriment of providing useful, comparable information to users of financial statements.

DO4 We believe that providing exceptions to principles further complicates accounting, introduces unjustified complexity to financial statements and reduces comparability of entities' financial reports across sectors. It also creates a precedent for further, less rigorous standard-setting.

DO5 For Australia, the exception to consolidation would require de-consolidation of controlled entities when Australia has been well-served by the control principle and has been relatively free of criticism of off-balance-sheet accounting.

DO6 Additionally, we have not heard from users of financial statements of investment entities in Australia that consolidation information is not useful or relevant for decision-making.

DO7 Furthermore, if the fair values of controlled investments held by investment entities are relevant, we are of the view that they could be provided as supplementary disclosures in financial statements, consistent with the disclosure requirements in AASB 7 Financial Instruments: Disclosures for financial instruments with carrying amounts that differ from their fair value.

Basis for Conclusions on AASB 2013-8

This Basis for Conclusions accompanies, but is not part of, AASB 10. The Basis for Conclusions was originally published with AASB 2013-8 Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities – Control and Structured Entities.

Background

BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's considerations in reaching the conclusions in this Standard. Individual Board members gave greater weight to some factors than to others.

BC2 Before finalising the implementation guidance set out in this Standard, the Board issued Exposure Draft ED 238 *Consolidated Financial Statements – Australian Implementation Guidance for Not-for-Profit Entities* in March 2013. ED 238 proposed for public comment implementation guidance for not-for-profit entities in respect of both AASB 10 *Consolidated Financial Statements* and AASB 12 *Disclosure of Interests in Other Entities*. The Board considered the submissions received in response to ED 238 in deciding the implementation guidance to be added to those Standards.

BC3 In the process of developing the proposals in ED 238, the Board commissioned research into the implementation issues that had been encountered by not-for-profit entities in applying the notion of control (and related public sector guidance) in the superseded Accounting Standard AASB 127 *Consolidated and Separate Financial Statements*. Discussions were also held with constituents experienced in not-for-profit public sector and private sector financial reporting, to ascertain implementation issues that might be encountered in applying AASB 10 (which replaces AASB 127, in part) in a not-for-profit context. Based on the research findings and the nature of many of the issues identified, the Board concluded that the principles in AASB 10 could be applied in a not-for-profit context, albeit using professional judgement, and that certain aspects of those principles and the terminology adopted warranted specific implementation guidance for not-for-profit entities.

BC4 In addition, the Board noted that some of the issues identified through the research are fundamental to the notion of control and therefore beyond the scope of AASB 10. These issues include:

(a) the nature of government departments as reporting entities;

(b) the role that disclosure of disaggregated information in whole of government financial reports might play in providing relevant information to users; and

(c) control of assets.

BC5 The Board concluded that, because they are beyond the scope of AASB 10 and would not impede the application of AASB 10 by not-for-profit entities, these issues do not need to be addressed prior to clarifying for not-for-profit entities the application of the notion of control in AASB 10. The Board noted that this approach is consistent with its policy of transaction neutrality. Accordingly, the Board decided to progress its Control in the Not-for-Profit Public and Private Sectors project in stages. The first stage, completed by the issue of this Standard, is intended to clarify the application of AASB 10 (and AASB 12) in a not-for-profit context. It is expected that later stages will address the associated fundamental issues noted above.

BC6 The Board also noted the current project of the International Public Sector Accounting Standards Board (IPSASB) to update its consolidation, joint ventures and associates Standards for the issuance of IFRS 10 *Consolidated Financial Statements* and its related IFRSs. The IPSASB published its Exposure Drafts in October 2013, but the AASB decided to finalise the implementation guidance for AASB 10 and AASB 12, having considered the decisions of the IPSASB as it developed its Exposure Drafts.

BC7 Since the implementation guidance does not change or depart from the principles in AASB 10, the types of harmonisation differences between AASB 10 and the ABS GFS Manual are not affected by the guidance. Accordingly, pre-existing GAAP/GFS differences were not addressed in ED 238.

BC8 The remainder of this Basis for Conclusions outlines the basis for the Board's decisions relating to the first stage of the project.

Significant issues

Nature and location of guidance relating to AASB 10

BC9 The Board considered whether the implementation guidance to be added to AASB 10 should be integrated into the body of that Standard as Aus paragraphs. The Board decided that, in general, consistent with a principles-based approach to drafting Standards, Aus paragraphs in the body of the Standard should be limited to those that either amend the requirements in AASB 10 or add new requirements. As the implementation guidance neither amends the requirements nor adds new requirements for not-for-profit entities, the Board decided that the guidance should not be presented as Aus paragraphs within the body of AASB 10. However, the Board decided to include one Aus paragraph in the body of the Standard as a signpost to the implementation guidance.

BC10 The Board then considered whether the guidance should be presented as Aus paragraphs located throughout the existing Application Guidance (Appendix B to AASB 10) or as a separate attachment to AASB 10. As Appendix B is integral to AASB 10 and therefore has the same authority as the other parts of the Standard, Aus paragraphs in Appendix B should also be limited to those that either amend the requirements in AASB 10 or add new requirements. Accordingly, the Board applied the same approach as stated in paragraph BC9 and decided to add the not-for-profit entity implementation guidance to AASB 10 as an attachment rather than as Aus paragraphs within Appendix B.

BC11 The implementation guidance is attached to AASB 10 as Appendix E. The Appendix is integral to the Standard and thus has the same authority as the body and other appendices of the Standard. The Board considered whether the guidance should merely accompany, and not be part of, AASB 10. To facilitate the guidance being applied consistently by not-for-profit entities, the Board decided to make the guidance integral to AASB 10.

BC12 The Appendix added to AASB 10 is labelled as Appendix E, to be consistent with the labelling of the appendices to IFRS 10 *Consolidated Financial Statements*. In IFRS 10, Appendix D consists of the consequential amendments to other Standards and Interpretations arising from the issuance of IFRS 10. AASB 10 does not have any Appendix D since those consequential amendments were made in AASB 2011-7 *Amendments to Australian Accounting Standards arising from the Consolidation and Joint Arrangements Standards* (August 2011), following the Board's practice of making amendments via separate Standards rather than through appendices to Standards.

Terminology in AASB 10

BC13 As AASB 10 incorporates IFRS 10, issued by the International Accounting Standards Board (IASB), the text of the body of AASB 10 and Appendices A–C is expressed from the perspective of for-profit entities in the private sector. The Board considered that some of the terminology in the Standard does not readily translate to a not-for-profit perspective and decided that it would be useful to explain that terminology for application in a not-for-profit context, rather than revise the terminology in some way for not-for-profit entities. The terms 'investor' and 'investee', for example, figure prominently in AASB 10, including in the definition of control, and are described in general terms in paragraph IG3 of Appendix E for AASB 10. The nature of 'returns', as another example, is also addressed in the implementation guidance. The Board believes the explanations provided will assist a not-for-profit entity to better relate to and apply the requirements of AASB 10.

Implementation guidance on control

BC14 In developing the implementation guidance, including some comprehensive examples, the Board sought to address the implementation issues that were identified in the research referred to in paragraph BC3 on the application of the notion of control by not-for-profit entities in the private and public sectors. For example, the guidance addresses rights arising from statutory arrangements (paragraphs IG6–IG7), economic dependence (paragraphs IG11–IG12), regulatory powers (paragraphs IG16–IG17), indirect returns (or benefits) to not-for-profit entities and congruent objectives (paragraphs IG18–IG20), and delegated power (paragraphs IG21–IG24).

BC15 The Board did not include implementation guidance in respect of some topics covered by AASB 10 due to the Board's assessment that the issues arise similarly for both for-profit entities and not-for-profit entities. For example, the requirements regarding de facto agents and control of specified assets raise issues in practice for any entity, not just not-for-profit entities.

Examples

BC16 To illustrate the requirements of AASB 10, the implementation guidance includes examples within guidance paragraphs as well as five discrete, comprehensive examples. The examples refer to particular types of not-for-profit entities, some in the private sector and others in the public sector. However, the Board intended that the examples apply by analogy to other types of not-for-profit entities and similar circumstances as relevant, rather than being limited to the specific cases presented.

BC17 The comprehensive examples emphasise a principles-based approach, which requires an analysis of the relevant activities of the investee and of the substantive rights of various investors in considering whether the investor has power (as that term is used in AASB 10) over the investee. The Board noted that it could be difficult to distinguish substantive rights from protective rights held by an investor in relation to an investee. Therefore, the Board decided to note in the introduction to the comprehensive examples that 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. The Board also decided to include a range of scenarios in most of the comprehensive examples to illustrate that alternative outcomes for the assessment of control by the investor reflect the facts and circumstances in any particular case.

BC18 The Board included specific comprehensive examples in respect of a local government (Example IG3) and a university (Example IG4), given the anticipated uncertainty in respect of how AASB 10 might apply in determining whether such entities are controlled by another entity. Two scenarios under which different control conclusions might be drawn are presented in the university example, whereas the local government example includes only one case, in which it is concluded that the local government is not controlled by another government. The Board took the view that this would be the normal outcome in relation to local governments under current arrangements in Australia, but noted in paragraph IG8 and at the end of Example IG3 that the assessment of whether a local government is controlled by another government would depend on the particular facts and circumstances.

BC19 Given the types of arrangements often found in the public sector, the Board also decided that an example concerning delegated powers and agency relationships affecting public sector entities would be useful guidance. Example IG5 presents two scenarios regarding whether a government department controls a statutory authority. The example might be relevant in some jurisdictions but not in others.

Former guidance in superseded AASB 127

BC20 The Board reviewed the specific public sector guidance in the superseded AASB 127 *Consolidated and Separate Financial Statements* (paragraphs Aus17.1–Aus17.10) in the context of the three criteria for control set out in AASB 10: power, returns, and a link between power and returns. Some of the guidance in the superseded AASB 127 was not incorporated into Appendix E, on the grounds that the Board considered that it was either inconsistent with or beyond the scope of the requirements of AASB 10 or no longer necessary. The following paragraphs address the major aspects of the guidance in the superseded AASB 127.

BC21 Paragraph Aus17.1 stated that AASB 127 did not attempt to identify all groups and reporting entities in the public sector. Nevertheless, paragraph Aus17.5 described the nature of some reporting entities in the public sector. Paragraph Aus17.7 also discussed identifying economic entities in relation to Ministerial portfolios and functions with separate objectives. The Board decided that it was not appropriate to include these general statements in the implementation guidance since the nature of reporting entities in the public sector is a fundamental issue beyond the scope of AASB 10 (see paragraph BC4).

BC22 The statement in paragraph Aus17.2 that control of an entity by the government may be indicated by the accountability of the entity to the Parliament (or the Executive or a Minister) and by the government holding the residual financial interest in the net assets of the entity has not been incorporated into the implementation guidance. Accountability to the Parliament, the Executive or a Minister might or might not indicate that the government has substantive rights in relation to the entity, so the power criterion might not be satisfied. Holding the residual financial interest in the entity shows that the government has exposure or rights to variable returns from the entity, but does not indicate whether the government has the ability to use power over the entity to affect the government's returns. Consequently, these two factors are insufficient to conclude whether an entity is controlled by the government.

BC23 Paragraph Aus17.3 listed circumstances that, individually or in combination, indicate that an entity is accountable to Parliament, the Executive or a Minister. The circumstances listed in paragraphs Aus17.3(a)–(d) are addressed in paragraphs B15 and IG9 in terms of rights that can give an investor power in relation to an investee. However, paragraph Aus17.3(e) has not been included in the implementation guidance because a requirement to submit reports to Parliament might reflect either protective or substantive rights, and hence is not useful as an indicator of power. Paragraph Aus17.3(f) regarding an entity established through legislation has been updated and included in paragraph IG7.

BC24 Paragraph Aus17.4 listed circumstances that indicate whether a government has a residual financial interest in the net assets of another entity. These circumstances (exposure to residual liabilities and the right to receive residual net assets on dissolution of the entity) indicate that the government would be exposed to variable returns from the entity. These returns are covered by the investment returns noted in paragraph B57(a).

BC25 Paragraph Aus17.6 stated that a government will usually control statutory authorities that it has established through legislation. This circumstance has been addressed through paragraph IG7 in respect of whether the government has power over an entity established through legislation. Power is just one of the control criteria.

BC26 Restrictions on the allocation of funds between activities and the existence of separate administrations are listed in paragraph Aus17.7 as factors that may affect the ability of an entity to deploy resources and should be considered in determining the existence of a group in the public sector. The ability to deploy resources is relevant to assessing whether an investor has power over an investee (see paragraph IG5). Restrictions on the ability to deploy resources may reflect barriers that prevent the holder of rights from exercising them. Examples of barriers are listed in paragraph B23, including operational barriers and legal or regulatory requirements.

BC27 Paragraph Aus17.8 noted that for a government to control an entity, it must have the power to require the entity's assets to be deployed towards achieving the government's objectives, and listed various actions that the government might be able to direct in respect of the controlled entity's assets. Whether these circumstances result in the government controlling the entity under AASB 10 would depend on whether the government has power to direct the relevant activities of the entity. The actions listed are broadly consistent with the activities listed in paragraph B11 that can be relevant activities of an investee, depending on the circumstances of the investee.

BC28 Paragraph Aus17.9 outlined a range of circumstances in which a government does not control another entity, such as an entity dependent on government funding but able to decide whether to accept resources from the government and how to use the resources (paragraphs Aus17.9(a) and (c)). These examples are no longer needed as paragraphs IG11 and IG12 concerning economic dependence and paragraph IG20 in respect of congruent objectives adequately address the issues.

BC29 Paragraph Aus17.9(b) stated that a government acting as the trustee of a trust would not control the trust as it would not be able to deploy the resources of the trust for its own benefit. In contrast, the implementation guidance includes an example of a trust that is controlled through the trustee (paragraph IG22). Under AASB 10, the investor's returns from a trust may be indirect non-financial returns, which the former guidance did not acknowledge.

BC30 Regulatory powers were addressed in paragraph Aus17.9(d) as not giving rise to control of regulated entities. Paragraph IG16 states that regulatory powers may represent either substantive rights (which could result in control of regulated entities) or protective rights (which would not result in control). Examples of protective rights are included in paragraph IG17.

BC31 Paragraph Aus17.9(e) stated that under existing legislative arrangements, State and Territory governments do not control local governments. The Board reconsidered the question of control of local governments but did not reach a categoric view. As noted in paragraph BC18, the Board concluded that although a local government normally would not be controlled by another government under current arrangements, the assessment of whether a local government is controlled by another government would depend on the particular facts and circumstances (paragraph IG8). Example IG3 illustrates how a decision as to whether a local government is controlled by another government could be addressed.

BC32 The final paragraph in the former public sector guidance, paragraph Aus17.10, addressed government control of independent statutory offices such as auditors-general and the judiciary. The same examples have been incorporated into the implementation guidance in paragraph IG10, which addresses more particularly the organisations assisting the independent statutory office holders.

AASB 12 and structured entities

BC33 While considering issues regarding AASB 10, the Board noted that the definition of 'structured entity' in AASB 12 *Disclosure of Interests in Other Entities* does not readily translate to a not-for-profit perspective as it focusses on voting or similar rights, which have less significance in general for many not-for-profit entities. The Board decided to propose implementation guidance to assist not-for-profit entities in applying this definition. As AASB 12 applies to not-for-profit entities in conjunction with AASB 10, the Board included the proposals in the same Exposure Draft (ED 238).

BC34 After considering the submissions received on the ED, the Board decided to add implementation guidance as Appendix E to AASB 12, integral to the Standard and thus with the same authority as the body and other appendices of the Standard. These decisions reflect the decisions on the nature and location of guidance as set out in paragraphs BC9–BC12 in respect of the AASB 10 guidance.

BC35 The Board decided that the implementation guidance for AASB 12 should be based on the principle underlying the definition of structured entity, and identified that principle as limiting the scope of structured entities to entities that are controlled through less conventional means. This is based on the definition emphasising that voting or similar rights are not the dominant factor in deciding who controls a structured entity – and for for-profit entities, voting rights are a common or conventional means of determining control.

BC36 The Board identified administrative arrangements and statutory provisions (legislation) as common means by which control may be determined for many not-for-profit entities, particularly those in the public sector. Accordingly, the Board took the view that the reference to 'similar rights' in the definition of structured entity encompasses, for not-for-profit entities, administrative arrangements and statutory provisions. Thus, not-for-profit entities for which administrative arrangements or statutory provisions are dominant factors in determining control of the entity are not regarded as structured entities. Appendix E for AASB 12 includes a range of examples to illustrate this approach.

AASB 1049 amendments

BC37 AASB 1049 *Whole of Government and General Government Sector Financial Reporting* was not addressed in the consequential amendments arising from AASB 10 (and related Standards) that were included in AASB 2011-7 *Amendments to Australian Accounting Standards arising from the Consolidation and Joint Arrangements Standards* (August 2011), given that the Board intended to address the application of AASB 10 to not-for-profit entities through its Control in the Not-for-Profit Public and Private Sectors project. This Standard (AASB 2013-8) sets out the consequential amendments to AASB 1049 arising from AASB 10 and the related Standards. Most of these amendments are editorial.

BC38 The Board noted that paragraph 45 of AASB 1049 does not require the General Government Sector (GGS) financial statements to comply with any of the disclosure requirements of the superseded AASB 127 *Consolidated and Separate Financial Statements*. The Board reconsidered this position in respect of the disclosure requirements set out in AASB 12, and concluded that the GGS financial statements should not be required to comply with those requirements. This is effected through the amendments in this Standard to paragraph 45 of AASB 1049.

BC39 The Board took the view that the GGS financial statements need not be required to comply with the disclosure requirements of AASB 12 on the grounds that such disclosures would essentially duplicate AASB 12 disclosures in the whole of government financial statements. As entities included in the GGS financial statements are also included in the whole of government financial statements, the entities' association with structured entities could be addressed in either set of financial statements. The nature of the risks associated with interests in structured entities is unlikely to change between the GGS level and the whole of government level.

Main changes from the Exposure Draft

BC40 The main changes made by the Board to the implementation guidance proposed in ED 238 following consideration of respondents' comments are noted in the following paragraphs.

BC41 Some respondents considered that the major examples emphasised substantive and protective rights of various investors without adequately identifying the relevant activities of the investee and in some cases did not clearly apply the three criteria for control in coming to their conclusions. The Board agreed that the relevant activities of the investee should be addressed clearly, since an investor can have power over an investee only when it has substantive rights that give it the current ability to direct the relevant activities of the investee. The examples were amended accordingly, including addressing the control criteria more directly. Nevertheless, the Board retained the substantive and protective rights details in the examples, albeit with some reclassification, as part of the background information for the examples.

BC42 Of the four major examples proposed in the ED, three related specifically to public sector entities (local governments, universities, and government departments and authorities) and one to not-for-profit private sector entities (a religious organisation and an association). Some respondents requested additional not-for-profit private sector examples. The Board added a further major example (Example IG2) based on not-for-profit private sector entities (a charity and a company) and illustrating four scenarios. As stated in paragraph BC16, the Board also decided to note in the implementation guidance that the illustrative examples apply by analogy to types of not-for-profit entities other than those specifically identified in the examples and similar circumstances, as relevant (see paragraph IG3).

BC43 The ED proposed that rights specified in substantively enacted legislation could not give an investor the current ability to direct the relevant activities of an investee. This was questioned by some respondents, who compared substantive enactment of substantive rights with substantive rights that were exercisable only in the future. The Board reconsidered the issue and decided to change the guidance to acknowledge that in limited circumstances rights under substantively enacted legislation could become exercisable in time for making decisions about an investee's relevant activities. For example, the progression from substantively enacted legislation to enacted legislation may be merely a matter of the formal approval of the legislation by the Governor in Council within a limited timeframe.

BC44 Several respondents questioned whether the notion of delegation in the not-for-profit public sector was adequately reflected in the proposed example illustrating whether a government department controlled a statutory authority. The Board revised the example and paragraph IG24 to clarify that a delegate in the not-for-profit public sector is not an agent of the delegator. The Board also deleted references to 'delegated control' as it was not necessary to introduce a new term. The Board noted that the term 'delegation' has a narrower meaning in the not-for-profit public sector than its general usage in the Standard to denote an agent/principal relationship.

Issues raised but guidance not revised

BC45 The Board discussed a range of issues raised by respondents to ED 238 that did not lead to changes to the implementation guidance that had been proposed in the ED. The more significant such issues included requests for guidance concerning assessing the relative significance of the rights of different parties, a controlled local government scenario, collective control in the public sector, and the effect of removal rights in the public sector, and comments on the power to enact or change legislation.

BC46 Respondents noted the difficulty in many cases of identifying which investor has power over an investee when more than one investor is able to direct different relevant activities of the investee. The Board was asked to provide further guidance on how to identify which investor was able to direct the activities that most significantly affected the investee's returns. The Board concluded that it was not feasible to provide guidance for weighing the relative significance of different relevant activities since this would be subject to judgement in the context of the facts and circumstances in any particular case.

BC47 Some respondents to ED 238 noted that, unlike the other comprehensive examples, the local government example did not include an alternative scenario. The only scenario illustrated concluded that in the circumstances presented the local government was not controlled by the State government. Some respondents suggested that if it was not possible for a local government to be controlled by another government, then the guidance should state that. Other respondents suggested the addition of an alternative scenario so that the alternative control outcome would not be overlooked when the guidance was being applied. The Board decided that an alternative scenario was not required, since the proposed example already referred to the possibility of an alternative outcome (ie the local government being controlled by another government) in different circumstances or based on different judgements. The proposed implementation guidance also indicated that the assessment of whether a local government is controlled by another government would depend on the particular facts and circumstances. As noted in paragraph BC18, this approach has been retained in the implementation guidance.

BC48 The Board considered whether to extend the proposed example concerning whether a department controlled a statutory authority to address so-called collective rights at a whole of government level, under which a particular entity would be consolidated in the whole of government financial statements despite no individual entity or Minister in the jurisdiction being considered to control the particular entity. The Board decided not to extend the example on the basis that judgement would be required to determine in the circumstances whether the collective rights amounted to control at the whole of government level, with or without joint control by entities in the jurisdiction, or some other outcome.

BC49 The Board was asked to provide guidance regarding the implications of removal rights since, in the public sector, a government or a Minister will often have the right to dismiss key executives of public sector entities, such as the head of a department. The Board noted that the AASB 10 requirements relating to agency relationships and removal rights might be interpreted to imply that the key executives or their organisations act only as an agent of the government or Minister and therefore would be unable to control other entities. However, the Board considers that the requirements do not prevent intermediate parent entities from controlling other entities or preparing consolidated financial statements. For example, a department head is a part of the department, and a Minister's ability to remove the department head does not prevent the department from being able to control other entities. The Board concluded that specific implementation guidance was not required.

BC50 Some respondents questioned the position proposed in the ED that the power to enact or change legislation could not give an investor the current ability to direct the relevant activities of an investee. The Board affirmed this view for the implementation guidance (paragraph IG14). If the power to legislate were relevant to determining whether a government controlled other entities, then, subject to the constitutional reach of its powers, the government might be considered to control all of the entities in its jurisdiction (including private sector entities) since it could conceivably cause Parliament to pass legislation to enable it to direct the activities of any or all of those entities so as to achieve its economic and social objectives. However, the political and social barriers (see paragraph IG13) to passing such legislation mean that the government realistically would not have the ability to exercise such power, and thus the power would not represent substantive rights.

ACNC requirements

BC51 Some respondents to ED 238 commented that, in determining the application of AASB 10 to not-for-profit entities, the Board should have regard to the financial reporting requirements of the Australian Charities and Not-for-profits Commission (ACNC).

BC52 The Board considered the requirements for annual financial reports under the *Australian Charities and Not-for-profits Commission Act 2012* (ACNC Act) and the *Australian Charities and Not-for-profits Commission Regulation 2013* (ACNC Regulation), in particular Subdivisions 60-C ‘Annual financial reports’ and 60-G ‘Collective and joint reporting’ of the ACNC Act and Subdivisions 60-B ‘Requirements for annual financial reports (core rules)’ and 60-C ‘Requirements for annual financial reports (special rules)’ of the ACNC Regulation. For example, under joint reporting, two or more registered entities may be permitted to prepare and lodge a single financial report, which might or might not be consistent with the AASB 10 requirements for consolidated financial statements. Collective reporting would not be consistent with AASB 10.

BC53 The Board also noted that section 60.30 of the ACNC Regulation requires a registered entity to prepare a special purpose financial statement, if it is not required to and does not propose to prepare a general purpose financial statement. The Board’s focus in setting accounting standards is on general purpose financial statements rather than special purpose financial statements.

BC54 The Board acknowledges that regulators might impose financial reporting requirements that differ from AASB Standards for their own regulatory purposes. The Board noted that the ACNC requirements would be expected to coincide with AASB Accounting Standards in most cases. However, the ACNC may permit registered entities to depart from AASB 10 in limited circumstances. The Board decided that it would not be appropriate for its requirements for general purpose financial statements to reflect those limited circumstances.