IASB documents published to accompany

IFRS 10

Consolidated Financial Statements

The text of the unaccompanied standard, IFRS 10, is contained in Part A of this edition. Its effective date when issued was 1 January 2013. The text of the Accompanying Guidance on IFRS 10 is contained in Part B of this edition. This part presents the following documents:

BASIS FOR CONCLUSIONS

APPENDICES TO THE BASIS FOR CONCLUSIONS

Previous Board approvals and dissenting opinions

Amendments to the Basis for Conclusions on other IFRSs

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Basis for Conclusions on IFRS 10 *Consolidated Financial Statements*

This Basis for Conclusions accompanies, but is not part of, IFRS 10.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in developing IFRS 10 *Consolidated Financial Statements*. Individual Board members gave greater weight to some factors than to others. Unless otherwise stated, any reference below to IAS 27 is to IAS 27 *Consolidated and Separate Financial Statements*, and to IAS 28 is to IAS 28 *Investments in Associates*.

BC2 The Board added a project on consolidation to its agenda to deal with divergence in practice in applying IAS 27 and SIC-12 *Consolidation—Special Purpose Entities*. For example, entities varied in their application of the control concept:

(a) in circumstances in which an investor controls an investee but the investor has less than a majority of the voting rights of the investee (and voting rights are clearly the basis for control).

(b) in circumstances involving special purpose entities (to which the notion of 'economic substance' in SIC-12 applied).

(c) in circumstances involving agency relationships.

(d) in circumstances involving protective rights.

BC3 IAS 27 required the consolidation of entities that are controlled by a reporting entity, and it defined control as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. SIC-12, which interpreted the requirements of IAS 27 in the context of special purpose entities,[1] placed greater emphasis on risks and rewards. This perceived conflict of emphasis had led to inconsistent application of the concept of control. This was aggravated by a lack of clear guidance on which investees were within the scope of IAS 27 and which were within the scope of SIC-12. As a result, assessing control sometimes resulted in a quantitative assessment of whether the investor had a majority of the risks. Such tests based on sharp 'bright line' distinctions created structuring opportunities to achieve particular accounting outcomes.

BC4 The global financial crisis that started in 2007 highlighted a lack of transparency about the risks to which investors were exposed from their involvement with 'off balance sheet vehicles' (such as securitisation vehicles), including those that they had set up or sponsored. As a result, the G20 leaders, the Financial Stability Board and others asked the Board to review the accounting and disclosure requirements for such 'off balance sheet vehicles'.

BC5 In developing IFRS 10, the Board considered the responses to ED 10 *Consolidated Financial Statements*, published in December 2008. Respondents to ED 10 pointed out that the Board and the US Financial Accounting Standards Board (FASB), in their Memorandum of Understanding, had agreed to work towards developing common standards on consolidation by 2011. Therefore, they asked the boards to discuss the consolidation project jointly to ensure that the ensuing standards contained identical, not only similar, requirements. As a result, the Board's deliberations in developing IFRS 10 were conducted jointly with the FASB from October 2009.

BC6 The FASB decided in January 2011 that it would not change the consolidation requirements in US generally accepted accounting principles (GAAP) at this time with one exception. The FASB tentatively decided that it would propose changes to the consolidation requirements relating to both variable interest entities and voting interest entities in the context of assessing whether a decision maker is a principal or an agent. Those proposals would be similar to the requirements developed jointly by the IASB and the FASB regarding the principal/agent assessment, which are included in IFRS 10.

[1] To maintain consistency with the terminology used in the original documents this Basis for Conclusions refers to 'special purpose entities (SPEs)' when discussing SIC-12 and 'structured entities' when discussing the exposure draft ED 10 *Consolidated Financial Statements* and the related deliberations and redeliberations. SIC-12 described an SPE as an entity that may be created to accomplish a narrow and well-defined objective, often created with legal arrangements that impose strict and sometimes permanent limits on the decision-making powers of its governing board, trustee or management over the SPE's operations. ED 10 defined a structured entity as an entity whose activities are restricted to the extent that those activities are, in essence, not directed by voting or similar rights.

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BC7 ED 10 proposed disclosure requirements for consolidated and unconsolidated investees. In its deliberation of the responses to those proposals, the Board decided to combine the disclosure requirements for interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities within a single comprehensive standard, IFRS 12 *Disclosure of Interests in Other Entities*. The Basis for Conclusions accompanying IFRS 12 summarises the Board's considerations in developing that IFRS, including its consideration of responses to the disclosure proposals in ED 10. Accordingly, IFRS 10 does not include disclosure requirements and this Basis for Conclusions does not describe the Board's consideration of responses to the proposed disclosure requirements in ED 10.

The structure of IFRS 10 and the Board's decisions

BC8 IFRS 10 replaces the requirements and guidance in IAS 27 relating to consolidated financial statements. It also replaces SIC- 12. As part of its consolidation project, the Board is examining how an investment entity accounts for its interests in subsidiaries, joint ventures and associates and what, if any, additional disclosures might be made about those interests. The Board expects to publish an exposure draft on investment entities later in 2011.[2]

BC9 In developing IFRS 10, the Board did not reconsider all the requirements that are included in the IFRS. The scope in paragraph 4 and the accounting requirements for consolidated financial statements in paragraphs 19–25 and B86–B99 were carried forward from IAS 27 or SIC- 12 to IFRS 10 without being reconsidered by the Board because their reconsideration was not part of the Board's consolidation project.

BC10 When revised in 2003, IAS 27 was accompanied by a Basis for Conclusions summarising the considerations of the Board, as constituted at the time, in reaching some of its conclusions in that Standard. That Basis for Conclusions was subsequently updated to reflect amendments to the Standard. The Board has incorporated into this Basis for Conclusions material from the Basis for Conclusions on IAS 27 that discusses matters that the Board has not reconsidered. That material is contained in paragraphs denoted by numbers with the prefix BCZ. In those paragraphs cross- references to the IFRS have been updated accordingly and minor necessary editorial changes have been made.

BC11 In order to portray the historical background of IFRS 10, the documents recording the Board's approval of the revision of IAS 27 in 2003 and the subsequent amendments are set out after this Basis for Conclusions. In addition, in 2003 and later, some Board members dissented from the revision of IAS 27 and subsequent amendments, and portions of their dissenting opinions relate to requirements that have been carried forward to IFRS 10. Those dissenting opinions are set out after the Basis for Conclusions.

Presentation of consolidated financial statements (2003 revision)

Exemption from preparing consolidated financial statements

BCZ12 Paragraph 7 of IAS 27 (as revised in 2000) required consolidated financial statements to be presented. However, paragraph 8 permitted a parent that was a wholly- owned or virtually wholly- owned subsidiary not to prepare consolidated financial statements. In 2003 the Board considered whether to withdraw or amend this exemption from the general requirement.

BCZ13 The Board decided to retain an exemption, so that entities in a group that are required by law to produce financial statements available for public use in accordance with International Financial Reporting Standards, in addition to consolidated financial statements, would not be unduly burdened.

BCZ14 The Board noted that in some circumstances users can find sufficient information for their purposes about a subsidiary from either its separate financial statements or the consolidated financial statements. In addition, the users of financial statements of a subsidiary often have, or can get access to, more information.

BCZ15 Having concluded that it should retain an exemption, the Board decided to modify the circumstances in which an entity would be exempt and considered the following criteria.

[2] *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), issued in October 2012, introduced an exception to the principle that all subsidiaries shall be consolidated. The amendments define an investment entity and require a parent that is an investment entity to measure its investments in particular subsidiaries at fair value through profit or loss instead of consolidating those subsidiaries. These amendments are discussed in paragraphs BC215–BC317.

Unanimous agreement of the owners of the minority interests[3]

BCZ16 The 2002 exposure draft proposed to extend the exemption to a parent that is not wholly- owned if the owners of the minority interests, including those not otherwise entitled to vote, unanimously agree.

BCZ17 Some respondents disagreed with this proposal, largely because of the practical difficulties in obtaining responses from all the minority shareholders. Acknowledging this argument, the Board decided that the exemption should be available to a parent that is not wholly- owned when the owners of the minority interests have been informed about, and do not object to, consolidated financial statements not being presented.

Exemption available only to non- public entities

BCZ18 The Board believed that the information needs of users of financial statements of entities whose debt or equity instruments are traded in a public market were best served when investments in subsidiaries, jointly controlled entities and associates were accounted for in accordance with IAS 27, IAS 28 and IAS 31 *Interests in Joint Ventures*.[4] It therefore decided that the exemption from preparing consolidated financial statements should not be available to such entities or to entities in the process of issuing instruments in a public market.

Scope of consolidated financial statements (2003 revision)

Scope exclusions

BCZ19 Paragraph 13 of IAS 27 (as revised in 2000) required a subsidiary to be excluded from consolidation when control is intended to be temporary or when the subsidiary operates under severe long- term restrictions.

Temporary control

BCZ20 In 2003 the Board considered whether to remove this scope exclusion and thereby converge with other standard- setters that had recently eliminated a similar exclusion. It decided to consider this question as part of a comprehensive standard dealing with asset disposals. It decided to retain an exemption from consolidating a subsidiary when there is evidence that the subsidiary is acquired with the intention of disposing of it within twelve months and that management is actively seeking a buyer. The Board's exposure draft ED 4 *Disposal of Non- current Assets and Presentation of Discontinued Operations* proposed to measure and present assets held for sale in a consistent manner irrespective of whether they are held by an investor or in a subsidiary. Therefore, ED 4 proposed to eliminate the exemption from consolidation when control is intended to be temporary and it contained a draft consequential amendment to IAS 27 to achieve this.[5]

Severe long- term restrictions impairing ability to transfer funds to the parent

BCZ21 The Board decided to remove the exclusion of a subsidiary from consolidation when there are severe long- term restrictions that impair a subsidiary's ability to transfer funds to the parent. It did so because such circumstances may not preclude control. The Board decided that a parent, when assessing its ability to control a subsidiary, should consider restrictions on the transfer of funds from the subsidiary to the parent. In themselves, such restrictions do not preclude control.

BCZ22–BCZ28 [Deleted]

[3] IAS 27 (as amended in 2008) changed the term 'minority interest' to 'non- controlling interest'.

[4] IAS 31 was superseded by IFRS 11 *Joint Arrangements* issued in May 2011.

[5] In March 2004 the Board issued IFRS 5 *Non- current Assets Held for Sale and Discontinued Operations*. IFRS 5 removed this scope exclusion and eliminated the exemption from consolidation when control is intended to be temporary. For further discussion see the Basis for Conclusions on IFRS 5.

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Exemption from preparing consolidated financial statements for an intermediate parent of an investment entity

BC28A In December 2014, the Board amended IFRS 10 to confirm that the exemption from preparing consolidated financial statements set out in paragraph 4(a) of IFRS 10 is available to a parent entity that is a subsidiary of an investment entity. This question came about because an investment entity may measure all of its subsidiaries at fair value through profit or loss in accordance with paragraph 31 of IFRS 10. This decision was consistent with the proposal in the Exposure Draft *Investment Entities: Applying the Consolidation Exception* (Proposed amendments to IFRS 10 and IAS 28), which was published in June 2014.

BC28B Paragraph 4(a)(iv) of IFRS 10, which is one of the criteria for the exemption from preparing consolidated financial statements, previously specified the requirement that the entity's ultimate or any intermediate parent 'produces consolidated financial statements that are available for public use and comply with IFRSs.' The IFRS Interpretations Committee was asked whether the exemption set out in paragraph 4(a) was available to a parent entity that is a subsidiary of an ultimate, or any intermediate, investment entity parent, if the conditions set out in paragraph 4(a)(i)–(iii) are met, but the investment entity parent does not consolidate any of its subsidiaries. Instead, the investment entity parent prepares financial statements in which all of its subsidiaries are measured at fair value through profit or loss in accordance with paragraph 31 of IFRS 10.

BC28C The Board observed that the exemption for intermediate parent entities was provided because the cost of requiring each intermediate parent entity within a group to prepare consolidated financial statements would outweigh the benefits in cases in which the conditions in paragraph 4(a) of IFRS 10 are met. The Board had previously decided that the conditions in paragraph 4(a) provide safeguards for the users of the intermediate parent's financial statements. In addition, the Board noted that the combination of information available in the consolidated financial statements of the higher level parent and the separate financial statements of the intermediate parent entity provide useful information to users.

BC28D The Board additionally observed that, when an investment entity measures its interest in a subsidiary at fair value, the disclosures required by IFRS 12 are supplemented by those required in IFRS 7 *Financial Instruments: Disclosures* and IFRS 13 *Fair Value Measurement*. Accordingly, the Board decided that this combination of information is sufficient to support the decision to retain the existing exemption from presenting consolidated financial statements for a subsidiary of an investment entity that is itself a parent entity. The Board noted that requiring an intermediate parent that is a subsidiary of an investment entity to prepare consolidated financial statements could result in significant additional costs, without commensurate benefit. The Board noted that this would be contrary to its intention in requiring investment entities to measure investments at fair value, which was to provide more relevant information at a reduced cost, as described in paragraphs BC309 and BC314 of IFRS 10.

BC28E The Board also decided to amend paragraph 17 of IAS 28 *Investments in Associates and Joint Ventures* for the same reasons. Paragraph 17 of IAS 28 uses the same criteria as paragraph 4(a) of IFRS 10 to provide an exemption from applying the equity method for entities that are subsidiaries and that hold interests in associates and joint ventures.

BC28F Furthermore, the Board decided to amend paragraph 6(b) of IFRS 12 to clarify that the relevant disclosure requirements in IFRS 12 apply to an investment entity. Paragraph 6 of IFRS 12 previously stated that IFRS 12 did not apply to an entity's separate financial statements without stating the applicability of IFRS 12 to investment entities. The Board decided to clarify that this scope exclusion does not apply to the financial statements of a parent that is an investment entity and has measured all of its subsidiaries at fair value through profit or loss in accordance with paragraph 31 of IFRS 10. In such cases, the investment entity shall present the disclosures relating to investment entities required by IFRS 12.

Control as the basis for consolidation

BC29 The Board's objective in issuing IFRS 10 is to improve the usefulness of consolidated financial statements by developing a single basis for consolidation and robust guidance for applying that basis to situations where it has proved difficult to assess control in practice and divergence has evolved (see paragraphs BC2–BC4). The basis for consolidation is control and it is applied irrespective of the nature of the investee.

BC30 Almost all respondents to ED 10 supported control as the basis for consolidation. However, some noted that it can be difficult to identify an investor that has power over investees that do not require substantive continuous decision- making. They suggested that exposure to risks and rewards should be used as a proxy for control when power is not evident. Some respondents were also concerned that applying the proposed control definition to all investees could lead to more structuring opportunities than was the case when

applying the requirements in IAS 27 and SIC-12. Others did not think that ED 10 expressed with sufficient clarity the importance of risks and rewards when assessing control.

BC31 The Board confirmed its view that control should be the only basis for consolidation—an investor should consolidate an investee and present in its consolidated financial statements the investee's assets, liabilities, equity, income, expenses and cash flows, if the investor has the current ability to direct those activities of the investee that significantly affect the investee's returns and can benefit by using that ability. An investor that is exposed, or has rights, to variable returns from its involvement with an investee but does not have power over the investee so as to affect the amount of the investor's return from its involvement does not control the investee.

BC32 Control as the basis for consolidation does not mean that the consideration of risks and rewards is unimportant when assessing control of an investee. The more an investor is exposed to risks and rewards from its involvement with an investee, the greater the incentive for the investor to obtain decision-making rights that give it power. However, risks and rewards and power are not necessarily perfectly correlated. Therefore, the Board confirmed that exposure to risks and rewards (referred to in IFRS 10 as variable returns) is an *indicator of control* and an important factor to consider when assessing control, but an investor's exposure to risks and rewards alone does not determine that the investor has control over an investee.

BC33 The Board observed that to conclude that exposure to risks and rewards is anything more than an indicator of control would be inconsistent with a control model that contains both a power element and a returns element.

BC34 The Board confirmed that an investor must have exposure to risks and rewards in order to control an investee—without any exposure to risks and rewards (ie variable returns) an investor is unable to benefit from any power that it might have and therefore cannot control an investee.

BC35 In reaching its conclusions regarding control as the basis for consolidation, the Board also noted the following:

(a) One of the main objectives of the consolidation project is to develop a consistent basis for determining when an investor should consolidate an investee, irrespective of the nature of the investee. Some respondents to ED 10 suggested including a particular level of exposure to risks and rewards as a presumption of, or proxy for, control, in the context of investees that are not directed through voting or similar rights. The Board concluded that introducing such a presumption for a particular set of investees would contradict the objective of developing a single consistent basis for consolidation that applies to all investees.

(b) Having a different consolidation model for some investees necessitates defining precisely those investees to which that model applies. There have been difficulties, in practice, in identifying which investees are special purpose entities to which SIC-12 applied. A number of respondents to ED 10 noted that any attempt to split the continuum of investee types into distinct populations and to subject the different populations of entities to different consolidation models would lead to divergence in practice for investees that are not clearly in the specified population sets. For that reason, the Board decided not to carry forward the distinction proposed in ED 10 between different types of investees when assessing control (see paragraphs BC71–BC75).

(c) Including exposure to risks and rewards as a presumption of, or proxy for, control in particular situations puts more pressure on the measurement of that exposure. The Board was particularly concerned that the need to measure risks and rewards might result in the adoption of a consolidation model based on quantitative criteria (for example, a model focused on the majority of risks and rewards). Any quantitative analysis of risks and rewards would inevitably be complex and, as a consequence, difficult to understand, apply and audit. The Board noted that, depending on the specific facts and circumstances, a quantitative model might identify a controlling party that is different from the party that a qualitative analysis of the power over, and returns from, an investee would identify as the controlling party. The Board's analysis is consistent with concerns raised by the FASB's constituents on the quantitative consolidation model in Interpretation 46 (Revised) *Consolidation of Variable Interest Entities*. The FASB has since issued Statement of Financial Accounting Standard No. 167 *Amendments to FIN 46 (Revised)* to amend Interpretation 46 to require a qualitative analysis focusing on the power over and returns from an investee to determine control.[6]

(d) The Board believes that having a control model that applies to all investees is likely to reduce the opportunities for achieving a particular accounting outcome that is inconsistent with the

[6] SFAS 167 was subsequently nullified by Accounting Standards Update No. 2009-17. The requirements of SFAS 167 have been included in Accounting Standards Update No. 2009-17.

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economics of an investor's relationship with an investee—ie it will reduce structuring opportunities.

BC36 The Board does not regard control and risks and rewards as competing models. The exposure to risks and rewards, or variable returns as it is expressed in IFRS 10, is an essential element of control. In the great majority of cases the approaches would lead to the same accounting conclusions. However, a control- based model forces an investor to consider all its rights in relation to the investee rather than relying on arbitrary bright lines that are associated with risks and rewards approaches, such as paragraph 10(c) and (d) of SIC- 12, which referred to control if the investor has rights to obtain the majority of the benefits of the investee or if the investor retains the majority of the risks related to the investee. The Board believes that an investor will, generally, want to control an investee when it has significant economic exposure. This should reduce the likelihood of structuring simply to achieve a particular accounting outcome.

Reputational risk

BC37 During the financial crisis, some financial institutions provided funding or other support to securitisation or investment vehicles because they established or promoted those vehicles. Rather than allowing them to fail and facing a loss of reputation, the financial institutions stepped in, and in some cases took control of the vehicles. ED 10 did not make any explicit reference to reputational risk in relation to control because the Board decided that having reputational risk in isolation is not an appropriate basis for consolidation. The term 'reputational risk' relates to the risk that failure of an investee would damage an investee's reputation and, therefore, that of an investor or sponsor, compelling the investor or sponsor to provide support to an investee in order to protect its reputation, even though the investor or sponsor has no legal or contractual requirement to do so.

BC38 Respondents to ED 10 agreed with the Board, almost unanimously, that reputational risk is not an appropriate basis for consolidation. Some, however, were of the view that reputational risk is part of an investor's exposure to risks and rewards and should be considered when determining control of an investee.

BC39 The Board believes that reputational risk is part of an investor's exposure to risks and rewards, albeit a risk that arises from non- contractual sources. For that reason, the Board concluded that when assessing control, reputational risk is a factor to consider along with other facts and circumstances. It is not an indicator of power in its own right, but may increase an investor's incentive to secure rights that give the investor power over an investee.

Definition of control

BC40 IFRS 10 states that 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 current ability to affect those returns through its power over the investee.

BC41 The definition of control includes three elements, namely an investor's:

(a) power over the investee;

(b) exposure, or rights, to variable returns from its involvement with the investee; and

(c) ability to use its power over the investee to affect the amount of the investor's returns.

Power

BC42 ED 10 proposed that in order to control an investee, an investor must have the power to direct the activities of that investee. IAS 27 defines control as the power to govern the financial and operating policies of an entity. The Board decided to change the definition of control because even though power is often obtained by governing the strategic operating and financing policies of an investee, that is only one of the ways in which power to direct the activities of an investee can be achieved. An investor can have the power to direct the activities of an investee through decision- making rights that relate to particular activities of an investee. Indeed, referring to the power to govern the financial and operating policies of an investee would not necessarily apply to investees that are not directed through voting or similar rights.

BC43 Respondents to ED 10 did not object to changing the definition of control to power to direct the activities of an investee. Many were confused, however, about what the Board meant by 'power to direct' and which 'activities' the Board had in mind. They asked for a clear articulation of the principle behind the term 'power to direct'. They also expressed the view that power should relate to significant activities of an investee, and not those activities that have little effect on the investee's returns.

BC44 ED 10 described various characteristics of power—power need not be absolute; power need not have been exercised; power precludes others from controlling an investee. ED 10 also implied that power could arise from rights that appeared to be exercisable only at some point in the future when particular circumstances arise or events happen. Respondents to ED 10 were confused about whether power referred to the legal or contractual power to direct, or to the ability to direct, which does not necessarily require the investor to have the legal or contractual right to direct the activities. Some respondents to ED 10 also commented that the statement that power precludes others from controlling an investee was confusing because it implied that an investor with less than a majority of the voting rights in an investee could never have power.

BC45 In response to the comments from respondents, the Board considered whether power should refer to having the *legal* or *contractual right* to direct the activities, or the *ability* to direct the activities.

BC46 According to a legal or contractual right approach, some would suggest that an investor has power only when it has an unassailable legal or contractual right to direct. This means having the right to make decisions about the activities of an investee that could potentially be contrary to the wishes of others in every possible scenario, within the boundaries of protective rights. Therefore, for example, an investor with less than half the voting rights of an investee could not have power unless it had additional legal or contractual rights (see paragraph BC101). Also, potential voting rights would not affect the assessment of control until exercised or converted because in and of themselves they do not give the holder the contractual right to direct. A consistent application of this view to 'kick- out' (removal) or similar rights would suggest that a decision maker could never have power when such rights are held by others because those rights could be exercised to remove the decision maker.

BC47 Supporters of the legal or contractual right approach point out that this approach requires less judgement than other approaches and, accordingly, is likely to result in more consistent application of the control definition. They are also concerned that other approaches might result in an investor frequently changing its assessment of control because of changes in circumstances. These changes could be outside the control of the investor (for example, changes in the shareholdings of others or market changes that affect the terms and conditions of potential voting rights).

BC48 The Board acknowledged that defining power as the legal or contractual right to direct the activities of an investee would require less judgement than some other approaches. Nonetheless, the Board rejected that approach because it would create opportunities for an investor to ignore those circumstances in which the Board believes that an investor controls an investee without having the unassailable legal or contractual right to direct the activities of the investee.

BC49 In addition, the Board concluded that preparers and others should be able to apply the judgement required by an 'ability' approach, as long as the principles underlying that approach were articulated clearly and the IFRS included application guidance, illustrating how control should be assessed.

BC50 Consequently, the Board concluded that power should refer to having the *current ability* to direct the activities of an investee. The Board observed that the current ability to direct the activities of an investee would, in all cases, arise from rights (such as voting rights, potential voting rights, rights within other arrangements, or a combination of these).

BC51 In addition, an investor would have the current ability to direct the relevant activities if that investor were able to make decisions at the time that those decisions need to be taken.

BC52 The Board also noted that an investor can have the current ability to direct the activities of an investee even if it does not actively direct the activities of the investee. Conversely, an investor is not assumed to have the current ability to direct simply because it is actively directing the activities of an investee. For example, an investor that holds a 70 per cent voting interest in an investee (when no other relevant factors are present) has the current ability to direct the activities of the investee even if it has not exercised its right to vote. Even if the remaining 30 per cent of voting rights were held by a single party actively exercising its voting rights, that minority shareholder would not have power.

BC53 The Board also noted that having the current ability to direct the activities of an investee is not limited to being able to act today. There may be steps to be taken in order to act—for example, an investor may need to initiate a meeting before it can exercise its voting or other rights that give it power. However, such a delay would not prevent the investor from having power, assuming that there are no other barriers that would prevent the investor from exercising its rights when it chooses to do so.

BC54 In addition, the Board observed that for some investees, particularly those with most of their operating and financing decisions predetermined, decisions that significantly affect the returns of the investee are not made continuously. Such decisions may be made only if particular events occur or circumstances arise. For such investees, having the ability to make those decisions if and when they arise is a source of a current ability to direct the relevant activities.

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BC55 When discussing the principles underlying power, the Board rejected the assertion that an 'ability' approach could result in an investee moving *frequently* in and out of consolidation because of changes that are outside the control of the investor (see paragraph BC47). Changes as to which party controls an investee could occur according to any control model, including a 'contractual rights' model, when relevant facts and circumstances change. For a discussion of concerns in respect to changes in market conditions and the assessment of potential voting rights see paragraphs BC124 and BC152.

Relevant activities

BC56 ED 10 did not propose explicit guidance explaining the activities of an investee to which the definition of control referred. In response to comments received from respondents, the Board decided to clarify that in order to control an investee an investor must have the current ability to direct the activities of the investee that *significantly affect the investee's returns* (ie the relevant activities).

BC57 The comments on ED 10 suggested that such a clarification would be particularly helpful when assessing control of investees that are not directed through voting or similar rights and for which there may be multiple parties with decision- making rights over different activities.

BC58 If an investor controls such an investee, its power should relate to the activities of the investee that significantly affect the investee's returns, rather than administrative activities that have little or no effect on the investee's returns. For an investee that is not directed through voting or similar rights it can be difficult to determine which investor, if any, meets the power element of the control definition. There is also a risk that, without adding the modifier 'significant', an investor with very little ability to affect the returns could be considered to have power over that investee (for example, if the investor has the ability to direct the most significant of a number of insignificant activities that have little effect on the investee's returns).

BC59 Although the guidance included in IFRS 10 in this respect would be particularly helpful in the context of investees that are not directed through voting or similar rights, the Board concluded that the amended wording would work well for all investees. For an investee that is directed through voting or similar rights, it is generally the case that a range of operating and financing activities are those that significantly affect the investee's returns—for example, selling goods or services, purchasing inventory, making capital expenditures or obtaining finance. In that case, an investor that is able to determine the strategic operating and financing policies of the investee would usually have power.

Returns

BC60 The definition of control in IFRS 10 uses the concept of returns in two ways.

BC61 In order to have power over an investee an investor must have the current ability to direct the relevant activities, ie the activities that significantly affect the investee's returns. The link to returns was included in the first element of control in order to clarify that having the current ability to direct inconsequential activities is not relevant to the assessment of power and control (see paragraph BC58).

BC62 The second element of control requires the investor's involvement with the investee to provide the investor with rights, or exposure, to variable returns. This retains the concept that control conveys the rights to returns from an investee. To have control an investor must have power over the investee, exposure or rights to returns from its involvement with the investee and the ability to use its power to affect its own returns. Control is not a synonym of power, because equating power and control would result in incorrect conclusions in situations when an agent acts on behalf of others. ED 10 used the term 'returns' rather than 'benefits' because 'benefits' are often interpreted as implying only positive returns.

BC63 The Board confirmed its intention to have a broad definition of 'returns' that would include synergistic returns as well as more direct returns, for example, dividends or changes in the value of an investment. In practice, an investor can benefit from controlling an investee in a variety of ways. The Board concluded that to narrow the definition of returns would artificially restrict those ways of benefiting.

BC64 Although some respondents to ED 10 commented that 'returns' could be interpreted narrowly to refer only to financial returns such as dividends, the Board believed that the broad description of returns included in the IFRS should ensure that the Board's intention to have a broad definition is clear. The Board also confirmed that an investor's returns could have the potential to be wholly positive, wholly negative or both positive and negative.

BC65 When assessing control of an investee, an investor determines whether it is exposed, or has rights, to variable returns from its involvement with the investee. The Board considered whether this criterion should refer to involvement through instruments that must absorb variability, in the sense that those instruments reduce the exposure of the investee to risks that cause variability.

BC66 Some instruments are designed to transfer risk from a reporting entity to another entity. During its deliberations, the Board concluded that such instruments create variability of returns for the other entity but do not typically expose the reporting entity to variability of returns from the performance of the other entity. For example, assume an entity (entity A) is established to provide investment opportunities for investors who wish to have exposure to entity Z's credit risk (entity Z is unrelated to any other party involved in the arrangement). Entity A obtains funding by issuing to those investors notes that are linked to entity Z's credit risk (credit- linked notes) and uses the proceeds to invest in a portfolio of risk- free financial assets. Entity A obtains exposure to entity Z's credit risk by entering into a credit default swap (CDS) with a swap counterparty. The CDS passes entity Z's credit risk to entity A, in return for a fee paid by the swap counterparty. The investors in entity A receive a higher return that reflects both entity A's return from its asset portfolio and the CDS fee. The swap counterparty does not have involvement with entity A that exposes it to variability of returns from the performance of entity A because the CDS transfers variability to entity A, rather than absorbing variability of returns of entity A.

BC67 Consequently, the Board decided that it was not necessary to refer specifically to instruments that absorb variability, although it expects that an investor will typically have rights, or be exposed, to variability of returns through such instruments.

Link between power and returns

BC68 To have control, an investor must have power and exposure or rights to variable returns and be able to use that power to affect its own returns from its involvement with the investee. Thus, power and the returns to which an investor is exposed, or has rights to, must be linked. The link between power and returns does not mean that the proportion of returns accruing to an investor needs to be perfectly correlated with the amount of power that the investor has. The Board noted that many parties can have the right to receive variable returns from an investee (eg shareholders, debt providers and agents), but only one party can control an investee.

Control is not shared

BC69 ED 10 proposed that only one party, if any, can control an investee. The Board confirmed this in deliberating IFRS 10. (See further comments regarding joint arrangements in paragraph BC83.)

BC70 ED 10 proposed that an investor need not have absolute power to control an investee. Other parties can have protective rights relating to the activities of an investee. For example, limits on power are often imposed by law or regulations. Similarly, other parties—such as non- controlling interests—may hold protective rights that limit the power of the investor. During its redeliberations the Board confirmed that an investor can control an investee even if other entities have protective rights relating to the activities of the investee. Paragraphs BC93–BC124 discuss rights that give an investor power over an investee.

Assessing control

BC71 In developing IFRS 10 the Board, while acknowledging that the factors to be considered in assessing control will vary, had the objective of developing a control model that applies the same concept of control as the basis for consolidation to all investees, irrespective of their nature.

BC72 In ED 10, the Board set out specific factors to consider when assessing control of a structured entity. ED 10 defined a structured entity as an entity whose activities are restricted to the extent that those activities are, in essence, not directed by voting or similar rights.

BC73 The Board's intention when including the subsection specifically for structured entities was as a convenience for those assessing control of traditional operating entities that are typically controlled through voting rights—the Board did not want to force those assessing control of traditional operating entities to read, and assess whether to apply, all the guidance relating to structured entities if that guidance was not relevant.

BC74 However, the vast majority of respondents to ED 10 were opposed to creating a subset of investees for which different guidance would apply when assessing control. In their view, such an approach would perpetuate problems faced in applying the guidance in IAS 27 and SIC- 12—two control models leading to inconsistent application and, therefore, potential arbitrage by varying investee- specific characteristics. Respondents also noted that the guidance provided for structured entities should apply generally to all investees. Therefore, they suggested that there should be a single section that combines guidance on assessing control of all investees.

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BC75 The Board was persuaded by this reasoning and decided to combine the guidance for assessing control of an investee within a single section, noting that its intention is to have a single basis for consolidation that could be applied to all investees and that that basis is control. However, the Board acknowledged that the way in which control would need to be assessed would vary depending on the nature of investees.

Understanding the purpose and design of an investee

BC76 Some respondents to ED 10 expressed the view that involvement in the design of an investee (with restricted activities) is a strong indicator of control and, indeed, in some situations, they would conclude that involvement in the design alone is sufficient to meet the power element of the control definition. SIC‑ 12 included this notion as one of its indicators of control and the accompanying Basis for Conclusions explained that:

> SPEs [special purpose entities] frequently operate in a predetermined way so that no entity has explicit decision‑ making authority over the SPE's ongoing activities after its formation (ie they operate on 'autopilot'). Virtually all rights, obligations, and aspects of activities that could be controlled are predefined and limited by contractual provisions specified or scheduled at inception. In these circumstances, control may exist for the sponsoring party or others with a beneficial interest, even though it may be particularly difficult to assess, because virtually all activities are predetermined. However, the predetermination of the activities of the SPE through an 'autopilot' mechanism often provides evidence that the ability to control has been exercised by the party making the predetermination for its own benefit at the formation of the SPE and is being perpetuated.

BC77 When developing IFRS 10 the Board confirmed the position in ED 10 that being involved in setting up an investee was not, in and of itself, sufficient to conclude that an investor has control. Being involved in the design does not necessarily mean that an investor has decision‑ making rights to direct the relevant activities. Often several parties are involved in the design of an investee and the final structure of the investee includes whatever is agreed to by all those parties (including investors, the sponsor of the investee, the transferor(s) of the assets held by the investee and other parties involved in the transaction).

BC78 Although the success of, for example, a securitisation will depend on the assets that are transferred to the securitisation vehicle, the transferor might not have any further involvement with the vehicle and thereby may not have any decision‑ making rights to direct the relevant activities. The benefits from being involved in setting up a vehicle could cease as soon as the vehicle is established. The Board concluded that, in isolation, being involved in setting up an investee would not be an appropriate basis for consolidation.

BC79 The Board confirmed, however, that considering the purpose and design of an investee is important when assessing control. Understanding the purpose and design of an investee is the means by which an investor identifies the relevant activities, the rights from which power arises and who holds those rights. It can also assist in identifying investors that may have sought to secure control and whose position should be understood and analysed when assessing control.

BC80 The Board noted that understanding the purpose and design of an investee also involves consideration of all activities and returns that are closely related to the investee, even though they might occur outside the legal boundaries of the investee. For example, assume that the purpose of a securitisation vehicle is to allocate risks (mainly credit risk) and benefits (cash flows received) of a portfolio of receivables to the parties involved with the vehicle. The vehicle is designed in such a way that the only activity that can be directed, and can significantly affect the returns from the transaction, is managing those receivables when they default. An investor might have the current ability to direct those activities that significantly affect the returns of the transaction by, for example, writing a put option on the receivables that is triggered when the receivables default. The design of the vehicle ensures that the investor has decision‑ making authority over the relevant activities at the only time that such decision‑ making authority is required. In this situation, 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 would be considered together with the founding documents of the investee to conclude whether the investor has the current ability to direct the activities of the securitisation vehicle that significantly affect the returns of the transaction (even before the default of the receivables).

Different activities significantly affect the returns

BC81 IAS 27, SIC‑ 12 and ED 10 did not specifically address situations in which multiple parties have decision‑ making authority over the activities of an investee. Some respondents to ED 10 questioned how the control model would be applied in such situations. Respondents were concerned that the absence of specific guidance would create structuring opportunities to avoid the consolidation of structured entities—they asserted that, without any guidance, power could easily be disguised and divided among different parties so that it could be argued that no one would have power over the investee.

BC82 The Board identified the following situations in which multiple parties may have decision‑ making authority over the activities of an investee:

(a) joint control

(b) shared decision-making that is not joint control

(c) multiple parties that each have unilateral decision-making rights to direct different activities of an investee that significantly affect the investee's returns.

Joint control

BC83 IFRS 11 *Joint Arrangements* defines joint control as the contractually agreed sharing of control of an arrangement. Joint control exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. When two or more parties have joint control of an investee, no single party controls that investee and, accordingly, the investee is not consolidated. IFRS 11 is applicable to all investees for which two or more parties have joint control. The Board confirmed that IFRS 10 does not change or amend the arrangements that are now within the scope of IFRS 11.

Shared decision-making that is not joint control

BC84 The power to direct the relevant activities can be shared by multiple parties but those rights may not meet the definition of joint control. For example, five parties each own 20 per cent of entity Z, and each has one seat on entity Z's board of directors. All strategic operating and financing decisions (ie decisions in respect of the activities that significantly affect the returns of entity Z) require the consent of any four of the five directors. The five parties do not jointly control entity Z because unanimous consent is not required for decisions relating to the activities of entity Z that significantly affect its returns. Nevertheless, it is clear that the power to direct the activities of entity Z is shared and no single party controls entity Z. Again, the Board confirmed that the requirements of IFRS 10 do not change or amend the application of IFRSs to such situations.

Multiple parties with decision-making rights

BC85 When discussing the sharing of power, the Board noted that for most investees it will be clear that one party or body has decision-making authority to direct the activities of an investee that significantly affect the investee's returns. For example, for an investee that is directed by voting or similar rights, the governing body or board of directors would typically be responsible for strategic decision-making. Thus, the current ability to direct that body would be the basis for power.

BC86 Nonetheless, it is possible that more than one party has decision-making authority over different activities of an investee and that each such activity may significantly affect the investee's returns—respondents to ED 10 noted the following as examples: multi-seller conduits, multi-seller securitisations, and investees for which the assets are managed by one party and the funding is managed by another. The Board was persuaded by the comments from respondents that IFRS 10 should specifically address situations for which multiple parties each have unilateral decision-making rights to direct different activities of the investee.

BC87 The Board considered whether, for such investees, none of the parties controls the investee because the ability to direct the activities is shared. If those different activities, in fact, significantly affect the returns of the investee, some would reason that it would be artificial to force the parties involved to conclude that one activity is more important than the others. An investor might be required to consolidate an investee when the investor would not have the power to direct *all* the activities of the investee that significantly affect the investee's returns.

BC88 Nonetheless, the Board decided that when two or more unrelated investors each have unilateral decision-making rights over different activities of an investee that significantly affect the investee's returns, the investor that has the current ability to direct the activities of the investee that *most* significantly affect the investee's returns meets the power element of the control definition. The expectation is that one investor will have that ability to direct the activities that *most* significantly affect the investee's returns and consequently would be deemed to have power. In effect, power is attributed to the party that looks most like the party that controls the investee. However, the Board decided not to prescribe a specific mechanism for assessing which activities of an investee *most* significantly affect the investee's returns.

BC89 The Board was concerned about creating the potential to avoid consolidation if an investor were to conclude that it has power only when it has the current ability to direct *all* the relevant activities. Such a requirement would be open to abuse because an investor could avoid consolidation by involving other parties in an investee's decision-making.

BC90 The Board's conclusions result in greater potential for an investee to be consolidated because one party would be deemed to have power when multiple parties have unilateral decision-making authority over different activities of an investee.

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BC91 In reaching its conclusions, the Board noted that the situation in which two or more investors (individually or as a group) have decision- making rights over different activities of an investee that significantly affect the investee's returns is not expected to arise frequently. This is because one party or body usually has overall decision- making responsibility for an investee (see paragraph BC85). The Board believes that its conclusions in this respect will ensure that it does not create an incentive to structure investees to achieve an accounting outcome by involving multiple parties in decision- making when there is no business rationale to do so.

BC92 The Board noted that in situations where two or more parties have the current ability to direct the activities that most significantly affect the investee's returns and if unanimous consent is required for those decisions IFRS 11 applies.

Rights that give an investor power

BC93 IAS 27 and SIC- 12 do not include guidance on rights that give an investor power, other than voting rights and potential voting rights. In addition, neither discusses the effect that such rights held by other parties have on the rights of an investor.

BC94 The Board addressed this issue to some extent in ED 10 by including guidance on protective rights. However, comments from respondents to ED 10 suggested that the guidance was not sufficient.

BC95 The Board decided to address the insufficiency by providing additional guidance about the activities that an investor must be able to direct in order to have power (ie those activities that significantly affect the investee's returns) and by providing guidance on when those rights are substantive. The Board believes that including such guidance should help an investor to determine whether it controls an investee, or whether the rights held by other parties are sufficient to prevent an investor from controlling an investee.

Voting rights

BC96 As with IAS 27 and ED 10, the Board decided to include guidance in IFRS 10 that addresses the assessment of control of investees that are controlled by voting rights.

Majority of voting rights

BC97 The Board carried forward the concept from IAS 27, with a modification to the words, that an investor that holds more than half the voting rights of an investee has power over the investee when those voting rights give the investor the current ability to direct the relevant activities (either directly or by appointing the members of the governing body). The Board concluded that such an investor's voting rights are sufficient to give it power over the investee regardless of whether it has exercised its voting power, unless those rights are not substantive or there are separate arrangements providing another entity with power over the investee (such as through a contractual arrangement over decision- making or substantive potential voting rights).

Less than a majority of voting rights

BC98 In October 2005[7] the Board stated that IAS 27 contemplates that there are circumstances in which an investor can control an investee without owning more than half the voting rights of that investee. The Board accepted that at that time IAS 27 did not provide clear guidance about the particular circumstances in which this will occur and that, as a consequence, there was likely to be diversity in practice.

BC99 The Board decided that in ED 10 it would explain clearly that an investor can control an investee even if the investor does not have more than half the voting rights, as long as the investor's voting rights are sufficient to give the investor the current ability to direct the relevant activities. ED 10 included an example of when a dominant shareholder holds voting rights and all other shareholdings are widely dispersed, and those other shareholders do not actively co- operate when they exercise their votes, so as to have more voting power than the dominant shareholder.

BC100 Respondents to ED 10 expressed mixed views about whether an investor could ever control an investee with less than half the voting rights and without other contractual rights relating to the activities of the investee.

BC101 Some who supported a 'contractual rights' control model believe that an investor with less than half the voting rights of an investee (and without other contractual rights) cannot control that investee. They

[7] The October 2005 edition of *IASB Update* included a statement from the Board outlining its views on control with less than a majority of voting rights.

reasoned that this is because the investor contractually does not have the unassailable right to direct the activities of the other investee in every possible scenario and cannot necessarily block the actions of others.

BC102 Supporters of the 'contractual rights' model believe that power should not be defined in a way that relies on the inactivity of other shareholders, as would be the case in an 'ability' model. In addition, they believe that if an investor wishes to control an investee, that investor would need to have a majority of the voting rights, or further contractual rights (in addition to its voting rights if necessary) that guarantee its power over the investee.

BC103 Other respondents supported the 'ability' model proposed in ED 10. They agreed with the Board that there are situations in which an investor with less than half the voting rights of an investee can control that investee, even when the investor does not have other contractual rights relating to the activities of the investee. However, they asked the Board to clarify when that would be the case. In particular, they questioned the following:

(a) The proposals in the exposure draft implied that an investor might have to consolidate an investee simply because the remaining shareholdings are widely dispersed or attendance at shareholder meetings is low, even though the investor might hold only a low percentage of voting rights in that investee (eg 10 per cent or 15 per cent).

(b) The proposals implied that an investor might be forced to obtain information about the shareholder structure, the degree of organisation and the other shareholders' future intentions. This would be particularly difficult to obtain if the investor owned a low percentage of the voting rights of an investee.

BC104 The Board noted the concerns raised by respondents but concluded that it would be inappropriate to limit power to situations in which an investor would have the contractual right to direct the activities of an investee, for the reasons noted in paragraphs BC45–BC50. Specifically in the context of voting rights, the Board believes that there are situations in which an investor can control an investee even though it does not own more than half the voting rights of an investee and does not have other contractual rights relating to the activities of the investee.

BC105 In reaching that conclusion, the Board noted that jurisdictions have differing legal and regulatory requirements relating to the protection of shareholders and investors. Those requirements often determine or influence the rights held by shareholders and consequently have an influence on the ability of an investor to have power over an investee with less than half the voting rights. For that reason, the Board concluded that drawing a line at 50 per cent in terms of voting power could lead to inappropriate consolidation conclusions in some jurisdictions.

BC106 The Board also concluded that an 'ability' model would result in more appropriate consolidation conclusions not only when applied in different jurisdictions, but also when applied to all investees. This is because the 'ability' model would be applied consistently to all investees by considering the rights held by the investor, as well as the rights held by other parties, when assessing control. For example, in the context of voting rights, an investor would assess whether its voting and any other contractual rights would be sufficient to give it the current ability to direct the relevant activities, or whether the voting and other rights held by other shareholders could prevent it from directing the relevant activities if those shareholders chose to act. The model would be applied in a similar way when other parties hold potential voting rights, kick- out rights or similar rights.

BC107 In response to the concerns raised by respondents to ED 10, the Board clarified that its intentions were neither to require the consolidation of all investees, nor to require an investor that owns a low percentage of voting rights of an investee (such as 10 per cent or 15 per cent) to consolidate that investee. An investor should always assess whether its rights, including any voting rights that it owns, are sufficient to give it the current ability to direct the relevant activities. That assessment requires judgement, considering all available evidence.

BC108 The Board decided to add application requirements setting out some of the factors to consider when applying that judgement to situations in which no single party holds more than half the voting rights of an investee. In particular, the Board decided to clarify that it expects that:

(a) the more voting rights an investor holds (ie the larger its absolute holding), the more likely it will have power over an investee;

(b) the more voting rights an investor holds relative to other vote holders (ie the larger its relative holding), the more likely the investor will have power over an investee; and

(c) the more parties that would need to act together to outvote the investor, the more likely the investor will have power over an investee.

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BC109 The Board also noted that, in some cases, considering the voting rights and potential voting rights that an investor and others hold, together with contractual rights, will be sufficient to determine whether the investor has power. However, in other cases these factors may not be sufficient to enable a determination to be made and additional evidence would need to be considered for an investor to determine whether it has power. IFRS 10 sets out additional factors to be considered in these circumstances. In particular, the Board noted that the fewer voting rights an investor holds and the fewer parties that would need to act together to outvote the investor, the more reliance would need to be placed on additional evidence to determine whether the investor has power.

BC110 The Board also decided to clarify that if, after all available evidence has been considered, the evidence is not sufficient to conclude that the investor has power, the investor should not consolidate the investee. If an investor controls an investee, that conclusion is reached on the basis of evidence that is sufficient to conclude that the investor's rights give it the current ability to direct the relevant activities. The Board's intention was not to create a presumption that in the absence of evidence to the contrary the shareholder with the largest proportion of voting rights controls an investee.

BC111 It might be the case that when an investor initially acquires voting rights in an investee and assesses control solely by considering the size of that holding and the voting rights held by others, sufficient evidence is not available to conclude that the investor has power. If that is the case, the investor would not consolidate the investee. However, the assessment should be reconsidered as additional evidence becomes available. For example, the voting rights held by an investor and others may be unchanged but over time the investor may have been able to appoint a majority of the investee's board of directors and may have entered into significant transactions with the investee, thereby enabling the overall assessment to be made that the investor now has control and should consolidate the investee.

Potential voting rights

BC112 An investor might own options, convertible instruments or other instruments that, if exercised, would give the investor voting rights.

BC113 IAS 27 referred to those instruments as potential voting rights. According to that standard, the existence and effect of potential voting rights that are currently exercisable or convertible were considered when assessing control. If the options or convertible instruments that give an investor potential voting rights are currently exercisable, IAS 27 required the investor to treat those potential voting rights as if they were current voting rights. According to IAS 27, the investor had to consider all facts and circumstances except the intentions of management and the financial ability to exercise or convert such rights.

BC114 Because of the revised definition of control, the Board reconsidered potential voting rights in developing the guidance in IFRS 10.

BC115 The questions that the Board considered with respect to potential voting rights were:

(a) Can potential voting rights give the holder the current ability to direct the relevant activities of an investee to which those potential voting rights relate?

(b) If so, in what situations do potential voting rights give the holder the current ability to direct the relevant activities of that investee?

BC116 The Board proposed in ED 10 that an investor should assess whether its power from holding potential voting rights, considered together with other facts and circumstances, gives it power over the investee. Such an investor would have power if the governing body acts in accordance with the wishes of the investor, the counterparty to the instrument acts as an agent for the investor or the investor has particular contractual rights that give it power.

BC117 Most respondents to ED 10 agreed that unexercised potential voting rights, taken in conjunction with other facts and circumstances, could give an investor power. However, many were confused by the application guidance—how would one know whether the decisions of the governing body were in accordance with the wishes of the investor? The respondents suggested that the other situations described in the discussion of power through potential voting rights could lead to power for reasons other than the potential voting rights instrument.

BC118 The Board concluded that the guidance in IFRS 10 that addresses control should apply to potential voting rights, ie when assessing control, an investor should consider all rights that it and other parties hold, including potential voting rights, to determine whether its rights are sufficient to give it control.

BC119 The Board observed that concluding that such instruments always or never give the holder control would cause inappropriate consolidation decisions in some cases.

BC120 Accordingly, the Board concluded that potential voting rights can give the holder the current ability to direct the relevant activities. This will be the case if those rights are substantive and on exercise or conversion (when considered together with any other existing rights the holder has) they give the holder the current ability to direct the relevant activities. The holder of such potential voting rights has the contractual right to 'step in', obtain voting rights and subsequently exercise its voting power to direct the relevant activities—thus the holder has the current ability to direct the activities of an investee at the time that decisions need to be taken if those rights are substantive.

BC121 The Board noted that the holder of such potential voting rights is, in effect, in the same position as a passive majority shareholder or the holder of substantive kick- out rights. The control model would provide that, in the absence of other factors, a majority shareholder controls an investee even though it can take time for the shareholder to organise a meeting and exercise its voting rights. In a similar manner, it can take time for a principal to remove or 'kick out' an agent. The holder of potential voting rights must also take steps to obtain its voting rights. In each case, the question is whether those steps are so significant that they prevent the investor from having the current ability to direct the relevant activities of an investee.

BC122 The Board observed that if power was characterised as requiring either the contractual right to direct the activities or active direction of the activities, the holder of unexercised potential voting rights would never have power without other contractual rights. However, power is the current ability to direct the activities of an investee. As such, the Board concluded that there are situations in which substantive potential voting rights can give the holder power before exercise or conversion to obtain those rights.

BC123 In response to comments from respondents to add clarity about when the holder of potential voting rights has power and to ensure that the control model is applied consistently, the Board added guidance and application examples to help assess when potential voting rights are substantive. Although that assessment requires judgement, the Board believes that an investor should be able to apply the judgement required. This is because potential voting rights exist for a reason—the terms and conditions of the instruments reflect that reason. Therefore, an assessment of the terms and conditions of the instrument (ie the purpose and design of the instrument) should provide information about whether the instrument was designed to give the holder power before exercise or conversion.

BC124 Some constituents were concerned about whether the proposed model would lead to frequent changes in the control assessment solely because of changes in market conditions—would an investor consolidate and deconsolidate an investee if potential voting rights moved in and out of the money? In response to those comments, the Board noted that determining whether a potential voting right is substantive is not based solely on a comparison of the strike or conversion price of the instrument and the then current market price of its underlying share. Although the strike or conversion price is one factor to consider, determining whether potential voting rights are substantive requires a holistic approach, considering a variety of factors. This includes assessing the purpose and design of the instrument, considering whether the investor can benefit for other reasons such as by realising synergies between the investor and the investee, and determining whether there are any barriers (financial or otherwise) that would prevent the holder of potential voting rights from exercising or converting those rights. Accordingly, the Board believes that a change in market conditions (ie the market price of the underlying shares) alone would not typically result in a change in the consolidation conclusion.

Delegated power (agency relationships)

BC125 IAS 27 and SIC- 12 did not contain requirements or guidance to assess whether a decision maker is an agent or principal. The absence of guidance has allowed divergence to develop in practice. The Board decided to introduce principles that address agency relationships to reduce this divergence.

BC126 ED 10 proposed criteria to identify an agency relationship on the basis of the following assumptions:

(a) Both the principal and the agent seek to maximise their own benefits. Therefore, the principal is likely to introduce additional measures that are intended to ensure that the agent does not act against the interest of the principal. For example, the principal may have rights to remove the agent with or without cause.

(b) A principal has no incentive to remunerate an agent more than what is commensurate with the services provided. Accordingly, remuneration that is not commensurate with the services provided is an indicator that a decision maker is not an agent.

BC127 ED 10 included guidance on dual roles and addressed situations in which an investor holds voting rights, both directly and on behalf of other parties as an agent. The exposure draft proposed that when assessing whether an investor acts as an agent or a principal, the investor would exclude the voting rights that it holds as an agent only if it could demonstrate that it is obliged to act in the best interests of other parties or has

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implemented policies and procedures that ensure the independence of the decision maker in its role as an agent from that as a holder of voting rights directly.

BC128 Most respondents to ED 10 agreed with the Board that the consolidation standard should provide application guidance to identify an agency relationship. However, some respondents believed that the exposure draft was not clear on whether the Board intended the proposed application guidance to be limited to legal or contractual agency relationships. Most respondents agreed that the form of remuneration can be an indicator of an agency relationship. However, many found the application guidance, in this respect, confusing. They did not agree with the dual role guidance that required an investor to assess in aggregate its rights as an agent and a principal. Nor did they believe that such an investor should automatically exclude its rights as an agent from the control assessment.

BC129 In response to those comments, the Board decided to base its principal/agent guidance on the thinking developed in agency theory. Jensen and Meckling (1976) define an agency relationship as 'a contractual relationship in which one or more persons (the principal) engage another person (the agent) to perform some service on their behalf which involves delegating some decision- making authority to the agent.'[8]

BC130 The Board clarified that, as defined, an agent is obliged to act in the best interests of the parties that delegated the power (ie the principal or principals) and not other parties by way of a wider fiduciary responsibility. The Board did not think it would be appropriate to conclude that every party that is obliged, by law or contract, to act in the best interests of other parties is an agent for the purposes of assessing control. This conclusion, in effect, assumes that a decision maker that is legally or contractually obliged to act in the best interests of other parties will always do so, even if that decision maker receives the vast majority of the returns that are influenced by its decision- making. Although this assumption might be appropriate for some decision makers, the Board observed that it would not be appropriate for all, in particular many investees that are not directed through voting or similar rights. Almost every investment or asset manager could contend that it is contractually obliged to act in the best interests of others. This conclusion could result in virtually every investee that is not directed through voting or similar rights being unconsolidated.

BC131 The Board observed that the difficulty in developing guidance that addresses agency relationships is that the link between power and returns is often missing. To have control, an investor must have power and be able to use that power for its own benefit.

BC132 If a decision maker receives a return that is relatively insignificant or varies insignificantly, most would be comfortable concluding that the decision maker uses any decision- making authority delegated to it to affect the returns received by others—this is because the decision maker would not have power for its own benefit. Similarly, if the decision maker held a substantial investment in the investee (say, a 95 per cent investment), most would conclude that the decision maker uses any decision- making authority delegated to it primarily to affect the returns it receives—the decision maker would have power for its own benefit. But at what point, between insignificant and very significant, does the decision maker change from using any decision- making authority primarily for others to using its authority primarily for itself?

BC133 The Board concluded that the guidance in IFRS 10 that addresses control should apply to agency relationships, ie when assessing control, a decision maker should consider whether it has the current ability to direct the relevant activities of an investee that it manages to affect the returns it receives, or whether it uses the decision- making authority delegated to it primarily for the benefit of other parties.

BC134 The Board observed that a decision maker always acts as an agent of another party when that other party holds a unilateral substantive right to remove the decision maker. Therefore, a substantive removal right that is held by a single party is a conclusive indicator of an agency relationship.

BC135 At the FASB's round- table meeting on consolidation in November 2010, participants asked whether a board of directors (or other governing body) can be evaluated as one party when considering whether a single party holds substantive removal rights. The IASB observed that the function of such governing bodies is to act as a fiduciary for the investors and therefore any rights given to an investee's board of directors (or other governing body) is a pass- through mechanism for the exercise of the investors' rights. Thus, the governing body itself cannot be considered to have or restrict decision- making authority over the investee. Rather it is the rights given to such a governing body by the investors and their effect on the decision- making authority that should be considered. Consequently, a governing body is not generally viewed as a single party.

BC136 In the absence of a substantive removal right that is held by a single party, judgement must be applied when assessing whether a decision maker acts as a principal or an agent. That assessment includes considering

[8] M C Jensen and W H Meckling, *Theory of the Firm: Managerial Behavior Agency Costs and Ownership Structure*, Journal of Financial Economics 1976, pp. 305–360.

the overall relationship between the decision maker, the entity being managed and the other interest holders, taking into account all available evidence.

BC137 With the exception of substantive removal rights that are held by one party, no single factor would provide conclusive evidence of an agency relationship. The Board observed that, depending on the facts and circumstances, a particular factor may be a strong indicator of an agency relationship and would receive a greater weighting than other factors when assessing control. However, the weighting would depend on the relevant facts and circumstances in each case and it would be inappropriate to specify that any factor would always be more important than the others.

Scope of decision- making authority

BC138 One of the factors to consider when assessing whether a decision maker is an agent or principal is the scope of its decision- making authority. The Board considered whether a decision maker would always be considered an agent if the breadth of its decision- making authority were restricted by contractual arrangements. The Board rejected such a conclusion for two reasons. First, it noted that it is rare for a parent to have unrestricted power over a subsidiary because debt providers or non- controlling interests often have protective rights that restrict the decision- making powers of a parent to some extent. Consequently, it would be difficult to set a particular threshold of restriction on decision- making that would automatically lead to a conclusion that the decision maker is an agent. The second reason was that it would inappropriately lead to many investees, such as securitisation vehicles, not being classified as a controlled entity by a decision maker even though it might have significant economic interests in the investee as well as discretion in making decisions about the relevant activities of the investee. The Board observed that a decision maker can have power over an investee if it has discretion in directing the relevant activities, even if those activities are restricted when the investee is established.

Rights held by other parties

BC139 When considering rights held by other parties in the context of a principal/agent analysis, the Board noted that an entity would assess whether those rights are substantive in the same way as any other rights held by other parties, such as voting rights. An entity would assess whether those rights give their holders the practical ability to prevent the decision maker from directing the activities of the investee if the holders choose to exercise those rights.

BC140 Some constituents said that it would be beneficial to address liquidation rights held by other parties. The Board observed that removal rights are defined as ‘rights to deprive the decision maker of its decision- making authority’ and that some other rights (such as some liquidation rights) may have the same effect on the decision- making authority as removal rights. If those other rights meet the definition of removal rights, they should be treated as such regardless of their label. Therefore, the Board concluded that there was no need to add further guidance in this respect in the IFRS.

Exposure to variability of returns

BC141 The Board considered whether to specify that in the absence of other parties having substantive removal rights, a decision maker that receives a particular level of returns or exposure to variability of returns would be deemed to control an investee (for example, exposure to more than half of the variability of returns of an investee). However, the Board rejected developing a model that would specify a particular level of returns that would result in the determination of an agency relationship. Rather, the Board concluded that the more a decision maker is exposed to the variability of returns from its involvement with an investee, the more likely it is that the decision maker is a principal.

BC142 Although prescribing a quantitative approach for assessing returns, and specifying a particular level of returns, might lead to more consistent application of the requirements by removing some of the judgement required, the Board observed that such an approach was likely to lead to inappropriate consolidation conclusions in some situations. It would create a bright line that might encourage structuring to achieve a particular accounting outcome. The Board also noted that when assessing agency relationships, a decision maker’s exposure to variability of returns is not necessarily correlated with the amount of power that it has, unlike the general assumption when investees are controlled by voting rights. Therefore, a decision maker does not necessarily have any more power over an investee when it is exposed, for example, to more than half of the variability of an investee’s returns than when it is not.

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Relationship with other parties

BC143 The Board decided that an investor should, when assessing control, consider the nature of its relationships with other parties. An investor may conclude that the nature of its relationship with other parties is such that those other parties are acting on the investor's behalf (they are 'de facto agents'). Such a relationship need not involve a contractual arrangement, thereby creating a non- contractual agency relationship. The Board concluded that 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.

BC144 ED 10 included a list of examples of parties that often act for the investor. The Board's intention was that an investor would look closely at its relationships with such parties and assess whether the party is acting on behalf of the investor.

BC145 Some respondents said that the list of examples of parties that often act on behalf of an investor was not helpful because they could think of circumstances in which it would be appropriate to regard each of the parties as agents of the investor and other circumstances when it would not. Respondents were unclear about the consequences of concluding that a party acts for an investor.

BC146 The Board clarified its intentions by stating that, when assessing control, an investor would consider its de facto agent's decision- making rights and exposure (or rights) to variable returns together with its own as if the rights were held by the investor directly. In reaching this decision, the Board noted that it would be inappropriate to assume that all other parties listed in paragraph B75 would *always* or *never* act for the investor. It acknowledged that the assessment of whether the nature of the relationship between the investor and the other party is such that the other party is a de facto agent requires judgement, including consideration of the nature of the relationship and the way that the parties interact with each other.

Control of specified assets

BC147 ED 10 introduced the term 'silo'—an investee within a legal structure—without defining it, noting that an investee can comprise more than one entity. This would be the case when the legal and contractual arrangements relating to an investee give one party control of a particular set of assets and liabilities, whereas another party might have control over another set of assets and liabilities within the investee. Respondents to ED 10 requested more guidance in order to apply the concept in practice.

BC148 In response to those requests, IFRS 10 includes application requirements regarding interests in specified assets. This guidance is consistent with the current guidance in US GAAP in that it sets out when a portion of an investee is treated as a separate entity for the purposes of consolidation. The Board noted that this situation arises most often in the context of investees that are not directed through voting or similar rights. However, the Board decided that to restrict the application requirements to investees that are not directed through voting or similar rights would be contrary to the objective of developing a control model that is applied consistently to all investees. In addition, the Board was not aware of any reason for such a restriction. Therefore, the guidance regarding interests in specified assets is applicable to all investees. This is in contrast with US GAAP, which applies this guidance only to portions of variable interest entities.

Continuous assessment

BC149 ED 10 proposed that an investor should assess control continuously. This is because the Board believes that the assessment of control requires consideration of all facts and circumstances and it would be impossible to develop reconsideration criteria that would apply to every situation in which an investor obtains or loses control of an investee. Therefore, the reassessment of control only when particular reconsideration criteria are met would lead to inappropriate consolidation decisions in some cases.

BC150 Most respondents to ED 10 did not comment on the requirement to assess control continuously. Some questioned whether the continuous assessment of control could be interpreted as requiring preparers to reassess control at the end of each reporting period.

BC151 The Board confirmed the proposal in ED 10 to require an investor to assess control continuously, and clarified that this would mean reassessing control when there is a change in relevant facts and circumstances that suggest that there is a change to one or more of the three elements of control. Such reassessment would not be restricted to each reporting date, nor would the requirement necessarily demand the reassessment of all control or potential control relationships at each reporting date.

BC152 Participants in the FASB's round- table meeting on consolidation held in November 2010 expressed concern about the reassessment of control (including a decision maker's status as principal or agent) when

there are changes in market conditions, in particular the reassessment of control in the context of potential voting rights. In response to those concerns, the IASB decided to add guidance to address the reassessment of control (including a decision maker's status as principal or agent) when there are changes in market conditions (for the reassessment of control in the context of potential voting rights see paragraph BC124). The Board observed that a change in market conditions alone would not generally affect the consolidation conclusion, or the status as a principal or an agent, for two reasons. The first is that power arises from substantive rights, and assessing whether those rights are substantive includes the consideration of many factors, not only those that are affected by a change in market conditions. The second is that an investor is not required to have a particular specified level of exposure to variable returns in order to control an investee. If that were the case, fluctuations in an investor's expected returns might result in changes in the consolidation conclusion.

BC153 Nonetheless, the Board confirmed that control should be reassessed when relevant facts and circumstances change to such an extent that there is a change in one or more of the three elements of control or in the overall relationship between a principal and an agent.

Accounting requirements

Consolidation procedures

BC154 The application requirements in IFRS 10 explain how potential voting rights should be accounted for in the consolidated financial statements. Paragraphs B89–B91 replace the guidance previously included in the implementation guidance accompanying IAS 27, but are not intended to change consolidation procedures.

Non- controlling interests (2003 revision and 2008 amendments)

BCZ155 The 2008 amendments to IAS 27 changed the term 'minority interest' to 'non- controlling interest'. The change in terminology reflects the fact that the owner of a minority interest in an entity might control that entity and, conversely, that the owners of a majority interest in an entity might not control the entity. 'Non- controlling interest' is a more accurate description than 'minority interest' of the interest of those owners who do not have a controlling interest in an entity.

BCZ156 Non- controlling interest was defined in IAS 27 as the equity in a subsidiary not attributable, directly or indirectly, to a parent (this definition is now in IFRS 10). Paragraph 26 of IAS 27 (as revised in 2000) required minority (non- controlling) interests to be presented in the consolidated balance sheet (statement of financial position) separately from liabilities and the equity of the shareholders of the parent.

BCZ157 As part of its revision of IAS 27 in 2003, the Board amended this requirement to require minority (non- controlling) interests to be presented in the consolidated statement of financial position within equity, separately from the equity of the shareholders of the parent. The Board concluded that a minority (non- controlling) interest is not a liability because it did not meet the definition of a liability in the *Framework for the Preparation and Presentation of Financial Statements*.[9]

BCZ158 Paragraph 49(b) of the *Framework* stated that a liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. Paragraph 60 of the *Framework* explained that an essential characteristic of a liability is that the entity has a present obligation and that an obligation is a duty or responsibility to act or perform in a particular way. The Board noted that the existence of a minority (non- controlling) interest in the net assets of a subsidiary does not give rise to a present obligation, the settlement of which is expected to result in an outflow of economic benefits from the group.

BCZ159 Instead, the Board noted that minority (non- controlling) interests represent the residual interest in the net assets of those subsidiaries held by some of the shareholders of the subsidiaries within the group, and therefore met the *Framework*'s definition of equity. Paragraph 49(c) of the *Framework* stated that equity is the residual interest in the assets of the entity after deducting all its liabilities.

Attribution of losses (2008 amendments)

BCZ160 IAS 27 (as revised in 2003) stated that when losses attributed to the minority (non- controlling) interests exceed the minority's interests in the subsidiary's equity, the excess, and any further losses applicable to

[9] References to the *Framework* in this Basis for Conclusions are to the IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the Board in 2001 and in effect when the Standard was revised and amended.

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the minority, is allocated against the majority interest except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

BCZ161 In 2005 the Board decided that this treatment was inconsistent with its conclusion that non- controlling interests are part of the equity of the group, and proposed that an entity should attribute total comprehensive income applicable to non- controlling interests to those interests, even if this results in the non- controlling interests having a deficit balance.

BCZ162 If the parent enters into an arrangement that places it under an obligation to the subsidiary or to the non- controlling interests, the Board believes that the entity should account for that arrangement separately and the arrangement should not affect how the entity attributes comprehensive income to the controlling and non- controlling interests.

BCZ163 Some respondents to the 2005 exposure draft agreed with the proposal, noting that non- controlling interests share proportionately in the risks and rewards of the subsidiary and that the proposal was consistent with the classification of non- controlling interests as equity.

BCZ164 Other respondents disagreed, often on the grounds that controlling and non- controlling interests have different characteristics and should not be treated the same way. They argued that there was no need to change the guidance in IAS 27 (as revised in 2003) (ie that an entity should allocate excess losses to the controlling interest unless the non- controlling interests have a binding obligation and are able to make an additional investment to cover the losses). The reasons given by those respondents were:

(a) The non- controlling interests are not compelled to cover the deficit (unless they have specifically agreed to do so) and it is reasonable to assume that, if the subsidiary requires additional capital in order to continue operations, the non- controlling interests would abandon their investments. In contrast, respondents asserted that in practice the controlling interest often has an implicit obligation to maintain the subsidiary as a going concern.

(b) Often guarantees or other support arrangements by the parent protect the non- controlling interests from losses of the subsidiary in excess of equity and do not affect the way losses are attributed to the controlling and non- controlling interests. Respondents argued that allocating those losses to the parent and non- controlling interests and recognising separately a guarantee would not reflect the underlying economics, which are that only the parent absorbs the losses of the subsidiary. In their view, it would be misleading for financial statements to imply that the non- controlling interests have an obligation to make additional investments.

(c) Recognising guarantees separately is contrary to the principle of the non- recognition of transactions between owners.

(d) Loss allocation should take into account legal, regulatory or contractual constraints, some of which may prevent entities from recognising negative non- controlling interests, especially for regulated businesses (eg banks and insurers).

BCZ165 The Board considered these reasons but observed that, although it is true that non- controlling interests have no further obligation to contribute assets to the subsidiary, neither does the parent. Non- controlling interests participate proportionally in the risks and rewards of an investment in the subsidiary.

BCZ166 Some respondents asked the Board to provide guidance on the accounting for guarantees and similar arrangements between the parent and the subsidiary or the non- controlling interests. They also suggested that the Board should require additional disclosures about inter- company guarantees and the extent of deficits, if any, of non- controlling interests.

BCZ167 The Board considered these requests but observed that this was an issue wider than negative non- controlling interests. For example, the parent is not necessarily responsible for the liabilities of a subsidiary, and often there are factors that restrict the ability of a parent to move assets in a group, which means that the assets of the group are not necessarily freely available to the parent. The Board decided that it would be more appropriate to address comprehensively disclosures about non- controlling interests (disclosures about non- controlling interests are included in IFRS 12).

Changes in ownership interests in subsidiaries (2008 amendments)

BCZ168 The Board decided that after control of an entity is obtained, changes in a parent's ownership interest that do not result in a loss of control are accounted for as equity transactions (ie transactions with owners in their capacity as owners). This means that no gain or loss from these changes should be recognised in profit or loss. It also means that no change in the carrying amounts of the subsidiary's assets (including goodwill) or liabilities should be recognised as a result of such transactions.

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BCZ169 The Board reached this conclusion because it believed that the approach adopted in the amendments was consistent with its previous decision that non-controlling interests are a separate component of equity (see paragraphs BCZ156–BCZ159).

BCZ170 Some respondents agreed that non-controlling interests are equity but said that they should be treated as a special class of equity. Others disagreed with the requirement because in their view recognising transactions with non-controlling interests as equity transactions would mean that the Board had adopted an entity approach whereas they preferred a proprietary approach. The Board disagreed with this characterisation of the accounting treatment, noting that the accounting proposed was a consequence of classifying non-controlling interests as equity. The Board did not consider comprehensively the entity and proprietary approaches as part of the amendments to IAS 27 in 2008.

BCZ171 Many respondents to the 2005 exposure draft suggested alternative approaches for the accounting for changes in controlling ownership interests. The most commonly suggested alternative would result in increases in controlling ownership interests giving rise to the recognition of additional goodwill, measured as the excess of the purchase consideration over the carrying amount of the separately identified assets in the subsidiary attributable to the additional interest acquired.

BCZ172 Some respondents suggested that when an entity reduces its ownership interest in a subsidiary, without losing control, it should recognise a gain or loss attributable to the controlling interest. They would measure that gain or loss as the difference between the consideration received and the proportion of the carrying amount of the subsidiary's assets (including recognised goodwill) attributable to the ownership interest being disposed of. Respondents supporting this alternative said that it would provide relevant information about the gains and losses attributable to the controlling interest arising on the partial disposal of ownership interests in subsidiaries.

BCZ173 The Board rejected this alternative. Recognising a change in any of the assets of the business, including goodwill, was inconsistent with the Board's decision in IFRS 3 *Business Combinations* (as revised in 2008) that obtaining control in a business combination is a significant economic event. That event causes the initial recognition and measurement of all the assets acquired and liabilities assumed in the business combination. Subsequent transactions with owners should not affect the measurement of those assets and liabilities.

BCZ174 The parent already controls the assets of the business, although it must share the income from those assets with the non-controlling interests. By acquiring the non-controlling interests the parent is obtaining the rights to some, or all, of the income to which the non-controlling interests previously had rights. Generally, the wealth-generating ability of those assets is unaffected by the acquisition of the non-controlling interests. That is to say, the parent is not investing in more or new assets. It is acquiring more rights to the income from the assets it already controls.

BCZ175 By acquiring some, or all, of the non-controlling interests the parent will be allocated a greater proportion of the profits or losses of the subsidiary in periods after the additional interests are acquired. The adjustment to the controlling interest will be equal to the unrecognised share of the value changes that the parent will be allocated when those value changes are recognised by the subsidiary. Failure to make that adjustment will cause the controlling interest to be overstated.

BCZ176 The Board noted that accounting for changes in controlling ownership interests as equity transactions, as well as ensuring that the income of the group and the reported controlling interests are faithfully represented, is less complex than the other alternatives considered.

BCZ177 Some respondents disagreed with the proposal because they were concerned about the effect on reported equity of the subsequent acquisition of non-controlling interests by the parent. They seemed to be particularly concerned about the effect on the reported leverage of an entity that acquires non-controlling interests and whether this might, for example, cause those entities to have to renegotiate loan agreements.

BCZ178 The Board observed that all acquisitions of an entity's equity reduce the entity's equity, regardless of whether it is an acquisition of the parent's ordinary or preference shares or non-controlling interests. Hence, the treatment of a subsequent acquisition of non-controlling interests is consistent with the general accounting for the acquisition by an entity of instruments classified as equity.

BCZ179 The Board understands the importance of providing owners of the parent with information about the total changes in their reported equity. Therefore, the Board decided to require entities to present in a separate schedule the effects of any changes in a parent's ownership interest in a subsidiary that do not result in a loss of control on the equity attributable to owners of the parent (this disclosure requirement is now in IFRS 12).

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Loss of control (2008 amendments)

BCZ180 A parent loses control of a subsidiary when it loses the power to govern the financial and operating policies of an investee so as to obtain benefit from its activities. Loss of control can result from the sale of an ownership interest or by other means, such as when a subsidiary issues new ownership interests to third parties. Loss of control can also occur in the absence of a transaction. It may, for example, occur on the expiry of an agreement that previously allowed an entity to control a subsidiary.

BCZ181 On loss of control, the parent- subsidiary relationship ceases to exist. The parent no longer controls the subsidiary's individual assets and liabilities. Therefore, the parent derecognises the individual assets, liabilities and equity related to that subsidiary. Equity includes any non- controlling interests as well as amounts previously recognised in other comprehensive income in relation to, for example, foreign currency translation.

BCZ182 The Board decided that any investment the parent has in the former subsidiary after control is lost should be measured at fair value at the date that control is lost and that any resulting gain or loss should be recognised in profit or loss. Some respondents disagreed with that decision. They asserted that the principles for revenue and gain recognition in the *Framework* would not be satisfied for the retained interest. The Board disagreed with those respondents. Measuring the investment at fair value reflected the Board's view that the loss of control of a subsidiary is a significant economic event. The parent- subsidiary relationship ceases to exist and an investor- investee relationship begins that differs significantly from the former parent- subsidiary relationship. Therefore, the new investor- investee relationship is recognised and measured initially at the date when control is lost.

BCZ183 The Board decided that the loss of control of a subsidiary is, from the group's perspective, the loss of control over some of the group's individual assets and liabilities. Accordingly, the general requirements in IFRSs should be applied in accounting for the derecognition from the group's financial statements of the subsidiary's assets and liabilities. If a gain or loss previously recognised in other comprehensive income would be reclassified to profit or loss on the separate disposal of those assets and liabilities, the parent reclassifies the gain or loss from equity to profit or loss on the indirect disposal of those assets and liabilities through loss of control of a subsidiary.

BCZ184 The Board also discussed the accounting when an entity transfers its shares in a subsidiary to its own shareholders with the result that the entity loses control of the subsidiary (commonly referred to as a spin- off). The International Financial Reporting Interpretations Committee had previously discussed this matter, but decided not to add the matter to its agenda while the business combinations project was in progress. The Board observed that the issue was outside the scope of the business combinations project. Therefore, the Board decided not to address the measurement basis of distributions to owners in the amendments to IAS 27.

Multiple arrangements

BCZ185 The Board considered whether its decision that a gain or loss on the disposal of a subsidiary should be recognised only when that disposal results in a loss of control could give rise to opportunities to structure transactions to achieve a particular accounting outcome. For example, would an entity be motivated to structure a transaction or arrangement as multiple steps to maximise gains or minimise losses if an entity were planning to dispose of its controlling interest in a subsidiary? Consider the following example. Entity P controls 70 per cent of entity S. Entity P intends to sell all of its 70 per cent controlling interest in entity S. Entity P could initially sell 19 per cent of its ownership interest in entity S without loss of control and then, soon afterwards, sell the remaining 51 per cent and lose control. Alternatively, entity P could sell all of its 70 per cent interest in entity S in one transaction. In the first case, any difference between the amount by which the non- controlling interests are adjusted and the fair value of the consideration received on the sale of the 19 per cent interest would be recognised directly in equity, whereas the gain or loss from the sale of the remaining 51 per cent interest would be recognised in profit or loss. In the second case, a gain or loss on the sale of the whole 70 per cent interest would be recognised in profit or loss.

BCZ186 The Board noted that the opportunity to conceal losses through structuring would be reduced by the requirements of IAS 36 *Impairment of Assets* and IFRS 5 *Non- current Assets Held for Sale and Discontinued Operations*. Paragraph 12 of IAS 36 includes significant changes to how an entity uses or expects to use an asset as one of the indicators that the asset might be impaired.

BCZ187 Once an asset meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale), it is excluded from the scope of IAS 36 and is accounted for in accordance with IFRS 5. In accordance with paragraph 20 of IFRS 5 'an entity shall recognise an impairment loss for any initial or subsequent write- down of the asset (or disposal group) to fair value less costs to sell…'. Therefore, if appropriate, an impairment loss would be recognised for the goodwill and non- current assets

of a subsidiary that will be sold or otherwise disposed of before control of the subsidiary is lost. Accordingly, the Board concluded that the principal risk is the minimising of gains, which entities are unlikely to strive to do.

BCZ188 The Board decided that the possibility of such structuring could be overcome by requiring entities to consider whether multiple arrangements should be accounted for as a single transaction to ensure that the principle of faithful representation is adhered to. The Board believes that all the terms and conditions of the arrangements and their economic effects should be considered in determining whether multiple arrangements should be accounted for as a single arrangement. Accordingly, the Board included indicators in paragraph 33 of IAS 27 (as revised in 2008) to assist in identifying when multiple arrangements that result in the loss of control of a subsidiary should be treated as a single arrangement (those indicators are now in paragraph B97 of IFRS 10).

BCZ189 Some respondents disagreed with the indicators that were provided in the exposure draft. They said that the need for guidance on when multiple arrangements should be accounted for as a single arrangement indicates a conceptual weakness in the accounting model developed in the exposure draft. Moreover, such guidance would be unnecessary under other alternatives for accounting for decreases in ownership interests. The Board acknowledges that guidance on multiple arrangements would be unnecessary under some other accounting alternatives. However, the Board does not accept that this means that those models are conceptually superior.

BCZ190 Some respondents suggested that IAS 27 should include examples rather than indicators for when multiple transactions should be treated as a single transaction or arrangement, but that those examples should not be regarded as a complete list. The Board considered that suggestion, but decided to confirm the indicators that were proposed in the exposure draft. The Board believed that the indicators could be applied to a variety of situations and were preferable to providing what could be an endless list of examples to try to capture every possible arrangement.

BC190A–BC190O *[These paragraphs refer to amendments that are not yet effective, and are therefore not included in this edition.]*

Effective date and transition

Effective date

BC191 The Board decided to align the effective date for the IFRS with the effective date for IFRS 11, IFRS 12, IAS 27 *Separate Financial Statements* and IAS 28. When making this decision, the Board noted that the five IFRSs all deal with the assessment of, and related accounting and disclosure requirements about, a reporting entity's special relationships with other entities (ie when the reporting entity has control or joint control of, or significant influence over, another entity). As a result, the Board concluded that applying IFRS 10 without also applying the other four IFRSs could cause unwarranted confusion.

BC192 The Board usually sets an effective date of between twelve and eighteen months after issuing an IFRS. When deciding the effective date for those IFRSs, the Board considered the following factors:

(a) the time that many countries require for translation and for introducing the mandatory requirements into law.

(b) the consolidation project was related to the global financial crisis that started in 2007 and was accelerated by the Board in response to urgent requests from the leaders of the G20, the Financial Stability Board, users of financial statements, regulators and others to improve the accounting and disclosure of an entity's 'off balance sheet' activities.

(c) the comments received from respondents to the Request for Views *Effective Date and Transition Methods* that was published in October 2010 regarding implementation costs, effective date and transition requirements of the IFRSs to be issued in 2011. Most respondents did not identify the consolidation and joint arrangements IFRSs as having a high impact in terms of the time and resources that their implementation would require. In addition, only a few respondents commented that the effective dates of those IFRSs should be aligned with those of the other IFRSs to be issued in 2011.

BC193 With these factors in mind, the Board decided to require entities to apply the five IFRSs for annual periods beginning on or after 1 January 2013.

BC194 The majority of the respondents to the Request for Views supported early application of the IFRSs to be issued in 2011. Respondents stressed that early application was especially important for first- time adopters in 2011 and 2012. The Board was persuaded by these arguments and decided to permit early application of

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IFRS 10 but only if an entity applies it in conjunction with the other IFRSs (ie IFRS 11, IFRS 12, IAS 27 (as amended in 2011) and IAS 28 (as amended in 2011)) to avoid a lack of comparability among financial statements, and for the reasons noted in paragraph BC191 that triggered the Board's decision to set the same effective date for all five IFRSs. Even though an entity should apply the five IFRSs at the same time, the Board noted that an entity should not be prevented from applying any of the disclosure requirements of IFRS 12 early if by doing so users gained a better understanding of the entity's relationships with other entities.

Transition

BC195 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states that retrospective application results in the most useful information to users because the information presented for all periods is comparable.

BC196 In reaching its conclusions, the Board observed that IFRS 10 might result in an investor consolidating investees that were not previously consolidated or not consolidating investees that were previously consolidated. If an investor is required to consolidate a previously unconsolidated investee and has been accounting for its investment in that investee using proportionate consolidation or the equity method, the Board noted that the investor would often have the information available to consolidate the investee retrospectively as if IFRS 10 had always been in place. This is also likely to be the case if an investor no longer consolidates an investee that it previously consolidated but would now have to account for its investment in the investee using the equity method.

BC196A IFRS 3 *Business Combinations* was initially issued in 2004 and was then substantially revised in 2008. Those revisions apply prospectively. The Board noted that, when developing the transition guidance in paragraphs C4–C4A, it had not specified which version of IFRS 3 should be used when an investor concludes that it shall consolidate an investee that was not previously consolidated and over which control was obtained before the effective date of IFRS 3 (revised in 2008). Applying the current version of IFRS 3 in such cases may provide more comparable information.

BC196B However, as noted in BC196, if an investor has been accounting for its investment in such an investee using proportionate consolidation or the equity method, it will have already identified the fair values, goodwill and other amounts required to apply IFRS 3 (issued in 2004). Allowing investors to use existing information in such cases reduces the risk of using hindsight and may provide a more reliable basis for consolidation. Consequently, if control was obtained before the effective date of IFRS 3 (2008), the Board decided to allow entities to use either IFRS 3 (2008) or IFRS 3 (2004) in applying the transition requirements.

BC196C Similarly, IAS 27 *Consolidated and Separate Financial Statements*, as issued in 2003, was substantially revised in 2008. Those revisions apply prospectively. The requirements of IAS 27 (revised in 2008) have been carried forward into IFRS 10. For the same reasons as those described in BC196A–BC196B relating to IFRS 3, if control was obtained before the effective date of IAS 27 (2008), the Board also decided to allow entities to use either IAS 27 (2008) or IAS 27 (2003) in applying the transition requirements.

BC197 In addition, the Board acknowledged that retrospective application of IFRS 10 may not be practicable in some circumstances. If an investor on initial application of IFRS 10 consolidates an investee it previously did not consolidate and it is impracticable to apply the provisions of IFRS 10 retrospectively, the reporting entity would apply the acquisition method in IFRS 3 with the acquisition date being the beginning of the earliest period for which application of those requirements is practicable (goodwill would not be recognised for an investee that is not a business).

BC198 If an investor on initial application of IFRS 10 ceases to consolidate an investee that was previously consolidated, the investor measures its retained interest in the investee on the date of initial application, at the amount at which the interest would have been measured if the requirements of IFRS 10 had been effective when the investor first became involved with (but did not obtain control in accordance with this IFRS), or lost control of, the investee. If, in accordance with IFRS 10, the investor never obtained control, then it would eliminate the previous consolidation from the date that it first became involved with the investee and account for that interest in accordance with other IFRSs as applicable. Alternatively, the investor may have obtained control in accordance with both IAS 27 and IFRS 10, but then later lost control in accordance with IFRS 10 but not IAS 27. In this case, the investor would cease to consolidate from the date control was lost as defined by IFRS 10. If measurement of the retained interest at the date the investor first became involved with (but did not obtain control in accordance with this IFRS), or lost control of, the investee is impracticable, the investor would apply the requirements in IFRS 10 for accounting for a loss of control at the beginning of the earliest period for which application of those requirements is practicable. The earliest period may be the current period.

BC199 As stated in paragraph BC192, respondents to the Request for Views also commented on the transition requirements of the IFRSs to be issued in 2011. In relation to the transition requirements relating to consolidation, the Board noted that the majority of the respondents to the Request for Views had agreed with limited retrospective application for IFRS 10.

BC199A The Board identified a need to clarify the transition guidance that was intended to achieve limited retrospective application of IFRS 10. The Board noted that the main intention when issuing IFRS 10 was to ensure consistent accounting for transactions when IFRS 10 was applied for the first time (ie 1 January 2013 for a calendar-year entity, assuming no early application). In other words, the intention was to use the date of initial application as the point at which to determine the interests that should be accounted for in accordance with IFRS 10. The Board also noted that the intention was to provide transition relief if the consolidation conclusion would be the same whether applying IAS 27/SIC- 12 or IFRS 10 at the date that IFRS 10 was applied for the first time. The Board concluded that, in those situations, the incremental benefit to users of applying IFRS 10 retrospectively would not outweigh the costs.

BC199B Consequently, the Board confirmed that the 'date of initial application' means the beginning of the annual reporting period for which IFRS 10 is applied for the first time. The Board amended the transition guidance to confirm that an entity is not required to make adjustments to the previous accounting for its involvement with entities if the consolidation conclusion reached at the date of initial application is the same whether applying IAS 27/SIC- 12 or IFRS 10. In making this clarification, the Board confirmed that the transition relief in paragraph C3(b) would also apply to interests in investees that were disposed of before the date of initial application of IFRS 10, (ie 1 January 2013 for a calendar-year entity, assuming no early application).

BC199C In clarifying how an entity should retrospectively adjust its comparative information on initial application of IFRS 10, the Board acknowledged that presenting all adjusted comparatives would be burdensome for preparers in jurisdictions where several years of comparatives are required. Without changing the requirement to apply the recognition and measurement requirements of IFRS 10 retrospectively, the Board decided to limit the requirement to present adjusted comparatives to the annual period immediately preceding the date of initial application. This is consistent with the minimum comparative disclosure requirements contained in IAS 1 *Presentation of Financial Statements* as amended by *Annual Improvements to IFRSs 2009–2011 Cycle* (issued May 2012). Those amendments confirmed that when an entity applies a changed accounting policy retrospectively, it shall present, as a minimum, three statements of financial position (ie 1 January 2012, 31 December 2012 and 31 December 2013 for a calendar-year entity, assuming no early application of this IFRS) and two of each of the other statements (IAS 1 paragraphs 40A–40B). Notwithstanding this requirement, the Board confirmed that an entity is not prohibited from presenting adjusted comparative information for earlier periods. The Board noted that if all comparative periods are not adjusted then entities should be required to state that fact, clearly identify the information that has not been adjusted, and explain the basis on which it has been prepared.

BC199D The Board also considered the disclosure requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. On the initial application of an IFRS, paragraph 28(f) of IAS 8 requires an entity to disclose, for the current period and for each prior period presented, the amount of any adjustment for each financial statement line item affected. Changes in the consolidation conclusion on transition to IFRS 10 are likely to affect many line items throughout the financial statements. The Board agreed that this requirement would be burdensome for preparers and so agreed to limit the disclosure of the quantitative impact of any changes in the consolidation conclusion to only the annual period immediately preceding the date of initial application. An entity may also present this information for the current period or for earlier comparative periods, but is not required to do so.

BC199E The Board considered whether IFRS 1 *First-time Adoption of Financial Reporting Standards* should be amended to allow first-time adopters to use the transition guidance of IFRS 10. It was noted that some respondents to the exposure draft had commented that, particularly when an investee is disposed of or control is lost during the comparative period, the cost of providing temporary consolidation information is not justified. The Board noted that this raised broader issues with the application of IFRS 1 and, rather than address this issue in the context of clarifying IFRS 10 transition relief, it would be more appropriately addressed in the context of IFRS 1 itself.

Transitional provisions (2008 amendments)

BCZ200 To improve the comparability of financial information across entities, amendments to IFRSs are usually applied retrospectively. Therefore, the Board proposed in its 2005 exposure draft to require retrospective application of the amendments to IAS 27, on the basis that the benefits of retrospective application outweigh the costs. However, in that exposure draft the Board identified two circumstances in which it concluded that retrospective application would be impracticable:

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(a) accounting for increases in a parent's ownership interest in a subsidiary that occurred before the effective date of the amendments. Therefore, the accounting for any previous increase in a parent's ownership interest in a subsidiary before the effective date of the amendments should not be adjusted.

(b) accounting for a parent's investment in a former subsidiary for which control was lost before the effective date of the amendments. Therefore, the carrying amount of any investment in a former subsidiary should not be adjusted to its fair value on the date when control was lost. In addition, an entity should not recalculate any gain or loss on loss of control of a subsidiary if the loss of control occurred before the effective date of the amendments.

BCZ201 The Board concluded that the implementation difficulties and costs associated with applying the amendments retrospectively in these circumstances outweigh the benefits of improved comparability of financial information. Therefore, the Board decided to require prospective application. In addition, the Board concluded that identifying those provisions for which retrospective application of the amendments would be impracticable, and thus prospective application would be required, would reduce implementation costs and result in greater comparability between entities.

BCZ202 Some respondents were concerned that the transitional provisions were different for increases and decreases in ownership interests. They argued that accounting for decreases in non- controlling interests retrospectively imposes compliance costs that are not justifiable, mainly because the requirement to account for increases prospectively reduces comparability anyway. The Board accepted those arguments and decided that prospective application would be required for all changes in ownership interests (those transitional provisions are now in Appendix C of IFRS 10). The revised transitional provisions will lead to increases and decreases in ownership interests being treated symmetrically and the recasting of financial statements being limited to disclosure and presentation. The recognition and measurement of previous transactions will not be changed upon transition.

BCZ203 In response to practical concerns raised by respondents, the Board also decided to require prospective application of the requirement to allocate losses in excess of the non- controlling interests in the equity of a subsidiary to the non- controlling interests, even if that would result in the non- controlling interests being reported as a deficit balance (this transitional provision is now in Appendix C of IFRS 10).

Withdrawal of IAS 27 (2008) and SIC- 12

BC204 IFRS 10 identifies the principle of control and determines how to identify whether an investor controls an investee and therefore should consolidate the investee. IFRS 10 also identifies the principles for preparation of consolidated financial statements. IFRS 10 supersedes the requirements related to consolidated financial statements in IAS 27 (as amended in 2008) and SIC- 12.

BC205 IFRS 10 does not address the accounting for investments in subsidiaries, jointly controlled entities and associates in separate financial statements as specified in IAS 27. The parts of IAS 27 that relate to separate financial statements have been included in the amended IAS 27.

Summary of main changes from ED 10

BC206 The main changes made by IFRS 10 from the exposure draft ED 10 published in 2008 are:

(a) IFRS 10 includes application guidance on all the following topics:

(i) the meaning of 'power', 'activities' and 'returns' within the definition of control.

(ii) when assessing control of an investee:

- understanding the purpose and design of an investee.
- different activities of an investee that significantly affect the investee's returns.
- a discussion of rights that give an investor power and protective rights.
- power to direct the activities of an investee without a majority of the voting rights, including potential voting rights.
- contractual and non- contractual agency relationships.

(b) IFRS 10 requires retrospective application of its requirements subject to the practicability exemption in IAS 8. The exposure draft had proposed prospective application using the

requirements of IFRS 3 or the requirements relating to the loss of control on the date of first applying the IFRS.[10]

Cost-benefit considerations

BC207 The objective of general purpose financial reporting is to provide information about the financial position, performance and changes in financial position of a reporting entity that is useful to a wide range of users in making economic decisions. To attain this objective, the Board seeks to ensure that an IFRS will meet a significant need and that the overall benefits of the resulting information justify the costs of providing it. Although the costs of implementing a new IFRS might not be borne evenly, users of financial statements benefit from improvements in financial reporting, thereby facilitating the functioning of markets for capital and credit and the efficient allocation of resources in the economy.

BC208 The evaluation of costs and benefits is necessarily subjective. In making its judgement, the Board considered the following:

(a) the costs incurred by preparers of financial statements;

(b) the costs incurred by users of financial statements when information is not available;

(c) the comparative advantage that preparers have in developing information, compared with the costs that users would incur to develop surrogate information;

(d) the benefit of better economic decision- making as a result of improved financial reporting; and

(e) the costs of transition for users, preparers and others.

BC209 The Board observed that IFRS 10 will improve the usefulness of consolidated financial statements by developing a single basis for consolidation (control) and robust guidance for applying that basis to situations in which it has proved difficult to assess control in practice and divergence has evolved. IFRS 10 introduces a definition of control of an investee that is applied consistently when assessing whether an investor should consolidate an investee, irrespective of the nature of the investee. IFRS 10 also requires retrospective application of the requirements subject to the practicability exemptions in IAS 8 that will result in comparable information for all periods presented.

BC210 Users prefer information that is comparable from reporting period to reporting period for an individual entity and between different entities in a particular reporting period. The Board concluded that IFRS 10 provides much clearer principles that underlie the definition of control of an investee and provides more application guidance when assessing control than the requirements it replaces. As a consequence, users should have more comparable and verifiable information about the activities controlled by the reporting entity.

BC211 If the requirements in an IFRS are not clear, or there is no guidance, the preparer will often have to seek independent advice and engage with its auditors to resolve uncertainty about how to account for a particular type of transaction. These costs should decrease if the requirements in the revised IFRS are clearer. Accordingly, because IFRS 10 addresses the concerns conveyed to the Board about the absence of guidance in IAS 27 and SIC- 12, the Board concluded that preparers will benefit from the new requirements. The Board accepts that any new IFRS will cause preparers to incur one- - off costs associated with learning the new requirements and reassessing their accounting. However, the Board's assessment is that the benefits from providing clearer principles and more application guidance outweigh those costs.

BC212 The changes to the definition of control will inevitably lead to some reporting entities consolidating some entities that were previously not consolidated and ceasing consolidation of some entities, or both. The Board does not think it is appropriate to consider whether there will be 'more or less consolidation' by applying the new proposals. However, the clarifications in relation to less than a majority of the voting rights will lead to more consolidation. In the case of what SIC- 12 referred to as special purpose entities, the Board believes that the new requirements will result in more appropriate consolidation.

BC213 Given the benefits for users and preparers noted in paragraphs BC209–BC211 the Board believes that the benefits of IFRS 10 outweigh the costs.

BC214 This project also considered disclosure requirements in relation to consolidation. Those requirements, and the related costs and benefits, are assessed in the Basis for Conclusions on IFRS 12.

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10 *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), issued in October 2012, introduced an exception to the principle that all subsidiaries shall be consolidated. The amendments define an investment entity and require a parent that is an investment entity to measure its investments in particular subsidiaries at fair value through profit or loss instead of consolidating those subsidiaries. These amendments are discussed in paragraphs BC215–BC317.

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Exception to consolidation for investment entities (2012 amendments)

Background

BC215 In October 2012, the Board issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), which provides an exception to consolidation for a class of entities that are defined as 'investment entities'. The Board added the Investment Entities project to its agenda in the course of its deliberations on IFRS 10 as a response to the comments received on ED 10.

BC216 The Board had considered this issue previously. In 2002, the respondents to the Exposure Draft of IAS 27 asked the Board to provide an exception to consolidation for the subsidiaries of venture capital organisations, private equity entities and similar organisations. At that time, the Board decided not to introduce such an exception because it did not think that it should differentiate between the types of entity, or the types of investment, when applying a control model of consolidation. It also did not agree that management's reasons for holding an investment should determine whether or not that investment is consolidated. The Board concluded that for investments under the control of venture capital organisations, private equity entities and similar organisations, users' information needs are best served by financial statements in which those investments are consolidated, thus revealing the extent of the operations of the entities they control.

BC217 The scope of the proposals in ED 10 was the same as the scope of the proposals in IAS 27. IAS 27 required reporting entities to consolidate all controlled entities, regardless of the nature of the reporting entity. Respondents to ED 10 questioned the usefulness of financial statements of investment entities that consolidate investees that the investment entity controls. They pointed out that some national accounting requirements, including United States Generally Accepted Accounting Principles (US GAAP), have historically provided industry- specific guidance that requires investment entities to measure all of their investments, including those that they control, at fair value. The respondents argued that an investment entity holds investments for the sole purpose of capital appreciation, investment income (such as dividends or interest), or both. Users of the financial statements of these investment entities told the Board that the fair value of the investments and an understanding of how the investment entity measures the fair value of its investments is the most useful information.

BC218 Furthermore, respondents to ED 10 argued that consolidated financial statements of an investment entity may hinder users' ability to assess an investment entity's financial position and results, because it emphasises the financial position, operations and cash flows of the investee, rather than those of the investment entity. Often, an investment entity holds non-controlling interests in some entities that are reported at fair value, as well as controlling interests in other entities that are consolidated in accordance with current principles in IFRSs. Reporting investments on more than one basis hinders comparability within the financial statements, because all investments are held by an investment entity for a similar purpose—returns from capital appreciation, investment income, or both. In addition, some of the items consolidated may be measured at historical cost, which distorts the performance assessment of the investment entity and does not reflect the way in which the business of the entity is managed.

BC219 Respondents to ED 10 also argued that when an investment entity consolidates entities that it controls, it is not required to provide the disclosures related to fair value measurements that would be required if the subsidiaries were measured at fair value. For example, IFRS 7 relates only to recognised financial assets and liabilities. There is no requirement to provide disclosures related to fair value for investments in consolidated subsidiaries. Information about fair value and the methodology and inputs used for determining fair value is vital for users to make investment decisions about investment entities. Investors in an investment entity are interested in the fair value of their interest in that entity and often transact with it on a fair value basis (ie their investment in the investment entity is based on a share of the net assets of that entity). Reporting the fair value of substantially all of the net assets of an investment entity allows the investors in that entity to more easily identify the value of their share of those net assets.

BC220 In response to this feedback, the Board published an Exposure Draft *Investment Entities* (*Investment Entities* ED) in August 2011. The *Investment Entities* ED proposed that investment entities would be required to measure their investments in subsidiaries (except those subsidiaries that provide investment–related services) at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments* (or IAS 39,[11] if IFRS 9 has not yet been adopted).[12] The majority of respondents to the *Investment Entities* ED broadly supported the proposed exception to consolidation for the reasons outlined in paragraphs BC217–BC219.

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[11] IFRS 9 *Financial Instruments* replaced IAS 39. IFRS 9 applies to all items that were previously within the scope of IAS 39.

[12] In December 2014, the Board issued *Investment Entities: Applying the Consolidation Exception* (Amendments to IFRS 10, IFRS 12 and IAS 28). These amendments clarified which subsidiaries of an investment entity are consolidated in accordance with paragraph 32 of IFRS 10, instead of being measured at fair value through profit or loss (see paragraphs BC240A–BC240I).

BC221 The Board conducted its deliberations leading to the publication of the *Investment Entities* ED and the final investment entities requirements jointly with the FASB. The similarities and differences between the investment entities guidance in IFRS and US GAAP are discussed further in paragraphs BC289–BC291.

Scope of the project

BC222 The *Investment Entities* ED proposed a limited- scope exception to consolidation for investment entities. A number of respondents to the *Investment Entities* ED asked the Board to expand the scope of its proposals.

BC223 Some respondents asked the Board to expand the scope of the project to require an investment entity to measure all of its investments at fair value. However, the Board noted that, in most cases, existing IFRSs require or permit investments held by an investment entity to be measured at fair value. For example an entity:

(a) may elect the fair value option in IAS 40 *Investment Property*; and

(b) would be required to measure its financial assets at fair value through profit or loss in accordance with IFRS 9 (or IAS 39[13]) when those assets are managed on a fair value basis.

Consequently, the Board decided to limit the scope of the project to only providing an exception to consolidation for investment entities.

BC224 Other respondents requested an extension of the proposed exception to consolidation. In particular, respondents from the insurance industry requested an exception to consolidating their interests in insurance investment funds. They argued that presenting the fair value of their interests in insurance investment funds as a single line item, along with a single line item for the current value of their liability to policyholders who receive the returns from those investment funds, would provide more useful information to users than consolidation. The Board noted that providing an exception to consolidation for insurers' interests in insurance investment funds is outside the scope of the Investment Entities project, which was meant to provide an exception to consolidation for investment entities. In addition, any additional exceptions to consolidation would require the Board to do further work to define the entities that could apply those exceptions. The Board noted that this additional exception to consolidation was not contemplated in the scope of the project nor was it exposed for comment. Consequently, the Board decided not to extend the proposed exception to consolidation.

BC225 Other respondents asked the Board to provide guidance permitting an investor in an investment entity to use the reported net asset value (NAV) per share of that investment entity as a practical expedient for measuring the fair value of its investment in that investment entity. Similar guidance exists in US GAAP. The Board considered providing such a practical expedient in their deliberations on IFRS 13 but decided against it because, at the time, there was no specific accounting guidance for investment entities in IFRS and because there are different practices for calculating NAVs in jurisdictions around the world. The Board decided that it is outside the scope of the Investment Entities project to provide fair value measurement guidance for investments in investment entities. The Board developed the definition of an investment entity to identify which entities should qualify for an exception to consolidation. The definition was not designed to decide which entities should qualify for a fair value measurement practical expedient. Moreover, the Board still has concerns that NAV could be calculated differently in different jurisdictions. Consequently, the Board decided not to provide an NAV practical expedient for fair value measurement as part of the Investment Entities project.

BC226 The Board has decided to adopt an entity-based approach to the exception to consolidation. That is, the exception to consolidation is based on the type of entity that owns the subsidiary. The Board considered providing an asset-based approach to the exception to consolidation. Under an asset-based approach, an entity would consider its relationship with, and the characteristics of, each of its subsidiaries (that is, each individual asset) to decide whether fair value measurement is more appropriate than consolidation. However, the Board decided to retain the entity-based exception to consolidation that was proposed in the *Investment Entities* ED. The Board was concerned that an asset-based approach would significantly broaden the exception to consolidation by making the exception available to any entity holding relevant assets. This would represent a significant conceptual change to the consolidation model that the Board has developed in this IFRS. In addition, the Board believes that investment entities have a unique business model that makes reporting subsidiaries at fair value more appropriate than consolidation. An entity-based approach captures the unique business model of investment entities.

BC227 The Board also considered providing an option to allow investment entities to either consolidate subsidiaries or measure them at fair value through profit or loss. However, the Board believes that providing this option would be inconsistent with their view that fair value information is the most relevant

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[13] IFRS 9 *Financial Instruments* replaced IAS 39. IFRS 9 applies to all items that were previously within the scope of IAS 39.

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information for all investment entities. Moreover, providing an option would reduce comparability between different investment entities. Consequently, the Board decided that an investment entity should be required to measure its subsidiaries at fair value through profit or loss.

Approach to assessing investment entity status

BC228 In the *Investment Entities* ED, the Board proposed six criteria that must be met in order for an entity to qualify as an investment entity. These criteria were based on guidance in US GAAP (Topic 946 *Financial Services—Investment Companies* in the *FASB Accounting Standards Codification*®).

BC229 Many respondents expressed concern that requiring an entity to meet all six criteria proposed in the *Investment Entities* ED would be too prescriptive. They thought that the proposed criteria inappropriately focused on the structure of an investment entity rather than on its business model and did not allow for the use of judgement in determining whether an entity is an investment entity. These respondents stated that a less prescriptive approach to assessing the criteria would result in more consistent reporting by entities with similar business models.

BC230 In addition, many respondents argued that the six proposed criteria in the *Investment Entities* ED did not provide a general description of an investment entity and an explanation of why fair value measurement is more relevant for the subsidiaries of an investment entity. Because the concept of an investment entity is new to IFRS, those respondents argued that the guidance should include a more general definition of an investment entity (rather than merely criteria to be an investment entity) and a justification for the exception to consolidation.

BC231 In response to the comments from respondents, the Board decided to provide a definition of an investment entity based on some of the criteria originally proposed in the *Investment Entities* ED. An entity that meets the definition of an investment entity would not consolidate its controlled subsidiaries (other than those subsidiaries that provide investment-related services or activities).[14]

BC232 The Board agreed with respondents who stated that some of the proposed criteria were too strict and would inappropriately exclude some structures from qualifying as investment entities. The Board believes that there are structures in practice in which an entity does not meet one or more of the criteria that were described in the *Investment Entities* ED, but should still qualify as an investment entity. For example, the *Investment Entities* ED required an investment entity to have more than one investor; the Board thinks that some pension funds, sovereign wealth funds, and other investment funds with a single investor should qualify as investment entities. Moreover, respondents commented that the application guidance in the *Investment Entities* ED provided too many exceptions to the strict criteria.

BC233 Consequently, the Board decided that an entity would not be required to satisfy the remaining criteria to meet the definition of an investment entity and qualify for the exception to consolidation. However, the Board noted that the remaining criteria represent typical characteristics of an investment entity and decided to include these typical characteristics in the investment entities guidance to help entities determine whether they qualify as an investment entity. If an entity does not display one or more of the typical characteristics, it indicates that additional judgement is required in determining whether the entity meets the definition of an investment entity. Consequently, the Board also decided that an investment entity that does not have one or more of the typical characteristics would be required to disclose how it still meets the definition of an investment entity.

BC234 The Board thinks that it is very unlikely that an entity that displays none of the typical characteristics of an investment entity would meet the definition of one. However, it may be possible in rare circumstances. For example, a pension fund that has a single investor and does not issue equity ownership interests could qualify as an investment entity even if it only holds a single investment temporarily (eg at commencement or wind-down of the entity).

BC235 The Board believes that defining an investment entity and describing its typical characteristics achieves a balance between clearly defining those entities that qualify for the exception to consolidation and avoiding the use of bright lines. In addition, this approach allows the definition to stand on its own, with application guidance providing clarification rather than exceptions.

Definition of an investment entity

BC236 The definition of an investment entity has three essential elements that differentiate investment entities from other types of entities.

[14] In December 2014, the Board issued *Investment Entities: Applying the Consolidation Exception* (Amendments to IFRS 10, IFRS 12 and IAS 28). These amendments clarified which subsidiaries of an investment entity are consolidated in accordance with paragraph 32 of IFRS 10, instead of being measured at fair value through profit or loss (see paragraphs BC240A–BC240I).

Investment management services

BC237 The Board noted that one of the essential activities of an investment entity is that it obtains funds from investors in order to provide those investors with investment management services. The Board believes that this provision of investment management services differentiates investment entities from other entities. Consequently, the Board decided that the definition of an investment entity should state that an investment entity obtains funds from an investor or investors and provides the investor(s) with investment management services.

Business purpose

BC238 The Board believes that an entity's activities and business purpose are critical to determining whether it is an investment entity. An investment entity collects funds from investors and invests those funds to obtain returns solely from capital appreciation, investment income, or both. Consequently, the Board decided that the definition of an investment entity should state that an investment entity commits to its investor(s) that its business purpose is to provide investment management services and invest funds solely for returns from capital appreciation, investment income, or both.

BC239 The *Investment Entities* ED did not allow an entity to qualify as an investment entity if it provided substantive investment-related services to third parties. While some respondents agreed with this, others argued that an investment entity should be allowed to provide such services to third parties. They argued that the provision of these investment-related services to third parties is simply an extension of the investment entity's investing activities and should not prohibit an entity from qualifying as an investment entity. The Board agreed with these arguments, concluding that the provision of such services is within the business model of an investment entity. Although such an entity may earn fee income from the provision of investment-related services, its sole business purpose is still investing for capital appreciation, investment income, or both (whether that is for itself, for its investors or for external parties).

BC240 The Board noted that an investment entity may sometimes hold an interest in a subsidiary that provides investment-related services for its investment activities. The Board did not think that the existence of such a subsidiary should prohibit an entity from qualifying as an investment entity, even if those services were substantial or were provided to third parties in addition to the entity. The Board views such services as an extension of the operations of the investment entity and therefore concluded that subsidiaries that provide those services should be consolidated.

BC240A In December 2014, the Board issued *Investment Entities: Applying the Consolidation Exception* (Amendments to IFRS 10, IFRS 12 and IAS 28). This amended paragraphs 32, BC85C and B85E of IFRS 10 to clarify which subsidiaries of an investment entity should be consolidated instead of being measured at fair value. The amendments were made in response to a request for the Board to clarify how to apply paragraph 32 when the subsidiary of an investment entity itself meets the definition of an investment entity and provides services that relate to the parent's investment activities.

BC240B The Board decided to clarify that an investment entity shall measure at fair value through profit or loss all of its subsidiaries that are themselves investment entities. This is consistent with its decision not to distinguish between investment entity subsidiaries established for different purposes (see paragraph BC272). This was supported by the majority of respondents to both the *Investment Entities* ED and the Exposure Draft *Investment Entities: Applying the Consolidation Exception* (Proposed amendments to IFRS 10 and IAS 28), published in June 2014 (the '*Consolidation Exception* ED').

BC240C Some respondents to the *Consolidation Exception* ED suggested that requiring an investment entity to measure each investment entity subsidiary at fair value as a single item results in a loss of information about each subsidiary's underlying investments and the activities of that subsidiary. They suggested that an investment entity parent should be able to apply a 'dual-model' of consolidation, which would allow an investment entity parent to show its directly and indirectly held investments at fair value while consolidating other activities. This is similar to the asset-based approach previously rejected by the Board (see paragraph BC226).

BC240D The Board acknowledged some of the potential benefits of an asset-based approach. In particular, this approach may better avoid some structuring issues, particularly in multi-layer groups in which different types of subsidiaries are held at different levels within the group. However, the Board decided that developing a broader principle-based approach, together with guidance to enable consistent application, would be too difficult to achieve within the limited scope of the consolidation exception clarification project. In addition, the Board decided that such an approach and related guidance could not be developed within the short time frame that was needed to provide the necessary clarification before the end of 2014. These decisions were, in part, based on the variety of suggestions provided by respondents to the

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Consolidation Exception ED about which activities should be consolidated and which should be measured at fair value.

BC240E The Board noted that the requirement in paragraph 32 of IFRS 10 to consolidate particular subsidiaries of an investment entity was intended to be a limited exception, capturing only operating subsidiaries that support the investment entity parent's investing activities as an extension of the operations of the investment entity parent. It was not intended to capture subsidiaries that are themselves investment entities. The definition of an investment entity requires that the investment entity's business purpose and, therefore, its core activity is providing investment management services to its investors and investing the funds obtained from its investors solely for returns from capital appreciation, investment income, or both. When the Board decided that providing investment-related services to third parties would not prevent an entity from qualifying as an investment entity, it recognised that investment entities could benefit from synergies between the core investing activities and the provision of investment-related services to third parties.

BC240F The Board noted that, therefore, when an entity assesses whether it qualifies as an investment entity, it considers whether providing services to third parties is ancillary to its core investing activities. However, 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 and rental income) or both (see paragraph B85B of IFRS 10). Consequently, an entity whose main purpose is to provide investment-related services in exchange for consideration from third parties has a business purpose that is different from the business purpose of an investment entity. This is because the entity's main activity is earning fee income in exchange for its services. In contrast, for an entity that qualifies as an investment entity, such fee income, which could be substantial in amount, will be derived from its core investment activities, which are designed for earning capital appreciation, investment income or both.

BC240G The Board decided that requiring an investment entity to measure all of its subsidiaries that are themselves investment entities at fair value through profit or loss is consistent with the entity-based approach and decided to confirm its proposal in the *Consolidation Exception* ED. Consequently, when an investment entity parent assesses whether a subsidiary should be measured at fair value in accordance with paragraph 31 of IFRS 10 or, instead, should be consolidated in accordance with paragraph 32 of IFRS 10, the parent assesses whether the subsidiary meets the definition of an investment entity. If so, the investment entity parent measures its investment entity subsidiary at fair value through profit or loss in accordance with paragraph 31.

BC240H If the subsidiary is not an investment entity, the investment entity parent assesses whether the main activities undertaken by the subsidiary support the core investment activities of the parent. If so, the subsidiary's activities are considered to be an extension of the parent's core investing activities and the subsidiary would be consolidated in accordance with paragraph 32 of IFRS 10. The Board noted that a subsidiary of an investment entity that provides support services to its parent and other members of the group, such as administration, treasury, payroll and accounting services, is considered to be providing those services as an extension of the operations of the parent. Such a non-investment entity subsidiary would be consolidated in accordance with paragraph 32 of IFRS 10.

BC240I The Board concluded that these outcomes are consistent with its basic decision that measuring all investments of investment entities at fair value through profit or loss provides the most relevant information, except for operating subsidiaries that act as an extension of the investment entity parent.

BC241 The Board considered prohibiting investment entities from engaging in some activities, such as providing financial support to its investees or actively managing its investees. However, the Board understands that an investment entity may engage in these activities in order to maximise the overall value of the investee (ie to maximise capital appreciation), rather than to obtain other benefits. Consequently, the Board believes that these activities can be consistent with the overall activities of an investment entity and should not be prohibited as long as they do not represent a separate substantial business activity or source of income other than capital appreciation.

BC242 The Board was concerned that an entity that meets the definition of an investment entity could be inserted into a larger corporate structure to achieve a particular accounting outcome. For example, a parent entity could use an 'internal' investment entity subsidiary to invest in subsidiaries that may be making losses (eg research and development activities on behalf of the overall group) and would record its investments at fair value, rather than reflecting the underlying activities of the investee. To address these concerns and to emphasise the business purpose of an investment entity, the Board decided to include a requirement that an investment entity, or other members of the group containing the entity, should not obtain benefits from its investees that would be unavailable to other parties that are not related to the investee. In the Board's view, this is one of the factors that differentiate an investment entity from a non-investment entity holding company. If an entity or another member of the group containing the entity obtains benefits from its investees that are unavailable to other investors, then the investment will benefit that entity or the group in some operating or strategic capacity and the entity will therefore not qualify as an investment entity.

BC243 However, the Board also clarified that an investment entity may have more than one investment in the same industry, market or geographical area in order to benefit from synergies that increase the capital appreciation of those investments. It noted that such a fact pattern may be common in the private equity industry. Some Board members expressed concern that allowing transactions or synergies between investments may artificially increase the fair value of each investment and, consequently, inappropriately increase the assets reported by the investment entity. However, the Board decided that trading transactions or synergies that arise between the investments of an investment entity should not be prohibited because their existence does not necessarily mean that the investment entity is receiving any returns beyond solely capital appreciation, investment income, or both.

Exit strategy

BC244 The Board believes that a parent with operating subsidiaries often plans to own and operate its subsidiaries indefinitely to realise returns from those operations. However, the Board does not think that an entity that holds its investments indefinitely, especially its subsidiaries, should qualify as an investment entity. Accordingly, the Board considered requiring an exit strategy for substantially all investments held by an investment entity, including debt investments.

BC245 However, respondents to the *Investment Entities* ED noted that some investment funds that would otherwise qualify as investment entities may hold a significant amount of debt investments to maturity and therefore would not have an exit strategy for those debt investments. For example, the Board understands that, in some cases, private equity funds may make both debt and equity investments in their investees. The debt investments may have shorter maturities than the anticipated term of the fund's equity investment and may be held to maturity. Moreover, an investment entity may hold debt instruments to maturity to manage liquidity risk or to mitigate the risk from holding other types of more volatile investments. Although the entity does not have an exit strategy for these debt investments, it does not plan to hold them indefinitely—even if the entity does not plan to sell these investments before maturity, the vast majority of debt investments have a limited life.

BC246 The Board decided that such an entity should not be prohibited from qualifying as an investment entity, provided that substantially all of its investments (including debt investments) are measured at fair value. The Board noted that debt investments may be measured at fair value in accordance with IFRS 9 or IAS 39[15] even in the absence of an exit strategy.

BC247 However, the Board decided that an investment entity must have an exit strategy for substantially all of its investments that can be held indefinitely (typically equity investments and non- financial assets). The Board does not think it is appropriate for an entity to qualify for an exception to consolidation if that entity is holding equity investments indefinitely and is not planning to realise capital appreciation from those investments. Although the exit strategy may vary depending on circumstances, potential exit strategies that include a substantive time frame for exiting from the investment should still be identified and documented for equity and non- financial investments in order to meet the definition of an investment entity.

BC248 The Board noted that an entity may fail to meet this component of the definition of an investment entity if it is formed in connection with an investment entity investee for legal, regulatory, tax or similar business reasons (eg a 'blocker' entity or a 'master-feeder' structure), and that that investee holds investments on behalf of the entity. The Board decided that the entity should not be prohibited from qualifying as an investment entity merely because it does not have an exit strategy for the investee, if that investee qualifies as an investment entity and has appropriate exit strategies for its own investments.

Fair value measurement

BC249 In the development of IFRS 10 and the *Investment Entities* ED, the Board heard that fair value information is the primary driver of the decision-making processes both of the management of, and the investors in, investment entities. Many respondents stated that both management and investors evaluate the performance of an investment entity by reference to the fair value of its investments. The Board heard that some investors in investment entities disregard the consolidated financial statements of investment entities and instead rely on non-GAAP fair value reports.

BC250 The basis for the exception to consolidation that is provided to investment entities is that fair value information is the most relevant for an investment entity's investments, including its investments in subsidiaries. The Board therefore decided that an essential feature of the definition of an investment entity is that the entity would use existing IFRS requirements or accounting policy options to measure substantially all of its investments at fair value. The Board does not think that an entity that fails to elect the

15 IFRS 9 *Financial Instruments* replaced IAS 39. IFRS 9 applies to all items that were previously within the scope of IAS 39.

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fair value measurement options available in IAS 28 *Investments in Associates and Joint Ventures* or IAS 40, or that accounts for more than an insignificant amount of its financial assets at amortised cost under IFRS 9 or IAS 39,[16] should qualify as an investment entity.

BC251 The Board noted that some investments may be measured at fair value in the statement of financial position, with fair value changes recognised in other comprehensive income rather than through profit or loss, and agreed that this would satisfy the fair value measurement element of the definition of an investment entity.

BC252 The Board considers that a significant distinguishing characteristic of an investment entity is that investors in an investment entity are primarily interested in fair value and make their investing decisions based on the fair value of the investment entity's underlying investments. The Board notes that this is partly because, in many cases, investors in an investment entity transact with it on a fair value basis (for example, on the basis of a net asset value per share, which is calculated using the fair value of the entity's underlying investments). Similarly, the Board believes that fair value should also be used by an investment entity's key management personnel to assess the entity's performance and to make investing decisions. Consequently, the Board decided that, in order to meet the definition of an investment entity, an entity should demonstrate that fair value is the primary measurement attribute used to evaluate the performance of its investments, both internally and externally.

Regulatory requirements

BC253 The Board considered whether to include a reference to regulatory requirements in the definition of an investment entity. The Board noted that the FASB proposed, in their own Exposure Draft, that any entity that was regulated as an investment company under the US Securities and Exchange Commission's Investment Company Act of 1940 would automatically be considered to be an investment company for US GAAP financial reporting purposes. Some respondents to the Board's *Investment Entities* ED also asked the Board to include a reference to regulatory requirements in the definition of an investment entity, which would allow any entity regulated as an investment entity to fall within the scope of the investment entity requirements.

BC254 However, the Board was concerned that:

(a) the regulatory requirements in different jurisdictions may result in similar entities qualifying as an investment entity in one jurisdiction but not in another;

(b) regulatory requirements may change over time, resulting in an ever-changing population of entities that would be eligible for an exception to consolidation; and

(c) it would have no control over which entities would qualify for the exception to consolidation.

Consequently, the Board decided not to reference regulatory requirements in the definition of an investment entity.

Typical characteristics of investment entities

BC255 The Board identified several 'typical characteristics' of an investment entity. The Board decided that these typical characteristics could be used to help an entity decide if it meets the definition of an investment entity. The absence of any of these typical characteristics may indicate that an entity does not meet the definition of an investment entity. However, an entity that does not display all of these typical characteristics could, nevertheless, meet the definition of an investment entity.

BC256 The Board identified the following typical characteristics of an investment entity:

(a) more than one investment (paragraphs BC257–BC258);

(b) more than one investor (paragraphs BC259–BC260);

(c) unrelated investors (paragraphs BC261–BC262); and

(d) ownership interests (paragraphs BC263–BC267).

More than one investment

BC257 The *Investment Entities* ED proposed that an investment entity should hold more than one investment. However, respondents provided examples of entities that they believed should qualify as investment entities, but that only hold a single investment. These included single investment funds set up because the

[16] IFRS 9 *Financial Instruments* replaced IAS 39. IFRS 9 applies to all items that were previously within the scope of IAS 39.

required minimum investment is too high for individual investors, or investment funds that hold a single investment temporarily.

BC258 The Board agreed with these arguments and therefore decided that an investment entity would not be required to hold more than one investment. However, the Board understands that investment entities typically invest in more than one investment as a means of diversifying their portfolio and maximising their returns. Consequently, investing in more than one investment is described as a typical characteristic of an investment entity in this IFRS.

More than one investor

BC259 The presence of more than one investor was originally proposed as a requirement in the *Investment Entities* ED. However, respondents provided many examples of investment funds with a single investor. These included funds that temporarily have a single investor, government-owned investment funds, funds wholly- owned by pension plans and endowments, and funds set up by an investment manager for an unrelated single investor with a unique investment strategy.

BC260 The Board does not think that there is a conceptual reason why an investment fund with a single investor should be disqualified from being an investment entity. However, the Board thinks that having more than one investor would make it less likely that the entity, or other members of the group that contains the entity, would obtain benefits other than capital appreciation or investment income from its investment. Consequently, the Board decided to include the presence of more than one investor as a typical characteristic of an investment entity rather than as part of the definition of an investment entity.

Unrelated investors

BC261 The *Investment Entities* ED proposed that an investment entity be required to have investors that are unrelated to the entity or its parent (if any), partly to prevent entities from structuring around the requirement to have more than one investor. However, respondents provided examples of entities with related investors that they believed should qualify as investment entities. For example, a separate ‘parallel’ entity may be formed to allow the employees of an investment entity to invest in a fund that mirrors the investments in the main fund. The Board agreed with the respondents’ arguments and decided that an investment entity would not be required to have investors that are unrelated to the investment entity or to other members of the group that contains the investment entity.

BC262 However, the Board understands that investment entities typically have unrelated investors. Again, having unrelated investors is one way to help ensure that the entity, or another member of the group that contains the entity, does not receive returns from investments that are other than capital appreciation or investment income. Having investors that are unrelated to the entity or its parent (if any), is therefore described as a typical characteristic of an investment entity in this IFRS.

Ownership interests

BC263 An investment entity would typically have ownership interests in the form of equity or similar (eg partnership) interests that entitle investors to a proportionate share of the net assets of the investment entity. This characteristic explains in part why fair value is more relevant to investment entity investors: each unit of ownership in the investment entity entitles an investor to a proportionate share of the net assets of that investment entity. The value of each ownership interest is linked directly to the fair value of the investment entity’s investments.

BC264 However, the Board believes that this form of ownership interests in an entity should not be the deciding factor as to whether it is an investment entity. Respondents provided examples of entities that do not have units of ownership in the form of equity or similar interests but provide investors with a proportionate share of their net assets. For example, a pension fund or sovereign wealth fund with a single direct investor may have beneficiaries that are entitled to the net assets of the investment fund, but do not have ownership units. In addition, respondents noted that funds with different share classes or funds in which investors have discretion to invest in individual assets would be disqualified from investment entity status because they did not provide each investor with a proportionate share of net assets.

BC265 The Board does not believe that an entity that provides its investors only a return of their investment plus interest should qualify as an investment entity. Fair value information is more relevant to investors that are entitled to a specifically identifiable portion of the investment entity’s net assets and are, therefore, exposed to the upside and downside of the investment entity’s performance.

BC266 However, the Board agreed that the requirement proposed in the *Investment Entities* ED (that an investment entity’s ownership interests entitle investors to a proportionate share of its net assets) would have

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inappropriately excluded certain structures from investment entity status. As an alternative, the Board considered requiring that an investment entity's ownership interests be in the form of equity or similar interests. However, the Board was concerned that this would put too much emphasis on the debt/equity classification in IAS 32 *Financial Instruments: Presentation* and would inappropriately exclude some structures whose ownership interests were classified as debt. Moreover, the Board was also concerned that including the 'ownership interest' concept as part of the definition of an investment entity would put too much emphasis on the form of the entity, rather than emphasising its business model.

BC267 Consequently, the Board decided not to include ownership interests as part of the definition of an investment entity but that it should instead be regarded as a typical characteristic of an investment entity.

Reassessment and change of status

BC268 The Board included guidance in the *Investment Entities* ED on reassessing investment entity status. A few respondents asked the Board to clarify this guidance.

BC269 In the *Investment Entities* ED, the Board proposed that an entity would reassess its investment entity status whenever facts or circumstances changed. The Board decided to retain this requirement unchanged because it is consistent with the requirements for reassessment elsewhere in IFRS, including the general reassessment requirements in IFRS 10. The Board noted that they do not believe that the reassessment of facts and circumstances in other situations is considered unduly onerous for preparers or their auditors.

BC270 The Board decided that, when an entity loses investment entity status, it should account for that change as a 'deemed acquisition'. That is, the investment entity would use the fair value of the investment at the date of the change of status as the 'deemed' consideration transferred to obtain control of the investee. This recognises the change in status in the same way as a business combination achieved in stages, as described in IFRS 3. This would result in the recognition of goodwill or a gain on a bargain purchase.

BC271 The Board also decided that, when an entity becomes an investment entity, the entity should account for the change in status as a 'deemed disposal' or 'loss of control' of its subsidiaries. The fair value of the investment at the date of the change of status should be used as the consideration received when applying the guidance in IFRS 10. The Board considered how to account for the gain or loss on the 'deemed disposal' and decided to recognise it as a gain or loss in profit or loss. This treats the change in the business purpose of the investor as a significant economic event and is consistent with the rationale for gains and losses being recognised in profit or loss in IFRS 10 when control is lost.

Parent of an investment entity

Investment entity parent of an investment entity subsidiary

BC272 The *Investment Entities* ED proposed that an investment entity would measure all of its subsidiaries at fair value (except for those subsidiaries providing investment-related services), even those investees who were themselves investment entities. Some respondents questioned this proposal and suggested that at least some investment entity subsidiaries should be consolidated (for example, wholly- owned investment entity subsidiaries that are created for legal, tax or regulatory purposes). However, the Board thinks that fair value measurement of all an investment entity's subsidiaries (except for those subsidiaries providing investment-related services or activities) would provide the most useful information and therefore decided to retain this proposal. The Board considered requiring an investment entity to consolidate only those investment entity subsidiaries that are formed for legal, tax or regulatory purposes, but decided against this because there is no conceptual basis for distinguishing between different investment entity subsidiaries. Moreover, the Board thinks that it would be very difficult to distinguish between an investment entity subsidiary formed for a specific legal, tax or regulatory purpose and those that are set up only for other business reasons.

BC273 The Board considered whether it should require certain investment entity parents to attach the financial statements of their investment entity subsidiaries to the parent's financial statements. Some respondents argued that it would be essential for users of the financial statements of an investment entity parent to have information about the underlying investments of its investment entity subsidiary, particularly when the investment entity parent has only one investment entity subsidiary (eg 'master-feeder funds').

BC274 However, the Board decided against requiring financial statements of an investment entity subsidiary to be attached to the financial statements of an investment entity parent. The Board believed that it would be difficult to define which types of structures should be covered by such a requirement. Moreover, the Board thought that such a requirement would be inconsistent with the proposal that fair value information is always the most relevant information for investment entities.

Non-investment entity parent of an investment entity subsidiary

BC275 The Board also considered whether to retain investment entity accounting in the financial statements of a non-investment entity parent. In the *Investment Entities* ED, the Board proposed that a non- investment entity parent of an investment entity subsidiary would be required to consolidate all of its subsidiaries; that is, the exception to consolidation available to an investment entity would not be available to its non-investment entity parent.

BC276 The Board noted that the majority of respondents disagreed with the proposal, arguing that if fair value information is more relevant than consolidation at an investment entity subsidiary level, it is also more relevant information at the non-investment entity parent level.

BC277 The Board acknowledged the comments received but decided to retain the proposal to require all non-investment entity parents to consolidate all of their subsidiaries.

BC278 The Board has decided to provide an exception to consolidation because of the unique business model of investment entities. Non-investment entities do not have this unique business model; they have other substantial activities besides investing, or do not manage substantially all of their assets on a fair value basis. Consequently, the argument for a fair value measurement requirement is weakened at a non-investment entity level.

BC279 The Board also noted that the decision to define an investment entity and describe its typical characteristics rather than requiring an investment entity to meet a number of criteria has increased the population of entities that could qualify as investment entities, and has also increased the amount of judgement needed to determine whether an entity is an investment entity. For example, an entity with a single investor, or an entity that provides day- to- day management services or strategic advice to its subsidiary, can qualify as an investment entity under this IFRS, when such entities would have been excluded under the *Investment Entities* ED.

BC280 The Board was concerned that some of these changes would increase the likelihood that a non-investment entity parent could achieve different accounting outcomes by holding subsidiaries directly or indirectly through an investment entity. The Board noted that, for example, a non-investment entity parent may elect to hold subsidiaries through an investment entity subsidiary in order to hide leverage or loss-making activities.

BC281 In addition, the Board considered the practical difficulties in retaining the exception to consolidation when a non-investment entity parent and an investment entity subsidiary invest in the same investment or when an investment entity subsidiary holds a subsidiary that invests in the equity of a non-investment entity parent.

BC282 The Board noted that the retention of the specialised accounting used by an investment company subsidiary at a non-investment company level is a long-standing requirement in US GAAP. However, US GAAP has industry-specific guidance for a number of industries, and the application of that industry-specific guidance by a subsidiary is retained by a parent entity, regardless of whether the parent entity is part of that industry. IFRSs generally do not contain such industry- specific guidance.

BC283 Some respondents to the *Investment Entities* ED noted that not retaining the fair value accounting of an investment entity subsidiary in its non-investment entity parent's financial statements seems inconsistent with IAS 28 *Investments in Associates and Joint Ventures*. IAS 28 allows a parent that indirectly holds an investment in an associate through a venture capital organisation, mutual fund, unit trust or similar entity to measure that portion of the investment at fair value through profit or loss in accordance with IFRS 9 or IAS 39.[17] The Board acknowledged the inconsistency but thought it was important to keep the retention of fair value accounting that is currently allowed for venture capital organisations, mutual funds, unit trusts and similar entities. The Board also noted that the difference between using the equity method and fair value measurement for investments in associates and joint ventures is smaller than that between consolidation and fair value measurement for investments in subsidiaries.

Transition

BC284 The Board proposed in the *Investment Entities* ED that the exception to consolidation should be applied prospectively. Some respondents disagreed with the proposal, arguing that retrospective application would result in more useful information. In addition, they noted that retrospective application should not be onerous because investment entities would be expected to have information about the fair value of their

[17] IFRS 9 *Financial Instruments* replaced IAS 39. IFRS 9 applies to all items that were previously within the scope of IAS 39.

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investments. Those respondents also argued that retrospective application would be consistent with the other transition requirements in IFRS 10.

BC285 The Board agreed with these arguments and decided to require retrospective application of the exception to consolidation, subject to specific transition reliefs, such as:

(a) a relief for when it is impracticable to identify the fair value of investments;

(b) a relief for when an investment entity disposes of investments prior to the date of initial application; and

(c) a relief from providing comparative information for more than one period preceding the date of initial application.

BC286 The Board also noted that entities that adopt these amendments early may not have adopted IFRS 13, which has an effective date of 1 January 2013. Consequently, the Board decided that when an investment entity has not yet adopted IFRS 13, it may use the fair value amounts previously reported to investors or to management, as long as 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. The Board noted that if previously used fair value measurements are not available, it may be impracticable to measure fair value without using hindsight. In such cases, transition relief is available.

BC287 The Board also decided to require first-time adopters to apply the requirements retrospectively, subject to specific transition reliefs.[18]

BC287A The Board decided that no specific transition guidance was needed and, therefore, an entity should apply *Investment Entities: Applying the Consolidation Exception* (Amendments to IFRS 10, IFRS 12 and IAS 28) retrospectively in accordance with IAS 8. However, the Board decided that an entity need only present the quantitative information required by paragraph 28(f) of IAS 8 for the annual period immediately preceding the date of initial application of this IFRS (the 'immediately preceding period') when the amendments are first applied.

Effective date and early application

BC288 The Board decided on a 1 January 2014 effective date for the requirements for investment entities. The Board noted that because these requirements provide an exception to consolidation, they should have the same effective date as the revised consolidation requirements in IFRS 10 (annual periods beginning on or after 1 January 2013). However, given that the investment entities requirements were published in October 2012, the Board did not believe that a 1 January 2013 effective date would give adequate time for implementation between the publication and effective dates. However, the Board decided to permit early application of the investment entity requirements. The Board noted that it expects many entities to apply the requirements early. Some investments in subsidiaries may not have been consolidated in accordance with IAS 27 and SIC- 12 but, without the exception to consolidation, would need to be consolidated in accordance with IFRS 10. The Board noted that it would be potentially confusing to users of financial statements and time- consuming for the investment entity to consolidate a subsidiary in one accounting period and then carry the same investee at fair value in the following period. In addition, investment entities should already have the fair value information needed for implementation. Finally, the exception to consolidation has been a long-standing request from the investment entity industry. Consequently, the Board believes that many investment entities will want to adopt the requirements early.

Joint deliberations with the FASB

BC289 The Board deliberated this project jointly with the FASB. US GAAP has had comprehensive accounting guidance for investment companies for many years (contained in Topic 946 *Investment Companies*). By deliberating this project jointly, the boards hoped to achieve as similar guidance as possible. To that end, they came up with similar definitions of investment entities and guidance on how to assess investment entity status.

BC290 However, the scope of the project was different for the IASB and the FASB. The IASB's Investment Entities project started during the deliberations on the Consolidations project and was only intended to provide an exception to consolidation for investment entities. The FASB was seeking to improve and converge the definition of an investment company with that of the IASB because it already has comprehensive accounting and reporting guidance for investment companies.

[18] *Annual Improvements to IFRS Standards 2014–2016 Cycle*, issued in December 2016, amended IFRS 1 *First-time Adoption of International Financial Reporting Standards* by deleting the short-term exemption for first-time adopters (see paragraph BC99 of IFRS 1), because it was no longer applicable.

BC291 While the boards reached many common decisions, as a result of this scope difference, and other jurisdictional differences, the IASB and the FASB came to different decisions in a number of areas. These include:

(a) whether there should be a requirement that an investment entity measure and evaluate substantially all of its investments on a fair value basis rather than identifying such an activity as a typical characteristic of an investment entity;

(b) whether there should be a reference to existing regulatory requirements in the definition of an investment entity;

(c) whether an investment entity is permitted to provide investment-related services to third parties other than its own investors;

(d) the accounting by an investment entity parent for an investment entity subsidiary; and

(e) the accounting by a non-investment entity parent for an investment entity subsidiary.

Effects analysis for investment entities

BC292 The Board is committed to assessing and sharing knowledge about the likely costs of implementing proposed new requirements and the likely ongoing costs and benefits of each new IFRS—the costs and benefits are collectively referred to as 'effects'. The Board gains insight on the likely effects of the proposals for new or revised IFRSs through its formal exposure of proposals, analysis and consultations with relevant parties.

BC293 In evaluating the likely effects of introducing an exception to consolidation for investment entities to IFRS 10, the Board has considered the following factors:

(a) how the changes to IFRS 10 affect the financial statements of an investment entity;

(b) how those changes improve the comparability of financial information between different reporting periods for an investment entity and between different investment entities in a particular reporting period;

(c) how the changes will improve the quality of the financial information available to investors and its usefulness in assessing the future cash flows of an investment entity;

(d) how users will benefit from better economic decision-making as a result of improved financial reporting;

(e) the likely effect on compliance costs for preparers, both on initial application and on an ongoing basis; and

(f) whether the likely costs of analysis for users are affected.

Financial statements of investment entities

BC294 Before the exception to consolidation for investment entities was issued, IFRS 10 (and its predecessor, IAS 27) required reporting entities to consolidate all controlled entities, regardless of the nature of the reporting entity. Consequently, the assets, liabilities and non- controlling interests of each subsidiary were aggregated with those of the parent to represent the group of entities as a single reporting entity.

BC295 Respondents to ED 10 argued that an investment entity often holds non- controlling investments in some entities that are reported at fair value, as well as subsidiaries that are consolidated in accordance with current principles in IFRS. Reporting investments on more than one basis hinders comparability within the financial statements, because all investments are held by an investment entity for a similar purpose—capital appreciation, investment income, or both. In addition, some of the items consolidated would be measured at historical cost, which distorts the performance assessment of the investment entity and does not reflect the way in which the business of the entity is managed.

BC296 The exception to consolidation will change the way in which an investment entity parent reports its interest in an entity that it controls. Rather than consolidating its subsidiaries, an investment entity is now required to recognise a subsidiary as a single-line investment measured at fair value through profit or loss in accordance with IFRS 9 (or IAS 39,[19] if IFRS 9 has not yet been adopted).

BC297 Accordingly, the exception to consolidation will affect investment entities that hold, as investments, controlling interests in other entities. However, although the changes are important to those entities

[19] IFRS 9 *Financial Instruments* replaced IAS 39. IFRS 9 applies to all items that were previously within the scope of IAS 39.

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affected, the changes are only expected to affect a narrow range of entities. Only those entities that meet the definition of an investment entity and hold controlling interests in other entities will be affected by these changes.

BC298 The entities most likely to be affected are:

(a) private equity or venture capital funds; these have business models in which it is more likely that it would be beneficial to take a larger interest in a company, or control investees through debt and equity investment.

(b) master-feeder or fund-of-funds structures where an investment entity parent has controlling interests in investment entity subsidiaries.

BC299 Some pension funds and sovereign wealth funds may also be affected; these may meet the definition of an investment entity and may also hold controlling investments in other entities.

BC300 Other types of entities may meet the definition of an investment entity, such as mutual funds and other regulated investment funds, but are less likely to hold controlling investments in other entities. Instead, they tend to hold lower levels of investments in a wider range of entities. Consequently, the exception to consolidation is less likely to affect these entities.

Comparability

BC301 An investment entity's control of an investee may change from one reporting period to the next. Without the exception to consolidation, an investment entity could be required to consolidate an investment in one period and present it as an investment measured at fair value through profit or loss in the following period (or vice versa). This would reduce comparability between reporting periods. With the introduction of the exception to consolidation, an investment entity can report all investments at fair value, regardless of whether those investments are controlled. This will improve the comparability between reporting periods.

BC302 Many respondents to ED 10 and the *Investment Entities* ED pointed out that some national accounting requirements, including US GAAP, have historically had industry-specific guidance that requires investment entities to measure investments that they control at fair value. Some of these respondents argued that investment entities were actively choosing to adopt those national accounting requirements rather than IFRS so that they could measure all of their investments at fair value. Respondents also pointed out that some investment entities that followed IFRS provided non-GAAP information about the fair value of all of their investments. Consequently, comparability of the financial statements of different investment entities was hindered. The Board expects the introduction of the exception to consolidation to encourage adoption of IFRS among investment entities and to eliminate the need to provide non-GAAP information about fair value. This should improve the comparability of financial statements of different investment entities.

Usefulness of financial statements in assessing the future cash flows of an entity

BC303 Consolidated financial statements of an investment entity emphasise the financial position, operations and cash flows of the investee, rather than merely those of the investment entity. The exception to consolidation will reduce the information about the cash flows of those subsidiaries. However, the main business purpose of an investment entity is to invest funds solely for capital appreciation, investment income, or both. The relevant cash flows relating to these activities are those of the investment entity itself. Consolidating the cash flows of a subsidiary may hinder users' ability to predict the cash flows that may be passed on to investors. The Board therefore believes that these amendments will improve the quality of the financial information reported by an investment entity and will make that information more useful in assessing the future cash flows of the investment entity.

Better economic decision-making

BC304 One of the essential features of an investment entity is that, in order to make better investment decisions, it measures and evaluates substantially all of its investments on a fair value basis. Presenting consolidated financial statements does not reflect this method of management. Requiring an investment entity to account for its investments in subsidiaries at fair value provides a better insight into the information that management uses to evaluate the performance of its investments.

BC305 In addition, investors in an investment entity are typically entitled to a proportionate share of the net assets of the entity when they withdraw their investment. Reporting the fair value of substantially all of the net assets of the investment entity allows the investors to more easily identify the value of their share of those

net assets. As a result, the Board expect significant benefits for most users of investment entity financial statements arising from the provision of more fair value information.

BC306 However, some respondents in some jurisdictions objected to the exception to consolidation because it undermines the control- based approach to consolidation used in IFRS 10. These respondents noted that an exception to consolidation would deprive financial statement users of information about the activities of subsidiaries and the economic effects of the relationships between an investment entity and its subsidiaries. In addition, some respondents expressed concern that an exception to consolidation may encourage structuring to avoid consolidation, which would result in a loss of such information to users.

BC307 The Board acknowledges these arguments, but notes that the exception to consolidation has been introduced in response to comments from users that the most useful information for an investment entity is the fair value of its investments. Users also commented that consolidated financial statements of an investment entity may hinder users' ability to assess an investment entity's financial position and results, because it emphasises the financial position, operations and cash flows of the investee, rather than those of the investment entity.

BC308 In developing these amendments, the Board deliberately restricted the population of entities that would qualify for the exception to consolidation. In particular, the Board prohibited the use of the exception to consolidation by non-investment entity parents of investment entities, in order to address respondents' concerns about structuring and to restrict the use of the exception to situations where fair value information would be more relevant than information arising from the consolidation of subsidiaries.

Effect on compliance costs for preparers

BC309 The Board expects that the introduction of the exception to consolidation will result in significant compliance cost savings for preparers, particularly on an ongoing basis. This expectation is based on the feedback the Board has received from respondents to the *Investment Entities* ED and conversations with entities that are expected to qualify as investment entities.

BC310 On initial application, there may be some costs involved in identifying and documenting some of the additional disclosures introduced. In particular, investment entities will need to collect information to comply with the general disclosure requirements of IFRS 7, IFRS 13 and the amended requirements of IFRS 12. However, the Board has been told that the majority of investment entities will already have much of the fair value information that they need in order to comply with the new requirements, because they already measure substantially all of their investments on a fair value basis and many elect to provide this information to their investors already. The Board expects this to mitigate the initial and ongoing costs of applying the exception to consolidation.

BC311 In arriving at its decisions, the Board has considered those costs and believes that the benefits of the information produced as a result of its decisions would outweigh the costs of providing that information. In addition, the initial application costs will be more than offset by the cost savings resulting from the removal of the need to gather information from subsidiaries in order to consolidate details of their financial performance, position and cash flows on a line- by- line basis.

BC312 As described in paragraphs BC275–BC283, the Board decided not to expand the scope of the project to allow a non- investment entity parent to retain the fair value accounting of its investment entity subsidiary. Consequently, the compliance cost savings described above will not be available to non-investment entity parents. Because these entities are not within the scope of these amendments, they may incur ongoing costs because they will have two different bases of accounting within the group. At the investment entity subsidiary level, subsidiaries held by the investment entity will be measured at fair value, but at the non-investment entity parent level, those subsidiaries will be consolidated.

How the costs of analysis for users are affected

BC313 The likely effect of these amendments on the costs of analysis for users of financial statements is expected to be outweighed by the benefits of improved reporting, given that these amendments have been developed on request from users. However, the extent of the benefit will depend on existing practice.

BC314 In general, these amendments will provide improved information about the fair values of investments and the way in which the fair value is measured. Such information could reduce the cost of analysis by providing information more directly to users of financial statements. However, in many cases, investment entities already provide investors with fair value information, although this is often done in an alternative report rather than in the financial statements. This serves to emphasise that the main benefit of the changes is a reduction in costs to preparers because it eliminates what they see as a cumbersome reporting requirement that has little value.

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BC315 For analysts or potential investors that use financial statements to analyse investment entities from different countries, the existing problems of diversity in accounting models creates costs that would be reduced by standardised accounting requirements.

BC316 In addition, the Board expects that the requirement to apply the exception to consolidation retrospectively will mitigate some of the transition costs for users. However, some of the transition reliefs will mean that users may receive less information on transition. In particular, the fact that investment entities will be required to provide only one period of comparative information may affect users who might otherwise receive more than one period of comparative information. However, again, the Board expects the benefits to outweigh the costs incurred as a result of the implementation of these amendments.

Summary

BC317 In summary, the cost savings resulting from implementing these amendments are expected to be significant for investment entities and the users of their financial statements. Additionally, the implementation of the investment entities amendments should result in the benefits of increased comparability between entities and across jurisdictions, and more relevant reporting of information used by investors in making economic decisions.

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Appendix
Previous Board approvals and dissenting opinions

Approval by the Board of IAS 27 issued in December 2003

International Accounting Standard 27 *Consolidated and Separate Financial Statements* (as revised in 2003) was approved for issue by thirteen of the fourteen members of the International Accounting Standards Board. Mr Yamada dissented. His dissenting opinion is set out after the previous Board approvals.

Sir David Tweedie	Chairman
Thomas E Jones	Vice-Chairman
Mary E Barth	
Hans-Georg Bruns	
Anthony T Cope	
Robert P Garnett	
Gilbert Gélard	
James J Leisenring	
Warren J McGregor	
Patricia L O'Malley	
Harry K Schmid	
John T Smith	
Geoffrey Whittington	
Tatsumi Yamada	

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Approval by the Board of amendments to IAS 27 issued in January 2008

The amendments to International Accounting Standard 27 *Consolidated and Separate Financial Statements* in 2008 were approved for issue by nine of the fourteen members of the International Accounting Standards Board. Messrs Danjou, Engström, Garnett, Gélard and Yamada dissented. Their dissenting opinions are set out after the previous Board approvals.

Sir David Tweedie	Chairman
Thomas E Jones	Vice-Chairman
Mary E Barth	
Hans-Georg Bruns	
Anthony T Cope	
Philippe Danjou	
Jan Engström	
Robert P Garnett	
Gilbert Gélard	
James J Leisenring	
Warren J McGregor	
Patricia L O'Malley	
John T Smith	
Tatsumi Yamada	

Dissenting opinions

Dissent of Tatsumi Yamada from IAS 27 (as revised in 2003)

Cross-references have been updated.

DO1 Mr Yamada dissents from this Standard because he believes that the change in classification of minority interests in the consolidated balance sheet, that is to say, the requirement that it be shown as equity, should not be made as part of the Improvements project. He agrees that minority interests do not meet the definition of a liability under the *Framework for the Preparation and Presentation of Financial Statements*,[20] as stated in paragraph BCZ158 of the Basis for Conclusions, and that the current requirement, for minority interests to be presented separately from liabilities and the parent shareholders' equity, is not desirable. However, he does not believe that this requirement should be altered at this stage. He believes that before making the change in classification, which will have a wide variety of impacts on current consolidation practices, various issues related to this change need to be considered comprehensively by the Board. These include consideration of the objectives of consolidated financial statements and the accounting procedures that should flow from those objectives. Even though the Board concluded as noted in paragraph BC27, he believes that the decision related to the classification of minority interests should not be made until such a comprehensive consideration of recognition and measurement is completed.[21]

DO2 Traditionally, there are two views of the objectives of consolidated financial statements; they are implicit in the parent company view and the economic entity view. Mr Yamada believes that the objectives, that is to say, what information should be provided and to whom, should be considered by the Board before it makes its decision on the classification of minority interests in IAS 27. He is of the view that the Board is taking the economic entity view without giving enough consideration to this fundamental issue.

DO3 Step acquisitions are being discussed in the second phase of the Business Combinations project, which is not yet finalised at the time of finalising IAS 27 under the Improvements project. When the ownership interest of the parent increases, the Board has tentatively decided that the difference between the consideration paid by the parent to minority interests and the carrying value of the ownership interests acquired by the parent is recognised as part of equity, which is different from the current practice of recognising a change in the amount of goodwill. If the parent retains control of a subsidiary but its ownership interest decreases, the difference between the consideration received by the parent and the carrying value of the ownership interests transferred is also recognised as part of equity, which is different from the current practice of recognising a gain or a loss. Mr Yamada believes that the results of this discussion are predetermined by the decision related to the classification of minority interests as equity. The changes in accounting treatments are fundamental and he believes that the decision on which of the two views should govern the consolidated financial statements should be taken only after careful consideration of the ramifications. He believes that the amendment of IAS 27 relating to the classification of minority interests should not be made before completion of the second phase of the Business Combinations project.

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20 The reference is to the IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the Board in 2001 and in effect when the Standard was revised.

21 Paragraph BC27 of the Basis for Conclusions on IAS 27 (as revised in 2003) was deleted as part of the amendments to IAS 27 in 2008. The paragraph stated: The Board acknowledged that this decision gives rise to questions about the recognition and measurement of minority interests but it concluded that the proposed presentation is consistent with current standards and the *Framework* and would provide better comparability than presentation in the consolidated balance sheet with either liabilities or parent shareholders' equity. It decided that the recognition and measurement questions should be addressed as part of its project on business combinations.

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Dissent of Philippe Danjou, Jan Engström, Robert P Garnett, Gilbert Gélard and Tatsumi Yamada from the amendments to IAS 27 issued in January 2008 on the accounting for non-controlling interests and the loss of control of a subsidiary

Cross- references have been updated.

DO1 Messrs Danjou, Engström, Garnett, Gélard and Yamada dissent from the 2008 amendments to IAS 27.

Accounting for changes in ownership interests in a subsidiary

DO2 Messrs Danjou, Engström, Gélard and Yamada do not agree that acquisitions of non- controlling interests in a subsidiary by the parent should be accounted for in full as equity transactions.

DO3 Those Board members observe that the consideration paid for an additional interest in a subsidiary will reflect the additional interest's share in:

(a) the carrying amount of the subsidiary's net assets at that date;

(b) additionally acquired goodwill; and

(c) unrecognised increases in the fair value of the subsidiary's net assets (including goodwill) since the date when control was obtained.

DO4 Paragraphs 23 and B96 of IFRS 10 require such a transaction to be accounted for as an equity transaction, by adjusting the relative interests of the parent and the non- controlling interests. As a consequence, the additionally acquired goodwill and any unrecognised increases in the fair value of the subsidiary's net assets would be deducted from equity. Those Board members disagree that such accounting faithfully represents the economics of such a transaction.

DO5 Those Board members believe that an increase in ownership interests in a subsidiary is likely to provide additional benefits to the parent. Although control has already been obtained, a higher ownership interest might increase synergies accruing to the parent, for example, by meeting legal thresholds provided in company law, which would give the parent an additional level of discretion over the subsidiary. If the additional ownership interest has been acquired in an arm's length exchange transaction in which knowledgeable, willing parties exchange equal values, these additional benefits are reflected in the purchase price of the additional ownership interest. Those Board members believe that the acquisition of non- controlling interests by the parent should give rise to the recognition of goodwill, measured as the excess of the consideration transferred over the carrying amount of the subsidiary's net assets attributable to the additional interest acquired. Those Board members acknowledge that this amount also includes unrecognised increases in the fair value of the subsidiary's net assets since the date when control was obtained. However, on the basis of cost- benefit considerations, they believe that it is a reasonable approximation of the additionally acquired goodwill.

DO6 Messrs Danjou, Gélard and Yamada agree that, in conformity with the *Framework for the Preparation and Presentation of Financial Statements*,[22] non- controlling interests should be presented within the group's equity, because they are not liabilities. However, they believe that until the debates over the objectives of consolidated financial statements (ie what information should be provided and to whom) and the definition of the reporting entity have been settled at the conceptual level, transactions between the parent and non- controlling interests should not be accounted for in the same manner as transactions in which the parent entity acquires its own shares and reduces its equity. In their view, non- controlling interests cannot be considered equivalent to the ordinary ownership interests of the owners of the parent. The owners of the parent and the holders of non- controlling interests in a subsidiary do not share the same risks and rewards in relation to the group's operations and net assets because ownership interests in a subsidiary share only the risks and rewards associated with that subsidiary.

DO7 In addition, Messrs Danjou and Gélard observe that IFRS 3 *Business Combinations* (as revised in 2008) provides an option to measure non- controlling interests in a business combination as their proportionate share of the acquiree's net identifiable assets rather than at their fair value. However, paragraph BC207 of the Basis for Conclusions on IFRS 3 (as revised in 2008) states that accounting for the non- controlling interests at fair value is conceptually superior to this alternative measurement. This view implies that the subsidiary's portion of goodwill attributable to the non- controlling interests at the date when control was

[22] The reference is to the IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the Board in 2001 and in effect when the Standard was amended.

obtained is an asset at that date and there is no conceptual reason for it no longer to be an asset at the time of any subsequent acquisitions of non-controlling interests.

DO8 Mr Garnett disagrees with the treatment of changes in controlling interests in subsidiaries after control is established (paragraphs BCZ168–BCZ179 of the Basis for Conclusions). He believes that it is important that the consequences of such changes for the owners of the parent entity are reported clearly in the financial statements.

DO9 Mr Garnett believes that the amendments to IAS 27 adopt the economic entity approach that treats all equity interests in the group as being homogeneous. Transactions between controlling and non-controlling interests are regarded as mere transfers within the total equity interest and no gain or loss is recognised on such transactions. Mr Garnett observes that the non-controlling interests represent equity claims that are restricted to particular subsidiaries, whereas the controlling interests are affected by the performance of the entire group. The consolidated financial statements should therefore report performance from the perspective of the controlling interest (a parent entity perspective) in addition to the wider perspective provided by the economic entity approach. This implies the recognition of additional goodwill on purchases, and gains or losses on disposals of the parent entity's interest in a subsidiary.

DO10 If, as Mr Garnett would prefer, the full goodwill method were not used (see paragraphs DO7–DO10 of the dissenting views on IFRS 3), the acquisition of an additional interest in a subsidiary would give rise to the recognition of additional purchased goodwill, measured as the excess of the consideration transferred over the carrying amount of the subsidiary's net assets attributable to the additional interest acquired.

DO11 Mr Garnett does not agree with the requirement in paragraph B96 of this IFRS that, in respect of a partial disposal of the parent's ownership interest in a subsidiary that does not result in a loss of control, the carrying amount of the non-controlling interests should be adjusted to reflect the change in the parent's interest in the subsidiary's net assets. On the contrary, he believes that the carrying amount of the non-controlling interests should be adjusted by the fair value of the consideration paid by the non-controlling interests to acquire that additional interest.

DO12 Mr Garnett also believes that it is important to provide the owners of the parent entity with information about the effects of a partial disposal of holdings in subsidiaries, including the difference between the fair value of the consideration received and the proportion of the carrying amount of the subsidiary's assets (including purchased goodwill) attributable to the disposal.

Loss of control

DO13 Mr Garnett disagrees with the requirement in paragraph B98 of this IFRS that if a parent loses control of a subsidiary, it measures any retained investment in the former subsidiary at fair value and any difference between the carrying amount of the retained investment and its fair value is recognised in profit or loss, because the retained investment was not part of the exchange. The loss of control of a subsidiary is a significant economic event that warrants deconsolidation. However, the retained investment has not been sold. Under current IFRSs, gains and losses on cost method, available-for-sale and equity method investments are recognised in profit or loss only when the investment is sold (other than impairment). Mr Garnett would have recognised the effect of measuring the retained investment at fair value as a separate component of other comprehensive income instead of profit or loss.

Accounting for losses attributable to non-controlling interests

DO14 Mr Danjou disagrees with paragraph B94 of this IFRS according to which losses can be attributed without limitation to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

DO15 In many circumstances, in the absence of any commitment or binding obligation of the non-controlling interests to make an additional investment to cover the excess losses of the subsidiary, the continuation of the operations of a subsidiary will be funded through the contribution of additional capital by the parent and with the non-controlling interests being diluted. In those circumstances, the deficit balance attributable to the non-controlling interests that would result from the amendment in paragraph B94 does not present faithfully the equity of the consolidating entity.

DO16 Mr Danjou believes that the Standard should therefore not preclude the allocation against the parent equity of losses that exceed the non-controlling interests in a consolidated subsidiary when the facts and circumstances are as outlined in paragraph DO15.

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Appendix
Amendments to the Basis for Conclusions on other IFRSs

This appendix contains amendments to the Basis for Conclusions on other IFRSs that are necessary in order to ensure consistency with IFRS 10 and the related amendments to other IFRSs. Amended footnotes are shown with new text underlined and deleted text struck through.

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The amendments contained in this appendix when IFRS 10 was issued in 2011 have been incorporated into the Basis for Conclusions on the relevant IFRSs published in this volume.

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