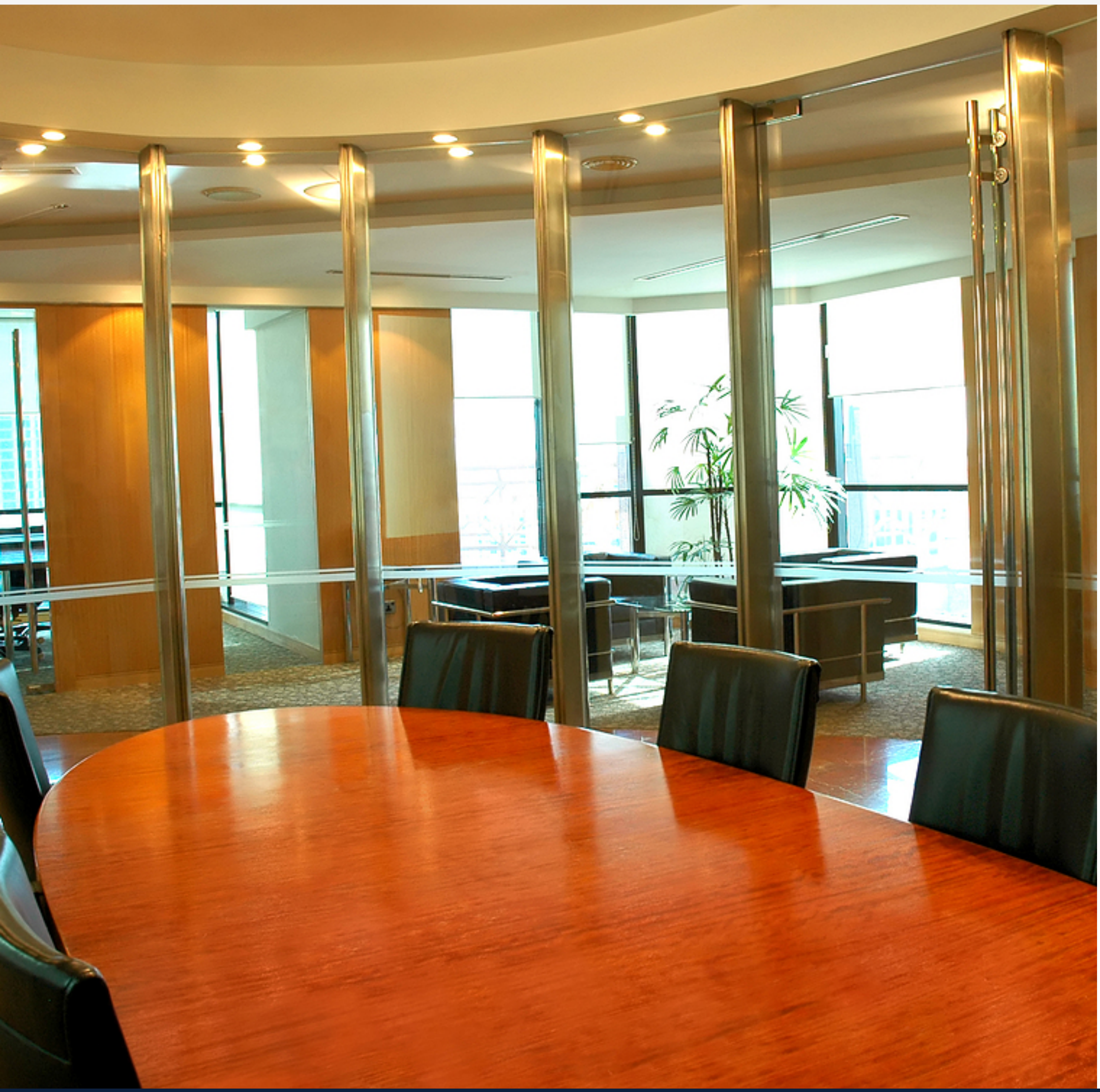
IFRS 10: A simple matter of control?



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IFRS 10 governs the presentation of consolidated financial statements. It provides substantial guidance to determine when an entity is considered to be a subsidiary controlled by a parent entity. While it may be a relatively simple exercise to assess control in some cases, this assessment can be extremely complex in other cases where control does not simply stem from shareholding. This article provides a brief overview of the definition of control in IFRS 10 and some areas of complexity in practice.

IFRS 10 *Consolidated Financial Statements* (**'IFRS 10'**) governs the presentation of consolidated financial statements that represent the affairs of a parent and its subsidiaries as a single economic unit. The consolidation accounting model is centred around control. An entity is considered to be a subsidiary if it is controlled by another entity, the parent. While control is sometimes obvious, the assessment is very complex in others. This article provides a brief overview of the elements of control and some aspects of these elements that are often contentious in practice.

Control

An investor controls an investee if the investor meets all of the following requirements:

- It has power over the investee,
- It has exposure, or rights, to variable returns from its involvement with the investee, and
- It is able to use its power over the investee to affect the amount of the investor's returns.

Power

An investor has power over an investee if it has existing rights that give it the practical ability to unilaterally direct the relevant activities of the investee. It is necessary to understand various aspects of the investee's business model and its governance structures to make this assessment. This involves:

- Determining and defining the relevant activities of the investee, being those activities of the investee that significantly affect the investee's returns. This requires a detailed understanding of the business activities and operating model from which an investee derives returns. Where multiple investors hold rights to direct different activities, it is necessary to identify the activities that most significantly affect the investee's returns.
- In simple cases, the rights to direct the relevant activities may simply stem from voting rights attached to shares. This assessment becomes much more complicated if the rights to direct an investee's activities are also affected by contractual arrangements (or in some cases, only governed by contractual arrangement). It is essential to understand the overall decision-making and governance structures and the impact of the various elements thereof on decisions to direct the relevant activities of the investee to properly assess rights held by an investor.
- The assessment of power must be based on substantive rights to direct an investee's activities. This requires an analysis of the rights of all parties involved to establish whether, amongst others, they are in reality practically exercisable rights or whether they merely represent protective rights.

Variable returns

Variable returns are returns that are not fixed and have the potential to vary as a result of the investee's performance. The variability may be positive and/or negative. Exposure to returns must be considered widely. This includes yields from an investment, such as dividends, but also returns not available to others, such as business synergies.

Link between power and returns

Whether an investor is able to use its power to direct the relevant activities of the investee to affect its own returns from its involvement with the investee depends on whether the investor exercises its powers as an agent on behalf of others or as principal for its own benefit. The scope of the investors decision-making authority, the rights of parties involved with the investee, the investor's remuneration and the extent and investor's sources of exposure to variable returns all play a role in determining the capacity in which the investor exercises its decision-making powers.

In conclusion

The IFRS 10 control assessment is often complex when arrangements other than mere shareholding influence or govern the direction of an entity's activities. In such cases, the assessment requires a thorough fact specific analysis and may involve significant judgement.

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