Straight away
IFRS bulletin from PwC

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Consolidation standard (IFRS 10) revises definition of control

What is the issue?

The IASB has issued the long-awaited IFRS 10, 'Consolidated financial statements', as part of the group of five new standards that address the scope of the reporting entity (see our 'Straight aways' on the joint arrangements and disclosure standards). IFRS 10 replaces all of the guidance on control and consolidation in IAS 27, 'Consolidated and separate financial statements', and SIC-12, 'Consolidation – special purpose entities'. IAS 27 is renamed 'Separate financial statements'; it continues to be a standard dealing solely with separate financial statements. The existing guidance for separate financial statements is unchanged.

The rest of the package includes IFRS 11, 'Joint Arrangements'; IFRS 12, 'Disclosure of interests in other entities'; and consequential amendments to IAS 28, 'Investments in associates'.

IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control. This definition is supported by extensive application guidance that addresses the different ways in which a reporting entity (investor) might control another entity (investee). The changed definition and application guidance is not expected to result in widespread change in the consolidation decisions made by IFRS reporting entities, although some entities could see significant changes.

All entities will need to consider the new guidance. The core principle that a consolidated entity presents a parent and its subsidiaries as if they are a single entity remains unchanged, as do the mechanics of consolidation.

IFRS 10 excludes guidance specifically for investment companies, as the IASB continues to work on a project on accounting by investment companies for controlled entities.

Revised definition of control

The revised definition of control focuses on the need to have both power and variable returns before control is present. Power is the current ability to direct the activities that significantly influence returns. Returns must vary and can be positive, negative or both.

The determination of power is based on current facts and circumstances and is continuously assessed. The fact that control is intended to be temporary does not obviate the requirement to consolidate any investee under the control of the investor. Voting rights or contractual rights may be evidence of power, or a combination of the two may give an investor power. Power does not have to have to be exercised. An investor with more than half the voting rights would meet the power criteria in the absence of restrictions or other circumstances.

The application guidance includes examples illustrating when an investor may have control with less than half of the voting rights. When assessing if it controls the investee, an investor should consider potential voting rights, economic dependency and the size of its shareholding in comparison to other holdings, together with voting patterns at shareholder meetings. This last consideration will bring the notion of 'de facto' firmly within the consolidation standard.

IFRS 10 also includes guidance on participating and protective rights. Participating rights give an investor the ability to direct the activities of an investee that significantly affect the returns. Protective rights (often known as veto rights) will only give an investor the ability to block certain decisions outside the ordinary course of business.

The new standard includes guidance on agent/principal relationships. An investor (the agent) may be engaged to act on behalf of a single party or a group of parties (the 'principals'). Certain power is delegated to the agent – for example, to manage investments. The investor may or may not have control over the pooled investment funds. IFRS 10 includes a number of factors to consider when determining whether the investor has control or is acting as an agent.
The revised definition of control and associated guidance replaces not only the definition and guidance in IAS 27 but also the four indicators of control in SIC 12.

Am I affected?

IFRS 10 has the potential to affect all reporting entities (investors) that control one or more investees under the revised definition of control. The determination of control and consolidation decisions may not change for many entities. However, the new guidance will need to be understood and considered in the context of each investor's business.

What do I need to do?

The revised standard is effective for annual periods beginning on or after 1 January 2013; earlier application is permitted.

IFRS preparers should consider whether IFRS 10 will affect their control decisions and consolidated financial statements.

If you have questions about this issue, please contact your PwC engagement partner.