IFRS 10: De Facto Control

Extract, IFRS Discussion Group Report on Meeting – October 18, 2012

A determination of control requires an investor to assess whether it has power over an investee (in addition to the other attributes described in paragraph B2 of IFRS 10 *Consolidated Financial Statements*). To have power over an investee, an investor must have existing rights that give it the current ability to direct the relevant activities. Power arises from rights that include voting rights as well as other rights (paragraph B15 of IFRS 10). Paragraph B38 of IFRS 10 states that "an investor can have power with less than a majority of the voting rights." Paragraphs B41-B45 of IFRS 10 elaborate on when such circumstances may arise.

Group members discussed three issues in the context of an investor that has a voting interest less than 50 per cent and an investee in which the relevant activities are directed through voting rights.

The Group's Discussion

Issue 1: What factors should an investor consider when assessing whether its voting rights give it power over an investee?

Group members noted that IFRS 10 has a broader definition of power than IAS 27 *Consolidated and Separate Financial Statements*, and it is more likely that some entities holding less than a 50 per cent voting interest in another entity would be considered to have control. The assessment under IFRS 10 depends more on facts and circumstances.

Group members observed that the application guidance in Appendix B of IFRS 10 requires that "all facts and circumstances" be considered by the investor but paragraph B42 specifically includes:

(a) "the size of the investor's holding of voting rights relative to the size and dispersion of holdings of the other vote holders …";

(b) "potential voting rights held by the investor, other vote holders or other parties";

(c) "rights arising from other contractual arrangements"; and

(d) "any additional facts and circumstances that indicate the investor has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings."

Group members noted that the focus in IFRS 10 is on "ability" and the guidance provides for situations in which power may exist even though less than a majority of the voting rights are held by an investor. Notwithstanding the broader notion of control, Group members observed that the intent is not to result in consolidation of every investee but rather to require a balanced assessment with consideration of all available evidence.

Group members observed that paragraphs B43-B45 of IFRS 10 provide a series of examples that illustrate how these requirements might be applied in practice.

Issue 2: When is an investor obliged to consider voting patterns at previous shareholders' meetings in the assessment of de facto power?

Paragraph B43 of IFRS 10 states that, in some circumstances, it may be clear, after considering the factors listed in paragraph B42 (a)-(c) alone, that the investor has power over the investee. Questions then arise over when voting patterns are required to be considered. Four alternatives have been advanced:

View A – Never.

View B – When the investor becomes aware of such information (i.e., cannot ignore known information).

View C – Always.

View D – It depends on the facts and circumstances.

Group members found it difficult to support View A, given that paragraph B42(d) of IFRS 10 refers specifically to voting patterns. Similarly, Group members struggled with View C because requiring additional analysis of voting patterns when, based on paragraph B42(a)-(c), it is clear that the investor has power over the investee would be contrary to paragraph B43.

Although Group members agreed that known information cannot be ignored (*View B*), many argued that the assessment depends on the specific facts and circumstances (*View D*). They supported this view because the standard is not meant to provide a "one size fits all" answer and instead, requires judgment to be used to determine when voting patterns are relevant.

Group members noted that the IFRS 10 application examples only involve circumstances in which it is either very clear that the investor has power over the investee or very clear that it does not. As a result, those examples do not illustrate the circumstances in the wide range of less clear circumstances in which the voting patterns would more likely be relevant.

Issue 3: What factors should be considered when evaluating voting patterns at previous shareholders' meetings?

Group members noted that when voting patterns need to be considered (i.e., paragraph B42(d) of IFRS 10 applies in a particular fact pattern), a range of factors could be relevant. Group members observed that, in practice, determining what data, how many periods and how to interpret the information gathered will involve judgment. Group members noted that relevant factors to consider may include:

- Any legal or regulatory requirements relating to the protection of investors.
- Voting history supporting a demonstrated pattern of ability of an investor to make decisions about the relevant activities (for example, a practical ability to direct the relevant activities unilaterally as illustrated in example 8 in paragraph B45 of IFRS 10).

- Voting history indicating a lack of ability to make decisions about the relevant activities when other investors have been able to block such decisions.
- Changes in ownership interests held by other investors over time affecting the ability to place reliance on voting history.
- Nature of the other shareholders (for example, investment funds).
- Relationships between shareholders (for example, related parties, major and junior mining companies).

Some Group members cautioned that looking to past voting patterns would not be appropriate following large changes in the composition of shareholders. Also, they would be skeptical of suggestions to use data selectively (for example, an argument that voting at a particular meeting was an anomaly for one reason or another).

Group members indicated that anticipated future changes in shareholdings should not override the facts existing at the reporting date (for example, an exploration entity expects that it will issue shares in the near future thereby diluting the current ownership).

Overall Comments

Group members noted that the concept of de facto control in IFRS 10 will affect a range of Canadian companies resulting in some entities being consolidated that were not previously consolidated prior to applying IFRS 10. Group members observed that the guidance on de facto control will likely give rise to some practical challenges when applied to certain fact patterns.