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What are the ongoing issues with IFRS 10?

A study from both a theoretical and practical perspective.

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Introduction

Consolidated financial statements show aggregated data for a group of companies, namely the parent firm and its subsidiaries. The importance of this statements are not only on the data provided but also on the relevant information that can be extracted. Looking at the international scenario, the International Accounting Standard Board (IASB) adopted the International Financial Reporting Standard (IFRS) 10 *Consolidated Financial Statements* on 11th of May 2011, with the goal of providing a framework for the exact purpose of the preparation and presentation of consolidated financial statements. After nearly ten years since the publication of IFRS 10, it is critical to make changes and challenge the outlined principles to determine whether the concepts contained within it are still relevant to the current general framework of companies and market needs, as well as recognising the needs of other market actors such as auditing firms. Furthermore, the International Accounting Standards Board (IASB) has recently implemented the so-called Post Implementation Review (PIR), which regards the financial accounting standard as the protagonist, alongside the other two IFRS 11 *Joint Arrangements* and 12 *Disclosure of Interests in Other Entities*. This review is a part of a process, called Due Process, that the Board employs for each new IFRS accounting policy or significant adjustment. The PIR allows the IASB to analyse the impact of new IFRS Accounting Standard requirements on investors, firms, and auditors.

In light of the foregoing, it is critical to comprehend the current challenges that can arise in the consolidation process undertaken by companies in order to determine their position during consolidation. It is also valuable to try to comprehend the nature of such issues and why they occur. Besides, the goal of this study is to identify the current significant issues related to the international standard IFRS 10. The view of subject's theorists who dispute the relevance of the concepts represented within the statement will be given space. However, it is of interest to consider also the professionals' view on the subject to have an overall picture of the challenges, due to the fact that they have the possibility to apply the principles specified by IFRS 10 and for this reason they can offer an opinion more closely related to the domain of application. The research process for valuable information is based primarily on academic and non-academic sources. Textbooks will be utilised to revise the academic theory, while other material will primarily focus on publications proposed directly by the IFRS Foundation, such as

revision publications of the Big 4, but also publications of key exponents today, such as Christopher Nobes and Tereza Gulzovà. Moreover, concerning the practical view of the research, the additional methodology used to explore this matters comprehend an analysis of the comment letters that the majority of auditing companies and bodies of accounting, both at national and international level, sent to IASB in response to the second phase of the PIR (see Appendix A). More pointedly, with reference to chapters 2 and 3, the approach used to analyse the problems presented in the comment letters is divided into two parts. Concerning the second chapter, which deal with the notion of 'Control', the decision was made to focus on the problems found in the majority. The reason behind this choice is justified by the fact that every company applies this concept every day and it is more likely that similar situations will occur. Therefore, as illustrated in Appendix A of this paper, the major problems resulting from the analysis of the comment letters have been reported. After careful skimming, the most recurring ones were highlighted. On the other hand, as regards the topic of the third chapter, namely that of investment entities, a different choice of evaluation of the problems was made, because the subject is limited only to a particular class of business necessitating a different focus and approach. Furthermore, the third chapter's main argument is a new introduction to the scope of the consolidated financial statements. As an outcome, the methodology used to illustrate the problems is based on a discussion of issues raised by various audit bodies and professionals, with the goal of comparing views and attempting to comprehend how this new topic is perceived in the international context. Finally, both approaches to problems are intended to spark discussion and highlight issues on which the Board should focus, taking into account the Post-Implementation Review that the IASB has decided to conduct.

Before going ahead with the comprehensive discussion of the issues encountered, the first chapter will provide a brief overview of what IFRS means and what are its responsibilities. After this historical viewpoint, in the second half of the first chapter, additional exploratory topics are introduced. The accounting principle in question, IFRS 10, will be generally analysed, adding also an overview about the major changes between the IFRS 10 and its predecessor IAS 27 *Separate Financial Statements* in conjunction with SIC-12 *Special Purpose Entities*. The objective of this chapter is to provide the reader with a broad framework for understanding what will be provided in the subsequent chapters. As a result, the reminder of this paper is organized as follows. Beginning with the

formulation and composition of the standard, the significant differences and innovations made in comparison to its predecessor IAS 27, which governed consolidation in conjunction with the SIC-12 approach, will be discussed. Then continuing with a brief examination of the notion of Post-Implementation Review and its characteristics, tying it to the initiative recently launched by the IASB in regard to IFRS 10.

The second chapter will go through the three main components of the IFRS 10's control concept: power over the investee, exposure to variable returns and link between power and returns. Before dealing with the features of control, a brief literature review around this theme is given related to what the IFRS 10 provides for. Then continuing with the first component, each aspect included in the standard is illustrated correlated to the major problems evidenced. The 'Power Over An Investee' in turn differentiates itself into three main sections, namely relevant activities, rights that confer to investor power and a particular provision in which power can arise also without holding the majority of rights, in opposition to what was expected until the introduction of this standard. The latter is of strategic importance given that the Board has introduced the concept of 'De Facto Control' relating it to the ability of having power over an investee even if the parent company does not possess the majority of the rights. Afterwards, the chapter continues with the analysis of what the standard means when referring to exposure to variable returns, however this argument will be solely introduced for understanding better the requirements given by the Board since there were no meaningful matters identified. The concluding theme of the chapter is the one that bridges power and variable returns. Consequently the main focus is on the agency relationship displayed in the IFRS 10, providing some insights related to the concept of De facto Agent, that is the proper definition of agent in the standard.

Finally, the third chapter addresses a specific topic linked to a particular kind of companies known as 'Investment Entities'. This special subject was not included in the original wording of the IFRS 10 in 2011, but was added later with an amendment to the standard's text as a result of the Exposure draft issued after the first publication of the standard. The growing importance of this topic and consequently the interest of popular opinion has led the IASB to consider the development of a section dedicated to these entities. In the first part of the chapter, the definition of Investment Entities is presented and a brief history about this topic is introduced. Additionally there is a another part in which is illustrated what the Board indicate as typical characteristics of an investment

entity. Thereupon, the other half of the chapter deals with the four mandatory attributes which are put in relation to the problems the audit companies have highlighted.

CHAPTER 1 – AN OVERVIEW OF IFRS 10

1.1. Background Introduction: The International Financial Reporting Standards (IFRSs)

To evaluate the International Financial Reporting Standard (IFRS) 10 *Consolidated Financial Statements* governing the consolidation process and, more significantly, to appreciate what concerns currently persist related to this rule, an examination of the broad environment in which the standard is established is an appropriate starting point. Therefore, a brief history and explanation of what are the primary factors that led to the global adoption of the International Financial Reporting Standards, commonly called IFRS, will be provided in the subsequent section.

First and foremost, the depiction of IFRS Foundation's function is required in order to comprehend the importance of this not-for-profit corporation. "IFRS Accounting Standards set out how a company prepares its financial statements" (IFRS, 2014)[1]. The benchmarks produced by IFRS are a standardised approach of presenting a company's financial performance and position, allowing financial statements to be understood and compared across international boundaries. They are especially important for businesses that have stock or securities listed on a public stock exchange because multiple players from different jurisdictions interact in this environment, thus a uniform accounting language is essential. The mission, according to the IFRS Foundation's website, is claimed as follows: "our mission is to develop IFRS Standards that bring transparency, accountability and efficiency to financial markets around the world. Our work serves the public interest by fostering trust, growth, and long-term financial stability in the global economy" (IFRS-Foundation, Use of IFRS Standards around the world, 2018)[2]. As it can be seen, the mission is divided into three dominant parts: the creation of standards aims to increase transparency by improving the international comparability and quality of financial data, allowing investors and other market participants to make well-informed economic decisions. At the same time, International Financial Reporting Standards (IFRS) improves capital allocation by supporting investors in spotting opportunities around the

[1] IFRS. (2014). Who we are. https://www.ifrs.org/about-us/who-we-are/
[2] IFRS-Foundation. (2018). Use of IFRS Standards around the world. Tratto da https://www.ifrs.org/content/dam/ifrs/around-the-world/adoption/use-of-ifrs-around-the-world-overview-sept-2018.pdf

world. The employment of a single, well-understood accounting language lowers the cost of capital and the cost of international reporting for businesses. Whilst finally, according to the mission, the guidelines are designed to improve accountability by closing the information gap between capital providers and those to whom they have entrusted their funds.

Each Standard has been promulgated by the IFRS Foundation together with the International Accounting Standard Board (IASB), an independent private-sector body. Dated back to June 1973, accountancy bodies from ten nations (Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom and Ireland, and the United States of America) formed the International Accounting Standard Committee (IASC) with the aspiration of developing and publishing: interpretations, a conceptual framework and International Accounting Standards (IAS). The International Accounting Standard Board superseded the IASC in 2001, with the mission of bringing national accounting standards closer together through the creation of global accounting standards. The International Accounting Standards Board (IASB) has continued to produce new standards, although they decided to rename the standards published as "International Financial Reporting Standards". The new Board ratified the Standing Interpretation Committee, including a part of the previous IAS during its first meeting.

Disparities within international financial reporting have been the subject of extensive investigation, indeed, in the early new century, owing to the European Union's recent introduction of the single market, the necessity to adopt a universal accounting system expanded quickly. “The globalization of markets has made firms’ financial reporting ever more international. The pressure of European multinationals and the rapid development of global financial markets demand harmonization of accounting standards and approaches around the world” (Callao, Ferrer, Jarne, & Laínez, 2009).[3]

The IASB body presented a set of 17 principles-based standards as a result of this convergence of public opinion. Following this, the European Union's Parliament and EU Council issued the Regulation 1606/2002 on the Application of International Accounting Standards on July 19th, 2002, announcing the adoption of the International Financial Reporting Standards as a pivotal step forward in the direction of harmonisation.

[3]Callao, S., Ferrer, C., Jarne, J., & Laínez, J. (2009). The impact of IFRS on the European Union: Is it related to the accounting tradition of the countries? Journal of Applied Accounting Research, Vol. 10(1), p. 33-55. https://doi.org/10.1108/09675420910963388

It required some time for businesses to prepare for the transition, given this circumstance, the adoption did not happen immediately. As designated by the European legislation, regulations take effect on the date of their enactment, namely on the date specified by the law. They also become binding everywhere in the Union without the need for transposition into national legislation. Therefore, it was opted to make the regulations operative while taking into consideration the amount of time needed for a radical passage. “On 1 January 2005, all stock exchange listed companies in the European Union (EU) began using International Financial Reporting Standards (IFRS)” (Perry & Nölke, 2006).[4] However, “passage of the 2002 Regulation did not eliminate domestic generally accepted accounting principles (GAAP) in Europe as per a “switch-over date.” In fact, the Regulation provides for considerable discretion of member states with respect to their IFRS implementation choices” (Forst & Salerno, 2016)[5].

Hence, it can be reckoned that, the European Union's action was the starting point of a series of interlinked events that leads to the present days, where more than 160 jurisdictions required to implement the standards proposed by IFRS, this means that, IFRS standards are required or permitted in around 87 percent of jurisdictions around the world, for most domestically accountable enterprises. “The EU has, however, been a catalyst in the progress of IFRS. When it announced in 2000 that it would adopt them from 2005, it started a momentum that is still continuing. Australia and South Africa decided to switch at the same time and […] more than 100 countries worldwide decide either require or permit the use of IFRS for listed companies” (Walton, 2011)[6]. The widespread adoption of IFRS can be justified by the fact that the world is becoming much more globalised and multinational corporations are spread all over the countries. Moreover, the intention to open up to a foreign market enables a company to strengthen its position as a global financial player while also emphasizing the interest of a common language in financial reporting. But also, “access to international markets also means that companies can have access to wider source of finance, which should in turn mean their finance become cheaper” (Walton, 2011)[7]. It must however be noted that, even if IFRS have been defined as the most-used set of accounting standards all over the world, the United States, a state

[4] Perry, J., & Nölke, A. (2006). The political economy of International Accounting Standards. Review of International Political Economy, p. 13:4, 559-586. doi:10.1080/09692290600839790
[5] Forst, A., & Salerno, D. (2016). Ten Years of Mandatory Use of IFRS in the European Union: A Status Report. *Journal of Corporate Accounting & Finance*, p. 29-36. doi:10.1002/jcaf.22176
[6] Walton, P. (2011). An *executive guide to IFRS content, costs and benefits to business. Chichester: Wiley.
[7] See note n. 6

having significant international influence, is not among the participants in the change. Currently, the U.S.A. utilizes the Generally Accepted Accounting Principles, also known as U.S. GAAP, which are rule-based approaches and still are distinct from the International Financial Reporting Standards. The independent federal government regulatory agency, the Securities Exchange Committee (SEC), mandates domestic enterprises with publicly traded securities to utilize U.S. GAAP and, given this circumstance, it does not allow them to use IFRS. The main distinction between the two approaches is that IFRS contains principle-based standards while U.S. GAAP rule-based standards. "IAS/IFRS are principle-based standards [...] since their primary role is to provide sensible principles to which all applying entities must conform, which aim to be as universal as possible and therefore independent of the actual contractual form chosen by applying entities for their business operations or transactions. A principle is a general statement which is intended to support the true and fair presentation of the economic consequences of business transactions and acts as a guide to action. Opposed to principle-based rules are rule-based standards, such as U.S. GAAP, which attempt to rule all the actual situations that applying entities might face[...]" (Gallimberti, Marra, Prencipe, Toselli, & Andrea, 2013)[8].

Notwithstanding, both sides have expressed a willingness to harmonize the two systems in order to improve the quality of information provided to investors and to have at least comparable standards. As Ortega pointed out "the FASB and the IASB have been working closely together to improve and converge the U.S. GAAP and IFRS since 2002. Precisely in that year, the two boards issued the Norwalk Agreement, establishing the goal of developing compatible and high-quality accounting standards that can be used domestically and internationally. The agreement also set up strategies to achieve the goal including eliminating small differences, when possible, and developing standards jointly" (Ortega, 2017).[9] This convergence of GAAP and IFRS has had a significant impact on the global economy, fostering consistency in financial statement preparation and interpretation.

The advent of IFRS, which have sought to be interposed as a single set of high-quality standards, marked a fundamental novelty in corporate reporting, in light of the fact that companies previously followed a range of country-specific and GAAP-based

[8] Gallimberti, Marra, Prencipe, Toselli, & Andrea, T. G. (2013). Consolidation preparing and understanding consolidated financial statements under IFRS updates to the new IFRS 10 and 11. Milano: McGraw-Hill.
[9] Ortega. (2017). A Review of IFRS and U.S. GAAP Convergence History and Relevant. International Business Research, 10(9).

norms. Ergo, the IFRS application has provided some significant benefits to those who participate in the reporting process. "An early report by the European Commission on the application of IFRS […] enforcers that application of IFRS has improved the comparability and quality of financial reporting and has led to greater transparency […]. The report also stated that stakeholders considered that the understandability of financial statements had generally improved" (Brown & Tarca, 2012)[10]. This fact can be further confirmed because, in general, the opinion was fairly uniform in judging not only the immediate effects of these new standards, but also the incorporation of these standards over time. Further to this, it has always been said that IFRS has been a fundamental changeover that has increased the quality of information provided, credibility and transparency by facilitating the analysis and comparison between companies established in different states as well as the primary investigation of organizations' performance.
On the other hand, it must however be noted that, in addition to the above-mentioned benefits, there are clearly drawbacks of a qualitative nature, amongst which the issue of interpretation stands out, that is the fact that some IFRS standards necessitate a notably complicated threshold of judgment and assessment. This forces managers to find ways to fill any skills shortages and to provide for the development of new skills capable of bridging gaps and improving managerial performance. Furthermore, Ray J. Ball has expressed some scepticisms concerning the differences in financial reporting quality that he retains inevitable among countries and which have been pushed down to the level of implementation, and now will be concealed by a veneer of uniformity, as well as concerns regarding fair value emphasis of IFRS (Ball, 2006)[11].

1.2. IFRS 10: Consolidated Financial Statements

Numerous companies are made up of multiple separate branches that form a group, this is the reason why investors and other business partners need to keep track of the group's financial activities and performances in order to estimate profits. Consolidated financial statements are the most common way for investors to gain knowledge about a company's overall performance. In general, businesses are required

[10]Brown, & Tarca. (2012). Ten Years of IFRS: Practitioners' Comments and Suggestions for Research. Australian Accounting Review, p. 319-330. https://doi.org/10.1111/j.1835-2561.2012.00198.x
[11] Ball, R. J. (2006). Ray Ball International Financial Reporting Standards (IFRS): pros and cons for investors,. *Accounting and Business Research, 36*(1), p. 5-27. doi:10.1080/00014788.2006.9730040

to disclose economic-financial information about their group in their annual reports, with the consolidated financial statements being just one part of a larger yearly disclosure to stakeholders. A group is typically made up of a parent company and all of its subsidiaries, or the holding's-controlled entities. "As soon as one company controls at least one other, a parent-subsidiary relationship exists, and consequently, consolidated financial statements for the group in question are required" (Dick & Missonier-Piera, 2010)[12]. Therefore, the holding company is in charge of editing and drafting the aggregate accounts and has unified management of the entire group.

Looking at the international normative background the consolidated financial statements are governed by the International Financial Reporting standard IFRS 10, which in turn represents a major evolution in accounting practice, allowing for a reduction in disparities along with a more suitable identification of situations of non-conformity. "The objective of this IFRS is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities" (EUR-Lex - 32012R1254 , 2012). This standard was issued on 12th May 2011, by the International Accounting Standard Board. It should be noted that this principle has entered into force from fiscal years that begin on or after January 1st 2013, except for the European Union, which, with the withdrawal of the EU Regulation 11 December 2012 n. 1254, provided for the postponement of a year from the entry into force of the new Standard, thus the entrance into force is from year 2014.

As stated in the preceding section, when the IASB decided to issue new standards under the name of IFRS, there were several principles in place prior to the birth of the latter, which could have been replaced by a new IFRS, as was the case with IFRS 10. Precisely, the concept of consolidation was already included in two prior principles established by the advisory board, SIC 12 and IAS 27. Accordingly, "on 12 May 2011, the International Accounting Standards Board (IASB) published International Financial Reporting Standard (IFRS) 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Interests in Other Entities, as well the amended International Accounting Standard (IAS) 27 Separate Financial Statements and IAS 28 Investment in Associates and Joint Ventures" (EUR-Lex - 32012R1254 , 2012)[13].

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[12] Dick, & Missonier-Piera. (2010). Financial reporting Under IFRS a topic based approach. Wiley.
[13] EUR-Lex - 32012R1254 . (2012). Tratto da Europa.eu: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32012R1254

However, it is meaningful to highlight what are the main driving factors behind the decision making this change. Of a significant importance, the conclusion to generate a new standard stem from a principal motivation traced back to a general need felt by operators in the sector to eliminate some inconsistencies present in the old principles and secondly, contemporaneously with an exogenous force. Specifically, the financial crisis of 2008 presented the IASB with additional challenges. "The 2007–2009 financial crisis highlighted the lack of corporate transparency due to the existence of 'off balance sheet vehicles' […]. As a result, the IASB added a project on consolidation to its agenda to address inconsistent application of consolidation principles, particularly 'a perceived conflict of emphasis between IAS 27 and SIC 12'" (Van Zijl & Maroun, 2017)[14]. Financial regulatory agencies discovered how dangerous dependency between financial products can be and that the practice of pricing financial instruments at their fair value, in particular, has shown to be damaging. Furthermore, the G20, the Financial Stability Board, and other industry players have requested the IASB to analyse the disclosure requirements for the risks that enterprises face as a result of their involvement with structured entities. Users also demanded improved disclosure of information that would allow them to better understand the composition of a reporting entity, its relationships with other organizations, and the value of investments in other entities. The IASB promptly responded by clarifying the methods for applying the fair value principle when the market is no longer active and providing more detailed information on liquidity risk. Within the calendar year 2011, the IASB in conjunction with the FASB (*Financial Accounting Standards Board*) intended to complete a number of significant projects, including modifying their consolidation standards, in order to provide support to countries and users in adopting them and avoiding an interconnected sequence of changes and diverse reporting practices in relation to consolidation. The FASB is a US non-governmental organization which its main regulatory powers are in the field of accounting, it regularly issues the principles that US companies must follow when preparing financial statements. As a consequence, "in May 2011 the IASB published a new and revised set of standards that is still currently known as "package of five" or "consolidation package". […] The "package of five" includes the following: i) IFRS 10, Consolidated Financial Statements […], ii) IFRS 11, Joint Arrangements […], iii) IFRS 12,

[14] Van Zijl, W., & Maroun, W. (2017). Discipline and punish: Exploring the application of IFRS 10 and IFRS 12. Critical Perspectives on Accounting, 44, 42-58.

Disclosure of Interests in Other Entities[…], iv) IAS 27, Separate Financial Statements […] and v) IAS 28, Investments in Associates and Joint Ventures[…]" (Lopes & Lopes, 2019).[15]

Bearing in mind that, IFRS 10 proposes a single consolidation framework applicable to all kinds of companies, in order to fulfil this purpose, it includes a number of effective features that provide users with a concise understanding. To accomplish this goal, the IFRS has established some imperative parameters within the promulgated text to comply with. To begin, the standard requires a company, referred to as a "parent", that controls one or more additional entities, alluded to as "subsidiaries", to provide consolidated financial statements, as well as define control and lays the groundwork for consolidation. The document whereupon goes on to explain when to use the principle of control to determine whether an investor controls an investee, which are the accounting requirements for the preparation, but also, following one of the most recent amendments, provides that investment entities and specific typologies of subsidiaries are exempt from consolidation.

"In defining the scope, IFRS 10 states, in paragraph 4, that the provision is applicable to "all" parent entities by clearly stating the need for consolidated disclosure relating to the core group, with respect to the units in question, where there is a control relationship between entities. The underlying principle is that each group must draw up consolidated financial statements. IFRS 10 identifies some cases of exemption but is, according to the same pronouncement, a limited exemption and, as such, a reaffirmation of the principle of the general obligation of consolidated reporting in the case of corporate groups" (Sòstero, Cerbioni, & Saccon, 2018)[16]. Therefore, the regulation was brought over from IAS 27 to IFRS 10 where it was previously incorporated. On the subject of the exemptions, according to the standard, a parent company is not required to draw up consolidated financial statements if:

i. "it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;

[15] Lopes, A., & Lopes, M. (2019). Effects of adopting IFRS 10 and IFRS 11 on consolidated financial statements: an exploratory research. Meditari Accountancy Research, 27 , p. 91-124.
[16] Sòstero, U., Cerbioni, F., & Saccon, C. (2018). Bilancio consolidato: Disciplina nazionale e IFRS (2. edizione ed.). Milano: McGraw-Hill Education.

ii. its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);
iii. it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and
iv. its ultimate or any intermediate parent produces financial statements that are available for public use and comply with IFRSs, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with this IFRS" (IFRS 10 — Consolidated Financial Statements, 2013)[17].

Each organisation that meets all of the requirements is eligible for the exemption. Additionally, IFRS 10 provides other two exemptions. The first one is that the pronouncements of the standard are not addressed to post-employment benefit plans or other long-term employee benefit plans because these topics are governed by the IAS 19 *Employee Benefits*. The other one is a novelty as with respect to IAS 27 and SIC 12 which did not mention it, that a parent company that mirrors in an investment entity shall not consolidated financial statements, and in accordance with paragraph 31 of the text, it has to measure all of its subsidiaries at fair value through profit or loss.

Continuing with the analysis of the text of the accounting policy under examination, it can be noted that, contrary to what is provided for in the two standards IAS 27 and SIC 12, in its Appendix B, IFRS 10 contains an application guidance consisting of concrete definitions and practical examples with attached solutions so as to direct to one common direction the interpretations of those who use the concepts and to assist users in situations where control and the other notions are difficult to evaluate and apply. This decision also derives from the fact that IFRSs are principle-based approaches for which, as mentioned above, they require specific interpretative and judgmental skills, giving leeway for interpretation that could lead to inconsistencies and different outcomes for the same issue. According to the text of the regulation, the standard reports the following definitions in Appendix A in order to not create dissonances. These substantives will be referred also to throughout this paper:

[17] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5

- “Consolidated financial statements: The financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.
- Control of an investee: An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.
- Decision maker: An entity with decision-making rights that is either a principal or an agent for other parties.
- Group: A parent and its subsidiaries.
- Non-controlling interest: Equity in a subsidiary not attributable, directly or indirectly, to a parent.
- Parent: An entity that controls one or more entities.
- Power: Existing rights that give the current ability to direct the relevant activities.
- Protective rights: Rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.
- Relevant activities: For the purpose of this IFRS, relevant activities are activities of the investee that significantly affect the investee’s returns.
- Removal rights: Rights to deprive the decision maker of its decision-making authority.
- Subsidiary: An entity that is controlled by another entity” (EUR-Lex - 32012R1254 , 2012).[18]

IFRS 10 develops specific concepts that revolve around the concept of control, the cornerstone of this new standard, these will be hereafter outlined in a very synthetic way, because they will be discussed further in the next sections. In the first place, a mention has to be made to the concept of control, which differs from the one governed by the previous IAS 27. The motivation resides in the fact that one of the objectives the IASB intended to pursue was to make IFRS 10 differs in delimiting the control area and method and attempts to resolve the divergence of practice concerning the applicability of the control definition in IAS 27 and enhance the uniformity of interpretation about which entities were required to be consolidated. In IFRS 10 control is composed by three fundamental components, meaning the concept of power, returns, and the relationship between power and returns, which are examined in the next chapter. Finally, in terms of

[18] EUR-Lex - 32012R1254 . (2012). Tratto da Europa.eu: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32012R1254

text analysis, the paper concludes with the cases in which an investment entity has an exemption in terms of presenting consolidated financial statements.

1.3. IAS 27 to IFRS 10 Transition

To better comprehend the practice of consolidation and the Consolidated Financial Statements, it is necessary to understand the most important historical events related to this topic as well as the regulations governing the elaboration of this knowledge. This section explores the consequences of the introduction of the IFRS 10 on consolidated financial statements when compared to the preceding guidance IAS 27 *Consolidated and Separated Financial Statements*. "Until the end of 2013, the international standard IAS 27 Consolidated and Separate Financial Statements was in force governing the preparation of consolidated financial statements. For accounting periods beginning from 1st January 2014 and later, rules for consolidated financial statements were relocated to IFRS 10 Consolidated Financial Statements. This new standard issued has not changed the principles of consolidation. The main aim was still to present asset, liabilities, equity, income, expenses and cash flows of the parent and subsidiary companies as if they were one economic entity and intragroup transactions did not exist. The most substantial impact of IFRS 10 is the newly introduced control concept used to decide which companies will be included in the consolidated statements" (Gluzová T. , Consolidation Exemptions under IFRS, 2015)[19].

Between 1973 and 1989, the IASB published a new set of regulations that were characterized by a descriptive approach and content based on the most widespread practice in nations with an embedded accounting tradition as main shared feature. The IAS 3 (1976) *Consolidated Financial Statements* and the IAS 27 (1989) *Consolidated Financial Statements and Accounting for Investments in Subsidiaries* are highlighted in the organization's issued standards governing consolidation. IAS 27 *Consolidated and Separate Financial Statements* was accepted for publication in 1988 and entered into force on January 1st 1990. It succeeded IAS 3 with the exception of the sections concerning accounting for associates' investments since IAS 27 does not address all issues relating to

[19] Gluzová, T. (2015). Consolidation Exemptions under IFRS. Tratto da Procedia Economics and Finance: https://reader.elsevier.com/reader/sd/pii/S2212567115007108?token=1539B8EEEC2DD22BF51AB2D634C2790B17A0845DD98DF856684F5BAE273B8D3B6A72534068FCB8E083F8DF027CE1CB32&originRegion=eu-west-1&originCreation=20220514090008

accounting for business combinations. Seeing that the principles introduced by the standard caused some misunderstanding, the IAS 27 has been changed and modified over the years in order to feel the gap in the conceptual framework. Furthermore, a Standing Interpretations Committee (SIC) was constituted with the primary goal of providing assistance on how to approach certain accounting matters in which there are differences. This standard, which was published in 1998, is identified in the various documents prepared by the committee as named as SIC 12: *Consolidation – Special Purpose Entities*. The objective of SIC 12 was to address some of the concerns about IAS 27's applicability. Furthermore, the Board issued a revised IAS 27 in December 2003, renaming it *Consolidated and Separate Financial Statements*. The IASB's initial process of improvement agenda included in the program a point regarding the revision of IAS 27. This even took advice from two related interpretations, SIC-12 and SIC-33 *Consolidation and Equity Method—Potential Voting Rights and Allocation of Ownership Interests*, respectively. As part of its business combinations' research work, the Board amended IAS 27 in January 2008 to resolve the issues concerning financial reporting for noncontrolling interests and loss of control of a subsidiary.

Despite the introduction of the current standard (IFRS 10) that directs consolidation procedures, IAS 27 has been amended twice in the subsequent years. "In October 2012 IAS 27 was amended by Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27). These amendments introduced new disclosure requirements for investment entities. In August 2014 IAS 27 was amended by Equity Method in Separate Financial Statements (Amendments to IAS 27). These amendments allowed entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements" (Ifrs.org, 2014)[20]

Finally, the historical excursus ends with the point in time when IFRS 10 was published. As a result of the new regulations introduced by IFRS Foundation together with IASB, the updated iteration of IAS 27 only encompasses specifications for separate financial statements: this modification is evidenced in the title, which had been updated to IAS 27 – *Separate Financial Statements*.

IFRS 10, with the goal of promoting consistency and transparency, introduces a new principles-based concept of control that applies to all types of companies, including

[20] Ifrs.org. (2014). IFRS - IAS 27 Separate Financial Statements. Tratto da https://www.ifrs.org/issued-standards/list-of-standards/ias-27-separate-financial-statements/

special-purpose businesses and substitutes the obligations relating to consolidated financial statements in both IAS 27 and SIC 12.

Because of the constant divergence between IAS 27 and SIC-12 in assessing which was more meaningful, different conclusions on the application of the concept of control were reached. Nevertheless, the new standard also requires significant judgement on the matter in order to implement it. The new standard's cornerstone stands that consolidation is only necessary if the investor has power over the investee, is exposed to variable returns, as a result of its connection with the investee, and has the potential to employ power over the investee to influence its results. In addition, IFRS 10's notable change from the old consolidation standard IAS 27 places a larger emphasis on the investor's influence over an investee's activities, rather than the company with the majority of voting rights. Determining whether or not an entity has control may necessitate a considerable amount of judgment. While the consolidation appraisal for many organizations could vary, the effect will be determined by the parameters of each arrangement.

Henceforward the main differences introduced by IFRS 10 in comparison to IAS 27 will be shown, including explanations, seeing that some of them may be merely supplements. The differences between the two standards will be thereupon summarized in a table (Table n. 1) at the end of this chapter's section in order to have a clear understanding of which changes has been introduced. The fundamental novelty brought by the new standard, as previously indicated, is the revised definition of control in its completeness, however without introducing new concepts or accounting requirements. In fact, IFRS 10 gives a new perspective on the notion as well as a more thorough interpretation.

Comparing the two control definitions proposed by the two standards it is possible to appreciate the different imprint that IASB wanted to give to this idea. "Control was defined by IAS 27 as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities" (Gluzová T. , 2015)[21]. In addition, researchers said that "the definition of control in IAS 27 was criticized for two primary reasons [...]. First, the use of the term the "power to govern" as a condition for control allowed firms to argue that greater than 50 percent ownership was required by the firm to have the ability

[21] Gluzová, T. (2015). The Adoption of Ifrs 10 and Its Impact on the Scope of Consolidation. Acta Academica Karviniensia, 4, p. 18–27. Tratto da https://doi.org/10.25142/aak.2015.039

to govern another entity. The second criticism regarding the IAS 27 definition of control was the requirement for firms to "… benefit from the activities …"[…] of the other entity to be regarded as having control. This allowed firms to argue that loss-making entities did not provide benefits to the investor thereby enabling them to omit these entities from financial reports" (Bedford, A., Bugeja, M. and Ma, N., 2022)[22]. Moreover, to have an enhanced understanding, it is useful to compare the definition sanctioned by SIC 12 to the definition within IAS 27 for comparison purposes. Beforehand, it has to be evidenced that, SIC-12 Special Purpose Entities interpretation was used to determine whether a Special Purpose Entity (SPE) should be included in consolidated financial statements. Accordingly, the companies consolidated SPEs based on the risks and rewards associated with their activities, according to the interpretation. "Perceived inconsistencies between the consolidation guidance in IAS 27 and SIC-12 resulted in diversity in practice. IAS 27 used control as the basis for consolidation, while SIC-12 focused more on risks and rewards. Although the guidance in SIC-12 applied to special purpose entities, there was confusion over which entities met the definition of a special purpose entity and, thus, whether to apply IAS 27 or SIC-12" (ifrs.org, Project Summary and Feedback Statement: IFRS 10 Consolidated Financial Statements and IFRS 12 Disclosure of Interests in Other Entities, 2011)[23]. On the other hand the definition provided by IFRS 10 states that "an investor controls an investee when is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns though its power over the investee" (IFRS 10 — Consolidated Financial Statements, 2013)[24]. At first glance, the two factions appear to be focusing their attention on two different users. IAS introduces a consolidation model aimed at all investee companies, which is offset by SIC 12, which deals with the so-called special purpose entities. However, when deciding on control over an entity, the principles of control in IAS 27 and SIC-12 differed, resulting in numerous inconsistencies because it was difficult for some listed companies to ascertain which investees were addressed by the two standards. Differing from them, the new definition of control is broader than those in IAS

[22] Bedford, A., Bugeja, M. and Ma, N. (2022). The impact of IFRS 10 on consolidated financial reporting. . Account Finance, 62, p. 101-141. Tratto da https://doi.org/10.1111/acfi.12782
[23] ifrs.org. (s.d.). Project Summary and Feedback Statement: IFRS 10 Consolidated Financial Statements and IFRS 12 Disclosure of Interests in Other Entities. Tratto da ifrs.org: https://www.ifrs.org/content/dam/ifrs/project/consolidation-and-disclosure/ifrs-10-and-12-feedback-statement.pdf
[24] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5

27 and SIC-12, and the IFRS 10 consolidation model is depicted as a single consolidation model that applies to all businesses regardless the nature of them. Notwithstanding, it should be highlighted that, rather than introducing new concepts, IFRS 10 was built on existing control guidance from the prior two, but adds a frame of reference, clarification, and application advice that is consistent with the meaning of control displayed.

Another point worth mentioning seems to be the fact that, as for IAS 27, "control was deemed to exist when the parent company had more than half of the voting rights in another entity. The standard also considered situations, where control existed without the majority of voting rights and mentioned contractual agreements or ability to appoint the majority of the members of the governing body. Nevertheless, voting rights were perceived to be primarily, and often the only, indicator of the relationship of control between companies" (Gluzová T. , 2015)[25].

At the same time, although voting rights are indeed referenced as a measure of power over the investee, IFRS 10 asserts that having a majority of voting rights may not be enough and thus could not constitute a foundation of control. Quite relevantly, standard-setters took into account also situations in which power exists despite the investor's lack of a majority of voting rights. Furthermore, because they did not give application guidance, IAS 27 and SIC-12 did not include an in-depth reasoning of the control definition. Conversely, an application guidance is also included in IFRS 10 for situations where control is challenging to gauge, since it is founded on a set of principles. "Similar to IAS 27 and the SIC-12, the consolidation model in IFRS 10 is also based on control, given that the investor is required to consolidate an investee, when it has control over that investee. However, IFRS 10 more clearly articulates the principle of control, in order to be more basically applied to all investees. It defines control as consisting of three elements: power, exposure to variable returns, and an investor's ability to use power to affect its amount of variable returns." (Morgado, 2013)[26]. As for IFRS 10, to conclude that an investor controls an investee, it must have all three elements. Control is evaluated based on all circumstances of the case, and the conclusion is properly evaluated if there is evidence that at least one of the three elements of control has

[25] Gluzová, T. (2015). The Adoption of Ifrs 10 and Its Impact on the Scope of Consolidation. Acta Academica Karviniensia, 4, p. 18–27. Tratto da https://doi.org/10.25142/aak.2015.039
[26] Morgado, M. (2013). Effect analysis on the application of IFRS 10 compared with the IAS 27. Tratto da https://1library.org/document/y6jk7onq-effect-analysis-application-ifrs-compared-ias.html

changed. Furthermore, throughout IFRS 10, the principle of control and its three elements are explained in detail because of application guidance together with examples, instead IAS 27 and SIC-12 did not include a detailed explanation of the control definition due to the absence of the guidelines.

Starting with the first element "power", in IAS 27 it can be seen that it is embedded into the definition of control, meaning that an investor has power as long as it governs the financial and operating policies. However, the standard explains that this is not the only way an investor can gain power, because power can be gained in a variety of ways, as an example, by having voting rights or by having options or convertible instruments, as well as through means of contractual arrangements and otherwise having an agent with the aptitude to direct activities for the advantage of the dominant entity. While the newest standard provides a separate definition, it remarks that when an investor has existing rights that allow it to direct activities that have a significant impact on an investee's returns, the investor has power. In this way the standard also specifies that "relevant activities" are defined as activities that have a significant impact on an investee's returns (this is a new definition, because it was not present in the previous standard). As a consequence of the definition provided by the standard, it could be said that, under IFRS 10, when determining whether or not the investor has power over the investee, the investor must consider two key concepts: the one of relevant activities and the one of existing rights.

The investor's exposure of variable returns is the second component of the new definition of control proposed by IFRS 10. When determining whether an investor has control, under IFRS 10, the investor must be exposed to or have rights over the investee's variable returns. IFRS 10 also lists a number of examples of situations connected to the returns from the investee's involvement: "a wide variety of possible returns are identified in IFRS 10, ranging from traditional dividends and interest to servicing fees, changes in the fair value of an investment, exposures arising from credit or liquidity support, tax benefits, access to future liquidity, economies of scale, cost savings and gaining proprietary knowledge" (PricewaterhouseCoopers, 2011)[27]. On the other hand, IAS 27 did not provide any additional information on this subject. There is only a passing reference

[27] PricewaterhouseCoopers. (2011). Practical guide to IFRS Consolidated financial statements: redefining control At a glance. Tratto da Pwc.com: https://www.pwc.com/jp/ja/ifrs/publication/pwc/2011/assets/pdf/201107-03.pdf

to this concept through the word "benefits", which is used only with positive acceptance, but it is insufficient in the contexts of the returns, as it may lead to misunderstanding of the concept itself.

The third criterion is not taken into account precisely in the text of IAS 27 in the same way that the last mentioned criterion. On the topic of the ability to use power to affect returns “IFRS 10 states that to have control over an investee, an investor must have the ability to use its power over the investee to affect its returns from its involvement with the investee” (Morgado, 2013)[28]. It is worth noting that the interaction between the first two control components is critical when determining whether or not an investor has control over an investee. An investor who has power through an investee, but cannot benefit from that power does not control the investee, just as an investor who has exposure or rights to the investee's variable return, but does not use that power to direct the activities that have a significant impact on the returns does not control that investee.

Finally, IFRS 10 incorporates situations when power is delegated by a principal to an agent. In other words the agency relationship that arises between principal and agent is examined, opposite to its predecessor, IAS 27, which did not anticipate into its concept of control, assuming this type of relationship being governed by another international accounting standard. The IFRS 10 addressed the theme defining the circumstances that allow to determine if a decision maker acts as an intermediary for an investor, who thus forms the true controlling party. These issues will also be considered in the following analysis.

[28] Morgado, M. (2013). Effect analysis on the application of IFRS 10 compared with the IAS 27. Tratto da https://1library.org/document/y6jk7onq-effect-analysis-application-ifrs-compared-ias.html

	IAS 27	IFRS 10
	-'Bright lines'. -Inconsistences in practice. -Tensions between IAS 27 and SIC 12.	-Principle-based approach -Additional context, explanation and application guidance.
Control Definition	Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Integrated with SIC 12 that governs Special purpose Entities.	An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns though its power over the investee.
Control Application	Applies to all investee companies.	Applies to all companies.
Power	The definition of power is within the definition of control.	Investor has power when it has existing rights that allow it to direct activities that have a significant impact on an investee's returns.
Exposure to Variable Returns	This criteria was not considered within this standard.	The investor must be exposed to or have rights to the investee's variable returns.
Ability to use Power to affect Returns	This criteria was not considered within this standard.	To have control over an investee, an investor must have the ability to use its power over the it to affect its returns.

Table 1: Key differences between IAS 27 Separate Financial Statements and IFRS 10 Consolidated Financial Statements. Personal elaboration of information.

1.4. Milestones in the Standard's Implementation

In this section, the most significant historical events that have led to the standard as it is today, will be inspected. In other words, the major amendments and changes to IFRS 10 will be taken into consideration. It should be noted that, the current standard differs from the one established in 2011, because the environment in which it is addressed is dynamic and requires continuous adjustments. Furthermore, as it has been stated numerous times, judgment must be guided, and if multiple users have had problems with the meaning of specific concepts, it is necessary to revise it and possibly find a solution for a better interpretation and application. The 'amendment' tool can be employed by the Board for the purpose of reassessing some specific parts of a standard. The ultimate step of the IASB due process includes the possibility of holding frequent meetings with relevant parties after the standard is established to help them understand any issues connected to the practical implementation and potential impact of its suggestions. The Board's discussion of potential projects and decisions to adopt new undertakings takes place in open to the public Board's meetings, and a project's inclusion in the work plan is considered only if the Board determines that the benefits of improved financial reporting outweigh the costs. Following that, the IASB examines all of the considerations made on that topic and searches for sufficient evidence to support the thesis. If the process yields to a favourable outcome, the International Standard Accounting Board will consider adding the project to the agenda. "The Board would normally propose to develop a new IFRS Standard or to make major amendments to a Standard only after it has published a discussion paper and considered the comments it receives from that consultation" (IFRS-Foundation, 2020)[29]. The amendments produced by the Board will be listed hereunder.

The *Investment Entities (Amendments to IFRS 10, IFRS 12, and IAS 27)* Amendment, which was made in October 2012, outlined what the standard intends to denote when it alludes to an investment entity and brought an exemption to the consolidation of certain subsidiary companies for investment entities. This even made it mandatory for the entities in analysis to measure their subsidiaries at fair value through profit or loss statement in their consolidated and separate financial statements, through conformity with IFRS 9 Financial Instruments. "The exception means that investment entities will be

[29] IFRS-Foundation. (2020). International Accounting Standards Board and IFRS Interpretations Committee. Due Process Handbook. Tratto da ifrs.org: https://www.ifrs.org/content/dam/ifrs/about-us/legal-and-governance/constitution-docs/due-process-handbook-2020.pdf

able to measure all of their investments at fair value using the requirements in IFRS" (ifrs.org, Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27), 2012)[30]. In this case, the reason for the change to IFRS 10 is due to the address divergence that occurs in practice when applying IAS 27 and SIC 12. Following that, the Board pursued another revision that took the investment entities' argument into account once more. In 2014, two years later the amendment, the IASB reasoned on compiling a set of clarifications regarding which companies are to be considered subsidiaries of an investment entity versus those for which a fair value valuation is required. The International Accounting Standard Board's desired to make two amendments to the issue of investment entities, demonstrates not only the importance of the latter in the economic context, but also the level of misunderstanding that existed previously because of the IASB's precedent actions.

Moreover, the so-called 'Post Implementation Review' is an additional mechanism available to the IASB to assess standards (either the IASB or the FASB, for IFRSs and US GAAPs, respectively). The Post-Implementation Reviews, also known as PIRs, are defined as "review of a Standard or major amendment to a Standard" (IFRS-Foundation, 2020)[31]. The PIRs are a mandatory part of the Board's due process and the purpose is to assist the Board in analysing how the standard is working and figuring out whether it has been successful as well as aiding instrument in determining the impact of new regulations on investors, preparers, regulators, and auditors. Whereupon, these reviews are a great opportunity for major IFRS users to participate in the standard-setting process. Nevertheless, they also serve as a guide for making the necessary updates to keep standards up to date, to ensure that entities did not come across into any issues when conforming to them, and to ensure that the guidance provided was sufficiently understandable and comprehensive. PIRs are part of the stage following the publication of a standard, are usually conducted after two years from the entry into force and the Board is required to carry out them after each standard, or significant amendment. In addition, the Board could consider conducting a Post-Implementation Review in response to changes in the financial reporting environment and regulatory requirements,

[30] ifrs.org. (2012). Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27). Tratto da ifrs.org: https://www.ifrs.org/content/dam/ifrs/project/investment-entities/investment-entities-amdments-to-ifrs-10-12-and-ias-27-summary-and-feedback.pdf

[31] IFRS-Foundation. (2020). International Accounting Standards Board and IFRS Interpretations Committee. Due Process Handbook. Tratto da ifrs.org: https://www.ifrs.org/content/dam/ifrs/about-us/legal-and-governance/constitution-docs/due-process-handbook-2020.pdf

or in reaction to issues about the quality of a Standard conveyed by the Advisory Council, the Interpretations Committee, standard-setters, or stakeholders. Finally, it is worth to underline that, "a PIR is not intended to be a cover-to-cover reconsideration of the entire underlying Standard. It starts with an initial assessment of how well the new Standard is performing in practice and includes outreach to the Board's consultative network" (Kabureck, 2018)[32].

When conducting a Post Implementation Review it has to be taken into consideration that there are two stages that characterize each review. "The first phase of the PIR involves the initial identification and assessment of the matters to be examined, drawing on discussions with the IFRS Interpretations Committee, the Board's advisory groups and other interested parties. The Board consults publicly on the matters identified in the first phase of the PIR. It also reviews relevant academic studies and other reports and may conduct surveys and other outreach." (IFRS - Post-implementation Reviews, 2014)[33]. In this way, it can be observed that in the initial phase, the Board identified and assessed the issues that would be investigated subsequently in a request for information. Whereas the second phase incorporates the taking into account of the feedbacks the Board received in response to the request for information, together with information gathered through other consultative activities. The Board then publishes a Report and Feedback Statement at the end of the PIR summarizing its findings and the actions it plans to take, whether any, as an outcome of the PIR. Depending on the nature of the content and the information submitted by the PIR, the procedure could result in the supply of more educational material, the Board deciding to add a standard-setting project to its agenda, or the Board considering one or more issues further as part of its research programme, or both. However, the third possibility is that the Board will take no action. As previously stated, even if potential improvements have been found, one possible outcome is that the Board makes no revisions to the Standard. This is because people desire a solid financial reporting platform, and little modifications may not pass the cost-benefit test. Even modest changes consume a substantial amount of time from both constituents and the Board.

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[32] Kabureck, G. (2018). IFRS - A holistic look at IFRS Standards: the role of Post-implementation Reviews. Tratto da Ifrs.org: https://www.ifrs.org/news-and-events/news/2017/09/role-of-post-implementation-reviews/

[33] IFRS - Post-implementation Reviews. (2014). Tratto da Ifrs.org: https://www.ifrs.org/projects/post-implementation-reviews/

In the PIRs conducted by the IASB, IFRS 10 has been considered, alongside the other two IFRSs 11 and 12, as part of a revision project. “In particular, the Board aims to assess whether:

(a) an entity applying the requirements in a Standard produces financial statements that faithfully portray the entity’s financial position and performance, and whether this information helps users of financial statements to make informed economic decisions;
(b) areas of the Standard pose challenges;
(c) areas of the Standard could result in inconsistent application; and
(d) unexpected costs arise when applying or enforcing the requirements of the Standard, or when using or auditing information the Standard requires an entity to provide” (IFRS Foundation, 2020)[34].

The first phase started around 2019 with a selection of matters for further examination. The Board did it by reviewing its publications, including the project summaries and feedback statements published when the three standard in object of this Review were issued alongside with all the amendments. Moreover it has undertaken meetings with users and preparers of financial statements, auditors, regulators and national standard setters, reviewing literature and academic researches.
As a consequence within the Q4 of 2020, December 2020, the Board published the Request for Information. The latter was, in fact, published on December 9th 2020. The next step aim at collecting the provided comment letters during the second quarter of the following year, so year 2021. The Board and the Interpretations Committee evaluate the issues raised in comment letters, as well as the related explanations and evidence provided by respondents. What matters is the quality of the analysis provided in comment letters, as well as the evidence supporting the analysis. Because the IASB determined that the topics identified in the Post-implementation Review were not of high enough priority to be added to the IASB's work plan of active projects or research pipeline for 2022 to 2026 based on its analysis and deliberation of the feedback, the Board will publish the *Report and Feedback Statement on the Post-implementation Review of IFRS 10, IFRS 11, and IFRS 12* in the second half of year 2022.

[34] IFRS Foundation. (2020). IFRS® Standard Request for Information Post-implementation Review. Tratto da Ifrs.org: https://www.ifrs.org/content/dam/ifrs/project/pir-10-11-12/rfi2020-pir10-11-12.pdf

CHAPTER 2 – THE ISSUE OF CONTROL

2.1. The Concept of Control Under IFRS 10

The concept of control within the boundaries of IFRS 10 was briefly presented in the first chapter. It is also worth noting again that, this notion is likewise characterized as the cornerstone of the IASB's entire modernization process in the field of consolidation, it is the most significant part of the international principle in analysis. The new definition, which replaces the one contained in IAS 27 Consolidated and Separate Financial Statements, in combination with SIC 12, shows a considerable change by establishing a single consolidation structure. The latter is applicable to all companies, thus the structure of the investment is meaningless in deciding which is within the scope of the construct of control, according to the IFRS 10. As a result, contrary to what was previously provided, the basic principle now incorporates Special Purpose Entities, previously regulated by SIC 12, which in this context are referred to as Structured Entities. However, it is essential to examine it in detail, in order to gain a greater understanding of the challenges that have arisen in recent years and for which the Board has not provided a definitive response. It is indeed remarkable to learn what theorists and professionals in practice, such as auditors, preparers, and managers, reckon about these issues.

Control that leads to line-by-line consolidation of the investee firm is also unilateral, in the sense that there is a single active controlling entity, a single investor who controls autonomously, without the involvement of others in the administration of the relevant activities. In actuality, there is a situation of joint control where two or more investors jointly control a company subject to investment by cooperating to carry out the required operations, and the interest in the investee must be assessed in accordance with the standards of IFRS 11.

The definition of control, which says that: "an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee" (IFRS 10 — Consolidated Financial Statements, 2013)[35] is the pillar on which the whole new model proposed is based. The distinction between the entities which belong to the side of the

[35] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5

"investor" and those which are believed to be "investee" is the initial and crucial element to comprehend. In other words, "the area of consolidation is therefore the first operation that the process of preparing the consolidated financial statements requires to face and in order to trace the boundaries of this perimeter, knowledge of the phenomenon to be represented, i.e. the group, cannot be ignored" (Sòstero, Cerbioni, & Saccon, 2018)[36]. Moreover, the delimitation of the consolidation region is, in fact, a step in a process that finds the initial inspirational principle in the formation of the group concept. The area of consolidation must, at least in theory, coincide with the group in the entirety of the phenomena asked to depict. "The delimitation of consolidation perimeter is of fundamental importance for making relevant group accounting information. This importance asks for a precise care in the perimeter disclosure. […] Thus disclosure on consolidation perimeter represents a key element in order to confer full intelligibility and significance to the consolidated accounts" (Saccon, 2008)[37]. However, defining the business group and, by extension, its boundaries is a difficult and complex task. As a result, it appears that the disclosure obligation applies to any organization that simply adopts the function of parent, regardless of legal structure. Provided that, as a general rule, the international principle makes no reference to the parent's legal form or typology when it comes to the need to prepare consolidated financial statements, which simply defines an entity as controlling one or more businesses.

When considering the boundaries of the group, reporting and legal entities are two extremely important concepts to consider, because the former is typically thought of as the entity that is supposed to consolidate group accounts, whereas the latter is thought of as the "investee", or the controlled entity, that operates within the consolidation perimeter. IFRS 10 – Consolidated Financial Statements displays these two concepts by attaching the reporting entity concept to the parent, while depicts the investee as the reporting entity's subsidiary or a potential subsidiary of it. This general rule is consistent with the principles of the Conceptual Framework for Financial Reporting.

Initially, the International Accounting Standards Board (IASB) proposed a meaning of reporting entity, as well as a description of its characteristics, in the Discussion Paper (DP) *Preliminary Views on an improved Conceptual Framework for Financial*

[36] Sòstero, U., Cerbioni, F., & Saccon, C. (2018). Bilancio consolidato: Disciplina nazionale e IFRS (2. edizione ed.). Milano: McGraw-Hill Education.

[37] Saccon, C. (2008). Perimeter of consolidation: converging regulations and national effects. Revista Economica, 40(3), 75-88. Retrieved from https://ideas.repec.org/a/blg/reveco/v39y2008i3p75-88.html

Reporting – The Reporting Entity, issued on May 29th 2008. The DP proposes that a reporting entity should be described as "a circumscribed area of business activities of interest to present and potential equity investors, lenders and other capital providers" (Deloitte, IASB considers 'what is a reporting entity'?, 2008)[38]. It also implies that a reporting entity should not be confined to business activities constituted as legal entities, implying that sole proprietorships, partnerships, associations, and groups of businesses would be included.

The new Conceptual Framework for Financial Reporting, that is a comprehensive set of concepts for financial reporting, was released by the International Accounting Standards Board (IASB) in March 2018. It was not a standard, for this reason it does not take precedence over any other standard. The prior Conceptual Framework was effective, but it was lacking in some areas and needed to be improved. As a result, a new chapter on reporting entities was created, explaining several terminologies and defining the reporting entity's boundaries. The Conceptual Framework describes the reporting entity as being "an entity that is required, or chooses, to prepare financial statements. A reporting entity can be a single entity or a portion of an entity or can comprise more than one entity. A reporting entity is not necessarily a legal entity" (IFRS-Foundation, Conceptual Framework for Financial Reporting, 2018)[39]. The first individualized issue is the selection of a reporting entity's acceptable boundary. The assessment can be challenging, for example, if the entity is not a legal entity or does not consist solely of legal entities linked by a parent-subsidiary connection. In such circumstances, the border is established by taking into account the information requirements of the entity's financial statement consumers. In addition, those users require information that is timely as well as that accurately reflects what it claims to represent.

"Faithful representation requires that:

(a) the boundary of the reporting entity does not contain an arbitrary or incomplete set of economic activities;

[38] Deloitte. (2008). IASB considers 'what is a reporting entity'? Tratto da https://www.iasplus.com/en/binary/iasplus/0807dpreportingentity.pdf

[39] IFRS-Foundation. (2018). Conceptual Framework for Financial Reporting. Tratto da ifrs.org: https://www.ifrs.org/content/dam/ifrs/publications/pdf-standards/english/2021/issued/part-a/conceptual-framework-for-financial-reporting.pdf

(b) including that set of economic activities within the boundary of the reporting entity results in neutral information; and

(c) a description is provided of how the boundary of the reporting entity was determined and of what constitutes the reporting entity" (IFRS-Foundation, Conceptual Framework for Financial Reporting, 2018). [40]

Implementing the notion outlined in this paper's Section 1.2 – "IFRS 10: Consolidated Financial Statements", if all of the succeeding conditions are met, a parent entity that prepares financial statements in accordance with IFRS 10 is exempt from consolidation processes. The exemption criteria originate from the fact that a firm must be a totally or partially owned subsidiary, and all owners must agree not to prepare consolidated financial statements. Moreover it disallows its debt and equity instruments to be sold in a public market. "It does not file, nor is in the process of filing, financial statements with a securities commission for the purpose of issuing instruments in a public market. Its ultimate or any intermediate parent produces consolidated financial statements that are available for the public use and comply with IFRS" (EY, Challenges in adopting and applying IFRS 10, 2013).[41]

In this scenario, there is no distinction between the present standard, IFRS 10, and its forefather, IAS 27. Historically, the previously applied standard IAS 27 included a number of instances in which the consolidation of a subsidiary was not required. The International Standard, on the other hand, provides an exemption for post-employment benefit plans or other long-term employee benefit plans to which IAS 19 Employee Benefits applies. This introduces a new criteria that was not previously stated in IAS 27. The last exemption derives from the fact that repeated demands from respondents, together with the continual convergence process of IFRS and US GAAP, where the exemption for investment corporations was already available, resulted in the Investment Entities action plan. "As a result of the project, in October 2012 IASB issued amendments to IFRS 10 presenting exemptions from preparation of consolidated financial statements for investment entities. Instead of consolidating, investment entity

[40] IFRS-Foundation. (2018). Conceptual Framework for Financial Reporting. Tratto da ifrs.org: https://www.ifrs.org/content/dam/ifrs/publications/pdf-standards/english/2021/issued/part-a/conceptual-framework-for-financial-reporting.pdf

[41] EY. (2013). Challenges in adopting and applying IFRS 10.

measures majority of its subsidiaries at fair value" (Gluzová T. , Consolidation Exemptions under IFRS, 2015)[42].

Literature around consolidation identifies primarily two types of control to be exercised. The first one is named as 'de jure', or formal control, it is exercised by owning a majority of voting rights, as mandated by law. Moreover, it is required, in addition to a majority of voting rights, that control be exerted effectively, because otherwise minority shareholders could run the company in their own interests. When a majority of voting rights does not indicate control, evidence of minority shareholders' management of the controlled firm must be presented. While, on the other hand, the second one is defined as 'de facto', or substantive control, which is supported by the IFRS 10. In particular, it is characterized by the parent company's ability to manage the operating policies of another organization, regardless of the number of shares held. One of the key modifications brought about by IFRS 10 is guidance on de facto control, as judgments in practice are challenging due to the many qualitative considerations that must be considered. According to the principle, "an investor with less than a majority of the voting rights may hold the largest block of voting rights with the remaining voting rights widely dispersed. The investor may have the power to unilaterally direct the investee unless a sufficient number of the remaining dispersed investors act in concert to oppose the influential investor. However, such concerted action may be hard to organise if it requires the collective action of a large number of unrelated investors" (PricewaterhouseCoopers, 2011)[43].

According to IFRS 10, control exists and therefore consolidation is required, when one company has, against another, each of the three following requisites:

1. Power over the investee.
2. Exposure, or rights, to variable returns from its involvement with the investee.
3. Ability to use its power over the investee to affect the investor's returns.

It is important to recall that for the above-mentioned consolidation model to be valid, all three parts must be present at the same time. It is also significant to emphasize that these three factors that give an investor control are the most essential part of the

[42] Gluzová, T. (2015). Consolidation Exemptions under IFRS. Procedia Economics and Finance, 25, p. 32-40. doi:10.1016/S2212-5671(15)00710-8
[43] PricewaterhouseCoopers. (2011). Practical guide to IFRS Consolidated financial statements: redefining control At a glance. Tratto da Pwc.com: https://www.pwc.com/jp/ja/ifrs/publication/pwc/2011/assets/pdf/201107-03.pdf

control assessment, and which will be subject to in-depth analysis in the rest of the discussion.

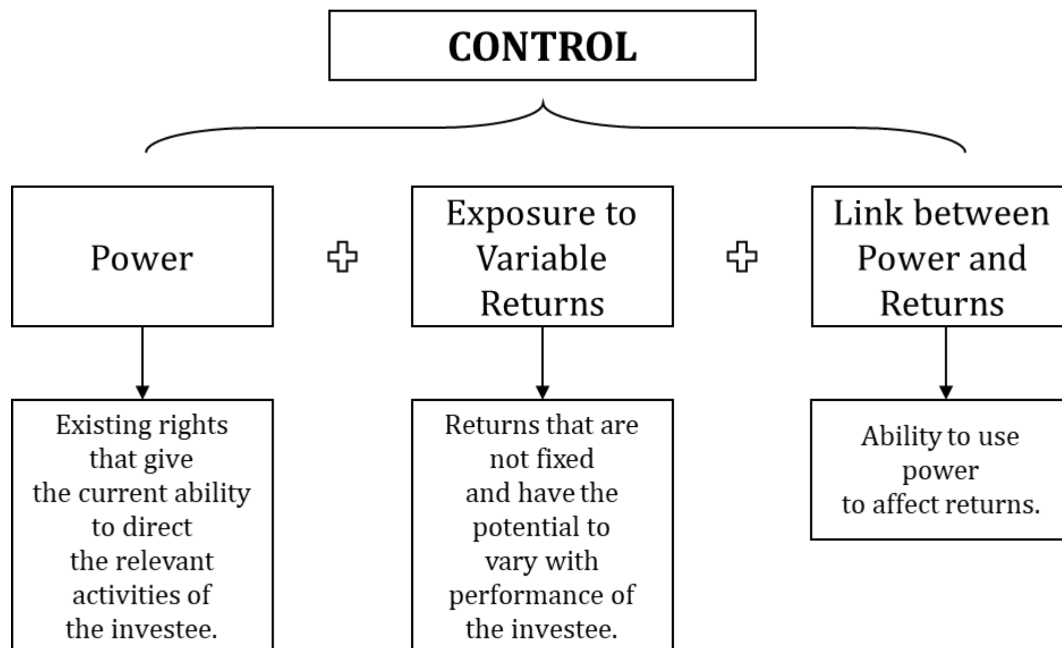


Figure 1: The three elements of control. Personal elaboration based on Deloitte's document "Clearly IFRS. Moving ahead in an IFRS world. A practical guide to implementing. IFRS 10 – Consolidated Financial Statements (Deloitte, Clearly IFRS - IFRS 10 Consolidated Financial Statements , 2014)[44]

The definition of control in IFRS 10 integrates the distinct parts articulated individually in prior accounting principles, namely control derived by rights and exposure to variable returns, which had previously generated mixed approaches and therefore not always straightforward to combine in identifying control situations. Furthermore, IFRS 10 ties power with returns by requiring the ability to impact returns through power. Again, it is critical to emphasise that the criterion employed by IFRS to define control is "principle-based", which means that there are no predetermined thresholds. Instead, the standard proposes a broad approach that attempts to effectively identify all circumstances in which any type of control is properly exercised, in accordance with the substance-over-form principle. In this regard, IFRS 10 prescribes taking into account all facts and circumstances while determining control.

To apply the control model, various preliminary actions must be completed before determining if each of the three control's elements is present. These processes include identifying the investee, understanding the purpose and design of the investee, and

[44] Deloitte. (2014). Clearly IFRS - IFRS 10 Consolidated Financial Statements . Tratto da https://www2.deloitte.com/content/dam/Deloitte/ca/Documents/audit/ca-en-audit-clearly-ifrs-consolidated-financial-statements-ifrs-10.pdf

identifying which activities of the investee are relevant and how judgments regarding these relevant activities are made.

The process of assessing control begins with the identification of the investee's objective and design. Because the term "investee" is not defined in IFRS 10, the investor must evaluate the purpose and design of an investee when determining whether it has control of an investee. The technique for finding the so-called investee is a crucial step once the figure of the reporting company and thus the partnership that must combine the financial statements has been determined. All of what has been mentioned hitherto is useful in developing an acceptable basic knowledge for control decisions. To be more specific, to define which companies belong under the concept of "investee", because, as stressed multiple times, control is the fundamental principle of choice.

Understanding the purpose and design of the investee is crucial in determining whether the investor has control or not. The aim and design considerations make it evident that the organization is controlled by voting or potential voting rights. Control, as previously said, is primarily determined by voting rights. However, in circumstances where majority voting rights do not occur, a more sophisticated mechanism is used to establish power. The circumstance the standard refer to is represented by the situation when any voting rights pertain to administrative tasks exclusively and the relevant activities are guided by contractual arrangements. according to the wording of the IFRS 10 an investee can be formed so that voting rights are not the major element in determining who controls the investee. “The investee may be on ‘auto-pilot’ through contractual arrangements. In those cases, the following should be considered in assessing the purpose and design of an entity [...]:

(a) downside risks and upside potential that the investee was designed to create;
(b) downside risks and upside potential that investee was designed to pass on to other parties in the transaction; and
(c) whether the investor is exposed to those risks and upside potential” (PricewaterhouseCoopers, 2011)[45].

Furthermore, an investee's purpose and design may influence the judgment of what the relevant activities can be, how those activities are selected, who can lead them, together

[45] PricewaterhouseCoopers. (2011). Practical guide to IFRS Consolidated financial statements: redefining control At a glance. Tratto da Pwc.com: https://www.pwc.com/jp/ja/ifrs/publication/pwc/2011/assets/pdf/201107-03.pdf

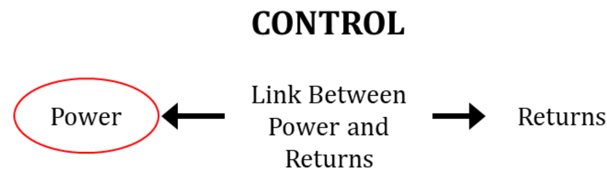
with who can benefit from those activities. But also how relevant activities affect returns, and whether parties with power and exposure to variable returns can use that power to influence returns. In short, comprehending the investee's purpose and design aids to determine the goal of each investor; that is, why it is associated with the investee and what that engagement is. Besides, control is evaluated at the individual level of each investee. “However, in some circumstances, the assessment is made for a portion of an entity (i.e. a silo). This is the case if, and only if, all the assets, liabilities and equity of that part of the investee are ring-fenced from the rest of the entity. The existence of silos is not confined to structured entities but is more likely to arise there” (Deloitte, Clearly IFRS - IFRS 10 Consolidated Financial Statements , 2014)[46]. With respect to the figure of silos, they are recognized when specific assets of an investee are treated as a separate company for accounting purposes. If the assets form a silo, the investor must decide whether it can control the silo using the IFRS 10 criterion. Likewise, if another investor controls and consolidates the corporation holding the silos, the last-mentioned that meet the stipulated parameters are exempt from consolidation.

Last but not least, “IFRS 10 contains an explicit requirement for investor/investee relationships to be reassessed on a continuous basis” (Yumpu.com, 2022)[47]. The standard's content refers to a specific aspect entitled continuous assessment of control, which takes into consideration the changes that can occur in the three control relationships and, as a response, might lead to a change in the investor engagement with the investee. Therefore, if one or more of the elements of control have changed, the investor should examine whether control is still existing or has arisen. Nevertheless, more information on each of these initial procedures will be presented in the following sections, with the goal of analysing the three components of control.

[46] Deloitte. (2014). Clearly IFRS - IFRS 10 Consolidated Financial Statements . Tratto da https://www2.deloitte.com/content/dam/Deloitte/ca/Documents/audit/ca-en-audit-clearly-ifrs-consolidated-financial-statements-ifrs-10.pdf

[47] Yumpu.com. (2022). need to know / ifrs 10 consolidated financial statements - BDO International. Tratto da yumpu.com: https://www.yumpu.com/en/document/read/38488427/need-to-know-ifrs-10-consolidated-financial-bdo-international

2.2. Power Over an Investee



One of the most important aspects in the consolidation process is determining the investor's control over the investee. Power, or, to put it another way, “existing rights that give […] the current ability to direct the relevant activities” (IFRS 10 — Consolidated Financial Statements, 2013)[48] as stated in the international standard IFRS 10, is the first requirement that an investor must meet in order to gain control. It should be emphasized that power is defined based on current ability, and thus an investor merely needs the power to manage relevant activities; whether or not the investor utilises this ability is unimportant. However, according to IFRS 10, the term current implies that an investor has the ability to influence the relevant activities of an investee even if those activities take place only when certain circumstances or specific events occur. Hence, the fact that a subject leads in the present an activity capable of having a considerable impact on the returns of another entity can be a revealing factor, but it is not definitive of the presence of power. Beyond, by carefully examining the suggested definition, two key elements can be identified: existing rights and relevant activities.

“Sometimes assessing power is straightforward, such as when power over an investee is obtained directly and solely from the voting rights granted by equity instruments such as shares, and can be assessed by considering the voting rights from those shareholdings. In other cases, the assessment will be more complex and require more than one factor to be considered, for example when power results from one or more contractual arrangements” (Stefan-Duicu, Explaining power over the investee - The rights that give the possibility to directs the investee's relevant activities, 2015)[49]. In the most basic circumstances, such power is derived from the voting rights granted by shares. A parent business wields power when it directly or indirectly owns more than

[48] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5
[49] Stefan-Duicu, A. (2015). Explaining power over the investee - The rights that give the possibility to directs the investee’s relevant activities. Challenges of the Knowledge Society, p. 718-723. Tratto da https://www.proquest.com/scholarly-journals/ex

half of the voting power of the investee. Furthermore, its vote enables it to direct the activities of the investee and designate important members of its governing board. It is evident that, whoever controls the investee has a majority of those voting rights. The use of majority voting rights in measuring control is obvious, as the investor's representatives have the authority to influence the vote at the investee's general meetings. Hence, assessing power in these circumstances is simplistic, similar to what was proposed within the IAS 27, because voting rights are indeed one key factor in determining control of an investee. The standard specifies that substantive rights must exist in all cases. However, when analysing the existence of power, the rights to protection must be ignored. In light of the foregoing, it is possible to state synthetically that the necessary of power exists when the investor possesses considerable rights that allow him to direct the relevant activities of the investee company. "In situations where less than a majority of voting rights is held, however, the investor would need to consider other factors in assessing power. A significant change from IAS 27 is that IFRS 10 focuses on the rights and ability to direct relevant activities that affect returns in addition to the test regarding the party that holds the majority of voting rights" (Ben-Shahar & al, 2016)[50]. In fact, as discussed in the preceding Chapter, IAS 27 defines control as the ability to direct an entity's financial and operational policies. The Board agreed to modify the concept of control because, while power is commonly achieved by managing an investee's strategic operational and financial strategies, it is only one of the techniques in which power is used as a tool to manage an investee's operations can be obtained. Therefore, in the absence of a clear determination of control via voting rights, additional research is required. To establish if an investor has control over the investee, an investor shall outline relevant activities and how the latter are directed, but also have to consider the rights that the investor and other parties have in relation to the investee together to the purpose and design of the investee.

[50] Ben-Shahar, D., & al, e. (2016). Does IFRS 10 on Consolidated Financial Statements Abandon Accepted Economic Principles? Australian Accounting Review, 26(4), p. 341-345.

2.2.1. Relevant Activities

In light of what has been stated above, in situations where less than a majority of voting rights are held, however, the investor would need to consider other factors in assessing power. A meaningful change with respect to IAS 27 is that IFRS 10 focuses on the rights and ability to direct relevant activities that affect returns in addition to the evaluation regarding the party that holds the majority of voting rights. Furthermore, in certain situations, this gives an investor power over an investee even without a majority of voting rights.

In the Appendix A of the International Financial Reporting Standard 10 the definition of relevant activities is given as activities which significantly affect the returns of the investee. In simpler terms, relevant activities include all of a company's main operations. Prior to the publication of the official text of the international standard, there was a stage of soliciting comments on the Exposure Draft (ED 10) authored by the IASB. This is due to the fact that following a request to clarify the principles under IFRS 10, the Board itself disclosed the ED 10 in December 2011. On the grounds of that, it should be noted that the Exposure Draft 10 lacked precise guidance on the activities of an investee whereby the term of control pertained. "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)" (IFRS Foundation)[51]. Observations on ED 10 indicated that such a clarification would be especially useful for analysing control of investees that are not directed by voting or comparable rights and for which several parties may have decision-making rights over distinct activities.

In precedence it has been said that, the identification of the purpose and design of the investee is the first step in the procedure carried out to assess control. As a matter of fact, in the most intricate circumstances, such as those in which voting rights do not allow for the management of important actions, the identification of control may be more difficult. The standard proposes studying the investee's purpose and design to tackle this challenge. The particular reason is that, this approach is a key part since it enables the recognition of the relevant activities as well as how decisions are made, but also who has been individualized to have the ability to direct these activities. "In other words, relevant

[51] IFRS Foundation. (n.d.). Basis for Conclusions on IFRS 10 Consolidated Financial Statements. Retrieved from https://www.masb.org.my/pdf.php?pdf=FRS10_BC.pdf&file_path=pdf

activities depend on the business model of an investee and how revenue is generated" (BDO, 2021)[52].

It is paramount to understand what are the activities that fall within the definition given by the standard. A variety of operating and financing activities, according to the standard, have a significant impact on the returns of many investees. Because it demands an assessment of a spectrum of operations ranging from operating and finance activities, some examples of what types of activities are deemed important by the International Standard Board are provided.

"Examples of activities [...] include, but are not limited to:

a) selling and purchasing of goods or services;
b) managing financial assets during their life (including upon default);
c) selecting, acquiring or disposing of assets;
d) researching and developing new products or processes; and
e) determining a funding structure or obtaining funding" (IFRS 10 — Consolidated Financial Statements, 2013)[53].

Concretizing the examples just proposed, it is worth pointing out that, the first is typically associated with a distribution company, while the second and third are typical of investment entities, researching and developing are referred to companies in the pharmaceutical sector that will be discussed later, and the final example may concern commercial entities. On account of this, the subsequent step to consider are the circumstances from which decision about relevant activities arise. Consequently, IFRS 10 bestows also key examples of relevant activity decisions. The latter comprehend operating, capital, and budgetary decisions, as well as the recruitment, remuneration, and termination of service providers or senior management. It should also be highlighted that, because relevant activities change over time, they must be reconsidered whenever facts and circumstances change. Moreover, under IFRS 10, if more than one investor has influence over relevant activities, the investor who directs the most relevant activities has control over the investee. In turn, the significance of an action is determined by its ability to influence returns.

[52] BDO. (2021). IFRS in Practice 2021/2022 IFRS 10 Consolidated Financial Statements.
[53] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5

Although the standard provides an appropriate guidance to assist preparers and other figures involved in the consolidation process, the identification might be difficult when entities are involved in complex ownership structures and otherwise structured entities. As it might be expected, while looking at the market as a whole, it is clear that it is made up of a great amount of heterogenic micro sectors, making it much more difficult to discover common areas. As a result, the standard's instructions for relevant activities can take a wide range of aspects because they are tailored to each unique setting. The majority of professionals, including auditors and preparers, agree that, while the standard provides detailed and fairly thorough guidance, high degree of judgmental abilities are necessary, and their application can result in contradictory and highly varied views. Furthermore, the application of judgements without sufficient instructions may result in the use of preceding judgments in comparable situations, which are not necessarily suitable to the scenario that want to be examined. More pointedly, the ASC (Accounting Standards Council of Singapore) in the Comment Letter sent to the International Accounting Standard Board, when requesting feedbacks for the PIR, asserts that "the assessment involves added complexity when different activities affect the investee's returns to different extent before and after a particular set of circumstances or events. The application of judgement by different investors can lead to inconsistent conclusions for similar fact patterns" (Accounting Standard Council Singapore, 2021)[54]. Furthermore, there are recurring scenarios that have been identified which continue to provide some challenges.

Among these, a case involving investees who are Structured Entities or SPE has been mentioned. A SPE, as the acronym indicates, is a business formed to pursue a specific and well-defined goal, which is frequently specified for a limited time period. "The existing guidance in IFRS 10.B11 – B13 is from the standpoint of an investee that is a 'standard' business with various operating and financing activities. It does not explicitly deal with situations where the investee is a structured entity, set up for a narrow and specific purpose" (KPMG-IFRG-Limited, 2021)[55].

[54] Accounting Standard Council Singapore. (2021). Response to request for information on post-implementation review of IFRS 10 consolidated financial statements, IFRS 11 joint arrangements and IFRS 12 disclousure of interests in other entities. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28346_SuatChengGohSingaporeAccou

[55] KPMG-IFRG-Limited. (2021). Comment letter on Request for Information on the Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28356_ChrisJacksonKPMGIFRGLimited_0_KPMGcommentletteronRFIonPIRofIFRS101112.pdf

The particular reason for the circumstance is that, when dealing with investees labelled as Special Purpose Entities or Structured Entities, the typical problem is that the number of relevant activities that are firmly dependent on purpose and design, as well as the extent to which activities have been pre-determined, is limited. Furthermore, there are specific decisions or procedures based on structure and relevant activities, and the majority of the rights that direct the decisions are derived from contractual rights. “The requirement on SEs in IFRS 10 applies to any entity that is not managed by the traditional means. These may include vehicles created for transfers of assets and liabilities, entities that an investor sponsors or provides financial (including guarantees) and other support, and involvement in clubs, trusts and non-profit organisations” (Liong Tong, T.)[56]. The issue highlighted is whether to consider when activities that cause variability in the structured entity's returns, and are carried out outside its legal boundaries, have to be recognized as a relevant activity of the Structured Entity in assessing control over it being in line with IFRS 10 principles. Always remaining in the same context, another common example discovered is that of so-called "autopilot" corporations. IFRS 10 addresses the situation in which relevant activities only occur in response to specific circumstances or events. However, it is unclear whether “an investee operating fully on autopilot with no decisions to make can still have relevant activities, if its design most significantly affects its returns” (KPMG-IFRG-Limited, 2021)[57]. In other words, investors do not control autopilot entities due to a lack of relevant activities within the autopilot entity shaping variable returns, despite the premise that investors are exposed to practically all or a significant portion of the variable returns. This issue arose as a result of the fact that, prior to the adoption of the IFRS 10, the autopilot entities, that fall within the definition of Special Purpose Entities, were controlled by the special purpose entity (SPE) guidance SIC-12. Accordingly, an entity is considered to be operating on autopilot when special purpose entities perform in a fixed manner in which no entity has explicit decision-making power over the SPE's continued activities after its inception. There was specific information about how to judge the

[56] Liong Tong, T. (s.d.). A Single Control Model for Consolidation, Involvement with Other Entities and Fair Value Measurement – A Review of IFRSs 10 – 13 . Tratto da MASB: https://www.masb.org.my/press_list.php?id=1

[57] KPMG-IFRG-Limited. (2021). Comment letter on Request for Information on the Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28356_ChrisJacksonKPMGIFRGLimited_0_KPMGcommentletteronRFIonPIRofIFRS101112.pdf

control assessment throughout the standard, but the newly provided standard lacks relevant activities within the auto-pilot entity because the single model of control indicates a uniform approach applicable to all types of entities. Even if situations of autopilot entities are not common, it would be worthwhile to evaluate whether risk and rewards elements should be given more weight in determining control over structured entities and thus provide more thorough guidance in this regard.

According to the standard, it is said that, the investor, who currently has the ability to direct the relevant activities that most significantly affect the investee's returns, has power over the investee. Albeit, because it may be common in practice, it is indeed necessary to address the case in which two or more investors have both the power to direct relevant activities. This is due to the fact that this scenario might be difficult to implement and manage. Among the causes contractual agreements could be designated since they impair different investors with power over different activities. However, the standard itself in the application guidance provides a clear representation of this issue giving also possible considerations to take into account. "Example 1 of the Application Guidance on IFRS 10 illustrates that when an investor is deciding which activity most significantly affects the investee's returns, the investor shall consider the profit margin, revenue and value of the investee, as well as any uncertainties about future developments" (IFRS Foundation, 2020)[58]. Nevertheless, where there are a large number of relevant activities and/or different investors have unilateral rights to make judgments on various relevant activities, some stakeholders have recognised issues in selecting the most decisive relevant activity.

Furthermore, the difficulty increases when such required activities occur at different moments or are dependent on future events. In such cases, the contribution of each activity to the profitability of the investee may alter over time. As a result, weights must be assigned to them while also taking into consideration that control must be examined on a continuous basis because investors must reassess this judgement over time if actual information or circumstances change. Briefly analysing the comment letters supplied to the IASB in response to the post-implementation review for IFRS 10, this type of difficulty has resurfaced several times in companies where the R&D department

[58] IFRS Foundation. (2020). Post-implementation Review of IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities. Findings from the first phase and determining the next step. Tratto da ifrs.org:
https://www.ifrs.org/content/dam/ifrs/meetings/2020/march/iasb/ap7a-pir-of-ifrs10-ifrs11-ifrs12.pdf

characterises the majority of the returns for investors from the key activities. These markets, for instance, are dominated by the pharmaceutical and medical sectors. "For example, when the relevant activities occur in sequence (for example R&D first, then production and sales), the party that controls the first activity in the sequence may control the entity initially. However, this may change during the life cycle of the investee if a different party controls the later activities, for example, the production and selling activities" (Ernst-&-Young-Global-Limited, 2021)[59]. In this regard Georgina Prokop, in an article published, says that a first thought might be to consider the development as relevant, given that it is the current activity of the investee. "However, a careful look at the definition shows that the relevant activity must affect the investee's return, which is not true for development activities. In fact, the investee will get returns from the license of the drug, so the sale of the license to pharmaceutical companies is what's relevant" (Prokop, 2018)[60]. However, the scenario will be different if alternative types of sales are considered, such as keeping them not fixed, because when dealing with IFRS 10, the details can be essential for the assessment of the conclusion.

2.2.2. Rights That Give Power

It has been stated in paragraph 2.1 – The concept of control under IFRS 10, that the first element of control, i.e. power, is made up of two fundamental features. To exert power over the investee, investors must have rights that allow them to direct the investee's relevant activities. To say it in another way, "the ability to direct relevant activities of the investee arises from legal rights the investor entity has over the investee, for instance voting rights coming from the ownership of shares, or contractual agreements between them […]". (Gallimberti, Marra, Prencipe, Toselli, & Andrea, 2013)[61]
After identifying the relevant activities, the next phase is to ascertain which investor, if any, currently has the ability to direct those operations, namely the power.
As a result, power stems from the relevant activities, that have been yet examined, in

[59] Ernst-&-Young-Global-Limited. (2021). Invitation to comment – Request for Information – Post-implementation Review – IFRS. Tratto da Ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28372_ELIZABETHHENRYEY_0_CommentLetterPIRIFRS101112May2021.pdf

[60] Prokop, G. (2018). Why it's still hard to get comfy with IFRS 10. Tratto da KPMG Luxembourg: https://blog.kpmg.lu/why-its-still-hard-to-get-comfy-with-ifrs-10/

[61] Gallimberti, Marra, Prencipe, Toselli, & Andrea, T. G. (2013). Consolidation preparing and understanding consolidated financial statements under IFRS updates to the new IFRS 10 and 11. Milano: McGraw-Hill.

conjunction with rights that give an investor power over an investee. Acknowledging the fact that the IFRS 10 characterises the principle of 'De Facto Control', power may exist either accounting whether the investor has a majority of voting rights either when an investor has less than 50 per cent of voting rights or other arrangements. In light of what has been explained above, in the introductory part of this chapter, in the majority of circumstances power over an investee is achieved when the investor possesses a majority of the voting rights and has the ability to employ these rights to define the investee's relevant activities, and no other arrangement exists that affects this decision making. On the grounds that voting rights are one of the key features in determining control. Of that kind, determinations can indeed be simple, as in the scenario where power is provided by voting rights, or more complicated, as in the case when voting rights are meaningless and power is provided by contractual rights. In fact, the standard specifies that when voting rights cannot have a major impact on an investee's returns, like whether voting rights relate to administrative tasks only and contractual arrangements determine the direction of the relevant activities, the investor must evaluate those contractual arrangements to establish if it has enough rights to exert power over the investee. On the other hand, when there is less than a majority of voting rights, the investor must examine additional factors and else rights in determining power. In contrast to IAS 27, IFRS 10 focuses on the rights and ability to direct relevant activities that affect returns. Existing rights are required for the investor to have influence. Further to this, power is still defined based on ability, for this reason, it does not need to be exercised.

To create a weighted judgement, the rights of the investor and other parties must be assessed. Diverse kinds of rights, either separately or in combination, might confer power to an investor. Hereafter are provided some examples:

- "Rights in the form of voting rights (or potential voting rights);
- Right to appoint, reappoint or remove key members of the investee's management personnel who have the rights to direct the relevant activities;
- Right to appoint, reappoint or remove another entity that directs the relevant activities;
- Rights to constrain the investee to intro or veto in matters that can benefit the investor;

- Other rights (such as rights written in management agreements) that gives the owner the possibility to direct relevant activities” (Stefan-Duicu, Explaining power over the investee - The rights that give the possibility to directs the investee's relevant activities, 2015).[62]

It is necessary to stress out that potential voting rights are the rights of an investor to obtain voting rights through convertible instruments or options, including forward contracts. An investor should evaluate the purpose and design of the instrument, as well as the purpose and design of any other relationship the investor has with the investee, when assessing potential voting rights. This involves an evaluation of the instrument's multiple terms and conditions, as well as their interaction with other rights owned by the investor and the ability to exercise them when it comes time to make judgments on the relevant activities. These rights must therefore be substantive in order to be considered.

Fundamentally, rights are divided into two categories in IFRS 10 while determining which rights convey the authority to manage the relevant activities of the investee. First substantive rights and second protective rights. Giving a brief definition, ‘Substantive Rights’ are those that grant the bearer the authority to direct relevant activity in the present. ‘Protective Rights’, on the other hand, are rights meant to protect the interests of the investor holding those rights, without granting that party control over the entity to whom those rights pertain. Distinguishing between substantive and protecting rights can have a significant impact in the analysis conducted aiming at identifying which investor, if any, has the unilateral power to control an investee. This is because when assessing control only substantive rights and other rights diverse from protective ones are accepted to confer control. As is noticeable, the bulk of cases in which difficulties are encountered concern precisely the analysis that has as its goal the differentiation and proclamation between protective and substantive.

[62] Stefan-Duicu, A. (2015). Explaining power over the investee - The rights that give the possibility to directs the investee’s relevant activities. Challenges of the Knowledge Society, p. 718-723. Tratto da https://www.proquest.com/scholarly-journals/ex

Substantive Rights

The substantiality of rights is one of the areas on which the standard primarily focuses when describing how to assess power. In practical terms, the IFRS 10 specifies that a right must be a substantive right in order to be deemed a source of power and, thus, control. Thence, when determining whether an investor has power or not, the investor considers only the substantive rights with respect to the investee. "The Exposure Draft of the proposals that preceded IFRS 10 used the term 'participating rights' to refer to rights that confer power on the investor. In developing these proposals, however, the IASB subsequently replaced 'participating rights' with 'substantive rights', which led many to conclude, incorrectly, that substantive rights were exactly the same as participating rights" (IFRS-Foundation, Effect of protective rights on an assessment of control, 2013)[63]. To avoid the confusion that could have resulted from this change in vocabulary, the substantive rights that must be considered are referred in the standard as those owned by the investor and other third parties. In order for a right to be defined as substantive, its owner must be able to exercise it when making pronouncements on the direction of activities that have a substantial impact on returns, but also the owner need to obtain benefits from the use. The term "right" in the IFRS 10 refers to any type of right that might be considered while analysing power. This indicates that these analyses are also required for examining voting rights, as they could not be used when making decisions about relevant activities. "Examples are the voting rights of ordinary shares, if the investor can legitimately vote; if for any reason the voting rights are not exercisable by the investor [...] those rights are not substantive and shall not be considered in assessing control" (Gallimberti, Marra, Prencipe, Toselli, & Andrea, 2013)[64]. When assessing power, only substantive rights that are actually exercisable are taken into account. Even in this scenario, while determining whether the rights are substantive or not, judgement must be applied by reckon with all elements and contexts as well as useful information. The international standard IFRS 10 specifies a set of elements to consider when identifying rights as substantial. However the latter are only partial instances of most recurrent

[63] IFRS-Foundation. (2013). Effect of protective rights on an assessment of control. Tratto da ifrs.org: https://www.ifrs.org/content/dam/ifrs/meetings/2013/march/ifrs-ic/ap11-ifrs-10-protective-rights.pdf
[64] Gallimberti, Marra, Prencipe, Toselli, & Andrea, T. G. (2013). Consolidation preparing and understanding consolidated financial statements under IFRS updates to the new IFRS 10 and 11. Milano: McGraw-Hill.

situations, for this reason are not limited to and the availability of such situations must be determined on a case-by-case basis.
In this process, there are three key suggestions: (1) barriers to exercise, (2) agreements of other parties required, and (3) exercise benefits right holder.

The first consideration is if there are any restrictions, the standard alludes at "barriers", that could impede the owners from exercising their rights. These barriers may or may not be related to the economic sphere. Proof of this stems from financial penalties and incentives which can obstruct people from exercising their rights. Along the lines of, there are times when an exercise or conversion price creates a barrier, "for example, the exercise price of options that would give the holder sufficient voting rights to obtain control of an entity may be deeply out of the money and therefore uneconomic to exercise" (BDO, 2021)[65]. Furthermore, the IFRS 10 indicates that a barrier might result from terms and conditions, such as when the enjoyment of rights is restricted in time. Again, the phenomena of barrier may happen when there is no express procedure in an investee's funding contracts or in the applicable law regarding the exercise of the rights in question. Additionally, because information is critical in measuring control, a barrier may arise if the holder is unable to get it. The standard then adds that there may be a barrier if legal or regulatory constraints limit the holder from exercising rights, the most noticeable case being when a foreign investor is barred from participating in the action. Lastly, in the Appendix B (Application guidance, paragraph B23) of the standard is said that an example of a barrier can be generated by "operational barriers or incentives that would prevent (or deter) the holder from exercising its rights (eg the absence of other managers willing or able to provide specialised services or provide the services and take on other interests held by the incumbent manager)" (IFRS 10 — Consolidated Financial Statements, 2013)[66].

The second scenario is about when the use of rights entails an agreement between more than one individual. Other elements must be considered, as it is standard practice, in order to provide a definite answer to the question of nature of substantive rights. Starting with when the rights are held by more than one person: the number of parties required to agree on the question asking to determine if exercise of the rights is critical in

[65] BDO. (2021). IFRS in Practice 2021/2022 IFRS 10 Consolidated Financial Statements.
[66] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5

establishing whether those rights are substantial. The likelihood is proportional, which means that the greater the number of rights held, the greater the probability that rights are classified as substantial. Thus, the concept of removal rights has to be considered given that they have a stronger possibility of being substantive when exercised by an independent board of directors, compared when exercised individually by a large number of stockholders. In other words, whether or not there is a scheme in place that allows the parties to jointly exercise their rights, whenever they will, must be considered. Further to this, the rights are implied not to be substantive when there is the unavailability of the mechanism that affords the parties with the actual ability to collectively utilize the right.

The final factor to deem, is whether one or more parties, who hold rights, would gain or not from using the rights. There is additionally the concern of whether the party with the right would gain by exercising it. For example, when the instrument is in the money, which means that the instrument presents a profit opportunity due to the relationship that is links, or the holder would benefit in other ways, i.e. "when the holder of these rights would benefit from the exercise by realizing synergies with the investee, then these rights are likely to be substantive" (Deloitte, The control concept in IFRS 10. Ten things investment managers need to know, 2013)[67]. Rights must also be exercisable when judgments concerning relevant activities are made for them to be substantial. When rights are currently exercisable, this will always be the case. However, a right might be substantive even if it is not immediately exercisable but will be when the required activities are carried out.

At this point and later in the chapter, it will be emphasised that the main issues encountered when it comes to rights that confer power concern the determination of whether a right is substantive or protective (they will be analysed below).

As previously indicated, substantive rights can be owned by other third parties, which, by the same way, might discourage an investor from exercising control over an investee. Those rights may prevent the owner to be able to make use of its rights. As illustration, a case can be when another party must approve for a decision to become operative, or when that other party has the authority to veto decisions relating to an investee's relevant activities. "The veto right could block the adoption of any strategic decisions, including approval of the budget and annual review of the business

[67] Deloitte. (2013). The control concept in IFRS 10. Ten things investment managers need to know. Tratto da Deloitte Malta: https://www2.deloitte.com/mt/en/pages/audit/articles/mt-audit-ifrs10-intro.html

plan. The enforcer found that the veto right did not give the issuer power over the relevant activities of the investee, as the issuer could not direct these activities but only block them. The veto right could also not be considered a protective right, since it applied in all circumstances and related to changes which are not only fundamental. Therefore, the issuer did not control the investee but only had significant influence" (European Securities and Market Authority, 2021)[68]. Again, "[…] if the operating budget is detailed and management has little latitude to deviate from the budget. […] because approving the annual operating budget is the activity that most significantly affects the investee's returns, then a veto right over the annual operating budget would be substantive, and is not a protective right" (EY, Challenges in adopting and applying IFRS 10, 2013)[69]. The organization of accounting and consultancy Grant Thornton says that, the assessment should consider matters such as the purpose and design of investee and of the veto right, but also whether the budget-setting process significantly affects the investee's returns considering matters such as the level of detail in the budget or the extent to which the budget determines management's actions and what happens next if the right of veto is used (Grant Thornton, 2017)[70]. Substantive rights held by a third party can preclude an investor from controlling the investee even if the rights only allow the owner to approve or disapprove decisions relating to the relevant activity.

On the other hand, it is important to note that the more individuals who are required to authorise the possibility of exercising the right, the less likely it is that it is a substantive right. Moreover, it is worth noting that relevant activities that are directed by others are not taken into account in the control evaluation, even if the investor has a majority of voting rights. This is due to the fact that the investor's rights are not deemed meaningful. However, this does not preclude an investor from exercising influence over a company that is subject to the direction of a government, court, or administrator. Instead, it is required to determine if such directive results in the government, court, or administrator having authority over the most important relevant operations. As a result, while the guidance in IFRS 10 may appear to be definitive at first glance, judgement is nevertheless necessary.

[68] European Securities and Market Authority. (2021). Report On the application of IFRS 10, IFRS 11 and IFRS 12. Tratto da ifrs.org.
[69] EY. (2013). Challenges in adopting and applying IFRS 10.
[70] Grant Thornton. (2017). Under control? A practical guide to applying IFRS 10 Consolidated Financial Statements. Tratto da https://www.grantthornton.ie/globalassets/1.-member-firms/ireland/insights/publications/grant-thornton---ifrs-10-financial-statements.pdf

Protective Rights

By the same token, in order to decide if particular rights provide the investor power over the investee, the investor must first assess whether its own rights or the rights of others are protective or not. However, protective rights, in contrast to substantive rights, are explicitly defined in the Appendix A of IFRS 10 as "rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate" (IFRS 10 — Consolidated Financial Statements, 2013)[71]. Protective rights are a novelty introduced by the IASB. These are rights that are solely intended to protect an investor when the investee's activities are subject to substantial changes as a response of unforeseen occurrences, for which the investment may experience severe effects. This actively demonstrates that the aforementioned category of rights may be confined to major changes in activity of the investee or may be utilised only in extraordinary circumstances. Even if it is repetitive, it is worth emphasising that the two characteristics that distinguish a right to be protected are: connection with fundamental changes in the investee's activities and application in unusual events. Moreover, "taking into consideration the nature of the protective rights, an investor that only holds protective rights cannot own the power and cannot prevent another party to hold the power over an investee" (Stefan-Duicu, Explaining power over the investee - The rights that give the possibility to directs the investee's relevant activities, 2015)[72]. Because of this, the holder of these rights has no capacity to influence relevant activities or to prevent another investor from acting likewise. It has to be mentioned that, the applicability of rights in specific circumstances does not give automatically the label of "protective" and of similar importance it has to be highlight that protective rights are not the opposite of substantive rights. Even in this scenario, the IFRS 10, in like manner, suggests some factors that can help standard preparers and users of the IFRS 10 in assessing the existence of power. "Protective rights include: (a) lender's rights to restrict borrower's activities that adversely affect its credit risk to the lender's detriment; (b) rights of a non-controlling shareholder to approve exceptional capital expenditure or debt/equity issues; and (c) rights of a lender to seize assets upon default"

[71] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5

[72] Stefan-Duicu, A. (2015). Explaining power over the investee - The rights that give the possibility to directs the investee's relevant activities. Challenges of the Knowledge Society, p. 718-723. Tratto da https://www.proquest.com/scholarly-journals/ex

(PricewaterhouseCoopers, 2011)[73]. Giving consideration to the example c, in some situations, a right, such as the potential to sell the investee's assets if the investee defaults on a loan, may be regarded protective when the default is considered an unusual occurrence. However, if the investee defaults on a loan, the investor holding that right must re-evaluate whether that right has become a substantive right, rather than a protective right, in light of the changed facts and circumstances. It has been opened a debate with respect to this case study, in September 2013, the IFRS Interpretations Committee examined this subject and issued an agenda decision. "The Interpretations Committee concluded that reassessment is required when facts and circumstances change in such a way that rights, previously determined to be protective, change. For example, when breach of a covenant in a borrowing arrangement causes the borrower to be in default" (EY, Challenges in adopting and applying IFRS 10, 2013)[74].

Another case in point of a protective right included in Appendix B, of IFRS 10, is that found in franchise agreements. In this regard, the concept indicates that such agreements frequently grant the franchisor the right to preserve the brand but do not grant the franchisor rights that would materially influence the franchisee's outcomes. "When the franchisor's decision-making rights relate to the franchisee's relevant activities, it may be challenging to distinguish protective rights that protect the franchise brand, from substantive rights to direct activities that significantly affect the franchisee's returns" (Accounting Standard Council Singapore, 2021)[75]. Therefore when determining whether a franchisor has authority over a franchisee, the purpose and design of the franchisee must be acknowledged. The AASB, the independent accounting standard-setter based in Australia states that in actuality, it is not uncommon for franchisors to direct the majority of the operations, and if the decision-making powers are regarded substantive, this would contradict the guidance's conclusions. "However, while a franchisor may appear to control a franchisee, stakeholders suggested it is either uncommon for franchisees to be consolidated or at best there are inconsistencies in this regard. This is because the guidance in IFRS 10 is not clear as it states that franchisor

[73] PricewaterhouseCoopers. (2011). Practical guide to IFRS Consolidated financial statements: redefining control At a glance. Tratto da Pwc.com: https://www.pwc.com/jp/ja/ifrs/publication/pwc/2011/assets/pdf/201107-03.pdf
[74] EY. (2013). Challenges in adopting and applying IFRS 10.
[75] Accounting Standard Council Singapore. (2021). Response to request for information on post-implementation review of IFRS 10 consolidated financial statements, IFRS 11 joint arrangements and IFRS 12 disclousure of interests in other entities. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28346_SuatChengGohSingaporeAccou

rights are normally protective" (Australian Accounting Standard Board, 2021)[76]. The relevant activities and which investor now has the ability to direct that activity through its rights are used to determine whether a franchisor has power. The franchisor's rights must be analysed to determine whether they are substantive or protective rights, as well as based on the different occurrences, a decision must be made in each case.

2.2.3. Power Without A Majority Of Voting Rights

"Guidance on de facto control introduced in IFRS 10 is a significant change. IFRS 10 states explicitly that consolidation can happen even when an investor owns less than a majority of the investee's voting interest" (Gornik-Tomaszewski & Larson, 2014)[77]. Hence, in an hypothetical circumstance where there are two businesses, A and B, business A owns 40% of the equity in company B, the definition could result in company A being declared the controlling entity. As anticipated in the first chapter of this paper, the concept of control can be exerted in two different way: "de jure" control, that implies it arises from only the investors having the majority of voting rights, in opposition to "de facto" control that recognizes the control over an investee despite the fact that the investor possess the majority.

The characteristic of de jure control can be seen in the principles adopted by the US GAAP, a differentiating indicator that identifies the two factions of international standards. In addition, in the previous standard regulating consolidation process, IAS 27, there was no precise reference to de facto control, "in October 2005 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" (IFRS Foundation)[78]. Therefore, in the Exposure Draft the Boards made a special reference to this notion. Also in the Basis for Conclusion it is stated that some respondents to the ED raised the question of other models of control, based for example on contractual

[76] Australian Accounting Standard Board. (2021). Request for Information—Post-implementation Review of IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28349_KimberleyCarneyAustralianAccountingStandardsBoard_0_AASBLetterToIFRS_SubPIRIFRS101112.pdf
[77] Gornik-Tomaszewski, S., & Larson, R. (2014). New consolidation requirements under IFRS. 35. Tratto da https://link.gale.com/apps/doc/A401904817/AONE?u=anon~adc914b4&sid=googleScholar&xid=c305c1bb
[78] IFRS Foundation. (n.d.). Basis for Conclusions on IFRS 10 Consolidated Financial Statements. Retrieved from https://www.masb.org.my/pdf.php?pdf=FRS10_BC.pdf&file_path=pdf

agreements. However, even if the Board decided to take into consideration the opinions expressed to in order to evaluate the most suitable scenario, the final consideration was drawn acknowledging the fact that placing a restriction only to the majority of voting rights to confer power would have cause difficulties in reaching the same conclusion because of the differences in legal requirements concerning this subject in various jurisdictions. Whereon, this new view on control also constitute a novelty introduced by the new standard. As a consequence the IFRS 10 contains, for the first time, the adjective "de facto" in order to refer to situations in which an investor with less than 50% of the voting rights has rights that are sufficient to give him/her power.

In the moment of considering the investor's rights over the investee's relevant activities, one important factor to consider is the existence of a combination of rights and agreements. As previously demonstrated, the right can arise from a variety of sources, such as the investee's ownership emanated from the majority of voting rights or from specific contracts that grant this ability. According to Appendix B to Paragraph 38, this particular occurrence of control is possible due to:

a) "a contractual arrangement between the investor and other vote holders (see paragraph B39);
b) rights arising from other contractual arrangements (see paragraph B40);
c) the investor's voting rights (see paragraphs B41–B45);
d) potential voting rights (see paragraphs B47–B50); or
e) a combination of (a)–(d)" (IFRS 10 — Consolidated Financial Statements, 2013)[79].

The first example the standard refers to is about contractual agreements that the investor stipulates with other vote holders. This particular typology of contract can allow the investor owner of the agreement to obtain the right to exercise the entitlements in a fashion adequate to bestow power, even if the investor does not meet the minimum amount required to be considered a majority shareholder. Proving some instances is useful to concretize to what the provisions of IFRS 10 refers to. Contractual arrangements with others vote holders can result in a situation in which the settlement make the investor influence and direct the other parties to behave in certain ways when there is a call for voting on matters linked to the direction or exercise of relevant activities. This is because relevant activities are the paramount element to consider in conjunction

[79] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5

and in relation to right in order to gain power and thus control. This fact can be further confirmed by another example which can be found in "[…] the scenario where a contract enables an investor to require enough other vote holders in that investor's favour when decision about relevant activities are made" (Yumpu.com, 2022)[80].

Keeping with the analysis of the aforementioned aspects, the second point (b) of the list is closely related to the first and states that additional contractual arrangements, when combined with voting rights, can give rise to the capacity to direct the relevant activities. Proof of this may be the specimen where voting rights combined with other agreements can provide the investor with additional power with the aim of managing some investee's strategic activities which can be related to production processes or to financial activities. This rights are referred throughout the official document of the IFRS 10 as "other decision-making rights" due to the explanation just given. Furthermore, the international standard specifies that "in the absence of any other rights, economic dependence of an investee on the investor (such as relations of a supplier with its main customer) does not lead to the investor having power over the investee" (IFRS 10 — Consolidated Financial Statements, 2013)[81].

Point (c) is of particular importance because is the pure definition of 'de facto control', as the sentence clearly states. "Under the de facto control concept, an entity holding a noncontrolling interest may control another entity in the absence of any formal arrangements that would give it a majority of the voting rights. Two common examples of de facto control […] are when other shareholdings are widely dispersed, or when a sufficient number of other shareholders regularly fail to exercise their rights as shareholders […] such that the noncontrolling interest shareholder wields the majority of votes actually cast" (EY, US GAAP/IFRS accounting differences identifier tool, 2021)[82]. When considering voting rights, those rights independently give the possibility to the investor to direct the major activities of the investee although not having the majority of voting right. In the instance of considering which rights can be considered to exercise control in this context, the standard shows some key characteristics to observe in order

[80] Yumpu.com. (2022). need to know / ifrs 10 consolidated financial statements - BDO International. Tratto da yumpu.com: https://www.yumpu.com/en/document/read/38488427/need-to-know-ifrs-10-consolidated-financial-bdo-international

[81] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5

[82] EY. (2021). US GAAP/IFRS accounting differences identifier tool. Tratto da ey.com: https://www.ey.com/en_us/assurance/accountinglink/us-gaap-ifrs-accounting-differences-identifier-tool---january-200

to draw conclusions. “A list of circumstances which a firm with non-majority ownership needs to consider to determine if it has sufficient power are provided in paragraph B42 of the standard. These circumstances include: ‘the size of the investor’s holding of voting rights relative to the size and dispersion of holdings of the other vote holders’” (Bedford, A., Bugeja, M. and Ma, N., 2022)[83]. Nonetheless, it has to be pointed out that, when considering the size it can be seen a sort of proportionate mechanism for the investor between possessing voting rights and the likelihood of those rights to give currently directing capabilities. In addition, there is also the same mechanism tied to rights relative to other vote holders or connected to the range of shareholders that would require to behave in concert to outvote the investor.

The standard's criteria for assessing de facto control continue with the evaluation of potential voting rights. “The investor should consider not only the potential rights held by it, but also the potential voting rights held by other parties. Paragraph B50 of IFRS 10 gives guidance to this subject considering that the potential voting rights are only measured when they are substantive and “alone, or in combination with other rights, can give an investor the current ability to direct the relevant activities”” (Morgado, 2013)[84]. In the precedent section it has been mentioned the importance in decree whether rights are substantive, because only those can give the power to the investor. IFRS 10 also requires that the purpose and design of the party involved in the analysis other than the investor, as well as any other relationship, be considered. However, “there is little guidance on the relative size and dispersion of holdings of the other vote holders that can prove or disprove that an investor has the practical ability to direct an investee’s relevant activities unilaterally” (Accounting Standard Council Singapore, 2021)[85].

In conclusion there is the provision to consider again if there are some contractual agreements or rather, “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

[83] Bedford, A., Bugeja, M. and Ma, N. (2022). The impact of IFRS 10 on consolidated financial reporting. . Account Finance, 62, p. 101-141. Tratto da https://doi.org/10.1111/acfi.12782
[84] Morgado, M. (2013). Effect analysis on the application of IFRS 10 compared with the IAS 27.
[85] Accounting Standard Council Singapore. (2021). Response to request for information on post-implementation review of IFRS 10 consolidated financial statements, IFRS 11 joint arrangements and IFRS 12 disclousure of interests in other entities. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28346_SuatChengGohSingaporeAccou

decisions need to be made, including voting patterns at previous shareholders' meetings" (IFRS 10 — Consolidated Financial Statements, 2013)[86].

One of the first concerns that could result by looking at these indications of the standard is that "according to paragraph B38, an investor can have power even if it holds less than a majority of the voting rights of an investee through (a)-(d). However, if several investors can have power through a combination of (a)-(d), it is not clear which investor's rights should be considered as a priority" (Korea Accounting Standards Board (KASB), 2021)[87]. The Korean body of accountants also argues that the standard has a lack of providing qualitative details regarding the determination of this de facto control which could provide to a better determination of power. In particular they asset this in relation to the word "size" that can be found throughout the IFRS 10's section dedicated to power without a majority of voting rights. Moreover, it is worth mention that in order to evaluate the control, investors or companies need to obtain information. "In the case of a listed investee, the information [...] can usually be obtained easily; however, [...] in the case of an unlisted investee, obtaining the information necessary for the assessment and continuous monitoring is more complex [...] (Accounting Standards Committee of Germany, 2021)[88]. On the other hand, comparing to the other notions that IFRS 10 portrays, the one of de facto control seems not creating dissonances as for the majority of consolidated financial statements preparers. Research suggests that the reason might be reflecting the fact that, since this new type of control was firstly provided by this International Accounting Standard Board, in the moment of issuing this new idea, it was deeply analysed by the Board itself and experts called to discuss this topic and, therefore, useful guidance on de facto control was published. Nonetheless, Generalova Natalia affirms in one of its publication that "however, the authors of the current publication have not found empirical study,

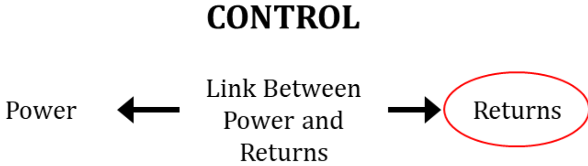
[86] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5

[87] Korea Accounting Standards Board (KASB). (2021). Request for Information, Post-implementation Review of IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28362_HyejinJungKASB_0_KASB_RFI.pdf

[88] Accounting Standards Committee of Germany. (2021). IASB Request for Information on the Post-implementation Review of IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, and IFRS 12 Disclosure of. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28381_SvenMorichDRSCeVASCGAccountingStandardsCommitteeofGermany_0_210510_CL_ASCG_IASB_PiR_IFRS1012_RfI.pdf

which is entirely devoted to the problem of determining "factual"[89] control on the basis of the professional judgement. As a result of the literature review, the authors of the current publication concluded that it is necessary to carry out empirical research in the application of the concept of "factual control" in accounting practice" (Generalova, 2019)[90]. This assertion shows that more comprehensive research is needed, both on a literary and practical level, to determine which subjects demand more investigation.

2.3. Exposure to Variable Returns



If the right attention is paid, it is possible to note that the theme of returns is employed in two control pillars. "In order to have power over an investee an investor must have the current ability to direct the relevant activities, i.e. 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" (IFRS Foundation)[91]. Comparing the concept with the previous regulation it is possible to discover that little changes has been made. Proof of this are the two parts of IAS 27 and SIC 12 in which, respectively, "IAS 27 refers to obtaining 'benefits' which can be interpreted as ownership benefits. [...] SIC 12 refers to majority of the benefits" (Yumpu.com, 2022)[92]. As a result, as it can be seen, the new standard does not include significant distinctions, but rather attempts to provide a broad definition.

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[89] It has to be noted that in this case de facto control is called 'factual' control. This can contribute to create further confusion.

[90] Generalova, N. (2019). Conceptual transformation of "de facto" control in preparing consolidated financial statements: the experience of Russian companies. Advances in Economics, Business and Management Research, 104. doi:https://doi.org/10.2991/ies-18.2019.28

[91] IFRS Foundation. (n.d.). Basis for Conclusions on IFRS 10 Consolidated Financial Statements. Retrieved from https://www.masb.org.my/pdf.php?pdf=FRS10_BC.pdf&file_path=pdf

[92] Yumpu.com. (2022). need to know / ifrs 10 consolidated financial statements - BDO International. Tratto da yumpu.com: https://www.yumpu.com/en/document/read/38488427/need-to-know-ifrs-10-consolidated-financial-bdo-international

The second of the three pillars of the control theory is linked to the concept of returns. The prerequisite for an investor to have management over an investee is that the investor be exposed to, or have rights to, varying returns deriving from the involvements with investee. First and foremost the IFRS 10 precises what it is intended when users are dealing with variable returns. Accordingly, “variable returns are defined as returns that are not fixed and have the potential to vary as a result of the performance of an investee” (PricewaterhouseCoopers, 2011)[93]. Furthermore, when describing the particular returns on which it concentrates, the standard establishes a specification. “Variable returns can be only positive, only negative or both positive and negative. Variable returns are therefore defined very broadly and extend well beyond the ownership benefits obtained through equity shares” (Grant Thornton, 2017)[94]. The concept of returns within the standard is more broadly defined with respect to the previous ordinance. However, it has to be asserted that, IFRS 10 includes, as usual, a list of examples that can be considered whenever the investor needs them. Three main classifications are presented in the standard. Firstly are “dividends, other distributions of economic benefits from an investee (e.g. interest from debt securities issued by the investee) and changes in the value of the investor’s investment in that investee” (IFRS 10 — Consolidated Financial Statements, 2013)[95]. Proof of that can be the instance in which supposing the investor owns a bond with fixed interest payments; to explain the choice of considering them variable is the fact that these payments are regarded an exposure to fluctuating returns because they are subject to default risk as well as they expose the owner to the issuer's credit risk. Second variety of return comprehends “remuneration for servicing an investee’s assets or liabilities, fees and exposure to loss from providing credit or liquidity support, residual interests in the investee’s assets and liabilities on liquidation of that investee, tax benefits, and access to liquidity that an investor has from its involvement with an investee” (EY, IASB issues three new standards: Consolidated Financial Statements, Joint Arrangements, and Disclosure of Interests in Other Entities,

[93] PricewaterhouseCoopers. (2011). Practical guide to IFRS Consolidated financial statements: redefining control At a glance. Tratto da Pwc.com: https://www.pwc.com/jp/ja/ifrs/publication/pwc/2011/assets/pdf/201107-03.pdf
[94] Grant Thornton. (2017). Under control? A practical guide to applying IFRS 10 Consolidated Financial Statements. Tratto da https://www.grantthornton.ie/globalassets/1.-member-firms/ireland/insights/publications/grant-thornton---ifrs-10-financial-statements.pdf
[95] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5

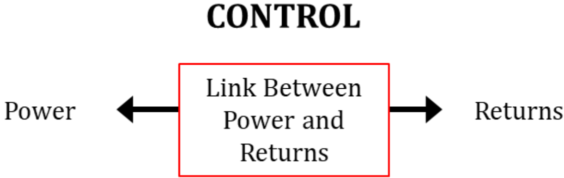
2011)[96]. Taking into consideration fees, they are identified as variable given that they expose the investor to the investee's performance risk and, even more, the degree of unpredictability is determined by the investor's capacity to generate enough money to cover the fee. To conclude with the third category analysed by the international standard, the Board decided to give debate on "returns that are not available to other interest holders. For example, an investor might use its assets in combination with the assets of the investee, such as combining operating functions to achieve economies of scale, cost savings, sourcing scarce products, gaining access to proprietary knowledge or limiting some operations or assets, to enhance the value of the investor's other assets" (IFRS 10 — Consolidated Financial Statements, 2013)[97]. Until now, reference has always been made to returns generated by the actions of the investor. However, when identifying an exposure to variable returns, the standard advises that, in addition to returns generated directly by the investee, other returns received by the investor from that involvement are also taken into account. This is thereby influenced by the investee's purpose and design.

On the whole, it has been clearly stated that control can be generated from returns, "this is because the greater an investor's exposure to the variability of returns from its involvement with an investee, the greater the incentive for the investor to obtain rights that give the investor power. However, the magnitude of the exposure to variable returns does not determine whether the investor holds power" (EY, Challenges in adopting and applying IFRS 10, 2013)[98]. Keeping this in mind, it should be underlined that the IFRS 10 meant to reflect on the occurrence of an exposure to variable returns rather than the extent of the exposure to variable returns.

Besides it can be reckon that, the Board pointed out that, in the moment of assessing the returns, an investor evaluates whether and how variable returns from an investee are based on the substance of the arrangement and regardless of the legal form of the returns. This can be discovered in the example of the bond furnished above, because the returns, if considering only the legal from are to be classified as fixed, however, in the end they are considered variables seeing that their capability to affect risks.

[96] EY. (2011). IASB issues three new standards: Consolidated Financial Statements, Joint Arrangements, and Disclosure of Interests in Other Entities. Tratto da ey.com.
[97] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5
[98] EY. (2013). Challenges in adopting and applying IFRS 10.

2.4. Link Between Power and Returns



IFRS 10 establishes that the notion of control requires a relationship between power over an investee and exposure to variable returns from involvement with the investee. Ergo, the third control's indispensable condition, as the illustration shows, is that the investor must be able to use its power over the investee to influence the magnitude of the investor's returns. To control the investee, investors need more than just 'power', over the investee, and/or 'exposure to variable returns'. "In particular, the standard wants to make sure that power is held only by the ultimate effective controller of the investment" (Gallimberti, Marra, Prencipe, Toselli, & Andrea, 2013)[99].This is actively demonstrated by the following scenario. Given that an investor having power over an investee, but having also the impossibility to benefit from that influence, it results that the investor does not have control over that investee. Likewise, if an investor who has exposure to a variable return from an investee but at the same time does not have the capacity to direct those activities that have the greatest impact on the investee's returns, therefore the investor does not gain control over that investee. However, it is useful to mark that "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" (IFRS Foundation)[100].

When it comes to the connection that occurs between power and returns, the standard corresponds to the relationship that forms between reporting entity and investee. More specifically, this form of relationship is classified as an agency relationship according to the standard.

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[99] Gallimberti, Marra, Prencipe, Toselli, & Andrea, T. G. (2013). Consolidation preparing and understanding consolidated financial statements under IFRS updates to the new IFRS 10 and 11. Milano: McGraw-Hill.
[100] IFRS Foundation. (n.d.). Basis for Conclusions on IFRS 10 Consolidated Financial Statements. Retrieved from https://www.masb.org.my/pdf.php?pdf=FRS10_BC.pdf&file_path=pdf

2.4.1. Agency Relationship

Agency theory has gained a lot of interest in subjects like economics, finance, organisational behaviour, sociology, political science, and marketing due to its versatility. For the purpose of the analysis concerning the link between power and returns, it useful to have a brief digression throughout the topic of agency relationship. The term relationship suggests that there are at least two part that have a connection. In facts, as a rule, the two characters are defined as follow. On one hand, there is the agent that is an individual or a firm who is recruited to fulfil some orders or represent the other party in businesses with a third person. On the other hand, the principal is the individual, or firm, who appoints a task to the above-stated party and is legally responsible for the behaviours performed by the agent. Therewith stems the first definition of agency relationship depicted as a contract between two persons, agent and principal, in which the first acts on behalf of the second with the aim of providing services with a delegated decision-making authority.

Aside from acting and making decisions strictly related to job performance, the agent has some other responsibilities such as:

- Duty of care: an agent has an obligation to act with common sense. In brief, an agent must operate in the same way as a rational person would in the same situation.
- Duty to provide information: An agent owes it to the principal to supply all necessary and truthful information in his or her disposal.
- Duty to obey instructions: an agent must obey his/her principal's instructions otherwise the principal will charge him/her of acting illegally or unethically. However, if the instructions proposed are illegal, the agent can refuse to follow them.
- Duty of loyalty: Every agent has a fiduciary duty to act loyally towards the principal. This fidelity must be implemented in all work domains. Furthermore, the agent must then keep secret information protected.

Additionally, an agent may not receive profits unless the principal is aware of them and approves of them, plus an agent may not act for two principals whose interests conflict unless otherwise established by the contract. Again, agents must not compete with their principal. Eventually, an agent may refrain from engaging in inappropriate behaviour that reflects negatively on the principal. This restriction applies even to off-duty behaviour that manifests after the agent's service is completed.

The principal, on the other hand, has some commitments in addition to handing power to agents and rewarding them.

- The obligation to provide reimbursement that has been agreed upon: the compensation must be in line with and coherent with the work given to the agent.
- Collaborative duty: In order to establish a successful relationship, the principal must work as a team with the agents and provide them with useful information.

Finally, because the principal is liable for the activities of the agents, the principal must compensate the agent for the consequences of the acts.

Literature associates and adjective to this form of collaboration, notably "fiduciary", on the grounds that the principal recognize a special confidence in the agent who, in turn, is required to behave honestly, putting his own needs in the background. The goal of a fiduciary partnership is for one person to benefit another, and as previously mentioned, both parties have duties to uphold. However, it has to highlight that if both agent and principal are will to maximize its utility it could be expected that the agent will not always act in the best interests of the principal. "Agency theory is economics oriented (e.g., relationships based solely on economic motivations), and the underlying assumption is that agents and principals seek self-interest and therefore, may act opportunistically" (Ahola & Matias & Martinsuo, 2021)[101].

The importance of an analysis of this subject lies in the two most frequent problems that arise from this relationship. These problems are related to the probability that the agent will not act on behalf of the principal in some occurrences. First category is called adverse selection. Generally the concept of adverse selection refers to the possibility of having different information when two parts relates, this mechanism is also called asymmetric information. If the topic is contextualized within the scope of analysis of this study, adverse selection, in this case, refers to obstacles that exist prior to the beginning of the agency relationship, such as reliably appraising the agent's capabilities and intentions because It is frequently difficult to obtain reliable information regarding agent candidates. Thus, in this context the asymmetry of information hang more onto the principal. The other challenge normally happens during the engagement of the two parties, namely moral hazard. "Moral hazard is the risk that a party has not entered into a contract in good faith or has provided misleading information about its assets, liabilities,

[101] Ahola, T. &., & Matias & Martinsuo, M. (2021). Agency relationships of project-based firms. International Journal of Project Management, 39. doi:10.1016/j.ijproman.2021.06.005

or credit capacity" (Moral Hazard Contemplates Unusual Business Risks That Have No Consequences, 2020)[102]. While transferring this theme to the agency relationship, it has to be noted that moral hazard is linked to "how the agent's performance should be evaluated and rewarded when it is acting on the behalf of its principal and how the principal may protect itself from malfeasance by the agent" (Ahola & Matias & Martinsuo, 2021)[103].

2.4.2. Principal and Agent in IFRS 10 and 'De Facto Agent'

It has been aforementioned that in the agency relationship there are two parties that interacts with each other, namely principal and agent. In accordance with the provisions of the International Financial Reporting Standard 10, when such relationship occurs an investor has to evaluate if he/she is considered an agent or if he/she acts as a principal. Therefore "when an investor with decision-making rights (a decision maker) assesses whether it controls an investee, it shall determine whether it is a principal or an agent" (IFRS 10 — Consolidated Financial Statements, 2013)[104].

Among the international standards issued by the IASB, the IFRS 10 has been the first to explore this topic. IAS 27 and SIC-12 did not provide rules or directives for determining in which cases an investor can be considered an agent or principal. In fact, this lack of guidelines has allowed for divergence. As a result, the International Accounting Standard Board decided to adopt some principles addressing agency interactions in order to reduce this gap.

In order to describe this collaboration, and thus give the definition of agency relationship, the Board in the Basis for Conclusion document utilizes one of the primary depictions of this subject given by Jensen and Meckling in the 70s. "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" (Jensen & Meckling, 1976)[105]. By looking at this definition

[102] Moral Hazard Contemplates Unusual Business Risks That Have No Consequences. (2020). Tratto da Investopedia: https://www.investopedia.com/terms/m/moralhazard.asp
[103] Ahola, T. &., & Matias & Martinsuo, M. (2021). Agency relationships of project-based firms. International Journal of Project Management, 39. doi:10.1016/j.ijproman.2021.06.005
[104] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5
[105] Jensen, M., & Meckling, W. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. Journal of Financial Economics, 3(4), p. 305-360. Tratto da https://www.sciencedirect.com/science/article/pii/0304405X7690026X

it can be appreciated what are the key characteristics to account for when assessing the roles an entity can assume in the agency relationship. First of all the main distinction between the principal and the agent, as stated in the preceding section, lies in the purpose of the performance. The agent acts on behalf of the principal, whereas the latter acts of its own behalf. Moreover the other significant element is the decision-making condition.

Starting the analysis of the agency relationship within the IFRS 10, it is useful to have a look at the definitions provided to depict the two actors of the relation. It follows that, for the standard, the principal or investor, is the one with decision making powers not subordinated by others. To say it in another way, the investor, generally characterized as the "decision-maker", has the right to control the investee if and only if it takes decisions independently, rather than through the commission of third parties. “An investor will be considered a principal if the investor is able to use its rights to influence returns. This means that the investor is required to consolidate the investee because they meet all three criteria” (BDO, 2021)[106]. On the other hand, “an agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)) and therefore does not control the investee when it exercises its decision-making authority” (IFRS 10 — Consolidated Financial Statements, 2013)[107]. This definitions says that the agent's figure is framed as being the subject designated with the responsibility to make decisions on the best interest of another only based on the previous establishment of right to do so. However, it is of paramount importance to highlight the fact that when the entity is acting on behalf of the principal “an agent does not control an investee when it exercises decision-making rights delegated to it” (Deloitte, The control concept in IFRS 10. Ten things investment managers need to know, 2013)[108]. Furthermore, contrary to the principal, the agent cannot consolidate the investee because it does not fulfil the three attributes of control, indeed it lacks the link between power and returns.

[106] BDO. (2021). IFRS in Practice IFRS 10Consolidated Financial Statements.
[107] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5
[108] Deloitte. (2013). The control concept in IFRS 10. Ten things investment managers need to know. Tratto da Deloitte Malta: https://www2.deloitte.com/mt/en/pages/audit/articles/mt-audit-ifrs10-intro.html

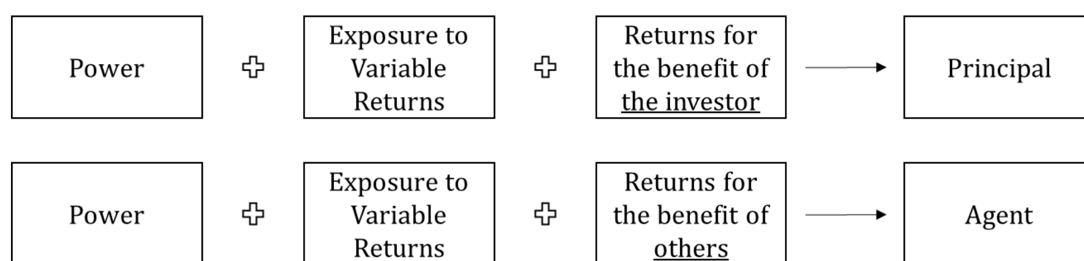

Figure 2. Principal-Agent Arrangement. Personal elaboration of data from BDO, IFRS in Practice. IFRS 10 Consolidated Financial Statements (BDO, 2021)[109].

When it comes to determining whether a decision maker is a principal or an agent, following the requisites showed in the Figure 2, it is not as simple as it may appear. The fact that others may profit from the decisions made and the duty to behave in someone else's best interests are not elements that can be used to identify an agent on their own. As a result of these potential concerns, the standard serves as a guide for investors examining their position. The following elements must be considered in detail, an agent shall assess the overall relationship between itself, the managed investee, and the other parties engaged with the investee.

a) "the scope of its decision-making authority over the investee (paragraphs B62 and B63).
b) the rights held by other parties (paragraphs B64–B67).
c) the remuneration to which it is entitled in accordance with the remuneration agreement(s) (paragraphs B68–B70).
d) the decision maker's exposure to variability of returns from other interests that it holds in the investee (paragraphs B71 and B72)" (IFRS 10 — Consolidated Financial Statements, 2013)[110].

The first criterion requires the investor to evaluate the ultimate goal of the decisions that must be made. To accomplish this, the investor must carry out an analysis of the actions that must be undertaken, with the standard requiring the investor to account for all decision-making activities related to the agreements highlighted with the investee and mandated by regulations. Besides that, when selecting on activities, the investor must consider judgments on them. Following the definition of control, the reporting entity, and therefore the principal need to have rights that give the current ability to exercise control over the investee's relevant activities. This means that

[109] BDO. (2021). IFRS in Practice IFRS 10Consolidated Financial Statements.
[110] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5

decision-making rights must be examined in order to determine whether they confer power over relevant activities. “If a decision-maker has been delegated rights that do not relate to the relevant activities it would not control the investee” (EY, Challenges in adopting and applying IFRS 10, 2013)[111]. Hence the investor will be deemed an agent in this situation. For this reason, the IFRS 10 goes on pointing out that, in addition to the two decision-making qualities listed above, an investor should examine other factors to achieve a more appropriate classification. The latter include, as is common, the purpose and design of the investee, as well as the risks to which it is exposed, together with the amount of risk that can be transferred to other parties if they become associated with the investee. Lastly, there has to be account for also the level of involvement of the investor within the design of the investee. It should be mentioned in relation to this final component that “significant involvement in the investee’s design may indicate that the decision-maker had the opportunity and incentive to obtain rights that result in the ability to direct the relevant activities” (Grant Thornton, 2017)[112].

Second, the standard states that, when evaluating the principal or agent position, it is appropriate to recognize the rights held by other parties. “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” (IFRS Foundation)[113]. The particular reason is because, as provided throughout this chapter, substantive rights can prevent power over investee, therefore if other parties, involved with the subsidiary, own substantive rights, the latter can restrict the decision making authority over relevant activities of the controlled entity. If this occurs, the investor is identified as an agent because of the inability to exert control over the party holding substantive rights. Particular attention has to be paid with respect to removal rights. As reported in the definitions in the first chapter, removal rights are a specific example of this type of substantive rights. With removal (or kick-out) rights, a situation arises in which, if such rights are owned by only one party and thus has the ability to remove the entity with decision-making powers. The one who holds this substantive right is regarded the

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[111] EY. (2013). Challenges in adopting and applying IFRS 10.
[112] Grant Thornton. (2017). Under control? A practical guide to applying IFRS 10 Consolidated Financial Statements. Tratto da https://www.grantthornton.ie/globalassets/1.-member-firms/ireland/insights/publications/grant-thornton---ifrs-10-financial-statements.pdf
[113] IFRS Foundation. (n.d.). Basis for Conclusions on IFRS 10 Consolidated Financial Statements. Retrieved from https://www.masb.org.my/pdf.php?pdf=FRS10_BC.pdf&file_path=pdf

principal, and the decision maker is the agent. For instance, "if an independent Board of Directors (or governing body), which is appointed by the other investors, holds a right to remove without cause, that would be an indicator that the decisionmaker is an agent" (EY, Challenges in adopting and applying IFRS 10, 2013)[114]. However, the outcome varies if the removal rights are owned by more than one person. In this situation, in addition to a more in-depth analysis, it is necessary to remember that "the greater the number of parties required to act together to exercise rights to remove a decision maker and the greater the magnitude of, and variability associated with, the decision maker's other economic interests (i.e. remuneration and other interests), the less the weighting that shall be placed on this factor" (IFRS 10 — Consolidated Financial Statements, 2013)[115]. In other words, if more investors have the right to remove a decision maker without damage other, the less likely it is that they will utilise it, making it difficult to discern whether the decision maker is a principle or an agent. One concern that arise, with a practical view, linked to substantive rights is that "while these examples do illustrate some common scenarios, in practice, it is often not as clear whether rights held by other parties are substantive or protective [...]" (Australian Accounting Standard Board, 2021)[116]. Besides, other considerations appear to need to be accounted for. As a side effect, when assessing the rights held by other parties, examining the rights enforceable by an investee's management board or other governing bodies and their impact on decision-making authority, must be considered.

Proceeding with the elements that characterize the assignment of principal or agent, there is an economic point of view, the one of the remuneration. In a basic sense, IFRS 10 defines the principal as the figure who has a remuneration that increases with the entity and the variability linked with the returns that the investor has related to the projected returns of the investee's relevant activities. Furthermore, the standard proposes two necessary conditions to be taken into consideration when, with reference to remuneration, it is necessary to decide which role the investor is covering. "[...] A decision-maker cannot be an agent unless remuneration:

[114] EY. (2013). Challenges in adopting and applying IFRS 10.
[115] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5
[116] Australian Accounting Standard Board. (2021). Request for Information—Post-implementation Review of IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28349_KimberleyCarneyAustralianAccountingStandardsBoard_0_AASBLetterToIFRS_SubPIRIFRS101112.pdf

- is commensurate with the services provided; and
- includes only terms, conditions or amounts that are customarily present in arrangements for similar services and level of skills negotiated on an arm's length basis" (Grant Thornton, 2017)[117].

However, as usual, the investor need to make a deeper judgment, also considering other factors and circumstances.

Finally, the investor's exposure to the variability of returns from other interests that it holds, contributes to the identification of the investor as a principal or agent. "A decision maker [...] may, in addition to or instead of receiving remuneration for services, hold other interests in an investee (such as an investment in the investee) or provide guarantees with respect to the performance of the investee" (BDO, 2021)[118]. For this reason, the decision maker is required to consider its exposure to variable returns from all sources. "IFRS 10 states that if a decision-maker has interests in an investee, just by virtue of holding those other interests, the decision-maker may be a principal" (IFRS 10 — Consolidated Financial Statements, 2013)[119]. Moreover, the standard provides some aspects to account for during evaluation phase:

a) "the greater the magnitude of, and variability associated with, its economic interests, considering its remuneration and other interests in aggregate, the more likely the decision maker is a principal.
b) whether its exposure to variability of returns is different from that of the other investors and, if so, whether this might influence its actions. For example, this might be the case when a decision maker holds subordinated interests in, or provides other forms of credit enhancement to, an investee" (EY, Challenges in adopting and applying IFRS 10, 2013)[120].

Taking into account the second point (b) of the above mentioned list, it has to be noted that a challenge can arise because "it is unclear what extent of exposure to variability of

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[117] Grant Thornton. (2017). Under control? A practical guide to applying IFRS 10 Consolidated Financial Statements. Tratto da https://www.grantthornton.ie/globalassets/1.-member-firms/ireland/insights/publications/grant-thornton---ifrs-10-financial-statements.pdf
[118] BDO. (2021). IFRS in Practice IFRS 10Consolidated Financial Statements.
[119] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5
[120] EY. (2013). Challenges in adopting and applying IFRS 10.

returns from other interests would tip the scale to indicate that the decision maker is a principal" (Accounting Standard Council Singapore, 2021)[121].

Given that the notion of agency relationship was firstly introduced by the IFRS 10, and, as a consequence, there were no provisions about this subject, such situation has resulted in an additional request of explanations from prepares, taking into account that IFRS 10 is a principle-based standard. Among the matters that have been identified there is the general aspect that "[…] the main challenge to identify an agency relationship on the basis of the factors listed in IFRS 10.B60 and the application guidance in IFRS 10.B62-B72 is to perform an assessment by considering all factors in combination" (Allianz SE, 2021)[122]. The fact that judgements are required and few examples are provided throughout the guidance within the IFRS 10, the latter allows the prepares of consolidated financial statements to conclude on this topic in different ways, resulting also in inconsistencies in practise between different nations or jurisdictions. Further to this, case studies in the standards can create applicational dissonance for corporates because as noted by the Autorité des Normes Comptables (French Accounting Standards Authority), "the application guidance in IFRS 10 and the Application Examples relate to financial institutions. It would be useful if the Standard were to provide some examples relating to other business activities" (French Accounting Standards Authority, 2021)[123]. Again, it should be evidenced that, most of the respondents to the request of feedbacks on the PIR of IFRS 10, have found out that there is a lack of provisions in terms of quantitative thresholds when doing the assessment of the principal/agent relationship. They have indicated also the absence of weight to be assigned in order to perform the evaluation based on the four point (a-d) listed above. This is further confirmed by literature provided by the Big 4, specifically Deloitte, which pointed out that "the standard does not provide guidance on how to weight each of the above criteria, except when a single party has a

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[121] Accounting Standard Council Singapore. (2021). Response to request for information on post-implementation review of IFRS 10 consolidated financial statements, IFRS 11 joint arrangements and IFRS 12 disclousure of interests in other entities. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28346_SuatChengGohSingaporeAccountingStandardsCouncil_0_ASCCommentLetterRFIPostimplementationReviewofIFRS10IFRS11andIFRS12.pdf
[122] Allianz SE. (2021). Post-implementation Review of IFRS 10, 11 and 12. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28363_THOMASHOEPPELAllianzSE_0_AllianzCLPiRIFRS101112signed.pdf
[123] French Accounting Standards Authority. (2021). IASB's Request for Information: Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28400_VincentLouisAutoritdesNormesComptablesANCFrenchstandardsetter_0_PIRIFRS101112_ANCCommentletterFinalIASB.pdf

unilateral ability to remove the decision maker without cause[…]" (Deloitte, IFRS in Focus — IASB issues new standard on consolidation, 2011)[124]. Always remaining in the field of the lack of quantitative tools, there is another inconsistency in the standard evidenced by PwC. PricewaterhouseCoopers indicated that "in our experience, it may be difficult to assess principal/agent relationships […] while the Board steered away from the use of quantitative thresholds, reference is frequently made to the quantitative guidance in Application Examples 13-15 when performing the assessment" (PricewaterhouseCoopers International Limited, 2021)[125]. Therefore the dissimilarity arise in light of the fact that the IASB is of the opinion not to provide quantitative specifications, however in the text it is possible to see numbers assigned to certain situations. Moreover, another issue that has been identified and summarized in the document of the IFRS that summarizes the results before the request of feedback, i.e. the document of the request for information, is that "some stakeholders noted that the remuneration […] and other interests held by the decision maker can be subject to complex arrangements and depend on future events or performance. In such cases, stakeholders find it challenging to assess whether the decision maker's exposure to variable returns is consistent with being an agent" (IFRS Foundation, 2020)[126].

To sum up what has been stated above, it can be deduced that, even though there are examples on the application of the guidelines, a greater effort on judgment each situation has to be applied in order to determine which is to be considered principal or agent.

[124] Deloitte. (2011). IFRS in Focus — IASB issues new standard on consolidation. Tratto da iasplus.com: https://www.iasplus.com/en/publications/global/ifrs-in-focus/2011/ifrs-10
[125] PricewaterhouseCoopers International Limited. (2021). Request for information - Post-implementation review (IFRSs 10, 11 and 12) . Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28376_HenryDaubeneyPricewaterhouseCoopersInternationalLimited_0_PwCcommentletterPIRIFRSs10_11_12.pdf
[126]

De Facto Agent

In light of what has been stated above, when assessing control, the standard advises the investor to evaluate the relationship with other parties. According to this, "IFRS 10 also requires an investor to consider whether there are other parties who are acting on behalf of the investor by virtue of their relationship with it" (EY, Challenges in adopting and applying IFRS 10, 2013)[127]. These circumstances can be detected by taking into account the nature of the relationship between the party and the investor, as well as their interaction. Such evaluations are required due to the fact that there could arise changes in the general relationship between the party and other investors. If, after the evaluation, it results that those parties are acting on the behalf of the investor, they are classified as 'de facto agents'. However, it has to be highlighted a precise expression that the IFRS 10 uses when providing for the definition of de facto agent. It states 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" (IFRS 10 — Consolidated Financial Statements, 2013)[128]. This means that multiple parties can interact and that could arise more than one agency relationship. It must now be noted that, the peculiarity of this relationship is that an agent is a de facto agent notwithstanding the presence of a contract. This is confirmed in the Basis for Conclusion, BC143, where the International Accounting Standard Board specified that "such a relationship need not involve a contractual arrangement, thereby creating a non-contractual agency relationship" (IFRS Foundation)[129]. Moreover, for the aim of assessing control in such situations, "the rights held by de facto agents, and the returns received by such parties, are considered [...]" (De Facto Agent – Annual Reporting, 2019)[130]. At first appearance, the review procedure appears to be difficult and judgmental, this increases in the scenario in which there is no contractual agreements between the two parties. As a result, in the section dedicated to this topic, there are some examples of agents in the cases when, in relationship with the investor, act as de facto agent, that investors can refer to when they are involved in this operation. "The following are

[127] EY. (2013). Challenges in adopting and applying IFRS 10.
[128] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5
[129] IFRS Foundation. (n.d.). Basis for Conclusions on IFRS 10 Consolidated Financial Statements. Retrieved from https://www.masb.org.my/pdf.php?pdf=FRS10_BC.pdf&file_path=pdf
[130] De Facto Agent – Annual Reporting. (2019). Tratto da Annual Reporting: https://annualreporting.info/de-facto-agent/

examples of such other parties that, by the nature of their relationship, might act as de facto agents for the investor:

a) the investor's related parties.
b) a party that received its interest in the investee as a contribution or loan from the investor.
c) a party that has agreed not to sell, transfer or encumber its interests in the investee without the investor's prior approval (except for situations in which the investor and the other party have the right of prior approval and the rights are based on mutually agreed terms by willing independent parties).
d) a party that cannot finance its operations without subordinated financial support from the investor.
e) an investee for which the majority of the members of its governing body or for which its key management personnel are the same as those of the investor.
f) a party that has a close business relationship with the investor, such as the relationship between a professional service provider and one of its significant clients" (IFRS 10 — Consolidated Financial Statements, 2013)[131].

By looking at these situations, it can be noted that, the first point concerning the investor's related parties has reference in the IAS 24 *Related Party Disclosures*. Furthermore, even when a party fits into one of the scenarios above does not imply that it is a de facto agent for the investor. "This guidance regarding the relationship of the investor with the other parties in the group it is necessary because of the relationship that a group could have with the investee. The investor and its probable "de facto agents" could have power, that considerer in isolation, might not result in a control conclusion to any party involved, but that considered together probably should result in a control conclusion" (Morgado, 2013)[132].

As for this topic of de facto agent, there are no particular issues commonly highlighted, but only few instances related to the level of judgements that the IFRS 10 requires to employ. "However, the guidance on assessing de facto agency is comparatively brief and provides minimal insight into how the "interaction" with those other parties should be assessed. This lack of clear guidance has led to significant room for judgement.

[131] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5
[132] Morgado, M. (2013). Effect analysis on the application of IFRS 10 compared with the IAS 27.

We are also aware that some entities in practice use the absence of explicit guidance to argue that no party has control" (KPMG-IFRG-Limited, 2021)[133]. Most of the main audit corporations have pointed out the need of additional examples and better explanations of the guidance yet provided by the IFRS 10. Another proof of this has been manifested by the CMA (the Capital Market Authority of the Saudi Arabia Kingdom), since it has stated that the provided guidance sometimes is insufficient to demonstrate if a potential agent is de facto or not (Capital Market Authority Saudi Arabia, 2021)[134].

In conclusion, it should be affirmed that, despite the fact that the IFRS 10 give some instances to proof the agency relationship, there is a lack of provisions with regards how to conduct the evaluations. Nevertheless, the suggested solution is always the same: considering the purpose and design of the investees having also taken into consideration the facts and circumstances.

[133] KPMG-IFRG-Limited. (2021). Comment letter on Request for Information on the Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28356_ChrisJacksonKPMGIFRGLimited_0_KPMGcommentletteronRFIonPIRofIFRS101112.pdf
[134] Capital Market Authority Saudi Arabia. (2021). Post Implementation Review-IFRS 10, IFRS 11 & IFRS 12. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28344_SimonWhiteheadCapitalMarketAuthority_0_CommentletteronIFRSs101112PIR5521FINAL.pdf

CHAPTER 3 – INVESTMENT ENTITIES' EXEMPTION

3.1. Definition of Investment Entity

The logic of the single consolidation model might yield situations that are opposed to the known aims of financial statements. In some circumstances, the consolidation of specific entities delivers less meaningful information to users. An example are the Investment Entities that are defined as firms that pursue the goal of managing participation investments rather than leading and coordinating various companies in order to form a group. Besides at the beginning of the first chapter, in the introductory part of IFRS 10, it has been mentioned that there are some exemptions to the consolidation process, i.e. some typologies of business are not included in the list of parent firms that have to consolidate their subsidiaries. A parent company is not required to draw up consolidated financial statements if it is a wholly-owned or partially-owned subsidiary of another firm, if the parent is not registered on a domestic or foreign stock exchange, including local and regional markets, that is, if the parent's debt or equity instruments are not traded in a public market nor if the holding is willing to issue any category of instruments in a public market or has intermediates' financial statement for the public use. Among those exemptions, it has been stated that the so called investment entities are encompassed in this list.

However, if examining the original wording of the standard there could be highlighted a meaningful difference with respect to this exemptions, in 2011 the Board did not list the investment entities among them. This chapter is aiming at introducing and analysing the concept of investment entities, because, as for the notion of principal and agent, the one of investment entities was newly introduced by the IFRS 10.

When the International Accounting Standards Board published the Exposure Draft, ED 10 Consolidated Financial Statements, in December 2008, it suggested that reporting companies integrate all controlled entities, regardless of their nature. "However, many respondents to ED 10 questioned the usefulness of financial statements of investment entities if IFRSs continued to require the consolidation of entities that an investment entity controls. They asked the Board to reconsider whether investment entities should be exempted from consolidating investments in entities that are

controlled" (IFRS Foundation, 2011)[135]. The rationale for this request is that consolidation made it more difficult for investors to understand the value of the entity's investments, which is what actors in the investment market are most interested in. Moreover, it should be stated that preparers and investors in the investment entity's business believed that merging the financial statements of an investment company and its investees does not provide the most helpful information, as well as respondents agreed that investment entities should be able to measure investments at fair value because they believe that measuring at fair value will allow companies to give more useful information with respect to the measurement provided by the IFRS 10 at that time. "In such statements they are able to clearly identify financial position, performance and cash flows of the investor and results derived from possession of, and transactions with, the investments. In consolidated statements on the other hand, information are aggregated for investment company and its subsidiaries which makes it difficult for interpretation as subsidiaries are not held for their assets and liabilities, financial performance or cash flows" (Gluzová T. , Consolidation Exemptions under IFRS, 2015)[136]. As a consequence of the matters detected and in response to the Exposure Draft, when the Board reconsidered the consolidation exemptions, it decided to combine its opinion about the issues with the Financial Accounting Standards Board (FASB), the US national standard-setter. The IASB chose this course because the GAAP had a pre-existing guidance on this subject, and adding this exemption would had contributed to the process of harmonization in the consolidation area, even though the final result has some similarities to US GAAP, however differences still persist. More pointedly, this difference is confirmed by the Japanese Institute of Certified Public Accountants which affirmed that "[…] the accounting treatment is quite different between IFRS and US GAAP when the ultimate parent is not an investment entity. Given the importance of global comparability in financial reporting, we highly recommend such differences should be resolved over the mid-to long-term by holding diligent and continuous discussions […]" (The Japanese

[135] IFRS Foundation. (2011). Exposure Draft. Investment Entities. Tratto da fondazioneoic.eu: http://www.fondazioneoic.eu/wp-content/uploads/downloads/2011/09/2011-08-ED-Investment-Entities.pdf
[136] Gluzová, T. (2015). Consolidation Exemptions under IFRS. Tratto da Procedia Economics and Finance: https://reader.elsevier.com/reader/sd/pii/S2212567115007108?token=1539B8EEEC2DD22BF51AB2D634C2790B17A0845DD98DF856684F5BAE273B8D3B6A72534068FCB8E083F8DF027CE1CB32&originRegion=eu-west-1&originCreation=20220514090008

Institute of Certified Public Accountants, 2021)[137]. Further to this, there was also another factor that the IASB took into account, several national accounting standards contain a consolidation exception for investment entities. Therefore, investment entities in some jurisdictions were offered the option of keeping their national accounting requirements rather than adopting IFRS. It follows that, both the bodies, IASB and FASB, began working together to create a project, with the goal of agreeing on this topic, providing guidance on which criteria should be utilised when defining an investment entity. The IASB separated the results of this project both in the IFRS 10 and in the IFRS 12 Disclosure of Interests in Other Entities.

After the conclusion of the research for the project, the IASB undertook the Amendment process and updated IFRS 10 in October 2012, with the document named *Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)*, with the objective of giving a limited scope exemption from consolidation guidelines for a parent entity that fulfils the definition of an investment entity. As stated before, the motives for the undertaking of this changes are principally two. Firstly, investors have pointed out the need for more relevant information, which will be satisfied with the measurement through fair value and according to financial statement preparers, preparing consolidated data for investment firms was time-consuming and costly, with little advantage, though since investors were more focused in non-consolidated, fair value information. Secondly, there was the need of more comparability with respect to financial statements of the investment entity itself, and financial statement of different investment entities because of the particular business model of the companies. The amendment, that has been effective from January 2014, included:

- "the creation of a definition of an investment entity;
- the requirement that such entities measure investments in subsidiaries at fair value through profit or loss instead of consolidating them;
- new disclosure requirements for investment entities; and

[137] The Japanese Institute of Certified Public Accountants. (2021). Comments on the Request for Information Post-implementation Review of IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28337_ToshiyukiHatanoTheJapaneseInstituteofCertifiedPublicAccountants_0_JICPAcommentsRFIPostimplementationReview_IFRS101112.pdf

- requirements for an investment entity's separate financial statements" (Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27), 2012)[138].

Another major change brought by the amendment, states that the investments of the subsidiaries are measured at fair value. This fair value requirements, prior the 2012, was governed by the IAS 28 *Investment in Associates and Joint Ventures*. This principle required venture capital organisations, mutual funds, unit trusts, and similar businesses, including investment-linked insurance funds, to account their investments in associates or joint ventures at fair value through profit or loss applying IFRS 9 Financial Instruments. The ED proposed to eliminate those provisions, requiring the IFRS 10 to contain the fair value evaluation, while making reference to IFRS 9, as provided by the preceding principle. Moreover, other key aspects introduced by the amendment can be summarized as follow:

- "a non-investment parent entity that controls an investment entity will continue to consolidate its subsidiaries (the consolidation exemption does not 'roll up')
- an investment entity's service subsidiaries (subsidiaries that are not 'investments') will continue to be consolidated
- if an investment entity has no non-investment subsidiaries it presents separate financial statements as its only financial statements" (Grant Thornton, 2012)[139].

However, if taking into consideration the relationship between IFRS 10 and IAS 28, another change to the topic of investment entities has been implemented during the IFRS 10's life. After the publication of the amendment of 2012, the Board gathered various arguments concerning the exemption's implementation. Consequently, in December 2014, the Board published the *Investment Entities: Applying the Consolidation Exception (Amendments to IFRS 10, IFRS 12 and IAS 28)*. The ED, which was issued in June, of the same year, for the phase of the comments, featured ideas deriving from three main issues brought to the Interpretation Committee. First, the IASB highlighted that the standard's exception addressing the exclusion of preparing consolidated financial statements by a parent company that is, in turn, a subsidiary of an investment entity is confirmed and effective. The second concern identified was that IFRS 10 requires all

[138] ifrs.org. (2012). Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27). Tratto da ifrs.org: https://www.ifrs.org/content/dam/ifrs/project/investment-entities/investment-entities-amdments-to-ifrs-10-12-and-ias-27-summary-and-feedback.pdf
[139] Grant Thornton. (2012). IFRS News Special Edition. Tratto da grantthornton.com: https://www.grantthornton.com.tr/globalassets/_markets_/tur/media/ufrs-yayinlari/gti_ifrs_2012p.pdf

subsidiaries that offer services related to the activities of investment firms to be consolidated. "The IASB proposes to clarify that this exception from fair value measurement is only applicable to subsidiaries that act as an extension of the operations of the investment entity parent. This means that the requirement to consolidate does not apply to subsidiaries that are themselves investment entities" (Deloitte, IFRS in Focus — IASB proposes amendments to IFRS 10 and IAS 28 related to the implementation of the investment entities exemption, 2014)[140]. The observation made by Deloitte is that "in the IASB's view, the clarification is also consistent with the requirement to consolidate those subsidiaries whose main purpose is to perform services that support the core investment activities of the investment entity parent [...]. If the subsidiary is an investment entity, it is clear that such services are not its main activity as it would otherwise not meet the definition of an investment entity" (Deloitte, IFRS in Focus — IASB issues amendments to IFRS 10, IFRS 12 and IAS 28 related to the application of the investment entities exceptions, 2014)[141]. Lastly, the Board specifies that "when applying the equity method to an associate or a joint venture, a non-investment entity investor in an investment entity may retain the fair value measurement applied by the associate or joint venture to its interests in subsidiaries" (Deloitte, IASB finalises amendments regarding the application of the investment entities exception, 2014)[142]. Nevertheless, as the title suggests, the amendment was not finite only to IFRS 10, but it included also provisions for IFRS 12 because this standard aim at governing the disclosure of interests in other entities. Thence, the change required is linked to the disclosure of investment entities that, meeting the condition of measuring subsidiaries at fair value, need to follow the principles listed in the IFRS 12.

Following this reminiscing perspective, the chapter's guiding theme will be introduced and discussed. First and foremost, like with all other concepts in IFRS 10, Appendix B of the updated standard IFRS 10, offers a definition of investment entity as well as extensive application instructions. Furthermore, before going through the depiction of this particular kind of entities, it should be evidenced that the exemption from

[140] Deloitte. (2014, June). IFRS in Focus — IASB proposes amendments to IFRS 10 and IAS 28 related to the implementation of the investment entities exemption. Tratto da iasplus.com: https://www.iasplus.com/en/publications/global/ifrs-in-focus/2014/investment-entities
[141] Deloitte. (2014, Decembre). IFRS in Focus — IASB issues amendments to IFRS 10, IFRS 12 and IAS 28 related to the application of the investment entities exceptions. Tratto da iasplus.com: https://www.iasplus.com/en/publications/global/ifrs-in-focus/2014/investment-entities-1
[142] Deloitte. (2014). IASB finalises amendments regarding the application of the investment entities exception. Tratto da iasplus.com: https://www.iasplus.com/en/news/2014/12/investment-entities

consolidation is not optional, otherwise it is mandatory. It is pivotal that, a parent company understands the concept of the investment entity when assessing whether the exemption should be applied. Generally, an investment entity is identified as "entity whose business purpose is to make investments solely for capital appreciation, investment income, or both, and that evaluates the performance of those investments on a fair value basis. The most common types of investment entities are private equity organisations, venture capital organisations, pension funds, sovereign wealth funds, investment funds and other similar entities" (BDO, 2021)[143].

A corporation must also face the international scene and thus better understand what is expected in IFRS 10.

According to the international standard "an investment entity is an entity that:

a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
c) measures and evaluates the performance of substantially all of its investments on a fair value basis" (IFRS 10 — Consolidated Financial Statements, 2013)[144].

In August 2011, the IASB issued the first proposal in which six mandatory conditions for becoming an investment entity were established, with the stipulation that an entity would be designated an investment entity if and only if it met all six elements. However, the Board received significant criticism, and as a result, the IASB has changed its attitude to allow for more flexibility and to allow users to make their own decisions.
The final definition above-mentioned include three components together with four typical investment entities characteristics. It can be stated that, in order for an entity to meet the definition it has to follow a sort or two-stages approach in which it identifies the three core elements in conjunction with the four traditional traits. Therefore by observing the three points there can be highlighted what are the basic characteristics an investment entity must possess. As previously indicated, these features are the result of the process of amendments the Board carried out. It is noted that, although most entities that are in line with the definition, they are also expected to have all four of these common features.

[143] BDO. (2021). IFRS in Practice IFRS 10Consolidated Financial Statements.
[144] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5

If an entity lacks one or more of the traits, further judgment to determine whether it fulfils the definition must be used. "The new requirements in IFRS 10 are principally concerned with establishing whether an entity qualifies as an 'investment entity'. IFRS 10 emphasises that the definition does not set a 'bright line' but establishes the typical features of an entity that meets the notion [..]" (Deloitte, IFRS in Focus — Fair value rules — new requirements for investment entities, 2012)[145]. Also in this instance, IFRS 10 gives case examples to determine if the absence of a typical attribute precludes, or not, the firm from being classified as an investment entity. The choice of giving a guidance is related to the fact that, most users have pointed out that highly judgmental skills need to be employed when evaluating if an entity is considered an investment entity. In particular because the standard contradicts itself when giving explanations to the characteristics to be accounted for. "[…]IFRS 10.27 contains mandatory elements when assessing whether or not an entity is an investment entity and IFRS 10.28 includes typical characteristics to consider. However, Appendix B notes that the typical characteristics need not be present. Stakeholders suggested that it is not clear how the mandatory elements interact with the typical characteristics, if the typical characteristics are not necessarily required to be present" (Australian Accounting Standard Board, 2021)[146].

The first characteristic is the one linked to point (a), which states an investment entity can be considered such if it obtains fund from one or more than one investors. As a consequence, this clearly denote that the primary feature to be inspected is the existence of the possession of one or more investments. Taking into account a typical representation of an investment entity, it should be asserted that, for the purpose of gaining access to investment management services and/or exploit investment opportunities, several investors are interested in the supplying fund into this type of corporations. The reason resides in the fact that the benefits deriving from pooling funds into a business collectively exclude the individual initiative to take the same approach. In other words group investors would not have access to the above mentioned services if acting individually. Considering at the investment entity perspective, on the other hand,

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[145] Deloitte. (2012). IFRS in Focus — Fair value rules — new requirements for investment entities. Tratto da iasplus.com: https://www.iasplus.com/en-ca/publications/ifrs-in-focus/2012/investment-entities

[146] Australian Accounting Standard Board. (2021). Request for Information—Post-implementation Review of IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28349_KimberleyCarneyAustralianAccountingStandardsBoard_0_AASBLetterToIFRS_SubPIRIFRS101112.pdf

it must be assumed that "having several investors would make it less likely that the entity, or other members of the group containing the entity, would obtain benefits other than capital appreciation or investment income" (Grant Thornton , 2017)[147]. Furthermore, the standard specifies that there could be particular situations in which the same opportunities of investment or services can be reached even if the entity has only one investor. Nevertheless, it is important to note that the case described is the result of the process of formation of an investment entity with the aim of serving one investor, i.e. the entity is founded exclusively to fulfil the purpose of an investor. However, there is another clarification to be made. The investor in question is, on average of cases, the delegate of a larger group of investors which have interests in the acts of the investment entity. Proof of this are the pension funds as well as government investment funds, seeing that, this two examples properly illustrate the logic behind the acting collectively that can reach particular results with respect to the same but pursue as a single investor. Moreover, during the discussion of the amendments the Board found out that there are circumstance in which there is a momentaneous status for an investment entity in which having one investor. Hence, the IFRS 10 acknowledges this by showing a list. "For example, an investment entity may have only a single investor when the entity:

a) is within its initial offering period, which has not expired and the entity is actively identifying suitable investors;
b) has not yet identified suitable investors to replace ownership interests that have been redeemed; or
c) is in the process of liquidation" (IFRS 10 — Consolidated Financial Statements, 2013)[148].

Overall, an entity can be classified an investment entity if it has more than one investor, however there IFRS 10 recognize the case in which a company having only one investor is characterized by the same way as an investment entity when investor represents the interests of a wider group of investors.

Continuing with the second feature of an investment entity, it can be found that, similarly to the first characteristic analysed, also this attribute is connected to the point (a), but at the same time it can be connected to the point (b) and point (c) because this

[147] Grant Thornton . (2017). IFRS: Investment entities. Tratto da Grant Thornton Ireland: https://www.grantthornton.ie/insights/factsheets/ifrs-investment-entities/
[148] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5

argument can be interrelated and can be defined as an guiding feature, essential for an investment entity in order to be declared such. Given this circumstance, this imply that the first feature is the possession of one or more investments. It is ordinary that corporations which operate in the investment sector hold various investments, since they accomplish this strategy in order to diversify its risk and maximise rewards. When companies act in this manner, an entity can possess a portfolio of investments directly or indirectly. As an instance, an entity can hold a single investment in another investment firm which in turn holds other assets. In addition to this, the standard specifically says one or more because, even though holding multiple investments is usual for an investment entity, nevertheless, there could be moments when an entity merely possesses a single investment.

Moreover, in most of the cases this represents a temporary situation. Therefore, in principles of the IFRS 10's criterion, this does not necessarily preclude an entity from meeting the definition of an investment entity; all facts and circumstances must be considered. "For example, an investment entity may hold only a single investment when the entity:

a) is in its start-up period and has not yet identified suitable investments and, therefore, has not yet executed its investment plan to acquire several investments,
b) has not yet made other investments to replace those it has disposed of,
c) is established to pool investors' funds to invest in a single investment when that investment is unobtainable by individual investors (for example, when the required minimum investment is too high for an individual investor),
d) is in the process of liquidation" (Grant Thornton , 2017)[149].

In other words, the IFRS 10 provides some instances in which entities can find themselves temporarily, some of them, as it can be seen, correspond with specific phases of the life cycle that a company can experience. To summarise what has been reported, parent companies should keep in mind that, according to IFRS 10, an investment entity would typically have more than one investment, making it unusual for it to have only one investment during its entire life labelled as an investment entity. Having a single investment is usually only a transitory period. Furthermore, even if the investment entity only has one investment, it might still qualify as an investment entity, which is unusual

[149] Grant Thornton . (2017). IFRS: Investment entities. Tratto da Grant Thornton Ireland: https://www.grantthornton.ie/insights/factsheets/ifrs-investment-entities/

for an investment entity. As a result, management must apply and report their considerable judgement in reaching this finding.

Third typical characteristic identified by the Board is with reference to investors dealing with the investment entity, but with respect to the first element explained the particular property that those investors have is that they are not related parties. For this reason the investment entity must have investors that are not related parties as outlined in IAS 24. The inclusion of this among the ordinary characteristics of an investment entity stems from the fact that the entities commonly incorporate investors who are not related parties. "Having unrelated investors would make it less likely that the entity, or other members of the group containing the entity, would obtain benefits other than capital appreciation or investment income" (IFRS 10 — Consolidated Financial Statements, 2013)[150]. The standard is keen to specify, in order not to create different interpretations among those who must apply the principles of IFRS 10, that a company is equally considered an investment entity even if its investors are related parties. "For example, an investment entity may set up a separate 'parallel' fund for a group of its employees (such as key management personnel) or other related party investor(s), which mirrors the investments of the entity's main investment fund. This 'parallel' fund may qualify as an investment entity even though all of its investors are related parties" (BDO, 2021)[151].

The last investment entity's feature is about the ownership aspect or a company. Although as for the purpose of IFRS 10, most investment entities are also separate entities. The latter implies that each entity has a distinct identity and is thus considered independent from its creditors or stakeholders, with transactions recorded separately. Concerning ownership of investment entities, the standard disposes that "ownership interests in an investment entity typically take the form of equity or similar interests (for example, partnership interests), to which proportionate shares of the net assets of the investment entity are attributed" (Grant Thornton , 2017)[152]. Notwithstanding, the International Accounting Standards Board states that there are instances where firms have different classes of stockholders. This distinction may result in firms having

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[150] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5

[151] BDO. (2021). IFRS in Practice IFRS 10Consolidated Financial Statements.

[152] Grant Thornton . (2017). IFRS: Investment entities. Tratto da Grant Thornton Ireland: https://www.grantthornton.ie/insights/factsheets/ifrs-investment-entities/

investors with different rights. In this case, investors may have rights solely to a specific investment or groups of investments, or they may have different proportionate portions of the net assets. Nonetheless, the Board categorised this circumstance as one that does not disqualify an entity from being an investment entity. Furthermore, the IFRS 10 provides that "in addition, an entity that has significant ownership interests in the form of debt that, in accordance with other applicable IFRSs, does not meet the definition of equity, may still qualify as an investment entity, provided that the debt holders are exposed to variable returns from changes in the fair value of the entity's net assets" (IFRS 10 — Consolidated Financial Statements, 2013)[153].

Concluding this section, it must however be noted that, "the IASB adopted the two-stage approach in response to criticism of the more bright-line approach that was included in the August 2011 exposure draft that preceded the amendments. For this reason, the amendments do not provide specific criteria that management should consider in assessing whether an entity qualifies as an investment entity despite failing one or more of the typical characteristics. However, the basis for conclusions notes that the IASB believes that only in rare circumstances would an investment entity have none of the typical characteristics" (KPMG, 2012)[154]. Because the IFRS 10 is a principle-based standard it is useful to remark that further judgment is always required, proof of this is that "on an international basis, there seems to be diversity in the application of the definition, some stakeholders using a less strict application of the criteria. This leaves room for a significant level of judgement and inconsistent outcomes for situations with similar facts and circumstances" (French Accounting Standards Authority, 2021)[155]. Taking into consideration what has been stated above, it is useful to notice that some professionals have observed that in practise, the interpretation of certain fact patterns aiming at reducing the possibility that an entity, concludes that it is an investment entity when it is not is lacking in the standard. Because, if looking at the text of the IFRS 10, both in the first part and in the Appendix B, there are no instances of possible scenarios as like

[153] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5

[154] KPMG. (2012). First Impressions: Consolidation relief for investment funds. Tratto da https://assets.kpmg/content/dam/kpmg/pdf/2013/12/First-Impressions-O-1312-consolidation-relief-for-investment-funds.pdf

[155] French Accounting Standards Authority. (2021). IASB's Request for Information: Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28400_VincentLouisAutoritdesNormesComptablesANCFrenchstandardsetter_0_PIRIFRS101112_ANCCommentletterFinalIASB.pdf

in the assessment of control part. In particular, when there are situation in which one of the typical characteristics is missing, but an entity need to evaluate its position, a more detailed guidance will be of extremely importance.

3.2. Applying the Investment Entity's Definition

In the preceding section, the four typical characteristics of an investment entities have been introduced and explained. Given that process of recognising an investment entity can be considered a two-stages approach, in this section will be analysed the application of the three essential elements of the definition. The latter corresponds to the first stage of the process because once the definition is met, the entity need to looking at the characteristics. "The application guidance to IFRS 10 describes the elements of the definition in more detail to help entities identify investment entities" (EY, Challenges in adopting and applying IFRS 10, 2013)[156]. The Board, included in the amendment extensive guidance for the assessment. "In assessing whether an entity meets the definition, all facts and circumstances should be considered – including the entity's purpose and design. It will often be straightforward to determine whether an entity is an investment entity" (Grant Thornton, 2012)[157]. Furthermore, it is useful to remind that the three conditions are mandatory, if an entity does not meet one of them it cannot be considered an investment entity.

3.2.1. Business Purpose

In the definition, it is reported that one of the essential activities of an investment entity is the one connected to obtaining funds from investors in order to provide those investors with investment management services. This is a feature that characterises investment entities and other entities, although other must be accounted. Accordingly, the second consideration to be put into practice, that relates to the first point of the depiction of investment entity, is the analysis of the business purpose. By looking at the definition, it can be seen that purpose of an investment entity is linked either to investments with the aim of capital appreciation or at gaining profits derived from the investment as well as both purposes. The most common profits that the standard refers to are for instance

[156] EY. (2013). Challenges in adopting and applying IFRS 10.
[157] Grant Thornton. (2012). IFRS News Special Edition. Tratto da grantthornton.com: https://www.grantthornton.com.tr/globalassets/_markets_/tur/media/ufrs-yayinlari/gti_ifrs_2012p.pdf

dividends or interests. The standard makes explicit that the business purpose of an entity is defined within its public document, because it is an information essential for stakeholders. "Typically an entity's investment objectives (ie its business purpose) will be evidenced by documents such as:

a) the offering memorandum
b) publications distributed
c) other corporate or partnership documents" (Grant Thornton , 2017)[158].

In addition to public documents, potential investees or rather future investors have to take into account the reputation and how the entity promotes itself in order to understand what is the business purpose. The example included in the standard is related to an empirical case of a company that portray its business to pertain to the area of medium-term investments, thus its investments' objective will be for the capital appreciation. However, in contrast to the example so far illustrated, IFRS 10 specifies that whenever an entity introduces itself to third parties as an investor which business purpose, in addition to make investments, is linked to develop, produce or market goods or services cooperatively to its possible investors, this particular business is viewed as mismatched with the conceptualization of investment entity. The reason is that the returns the entity will gain do not derive solely from one source, the one of investments attempted, whereas they came from respectively the formation, construction and selling of the goods or services and the investments.

As regards to activities that can be traced back to investment entities, the Board included some exemplification of what are the services an entity can provide directly or indirectly in order to comply with the exemption. Briefly the three categories of activities can be summarized as follow:

- provide investment-related services,
- provide investment-related activities.

By looking at the first activity, it has to be reconducted to the proper definition of investment entity. These tasks are generally coupled with investment advisory services, investment management or investment support as well as administrative services. In addition the requisite provided is that those activities can be executed "either directly or through a subsidiary, to third parties as well as to its investors, even if those activities are

[158] Grant Thornton . (2017). IFRS: Investment entities. Tratto da Grant Thornton Ireland: https://www.grantthornton.ie/insights/factsheets/ifrs-investment-entities/

substantial to the entity, subject to the entity continuing to meet the definition of an investment entity" (IFRS 10 — Consolidated Financial Statements, 2013)[159].

Going through the other point, the standard decided to specify these investment-related activities can be count always taking into consideration the fact that they can be carried out by the entity itself or outsourced to a third party. Importantly, there is a condition to be respected. Those activities, have to be made to maximise the capital appreciation or to improve income returns from the company's investees and the returns "does not represent a separate substantial activity or source of income" (EY, Challenges in adopting and applying IFRS 10, 2013)[160]. More precisely, the activities the IFRS 10 refers to, comprehend activities that have the goal of providing to an investee management and strategic advices services as well as furnishing loan, capital commitment or guarantee in the form of financial support to investees. Finally the IFRS 10 states that "if an investment entity has a subsidiary that is not itself an investment entity and whose main purpose and activities are providing investment-related services or activities that relate to the investment entity's investment activities […] to the entity or other parties, it shall consolidate that subsidiary […]. If the subsidiary that provides the investment-related services or activities is itself an investment entity, the investment entity parent shall measure that subsidiary at fair value through profit or loss […]" (IFRS 10 — Consolidated Financial Statements, 2013)[161]. One of the most recurrent issues that have been highlighted by the users and auditors is linked to interpretation of the provisions of the standard. Earlier, it has been illustrated that an investment entity provide investment management services, but the standard refers also to investment-related services and activities. "The underlined terms are critical in determining whether an entity should be considered as an investment entity. However, none of these are defined by the Standard and it is also unclear as to how these terms should be interpreted in relation to each other" (KPMG-IFRG-Limited, 2021)[162]. The Board, did not provide a lot of insight that can be used

[159] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5
[160] EY. (2013). Challenges in adopting and applying IFRS 10.
[161] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5
[162] KPMG-IFRG-Limited. (2021). Comment letter on Request for Information on the Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28356_ChrisJacksonKPMGIFRGLimited_0_KPMGcommentletteronRFIonPIRofIFRS101112.pdf

to make a distinction, consequently there are ambiguities that could discourage entities to attempt to evaluate themselves as an investment entity.

3.2.2. Exit Strategies

Concerning business purpose, the notion of investment's time frame is important. The Board in the application guidance makes references to exit strategies that an investment entity must account for, notwithstanding that "the definition of investment entity does not refer directly to exit strategies" (Grant Thornton, 2012)[163]. Thus, the investment strategy that an entity has planned to undertake must show the entity's business purpose. Despite this, the peculiar feature of an investment entity highlighted by the standard is that in the plan, it is not reported that the investment hold has an unlimited duration, but rather that the entity is supposed to hold it for a limited period and the investment entity should have some exit strategies for the investments realisation. In other words, "because equity investments and non-financial asset investments have the potential to be held indefinitely, an investment entity shall have an exit strategy documenting how the entity plans to realise capital appreciation from substantially all of its equity investments and non-financial asset investments" (IFRS 10 — Consolidated Financial Statements, 2013)[164]. Furthermore, the company is also required to develop exit strategies for other typologies of instruments, the instance included in the standard is the one related to debt instruments, like perpetual debt investments, that are hold by a company with an undefined time period. For this reason, given this feature of the debt instrument, the investment entity needs to account for the provision of an exit strategy. To say it in another way, to meet the definition of investment entity the company has to report in the business purpose the exits strategies to be put in place taking into consideration different situation the company may find itself. As a result the majority of an investment entity's equity, non-financial, and debt investments that have the potential to be held indefinitely should be covered by exit strategies. "As well as those investments that have an exit strategy by default through limited life, exit strategies also do not need to include investments in other investment entities that are formed in connection with the entity for legal, regulatory, tax or similar business reasons if those entities have an exit strategy for

[163] Grant Thornton. (2012). IFRS News Special Edition. Tratto da grantthornton.com: https://www.grantthornton.com.tr/globalassets/_markets_/tur/media/ufrs-yayinlari/gti_ifrs_2012p.pdf
[164] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5

their investments" (Grant Thornton , 2017)[165]. On the other hand, if a company manage exit strategies in relation to violation of agreed terms of in the case of non-performance, those mechanisms are not included in the definition, therefore cannot be accounted when assessing an investment entity. However, it is to be noted that, the entity is not obliged to provide an exit strategy for each single investment undertaken, but the company need to list possible exit plans to be put in place. IFRS 10 furnishes three areas in which exit strategies must be applied or not on the grounds that the strategies can be adjusted to fit in with different investments. These three sectors are the most common for investments and where exist strategies are more likely to be employed. The standard first considers exit strategies used for investments in private equity securities. Among the most common strategies, investment entities can exit through an initial public offering (IPO), which means that a private corporation sells shares to the public in a new stock issuance, allowing the company to raise capital from public investors. However, other approaches can be related to the distribution to investors of ownership interests in the investee through the sale of assets as a result of the liquidation process. Alternatively, a business's exit strategy can result from a trade sale as well as a private placement. Secondly, the IFRS 10 indicates that "for equity investments that are traded in a public market, examples of exit strategies include selling the investment in a private placement or in a public market" (IFRS 10 — Consolidated Financial Statements, 2013)[166]. Last but not least, investment entities can operate in the real estate sector. By participating in this particular investment's market, a company can implement exit strategies through selling the real estate property by professional distributors and otherwise through the sale of the investment in the open market. In addition, the Board specified a particular situation in which entities may found an attempt to give a guideline. "[…] An investment entity parent may have an investment in another investment entity subsidiary. The investment entity parent need not have an exit strategy for its investment in the subsidiary, provided that the investment entity subsidiary has appropriate exit strategies for its own investments" (BDO, 2021)[167]. Summing up what has been stated, the definition of investment entities does not make apparent specification of exit strategies, however in the Appendix B the

[165] Grant Thornton . (2017). IFRS: Investment entities. Tratto da Grant Thornton Ireland: https://www.grantthornton.ie/insights/factsheets/ifrs-investment-entities/
[166] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5
[167] BDO. (2021). IFRS in Practice IFRS 10Consolidated Financial Statements.

standard includes them. There should be some features an entity need to enhance, they have to cover all equity non-financial and debt investments, and moreover they have to be identified for different portfolios. "Exit strategies should be documented and include the following:

- the type of investment (or portfolio of investments the strategy relates to)
- how exit of the investment will be achieved
- expected outcomes and results to be achieved before the strategy is exercised
- the timeframe involved
- value of the investment to be achieved on exit
- confirmation the board has approved the strategy" (Grant Thornton , 2017)[168].

The main and most significant issue regarding the question of exit strategies is that the Board has not included the evidence required to conclude on some matters within the standard. Despite the recommendations given by the audit company Grant Thornton, there is no understanding on what a company should include in the exit strategies' documentation as well as the level of documentation necessary. "There is also no requirement for the entities to disclose their exit strategies and therefore the consistency of application of the definition may be difficult to conclude on. The auditors therefore just rely on the management judgement and supporting evidence" (South African Institute of Chartered Accountants (SAICA), 2021)[169]. Therefore, a more detailed guidance will align companies in preparing the useful information to be provided also for external use, as well as examples of what the IASB refers to when speaking about exit strategies. Furthermore, another interesting point of view on exit strategies has been carried out by the Canadian Accounting Standard Board which considered that "[…] an entity's ability to articulate an exit strategy and the extent of evidence an investment entity can provide to demonstrate that it is carrying out its business plan may vary depending on its stage of operation. When an entity is newly formed, less evidence may be available" (Accounting Standards Board (AcSB), 2021)[170]. In addition to this affirmation, the body of accounting

[168] Grant Thornton . (2017). IFRS: Investment entities. Tratto da Grant Thornton Ireland: https://www.grantthornton.ie/insights/factsheets/ifrs-investment-entities/

[169] South African Institute of Chartered Accountants (SAICA). (2021). Saica Submission On Request For Information: Postimplementation Review: Ifrs 10 – Consolidated Financial Statements, Ifrs 11 – Joint Arrangements, Ifrs 12 – Disclosure Of Interests In Other Entities. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28396_MulalaSadikiSAICA_0_SAICASubmissiononRequestForInformationPostImplementationReviewonIFRS1011and12v2.pdf

[170] Accounting Standards Board (AcSB). (2021). Post-Implementation Review – IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities

provided a viewpoint on how the nature of an investment, in conjunction with the stage of the life cycle, may impact an entity's ability to accurately articulate and demonstrate its exit strategy for an investment.

3.2.3. Earning From Investments

Before delving into the content of this section of the definition of an investment entity, it is necessary to highlight a specific detail that is critical to comprehending the theory behind it. First and foremost, it is necessary to emphasise the primary purpose of an investment entity, namely that of investing merely for capital appreciation, for investment income, or both motives. A non-investment holding company, on the other hand, typically attempts a broader range of benefits from its subsidiaries, moreover this kind of company operates more as an integrated business to achieve these benefits. As a result, a non-investment parent company is typically more involved in the operations of its subsidiaries, and the subsidiaries are typically more involved with one another. “The Amendments aim to capture this distinction by stating that an entity does not meet the business purpose component of the investment entity definition if it obtains (or has the objective of obtaining) benefits from its investees that are ‘unavailable to parties unrelated to the investee’” (Grant Thornton, 2012)[171]. In other words, if an entity inside a group has in its business purpose an objective other from solely obtaining benefits from investment, but it is complained that the company attempt benefits from alternate partied not related, this business cannot be considered an investment entity because it is opposed to the definition and provisions of IFRS 10. “The existence of benefits other than capital appreciation and/or investment income may indicate that the business purpose aspect is not met” (Deloitte, IFRS in Focus — Fair value rules — new requirements for investment entities, 2012)[172]. To clarify this characteristic some examples are demonstrated in the application guidance, that preclude an entity from qualifying as an investment entity. Primarily, if a firm is willing to profit from the acquisition, exploitation, or trade of its investee's processes or technologies, or other tangible and intangible resources, the firm

(RFI/2020/12). Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28348_LindaMezonAccountingStandardsBoardAcSB_0_AcSBResponseLetterPIRIFRS101112.pdf

[171] Grant Thornton. (2012). IFRS News Special Edition. Tratto da grantthornton.com: https://www.grantthornton.com.tr/globalassets/_markets_/tur/media/ufrs-yayinlari/gti_ifrs_2012p.pdf

[172] Deloitte. (2012). IFRS in Focus — Fair value rules — new requirements for investment entities. Tratto da iasplus.com: https://www.iasplus.com/en-ca/publications/ifrs-in-focus/2012/investment-entities

is excluded from the definition of investment entity. For example, this non-admission could be the result of a an option hold by a company to master an asset from an investee in the case in which the asset's development is successful.

Then, a company does not meet the requirement if the benefits derive from agreements such as joint arrangements (which are governed by IFRS 11 Joint Arrangements). If the parent company or a member of the group enters into these contracts with a potential investee for the purpose of marketing or producing goods and services. The same goal is also mentioned in the section on business goals. Third point in the list on benefits that not confer the investment entity classification concerns "financial guarantees or assets provided by an investee to serve as collateral for borrowing arrangements of the entity or another group member" (IFRS 10 — Consolidated Financial Statements, 2013)[173]. However, the IFRS 10 specifies that, if an company uses an investment in an investee as collateral for borrowings and benefit from it, it can be considered an investment entity. Moreover, the standard makes reference to benefits produced by an option secured by a subsidiary of the entity to purchase an ownership interest in an investee of the entity from that entity or another group member. Finally, the Board inserted that benefits gained from investees by the parent company of a group's member are prohibited for an investment entity, if those are the result of "transactions between the entity or another group member and an investee that are on terms that are unavailable to unrelated parties, that are not at fair value or that represent a substantial portion of one of the parties business activity" (BDO, 2021)[174].

"IFRS 10 aims to capture this distinction by stating that an entity does not meet the business purpose component of the investment entity definition if it obtains (or has the objective of obtaining) benefits from its investees that are 'unavailable to parties unrelated to the investee'" (Grant Thornton , 2017)[175].

On the other hand it is useful to report what are the benefits accepted by the IFRS 10 that are included in the definition of investment entity. More precisely the following benefits are permitted if they derive from:

- investments in an investee used as collateral for borrowings;

[173] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5
[174] BDO. (2021). IFRS in Practice IFRS 10Consolidated Financial Statements.
[175] Grant Thornton . (2017). IFRS: Investment entities. Tratto da Grant Thornton Ireland: https://www.grantthornton.ie/insights/factsheets/ifrs-investment-entities/

- synergies created between the investment entity and an investee of the same industry or geographical area;
- investments only if do not constitute a significant portion of the investee's or entity's business activity.

In conclusion, it has to be said that, "the above restrictions cover not only the entity itself, but also any member of the larger group of which it is a part – i.e. any subsidiary of the entity's ultimate parent. However, merely because investees trade with each other does not preclude an entity from qualifying as an investment entity. The IASB incorporated these restrictions into the amendments to avoid abuse – e.g. to ensure that an entity did not seek to establish an investment entity subsidiary within a corporate structure that would be used to hold loss-making subsidiaries" (KPMG, 2012)[176].

3.2.4. Fair Value Measurement

The concluding revision of the mandatory properties an investment entity deems fair value's field. Hence, the ending critical point of the definition of investment entity states that investments in subsidiaries are measured on a fair value basis as well as subsidiaries' performances are evaluated using the fair value method as per IFRS 9 *Financial Instruments*.

It follows that, the IASB requires, instead of consolidating using the methods provided for all "classical" corporations, that the investment entity must measure its subsidiaries through profit or loss. The Board made this decision based on comments received in response to the Exposure Draft, which was formed specifically to introduce the amendment to IFRS 10 on the subject of Investment Entities. Many respondents mentioned the difficulty in interpreting and obtaining information from investment entities' subsidiaries that were consolidated using IFRS 10 guidelines. For example, as referred in the IFRS 10, using the equity method, which implies that the investment in subsidiary is recorded as an asset on the parent company's balance sheet while documenting an equal transaction on the equity side of the subsidiary's balance sheet, it will not provide the same relevant information as recording the same investment in subsidiary using the fair value method. "The rationale for this exception to the principle

[176] KPMG. (2012). First Impressions: Consolidation relief for investment funds. Tratto da https://assets.kpmg/content/dam/kpmg/pdf/2013/12/First-Impressions-O-1312-consolidation-relief-for-investment-funds.pdf

of consolidation of controlled investees is that to consolidate entities that are controlled by an investment entity may reduce the comparability of different investments reported in an investment entity's financial statements and that the fair value of the investment of the investee with changes in that value recognised in profit or loss provides more relevant information for users of the financial statements of investment companies" (Deloitte, IFRS in Focus — Fair value rules — new requirements for investment entities, 2012)[177].

Having introduced the fair value concept, the first consideration to be highlighted is of meaningful importance. In order to not create confusion to users, the text of the standard makes clear reference to investments when speaking about this element of the definition. As a consequence, all investee's non-investment assets and liabilities are not included in the fair value measurement. The reason is because "an investment entity may have some non-investment assets, such as a head office property and related equipment, and may also have financial liabilities" (Grant Thornton , 2017)[178].

IFRS 10, in the Application Guidance, supplies two fundamental conditions that investment entities must respect in order to provide evidence that this third element of the definition of investment entity is met. Therefore, an entity needs to:

a) "provides investors with fair value information and measures substantially all of its investments at fair value in its financial statements whenever fair value is required or permitted in accordance with IFRSs; and
b) reports fair value information internally to the entity's key management personnel (as defined in IAS 24), who use fair value as the primary measurement attribute to evaluate the performance of substantially all of its investments and to make investment decisions" (IFRS 10 — Consolidated Financial Statements, 2013)[179].

However if an entity purposes to reach the two conditions aforementioned, there are also other features that would be fulfilled. "An investment entity is also required to measure substantially all of its investments at fair value whenever fair value is required or permitted in accordance with IFRSs" (BDO, 2021)[180]. Firstly, the entity have to account for investment properties using the guidance proposed in the IAS 40 *Investment Property*.

[177] Deloitte. (2012). IFRS in Focus — Fair value rules — new requirements for investment entities. Tratto da iasplus.com: https://www.iasplus.com/en-ca/publications/ifrs-in-focus/2012/investment-entities
[178] Grant Thornton . (2017). IFRS: Investment entities. Tratto da Grant Thornton Ireland: https://www.grantthornton.ie/insights/factsheets/ifrs-investment-entities/
[179] IFRS 10 — Consolidated Financial Statements. (2013). Tratto da Iasplus.com: https://www.iasplus.com/en/standards/ifrs/ifrs10#link5
[180] BDO. (2021). IFRS in Practice IFRS 10Consolidated Financial Statements.

The fair value model in the IAS 40 asks to entities to measure the investments properties at fair value, that is defined as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date" (IFRS - IAS 40 Investment Property, 2013)[181]. To say it in another way, the fair value is simply the price of an asset agreed upon by a buyer and seller. Moreover any change that arise from these investments should be included in the profit or loss statement and "fair value should reflect the actual market state and circumstances as of the balance sheet date" (Deloitte, IAS 40 — Investment Property, 2013)[182]. Then the entity's financial assets have to be measured at fair value, but the investment companies need to take into consideration what is disposed in the IFRS 9 Financial Instruments. The latter has replaced the IAS 39 *Financial Instruments: Recognition and Measurement* in 2014. The Standard is applicable for recognition and measurement, impairment, deferred recognition, and general hedge accounting. Besides, what is stated in the IFRS 9 with respect to this topic is that "after initial recognition, an entity shall measure a financial asset [...] at: (a) amortised cost; (b) fair value through other comprehensive income; or (c) fair value through profit or loss" (IFRS Foundation, 2017)[183]. It demonstrates that a financial asset shall be measured at fair value through profit or loss unless measured at amortised cost or fair value through other comprehensive income. Lastly, to satisfy the terms provided in the Appendix B, an investment entity might choose the exemption from applying the equity method in IAS 28 for its investments in associates and joint ventures. "The 'investment entity' provisions are achieved by electing to measure such investments at fair value under IAS 28.18 where the investment is held by an entity that is venture capital organization, mutual funds unit trust and similar entities including investment-linked insurance funds" (Deloitte, IFRS in Focus — Fair value rules — new requirements for investment entities, 2012)[184]. In fact, in the text of IAS 28 the exemption cases in applying the equity method are illustrated, the first coincides with the investment entities to which the consolidation exemptions proposed by IFRS 10 are added. But, it can be noted that "because the exception in IFRS

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[181] IFRS - IAS 40 Investment Property. (2013). Tratto da ifrs.org: https://www.ifrs.org/issued-standards/list-of-standards/ias-40-investment-property/#standard
[182] Deloitte. (2013). IAS 40 — Investment Property. Tratto da iasplus.com: https://www.iasplus.com/en/standards/ias/ias40
[183] IFRS Foundation. (2017). IFRS 9 Financial Instruments. Tratto da ifrs.org: https://www.ifrs.org/issued-standards/list-of-standards/ifrs-9-financial-instruments/
[184] Deloitte. (2012). IFRS in Focus — Fair value rules — new requirements for investment entities. Tratto da iasplus.com: https://www.iasplus.com/en-ca/publications/ifrs-in-focus/2012/investment-entities

10 and the exemption in IAS 28 seem to pursue the same objective, the IASB could consider aligning the definitions and wording" (French Accounting Standards Authority, 2021)[185].

Concerning these last three points illustrated, i.e. what are the alternative evaluations of investments an entity can account for, some users think that when applying the fair value conditions, the fact that an entity has to contemplate all the requirements and link them to other IFRS standard misleading can rise. Particularly, the Australian Accounting Standard Board have highlighted that "[…] the fair value appears to be inconsistent with accounting principles in other Standards" (Australian Accounting Standard Board, 2021)[186].

Nevertheless, on the whole, the fair value measurement has encountered positive feedbacks, as for users of financial statements in addition to the relevant information provided, it has been identified that, when comparing the two methods of consolidation as for fair value method managers "are able to clearly identify financial position, performance and cash flows of the investor and results derived from possession of, and transactions with, the investments. In consolidated statements on the other hand, information are aggregated for investment company and its subsidiaries which makes it difficult for interpretation as subsidiaries are not held for their assets and liabilities, financial performance or cash flows" (Gluzová T. , Consolidation Exemptions under IFRS, 2015)[187]. Although other bodies of accounting have pointed out that there are instances in which employing fair value is no efficient because the information given to the market do not always mirror the actual situation, as a consequence there are inconsistencies in applying the fair value. Furthermore, conclusions on the productiveness of applying the fair value guidelines in the IFRS 10, cannot be considered as strong as conclusions on the

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[185] French Accounting Standards Authority. (2021). IASB's Request for Information: Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28400_VincentLouisAutoritdesNormesComptablesANCFrenchstandardsetter_0_PIRIFRS101112_ANCCommentletterFinalIASB.pdf

[186] Australian Accounting Standard Board. (2021). Request for Information—Post-implementation Review of IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities. Tratto da ifrs.org: http://eifrs.ifrs.org/eifrs/comment_letters//575/575_28349_KimberleyCarneyAustralianAccountingStandardsBoard_0_AASBLetterToIFRS_SubPIRIFRS101112.pdf

[187] Gluzová, T. (2015). Consolidation Exemptions under IFRS. Tratto da Procedia Economics and Finance: https://reader.elsevier.com/reader/sd/pii/S2212567115007108?token=1539B8EEEC2DD22BF51AB2D634C2790B17A0845DD98DF856684F5BAE273B8D3B6A72534068FCB8E083F8DF027CE1CB32&originRegion=eu-west-1&originCreation=20220514090008

topic of control due to the fact that the application of fair value measurement is more recent and there the need to study and analyse better the general economic scenario.

Summary Of Findings

This section will be devoted to compiling all of the information on the problems discussed in the previous chapters in order to provide a comprehensive picture of the international scenario. Following the chronological thread in the various topics relating to the IFRS 10 principles, as previously stated, the concept of control is made up of three indispensable and inalienable components.

The opening topic is power over the investee: the standard states that for a parent company to have power over an investee or subsidiary, it must have rights that guarantee the ability to direct the relevant activities. As a result, the concept of relevant activities was the first to be examined. The primarily issue identified is related to a detail included in the document by the Board: in order to always guarantee the best returns from the investee, each investor must reconsider the activities in the event of changes. According to some professionals, however, this process causes complexities within the company because, as reported by an auditor within the single accounting body, when there are more than one investiture who must apply judgments regarding the change in the relevant activities, inconsistencies in the ending may occur. The following two issues are part of a larger topic called Special Purpose Entities. This type of business will be specifically mentioned throughout the paper because it was a major change during the transition from IAS 27 to IFRS 10. Previously, they were protected by SIC-12, but with the implementation of IFRS 10, they were merged into a single consolidation model. The distinguishing feature of Special Purpose Entities, as the name advises, is that they are entities that are set up for a limited time with a very specific purpose, such as a project. Many professionals in the sector have discovered, when applying the concept of relevant activities, that the guide, proposed in Appendix B of the standard, is aimed primarily at traditional companies, and many incompatibilities emerge when we depart from the normal vision of a company. As stated in the paper, one of the most common issues is the inability to connect the provisions with a company that has a limited number of activities that are closely related to the purpose and have been defined in advance. Furthermore, specific decisions or procedures are based on structure and relevant activities, and the majority of the rights directing the decisions are derived from contractual rights. Another

issue raised concerns a specific situation involving SPEs, namely when they are run on 'autopilot'. In this case, an entity has no direct decision-making power because the activities it performs are strictly defined and previously agreed upon. To begin with, it should be noted that there are no specific references to this situation in IFRS 10, which makes assessing case by case difficult. It should also be noted that the lack of decision-making power over the activities of an entity run on autopilot makes determining which activities are relevant even more difficult. To address the last issue, it is necessary to first highlight a sentence within the standard that states that when one or more investors have control over relevant activities, it is necessary to determine which activity has the greatest influence on returns. On the one hand, the standard provides exhaustive examples from which to draw exhaustive conclusions in its application guidance. On the other hand, a specific case was highlighted in the various comment letters in which this assessment is more difficult to establish. To be more specific, the identified issue pertains to both a specific economic sector and a specific situation. As a result, the difficulty rises when such required activities take place at different times or are dependent on future events. In such cases, the contribution of each activity to the investee's profitability may change over time. Furthermore, different weights must be assigned in relation to this activity. The medical and pharmaceutical sector are the most affected by this circumstance, because the returns are obviously dependent on the future due to the fact that scientific research takes a long time to determine whether what has been discovered has a beneficial effect. Besides that, the problem extends to the determination of which activity is considered relevant. The dilemma is whether research and development activities should be considered the most influential, or whether production and sales activities should be considered. Because the two cases are so closely related, the decision is complicated.

The second feature of the power concept is that the investor must have rights that confer power over the relevant activities. There are two types of rights that a parent company can consider when establishing control: substantive rights and protective rights. Only the so-called substantive rights have the ability to confer power and thus control on an investor. While protective rights safeguard the interests of the investor who owns them. Keeping this in mind, the majority of issues that arise are related to determining which rights, given the circumstances, belong to the substantive category and which to the protective category. Concerning the first point addressed, it was emphasised how veto

rights are used in the case that the latter precludes or does not preclude a significant activity from being defined as such. Veto rights, in instance, can prevent budgetary decisions from being made; but, they are regarded substantive only when the budgeting activity, such as operations budgeting, is included in the core activities. As a result, the veto right will be a substantive right in this situation. Moreover, the second topic addressed is a specific agreement to which the standard refers in the section on protective rights. There is a minor part dedicated to franchise agreements. Both the franchisor and the franchisee typically have some decision-making rights in the franchise operation. According to the guidance, the franchisor's rights are frequently protective and do not preclude the franchisee from exercising control. The rights of a franchisor to safeguard its brand, in particular, are protective in nature. However, it is fairly uncommon for franchisors to oversee the majority of activities, and if decision-making abilities are seen as substantive, the guidance's conclusions would be contradicted.

The third and last component of power is what is purely characterised as "de facto control". The word refers to the reality that a parent corporation can exert control over a subsidiary even though it lacks a majority of voting rights. The standard specifies which factors must be considered in order to carry out this assessment as effectively as feasible. Although some specialists have complained about a lack of quality in this list of points compiled. Furthermore, in order to evaluate organisations, they want information that, in most circumstances, that is, when it comes to unlisted companies, is difficult to obtain. Finally, considering the concept's recent introduction, both in terms of professional and theoretical perspectives, there is a need and desire for the Board to provide additional, more specific information and guidance.

Skipping the second control element for which no obvious problems have been highlighted the chapter goes on with the third control aspect, the relationship between power and returns. It should be observed that IFRS 10 specifically refers to the concept of Agency Relationship for this concept. As a result, the two key players are principal and agent. In the language of the international standard, there are features to consider when determining whether a corporation is a principal or agent in the relationship. These are: the breadth of its decision-making authority over the investee; the rights of other parties; the remuneration to which it is due under the remuneration agreement; and the decision maker's exposure to variability of returns from other interests in the investee. Starting with the purpose of the business, the parent company must consider what rights are

owned by third parties that have anything to do with the company, because, as previously stated, whoever has substantive rights can preclude another company from carrying out a relevant activity, with particular reference to removal rights. The third issue is about remuneration, which is a more quantitative aspect to end with the decision maker's exposure variability. In general, the most common concerns are the request for a quantitative threshold to be used as a metric to determine who is the decision maker, as well as specific instructions in reference to the various businesses. Because of these obstacles, financial statement preparers reach diverse conclusions on this topic, resulting in discrepancies in practise between nations or jurisdictions. Because the idea of primary and agent is a topic in which all decisions to decree control or not are the outcomes of judgments, a generic lack of guidelines is complained of, there are no specific situations among the problems disclosed.

The chapter also focuses on the concept of 'de facto agent', seeing that the standard states that while analysing control, an investor must consider the nature of its relationship with other parties, as well as whether those other parties are working on the investor's behalf. The final section is essentially a definition of a de facto agent. Determining whether other parties are acting as de facto agents takes judgement, taking into account not only the structure of the relationship but also how those parties interact with one another and the investor. Also in this circumstance, the same problems arise. The specialists have highlighted a short guide that might be developed further. Furthermore, there are a few crucial elements on which a corporation might base its evaluation of relationships with third parties.

The third chapter focuses on a type of business introduced for the first time by IFRS 10 and characterised broadly as corporations that pursue the purpose of managing participation investments rather than leading and coordinating different enterprises to form a group. The concept of investment entities was later incorporated to the standard's wording. Basically, the Board, after a thorough review of the Exposure Draft thanks to the comments received as feedback, has identified three mandatory characteristics that an entity must possess in order to be classified as an investment entity, namely: obtaining funds from one or more investors for the purpose of providing with investment management services, committing to investor that the business purpose is to invest funds solely for returns from capital appreciation, investment income, or both and measures and evaluating the performance of substantially all of its investments on a fair value basis.

Together with other characteristics defined as "typical" and which are seen as a surplus, which will be listed below: the entity has more than one investment, more than one investor, has investors that are not related parties of the entity and it has ownership interests in the form of equity or similar interests. A first matter was raised in relation to this statement because there is no clear reference in the first part of the text to the fact that the typical characteristics are mandatory or not because it is written that the absence of one or more characteristics does not exclude the entity from being an investment entity. Many people also complain about the lack of examples that can lead to a clear decision in specific instances. In addition, the subjective opinion of corporations or professionals from different states and jurisdictions results in a heterogeneous range of outcomes, which might also differ from state to state. Various concerns have been uncovered by evaluating the three main parts of the definition of an investment entity. The first is that there is no clear differentiation or definition of what the standard intends by investment management services and management related services, as shown in the chapter's explanation of the business purpose. Always staying connected to the business objective aspect, the standard advises in its guide that the latter must include exit strategies because the exit strategies must explain how the entity intends to realise capital appreciation. The most notable omission is that there are no guidelines for how these documents should be written or what they should contain. Furthermore, the Canadian Institute of Chartered Accountants presented their thoughts on exit plans related to the life cycle of a corporation. Finally, the concept of fair value was introduced. According to IFRS 10, subsidiaries of investment firms shall not be consolidated but must be evaluated using the fair value technique. IFRS 10 further suggests that alternative valuation methodologies reported in three distinct international standards, namely IFRS 9, IAS 28 and IAS 40, be adopted. However, for many, this causes confusion, and occasionally the notions presented are in contradiction to or overwhelm each other, resulting in unneeded misconceptions. However, even though this novel concept was presented lately and there are few studies that indicate its efficacy, fair value evaluation has received excellent reviews overall.

Conclusions

IFRS 10 Consolidated Financial Statements was issued taking into account user concerns about consolidation and strived to resolve practise diversity by creating a single model for consolidation based on a control approach and providing instructions for adopting that model. IFRS 10 defines control as consisting of three elements: power, exposure to variable returns, and the investor's ability to use that power to affect its amount of variable returns. IFRS 10 establishes standards for determining whether a reporting entity, or parent company has control over one or more other businesses that are defined as investees.

The aim of this academic project was to carry out what are the main perceived concerns, basing the study on the current situation. The analysis was accomplish by going through the main principles illustrated in the standard. The interesting point is that it has been over ten years since the introduction of the IFRS 10, therefore the International Accounting Standard Board in the 2020 has decided to carry out a revision of the international principle in analysis using a tool of the due process, the one of the Post-Implementation Review. In this process national and international accounting bodies are called to give a feedback about specific topics previously evidenced by the IASB referring to the practical experiences pursued by each Body. This comments are the major sources used in this paper to answer the guiding question concerning the practical view of the principles of the IFRS 10.

The initial broad topic considered was the control concept. The fact that this notion is the cornerstone of the standard justifies the prominence and attention allotted to it. This is why the IASB has decided to embark on a road of modernisation and alignment in the consolidation domain at the international level. By analysing the literature, on the whole, it could be stated that control is easy to assess in straightforward settings. However, preparers and auditors must use significant judgement in some circumstances. While they agree that using judgement to determine whether an investor controls an investee is important and appropriate, there are some portions of the standard that entities are struggling to apply in reality, as it can be seen in the summary of findings, which may lead to conflicting results in situations when fact patterns are similar.

The other main topic displayed in the paper regards the investment entities, a particular kind of companies which are increasing in importance in the economic scenario. Also in this area professionals of the sector have indicated that the major issues

are related to interpretation and lacking of guidance and examples within the wording of the IFRS 10. Generally, this challenges arise because the notions inside the standard are principle-based, as a consequence the International Accounting Standard Board did not included quantitative thresholds mandatory guidelines to be respected as for a rule-based standard. Each of the concerns raised throughout this study is guided by the issue of understanding and applying the standard's provisions.

The main goal of this study was to investigate each problem from both a theoretical and practical standpoint in order to provide a more complete understanding of the situation that would be confronted. However, as can be observed from reading the essay, the theoretical opinion was considered a few times. The motivation is evident and overwhelming: there is a general absence of theory underlying the standards' main concepts. The challenge in locating theoretical literature that do not just report the wording of IFRS 10 remains significant. Even among subject theorists, there appears to be little interest in addressing these concerns, which may be owing to a lack of literature. It is also worth noting that the majority of literary books dealing with the core principles of consolidation are produced by the Big 4 (EY, Deloitte, KPMG and PwC), but also by two other audit firms which are BDO and Grant Thornton. Hence, only the opinions of professionals and audit firms, as well as the body of accountants, were reported in the concerns addressed. As a result, the lack of theory and the number of comments about the practicality of the arguments might be attributed to the fact that in reality, queries about application are more common than inquiries about how to theoretically understand a concept. It is also true that some practical problems of application could be overcome if theorists' opinions directed the judgements to be made. To conclude, while the few theoretical opinions presented in the chapters may constitute a modest starting point for future research conducted by professionals, the Board should take into consideration the findings from the comment letters and provide additional guidance to help financial statement preparers.

Appendix A

Question: **RELEVANT ACTIVITIES**	
Company	**Problem detected**
The Japanese Institute of Certified Public Accountants	Difficult to assess relevant activities when they are predetermined by a contractual arrangement. Difficulties linked to SPEs.
MNP	Challenge in determining the activities in early stage companies.
ASC (Singapore Accounting Standards Council)	Complexity when there are more than one relevant activities.
AUSTRALIAN ACCOUNTING STANDARDS BOARD	Difficult to consider the relevant activities of entities that have multiple stage of company lifecycle. There is no provision if the activities that most significant affect returns are to be evaluated at stages or taking into account the entire life of the company.
CPA	Not clear about the continuous assessment of relevant activities. Challenge when dealing with SPEs.
KPMG	No provisions about how to deal with companies run in autopilot and/or companies with narrow scope and predetermined activities. Assessment is complex when there are more than one activity and more than one investor. In particular linked to the pharmaceutical sector.
Allianz	Relevant activities have not to focus only on financing and operating activities.
Ernst & Young Global Limited	Using the guidance lead to different conclusions due to subjectivity of judgements. Determine which is the most significant activity is challenge more pointedly when there are R&D activities. No provisions about SPEs and autopilot entities.
PricewaterhouseCoopers International Limited	Different parties have rights to direct different key activities in different phases.
SAICA (South African Institute of Chartered Accountants)	Lack of guidance with respect to SPEs.
Deloitte	Situations in which the power shifts overtime. In particular in the pharmaceutical sector is difficult to assess which is the activity to be considered relevant.

	Concerns with the concept of autopilot since there are no illustrative examples.
BDOIFRA	Determine relevant activities in situations that change overtime.
Autorité des Normes Comptables (ANC)	Identify relevant activities of SPEs is complex, especially when have predefined activities. Determine which are the activities more relevant in the presence of more than one investor. Determine the weights of relevant activities changing overtime. Situation in which an investor has veto rights.
ICAEW (Institute of Chartered Accountants in England and Wales)	Difficult to assess in the case of more than one investor. Difficult to assess in the situation in which there is a phase of R&D and a phase of selling.
Colombia’s INCP	Difficult to assess in the case of more than one investor. Moreover, this issue is also attributable to a lack of definitions or methods for analysing situations in which professional judgement may be employed incorrectly.
MASB (Malaysian Accounting Standards Board)	Relevant activities vary depending on the stage of the investment. No provision, with respect to the preceding standard, as for autopilot entities.
ISCA (Institute of Singapore Chartered Accountants)	Determine relevant activities in situations that change overtime. Not clear if the assessment has to be made at a specific point in time.
UKEB (UK Endorsement Board)	Identify relevant activities of SPEs is complex, especially when have predefined activities. Determine which are the activities more relevant in the presence of more than one investor. Determine the weights of relevant activities changing overtime.
EFRAG	Difficulties in deciding which is the activity that mostly affect the returns. Not clear when different parties have ability to affect returns/activities. Preparers appear to struggle with recognising and deciding on relevant actions, according to auditors.

Question: **PROTECTIVE AND SUBSTANTIVE RIGHTS IDENTIFICATION**	
Company	**Problem detected**
PETROBRAS	Current wording of the standard could be more precises in providing the definitions. Since only protective rights are illustrated in the IFRS 10, there is confusion about what the IASB means when dealing with substantive rights.
MNP	Standard useful only to determine if rights are protective.
ASC (Singapore Accounting Standards Council)	Complexity when dealing with franchising agreements.
ACSB (Canadian Accounting Standards Board)	Not clear about the level of decision making to be applied when evaluating relevant activities.
Australian Accounting Standards Board	Guideline not sufficient in the process of decision-making. Determine whether rights are protective or substantive in the case of franchising agreements is challenge. Common that franchisor direct decision making activities and therefore these are substantive rights and not protective as stated in the standard.
KPMG	Diversity in practice on certain decisions like veto rights. Lack of consistency.
Ernst & Young Global Limited	Problems with veto rights.
Grant Thornton International Ltd	No guidance on how to distinguish protective and substantive rights.
PricewaterhouseCoopers International Limited	Confusion about the guidance provided for franchising agreements and other investor/investee relationship.
SAICA (South African Institute of Chartered Accountants)	Issues with: franchising agreements; protective rights in SPEs.
Deloitte	Guidance based on a single model with respect to franchising topic, assessment of whether rights are protective or substantive is more holistic in practice than what is described in the standard.
Autorité des Normes Comptables (ANC)	Assessing the rights in a franchise is challenging. How to deal in the presence of veto rights linked to budgeting. Assessing whether the exercise price of a call is a barrier to exercising this option necessitates

	some judgement. Overall huge effort in judgment is required.
ICAEW (Institute of Chartered Accountants in England and Wales)	Issue of veto rights if are considered protective or substantive.
MASB (Malaysian Accounting Standards Board)	Different judgements that lead to different outcomes.
ISCA (Institute of Singapore Chartered Accountants)	Rights of a franchisor. Veto rights in budgeting.
EFRAG	The distinction requires a lot of judgement.

Question: **MAJORITY OF RIGHTS NOT HELD (DE FACTO CONTROL)**	
Company	**Problem detected**
PETROBRAS	No specific guidance on how to assess control in the case of minority rights held. Sometimes factors displayed in the standard are not conclusive. Different conclusion in different situations. Determine relevant activities is difficult in the presence of no contractual arrangements.
ASC (Singapore Accounting Standards Council)	There is little information on the relative size and distribution of other vote holders' shares that can demonstrate or disprove that an investor has the practical power to command an investee's relevant activities unilaterally. Difficult to evaluate past voting rights.
ACSB (Canadian Accounting Standards Board)	Challenge application. Difficult to evaluate past voting rights.
Chartered Accountants	Higher level of judgement required. More examples needed.
OICU-IOSCO	Higher level of judgement required.
BUSINESSEUROPE	Challenge application.
KPMG	Higher level of judgement required. Confusion about the level of rights required to establish power. No indication of relative size of other vote holders' shares.
ASBJ	There is no minimum level of voting rights needed to confer the control.
KASB (Korea Accounting Standards Board)	In the presence of multiple investors with minority of voting rights, it is unclear which is to be considered having control.

	Lack of detail and quantitative criteria. Additional guidance and examples needed.
Allianz	Not easy of obtaining information useful to run the assessment of control.
AOSSG	Information is easy to be gathered for listed companies, otherwise is more difficult.
ICAI	Greater judgement.
Ernst & Young Global Limited	De fact control is difficult to assess in practice.
Grant Thornton International Ltd	Lack of quantitative thresholds that would uniform the judgements.
DRSC (Accounting Standards Committee of Germany)	Cases of unlisted investee obtaining information is more complex.
SAICA (South African Institute of Chartered Accountants)	Challenges in assessing the information. Different interpretation lead to different conclusions on the same topic.
Deloitte	Information difficult to be gathered.
Autorité des Normes Comptables (ANC)	On average assessment of control is based on the active participation. More guidance needed.
ICAEW (Institute of Chartered Accountants in England and Wales)	De fact control is difficult to be applied in practice. Especially when there are no historical data. Judgment need to be revised frequently. Further examples not rules are needed.

Question: **PRINICPAL OR AGENT IDENTIFICATION**	
Company	**Problem detected**
The Japanese Institute of Certified Public Accountants	Need further guidance and examples.
ASC (Singapore Accounting Standards Council)	On the basis of the facts and circumstances of each case, significant judgement is necessary in deciding the weightings that should be assigned to each of the variables. Assessment of a decision maker's exposure to variability of returns from other interests held in an investee is particularly challenging. Specifically, it is unclear what extent of exposure to variability of returns from other interests would tip the scale to indicate that the decision maker is a principal.
Australian Accounting Standards Board	Significant amount of judgment required. Diverse outcomes in practice. Since the topic of agency relationship is linked to rights, the problem of identification of

	substantive vs protective rights apply in practice.
Chartered Accountants Australia And New Zeland	Significant judgement needs to be applied, and there is growing diversity in practice when applying such judgement.
IOSCO	Judgement is required in practice.
JFTC	Need more guidance and quantitative thresholds.
BUSINESSEUROPE	Assessment of control is more complex in cases of delegated power.
KPMG	Need quantitative thresholds. Guidance referred not only to finance and fund sector.
ASBJ	Need quantitative thresholds.
CERTIFIED PUBLIC ACCOUNTANTS	More guidance when considering the exposure to variability aspect. Additional examples referring to other types of industries, not only to fund sector.
KASB (Korea Accounting Standards Board)	Lack of guidance. No guidance on how to apply weights.
Allianz	Judgment complex when considering all factors together, especially in a qualitative way.
ICAI	Challenge when considering exposure to variable returns. Also when applying the assessment to SPEs.
Ernst & Young Global Limited	Some cases require greater judgement which can lead to inconsistent conclusions.
Grant Thornton International Ltd	Need quantitative thresholds.
PricewaterhouseCoopers International Limited	Need quantitative thresholds. Challenge when considering exposure to variable returns. How to consider remuneration.
SAICA (South African Institute of Chartered Accountants)	Guidance difficult to be applied to SPEs.
Deloitte	Examples are only for investment fund industry.
Autorité des Normes Comptables (ANC)	Need quantitative thresholds.
ICAEW (Institute of Chartered Accountants in England and Wales)	Challenge when considering exposure to variable returns.

Question: **DE FACTO AGENT IDENTIFICATION**	
Company	**Problem detected**
The Japanese Institute of Certified Public Accountants	More guidance needed.

Australian Accounting Standards Board	More guidance needed.
KPMG	Little guidance lead to inconsistences in application.
Grant Thornton International Ltd	More guidance needed.
PricewaterhouseCoopers International Limited	Difficulties in assessing de facto control while also applying the criteria for principal agent determination.
SAICA (South African Institute of Chartered Accountants)	More guidance needed.

Question: **INVESTMENT ENTITIES DEFINITION**	
Company	**Problem detected**
The Japanese Institute of Certified Public Accountants	Differences between US GAAP and IFRS.
MNP	Public companies give information not truly representing the entity.
ACSB (Canadian Accounting Standards Board)	Exit strategies and evidence that can provide are linked to the stage of operation. More examples needed on how to apply the criteria of the definition.
Australian Accounting Standards Board	Question of mandatory characteristics and typical characteristics. No coherence in the text. Fair value inconsistences when dealing with the other IFRS standards. Fair value does not provide efficient information. Not clear about the level of documentation needed for the exit strategies to meet the requirements.
Chartered Accountants Australia And New Zeland	Lack of clarity in assessing the typical characteristics together with the element of the definition. Lack of clarity around the evidence when dealing with business purpose and exit strategies.
OICU-IOSCO	High judgement in assessing if the definition is met, is too broad. Better explanation of the meaning of investment management services, investment-related services.
KPMG	Better explanation of the meaning of investment management services, investment-related services.

Certified Public Accountants	Diversity of interpretation in practice of the concepts of investment-related services and investment management services. More guidance on level of documentation needed for exit strategies.
SAICA (South African Institute of Chartered Accountants)	No requirement on how to disclose exit strategies as well as on the level of documentation needed. Which time frame has to be considered.
Deloitte	No illustrative examples of exit strategies. Additional guidance needed with respect to all the factors determining an investment entity.
Autorité des Normes Comptables (ANC)	On an international basis, diversity in the application of the definition due to diversity in jurisdictions. Inconsistent outcomes when evaluating fact and circumstances. Exemption on IFRS 10 and on IAS 28 seem to be similar and overlapping.
ICAEW (Institute of Chartered Accountants in England and Wales)	In applying the definition entities have to employ significant efforts. No provisions on how formal have to be the exit strategies.

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