30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
E-mail: iasb@iasb.org Website: www.iasb.org

International
Accounting Standards
Board

INFORMATION FOR OBSERVERS

Board Meeting:	**16 October 2008, London**
Project:	**Consolidation**
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[*Draft*] International Financial Reporting Standard X

Consolidated Financial Statements

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[*Draft*] International Financial Reporting Standard X *Consolidated Financial Statements*

Core principles

1 **This [*draft*] IFRS requires a reporting entity to present its assets and liabilities independent of the structure through which they are controlled. This ensures that a reporting entity presents its assets and liabilities the same way, whether the reporting entity controls the assets and is obligated for the liabilities:**

(a) **directly; or**

(b) **indirectly, by controlling the entity that controls those assets and is obligated for those liabilities.**

2 **A reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity for the benefit of the reporting entity.**

3 **A reporting entity must disclose information that enables users of its financial statements to evaluate:**

(a) **the judgements made by management in applying this IFRS when reaching decisions about whether it controls other entities;**

(b) **the nature and financial effect of legal boundaries that are a consequence of the use of subsidiaries to structure the activities of the group; and**

(c) **the nature of and risks associated with its involvement with structured entities that it does not control.**

Scope

4 This [*draft*] IFRS applies to all entities, with the following exceptions:

(a) A parent need not present consolidated financial statements if and only if:

(i) the parent is itself a wholly owned subsidiary or is a partially owned subsidiary of another entity and 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;

(ii) the parent's 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) the parent 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) the ultimate or any intermediate parent of the parent produces consolidated financial statements available for public use that comply with International Financial Reporting Standards.

(b) A subsidiary is excluded from consolidation if the subsidiary meets at the acquisition date the criteria to be classified as held-for-sale in accordance with IFRS 5 *Non-current Assets held for Sale and Discontinued Operations*. In such circumstances the parent applies IFRS 5.

(c) Post-employment benefit plans or other long-term employee benefit plans to which IAS 19 applies.

5 This [*draft*] IFRS does not deal with methods of accounting for business combinations and their effects on consolidation, including goodwill arising on a business combination (see IFRS 3 *Business Combinations*).

Consolidated financial statements

6 **A reporting entity, other than one described in paragraph 4(a), shall present financial statements that consolidate its assets, liabilities, equity, revenues and expenses with those of the entities that it controls and present them as those of a single entity.**

7 Consolidation begins from the date that a parent achieves control and ceases when it loses control.

Control of an entity

8 **A reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity for the benefit of the reporting entity.**

9 A reporting entity that controls another entity is a parent and the entity it controls is its subsidiary.

Paragraphs B1 to B20 provide additional guidance on the characteristics of control.

Assessing control

10 Power and benefits are related and must be considered together. The party that has the most to gain or lose from an entity's activities is the party most likely to have the power to direct that entity's activities.

Directing the activities of an entity

11 **A reporting entity that has power sufficient to direct the activities of an entity is presumed to use that power for its own benefit.**

12 **A reporting entity has the power to direct the activities of another entity if it can:**

(a) **appoint or remove the majority of the members of that entity's governing body, if control of that entity is by that body; or**

(b) **determine that entity's strategic operating and financing policies, because of a statute or agreement.**

13 Many entities have a governing body that is responsible for determining that entity's strategic operating and financing policies and directing its activities. A reporting entity that has power over such an entity's governing body has the ability to direct the activities of that entity.

14 If membership of an entity's governing body is determined by voting rights, a reporting entity that can exercise more than half of those voting rights has power over that governing body and therefore controls that entity. An agreement between the reporting entity and other vote holders can also give the reporting entity the right to exercise more than half of the voting rights, even though the reporting entity itself may not hold more than half of the voting rights. The holder of such power is presumed to use that power for its own benefit.

A majority of the voting rights but no control

15 A reporting entity can have a majority of the voting rights of an entity but not control that entity. This will occur if legal requirements, the founding documents or other contractual arrangements of the other entity restrict the power of the reporting entity to the extent that it cannot direct the activities of the entity. For example, if an entity in which a reporting entity has a majority of the voting rights is placed under statutory supervision, the reporting entity is prevented from directing the activities of that entity and therefore does not control that entity.

Control with less than a majority of the voting rights

16 A reporting entity can control another entity even if it holds less than half the voting rights of that entity.

17 A reporting entity controls another entity if:

(a) the reporting entity has substantially more voting rights than any other party; and

(b) the reporting entity's voting rights are sufficient to give the reporting entity power over that entity's governing body.

Other means of control

18 A reporting entity controls another entity if the reporting entity has a significant voting interest in that entity and other arrangements that allow the reporting entity to direct the activities of that other entity. Such arrangements might include supply contracts for goods or services that are part of the ongoing major or central activities of the reporting entity or the right of the reporting entity to participate in appointing the management of the other entity.

Paragraphs BX to BX provide application guidance for the circumstances in which a reporting entity controls another entity even though it holds less than half the voting interests of the entity.

Structured entities

19 The founding documents of an entity (such as a constitution) and the legal framework in which the entity operates often define how the activities of that entity are directed. Such documents can also define the range and type of activities the entity is permitted to undertake. For example, the founding documents might preclude an entity from investing in a new type of activity without all of its owners agreeing to such an investment. An agreement between the entity and the parties that contract with the entity also might restrict the entity's activities. For example, a debt agreement might limit

the entity's ability to invest in a new type of activity. Often, the conditions for changing or relaxing those restrictions are limited severely.

20 Some entities' activities are restricted by allocating responsibilities to parties by way of contractual arrangements, including predetermining how a party must respond to anticipated circumstances arising in the entity. In such cases, the direction of the entity cannot be determined by assessing who controls the governing body or by assessing who directs its strategic operating and financing policies.

21 Such entities are sometimes called special purpose entities, special purpose vehicles or conduits. Sometimes, those entities are referred to according to the type of transaction in which they are involved, such as securitisation vehicles, structured investment vehicles and lease vehicles, among other names. Some such entities are typically established to undertake a specific type of activity, such as to perform research and development for the benefit of the reporting entity. For the purposes of this [*draft*] IFRS, entities for which control cannot be determined by assessing who controls the governing body or by assessing who directs its strategic operating and financing policies are referred to as *structured entities*.

Control of a structured entity

22 This [*draft*] IFRS presumes that if the reporting entity benefits substantially more than any other party from its interest in a structured entity, then the reporting entity has power sufficient to control that structured entity. This presumption is on the basis that power and benefits are related.

23 A reporting entity that benefits substantially more than any other party from its interest in a structured entity must demonstrate that it does not control the structured entity. In assessing whether a reporting entity controls a structured entity, the form of the structured entity is less important than

24 An entity that has a limited range of activities, such as an entity that manages an asset securitisation, needs only a correspondingly limited range of activities to be controlled. For example, if the only assets of an entity are receivables, then how any defaulting receivables are managed is the only activity that affects the benefits generated by the entity. In this example, the party with the power to direct how any defaulting receivables are managed, for its benefit, controls that entity.

Purpose

25 A reporting entity controls another entity when that other entity has been created by, or for, the reporting entity to undertake activities for the benefit of the reporting entity. In such cases, the creation of the entity for the benefit of the reporting entity is evidence that the reporting entity has power sufficient to control the other entity. For example, such is the case when a parent creates a subsidiary as a means of providing the parent with a source of long-term financing, to hold legal title to an asset that the parent uses in its own activities or to provide the parent with a supply of goods or services that are part of the parent's activities.

26 Economic dependence of an entity on the reporting entity (such as relations of suppliers to a significant customer) does not, by itself, lead to a conclusion that the reporting entity controls that other entity.

Ability to change the restrictions under which an entity operates

27 A reporting entity controls a structured entity if the reporting entity has a unilateral ability to direct the activities of the structured entity for the benefit of the reporting entity through changes in the restrictions under which the structured entity operates. For example, a reporting entity controls an entity if the reporting entity has the right to dissolve the entity,

Related arrangements

28 A parent can control a subsidiary by directing activities by means of multiple, related arrangements. For example, a parent could establish a subsidiary, with restrictions on its activities, to hold assets that the parent uses in its activities. The parent also appoints an agent to direct the activities of the subsidiary in accordance with predetermined policies. Those policies require the parent to assume responsibility for the subsidiary from the agent in specified circumstances. All of these arrangements would be considered in establishing that the parent controls the subsidiary.

Accounting requirements

29 **Consolidated financial statements present the assets, liabilities, equity, revenues and expenses of the parent and its subsidiaries after eliminating all transactions between the entities in the group during the reporting period and all balances between the entities in the group at the reporting date.**

30 **Consolidated financial statements shall be prepared using uniform accounting policies for like transactions and other events in similar circumstances.**

31 If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements in preparing the consolidated financial statements.

Non-controlling interests

32 Non-controlling interests are presented in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent.

33 Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (ie transactions with owners in their capacity as owners).

Loss of control

34 If a parent loses control of a subsidiary, the parent:

(a) derecognises the assets and liabilities of the former subsidiary from the consolidated statement of financial position;

(b) recognises the gain or loss associated with the loss of control attributable to the controlling interest; and

(c) accounts for any investment retained in the former subsidiary and any amounts owed by or to the former subsidiary in accordance with other IFRSs from the date when control is lost.

Disclosure

35 **An entity must disclose information that enables users of its financial statement to evaluate:**

(a) **the judgements made by management in applying this [*draft*] IFRS when reaching decisions about whether it controls other entities;**

(b) **the nature and financial effect of legal boundaries that are a consequence of the use of subsidiaries to structure the activities of the group;**

(c) **the nature of and risks associated with its involvement with structured entities that it does not control;**

(d) **the accounting consequences for the parent shareholders when their ownership interest relative to that of any non-controlling interests in a subsidiary changes during the reporting period, but the parent does not lose control of that subsidiary; and**

(e) **the accounting consequences for the group when the entity loses control of a subsidiary during the reporting period.**

36 To meet the objectives in paragraph 35, an entity shall disclose the information specified in paragraphs BX-BX of the application guidance.

37 If the specific disclosures required by this and other IFRSs do not meet the objectives in paragraph 35, an entity shall disclose whatever additional information is necessary to meet those objectives.

Effective date

38 An entity shall apply this [*draft*] IFRS in its annual financial statements for periods beginning on or after [Date to be inserted after exposure]. Earlier application is permitted. If an entity applies this [*draft*] IFRS in its financial statements for a period before [Date to be inserted after exposure], it shall disclose that fact.

Withdrawal of IAS 27 and SIC-12

39 This [draft] IFRS supersedes IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation—Special Purpose Entities*.

Appendix A - Defined terms

Consolidated financial statements are the financial statements of a group of entities presented as a single economic entity.

For the purposes of this [*draft*] IFRS, **involvement** includes both contractual and non-contractual involvement that the entity has in structured entities that exposes the entity to risk. Involvement includes the holding of equity or debt instruments, as well as other forms of involvement such as the provision of funding, liquidity support, credit enhancement, guarantees, and asset management services.

Control of an entity is the power of a party to direct the activities of an entity for the benefit of that party.

An **entity** is …[ensure that a silo is consolidated. Suggest including a definition of a subsidiary and a paragraph (application or an example) with a silo.]

A **group** is a parent and all its subsidiaries.

Non-controlling interest is the equity in a subsidiary not attributable, directly or indirectly, to a parent.

A **parent** is an entity that has one or more subsidiaries.

For the purposes of this [*draft*] IFRS, **party** is used broadly to include legal and other entities as well as a single individual or a group of individuals.

A **subsidiary** is an entity, including an unincorporated entity such as a partnership or trust, which is controlled by another entity (known as the parent).

Appendix B - Application Guidance

Characteristics of control

Control must be current

B1 Control must be current. A reporting entity has a present ability to direct the activities of an entity if it controls the strategic operating and financing policies of the entity or has contractual rights to direct the activities of the entity.

B2 If the means of directing the activities of an entity have been predetermined, such predetermination gives the parent the present ability to direct the activities of the subsidiary. Control is current because that predetermination ensures that any anticipated actions are taken for the benefit of the parent when such actions are necessary.

B3 The ability to obtain control is not the same as having control. For example, although warrants, options, convertible instruments and other similar instruments can, if exercised or converted, give the holder control of an entity, such an instrument is not in itself sufficient to give its holder control of the entity.

B4 However, a reporting entity that holds such instruments shall consider those instruments when assessing control. Such instruments are often accompanied by other rights that combine to give the instrument holder control of the entity. The reporting entity shall examine all facts and circumstances including any related contractual arrangements that affect the ability of the reporting entity to direct the activities of the other entity for its benefit.

B5 A parent loses control of a subsidiary when it can no longer direct the subsidiary's activities.

Control is not shared

B6 Although a parent does not share its control of a subsidiary, its power does not need to be absolute. Other parties might have protective rights, through contractual arrangements or through operation of law, which, for example, often exist for non-controlling interests. Protective rights restrict the power of the parent, but they do not preclude it from controlling the subsidiary.

B7 Paragraphs B21 to **Error! Reference source not found.** provide additional guidance on protective rights.

Assessment is continuous

B8 The power a parent has to direct the activities of a subsidiary can change as a consequence of actions by the parent or through changes in facts or circumstances. Therefore, assessing whether the reporting entity has power sufficient to control another entity is a continuous process.

B9 A change in control is a consequence of a change in power. A change in the benefits to a reporting entity from another entity, without a corresponding change in the reporting entity's power over that entity, does not cause that reporting entity to obtain or lose control of that other entity.

B10 A reporting entity might obtain or lose control of another entity as a consequence of completing two or more related arrangements (transactions). In determining whether to treat the arrangements as a single arrangement, a reporting entity shall consider all of the terms and conditions of the arrangements and their economic effects.

B11 One or more of the following indicate that a party should treat multiple arrangements as a single arrangement:

(a) they are entered into at the same time or in contemplation of each other;

(b) they form a single arrangement designed to achieve an overall commercial effect; or

(c) one arrangement considered on its own is not justified economically, but it is justified economically when considered together with other arrangements, such as when a sale of shares is priced below market and is compensated for by a subsequent sale priced above market.

Power and Benefits

Power

B12 A reporting entity that controls another entity can direct the activities of the other entity and, by doing so, benefit from the activities of that entity.

B13 A parent can direct the activities of a subsidiary:

(d) by determining the subsidiary's strategic operating and financing policies, whether that is achieved by controlling its governing body or by statute or agreement (see paragraphs 11 to 17);

(e) by means of contractual arrangements, including predetermining how the entity will respond to anticipated events, that ensure the parent obtains benefits from the activities of the subsidiary (see paragraphs 18 to 27); or

(f) by having the right to remove, without cause, another party that is empowered to direct the activities of the subsidiary.

B14 A party that directs the activities of an entity primarily for the benefit of a reporting entity acts as an agent of the reporting entity. In such cases the reporting entity has the power to direct the activities of that entity through its agent.

B15 Paragraphs BX to BX provide additional guidance on the relationship between a principal and its agent.

Benefits

B16 The term benefit has wide meaning in this [draft] IFRS. The benefits to a parent include returns, such as dividends and changes in the value of the subsidiary attributable to the parent. Benefits also include up-front fees, access to cash or fees for servicing a subsidiary's assets or liabilities, tax benefits, and positive liquidity effects that a parent realises from controlling a subsidiary.

B17 Some benefits that are available to the parent are not available to non-controlling interests. For example, a parent might use its own assets in combination with the assets of a subsidiary, such as combining functions to achieve economies of scale, sourcing scarce products, gaining access to proprietary knowledge or limiting some operations or assets, to enhance the value of the parent's other assets.

B18 Benefits potentially include a wide range of returns to the parent, and because returns can be positive or negative, the potential benefits to a parent can also be positive or negative. The fact that potential benefits to a parent can be positive or negative is consistent with the fact that a parent enjoys the rewards and is exposed to the risks from controlling a subsidiary.

B19 The benefits to a parent from its interest in a subsidiary will vary with the activities of the subsidiary and have the potential to be positive. A parent has a right to a share of changes in the value of its subsidiary but, because benefits vary, a parent might never receive a positive return from a subsidiary. For example, a parent might establish a subsidiary to undertake research and development activities. The parent benefits from any successful outcome from those activities, but loses its investment in the subsidiary if those activities are unsuccessful.

B20 A reporting entity shall consider the different types of benefits it has received, and expects to receive, from its involvement with another entity, including benefits from related arrangements. For example, if a reporting entity generates fees from sponsoring an entity and remains exposed to the entity by providing credit and liquidity support, then the sponsorship fees and the returns from the credit and liquidity support must be considered together.

Protective rights

B21 Sometimes the ability of a reporting entity to direct the activities of another entity is restricted by approval or veto rights granted to other parties. Those rights might have little or no effect on the reporting entity's ability to control the entity or they might be so restrictive that they prevent the reporting entity from controlling the other entity.

B22 A reporting entity shall assess whether it controls an entity even though

ETC ETC ETC as per Agenda paper 13A