



Project	Consolidation
Topic	The project plan

Introduction

1. The purpose of this paper is to discuss the timetable for the consolidation project in light of comments received from respondents to *ED10 Consolidated Financial Statements*. This issue is highlighted as issue 1 in the summary of comment letters (agenda paper 4A).
2. The staff is asking the Board to make a decision about how the project should progress towards publication of a final IFRS for consolidated financial statements, and to confirm whether it agrees with the topics proposed for deliberation included in the appendix.

Comments from respondents to ED10 about the timing of the project

3. Many respondents to ED10 commented on the timing of the consolidation project. All understood and recognised the need for the Board to accelerate the work on consolidation in response to the financial crisis and calls from the G20 and Financial Stability Forum to address weaknesses in accounting and disclosure standards for off balance sheet vehicles. The vast majority also agreed with the objectives of the project—to improve the definition of control and related application guidance so that a single control model could be applied to all entities, and to improve disclosure requirements about consolidated and unconsolidated entities.

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in *IASB Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

4. However many questioned the need to accelerate the project as a whole, noting that they were of the view that IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation—Special Purpose Entities* function effectively, resulting in consolidation of the right entities even under the stress of recent market conditions. Some noted that the Board had not demonstrated that there are weaknesses in the current requirements, and therefore, that there is an urgent need to change those requirements. In addition, many feared that accelerating the work on developing a single control model might result in requirements that fail to improve on the current requirements, which could potentially create more inconsistency in practice.
5. Consequently, many of those respondents recommended that the Board split the project into two parts:
 - (a) Firstly, to focus on improving the disclosure requirements relating to consolidated and off balance sheet entities as an urgent matter (although some believe that a consolidation standard should not include disclosure requirements relating to off balance sheet entities).
 - (b) Secondly, to work together with the Financial Accounting Standards Board (FASB) in developing a control model that can be applied to all entities. Some respondents noted that they believed that the control element of the project could still be achieved before the 2011 deadline, whilst others suggested publication of a discussion paper as the starting point for such a joint project.
6. Respondents also noted the following in commenting on the accelerated timetable for the project:
 - (a) The objective of the project (ie to develop a control model that can be applied to all entities) is a difficult but worthy objective. The lack of clarity in the exposure draft on the proposed control model and how it would be applied demonstrates that a more comprehensive analysis and debate is needed that would include the information needs of users and how best to meet those needs in terms of consolidation. One respondent noted that ‘it is worth taking sufficient time to get [the

objectives and principles of consolidation] right, and the quality of this part of the project should not be compromised by the urgent need to improve disclosures.’

- (b) Before publication of a final IFRS, the Board should undertake field testing of the application of the control model and the disclosure requirements.
- (c) Any changes to the consolidation requirements must be coherent with any revisions to the derecognition framework—one respondent noted that ‘a single principles based framework for consolidation and derecognition would improve the transparency and consistency of financial reporting.’
- (d) Any changes to the consolidation requirements should be consistent with the conclusions reached in the Reporting Entity phase (phase D) of the conceptual framework project. Some suggested that the Reporting Entity phase (phase D) of the conceptual framework project should be finalised before publication of a final IFRS on consolidation.

Options for the Board in progressing towards publication of a final IFRS

- 7. The staff is of the view that the comments received from respondents confirm that the objectives of the project are the right objectives, ie that the Board should seek to improve the definition of control and related application guidance so that a control model can be applied to all entities, and should seek to improve the disclosure requirements about consolidated and unconsolidated entities. Achieving those objectives would improve financial reporting and the transparency of information available to users of financial statements.
- 8. The G20 and Financial Stability Forum have asked the Board to urgently address weaknesses in accounting and disclosure standards for off balance sheet vehicles.
- 9. 2011 is also an important milestone for the Board. The Board needs to make any major improvements to IFRSs by mid-2011—the consolidation project is

included in the Memorandum of Understanding and the proposed changes to the consolidation requirements are a major improvement to IFRSs.

10. Therefore, with those considerations in mind, we believe that the Board has three options available in progressing towards publication of a final IFRS on consolidation:
 - (a) Option 1: to proceed as planned, aiming to publish a final IFRS on consolidation (including both the control model and disclosures) by the end of 2009.
 - (b) Option 2: to align the publication date for a final IFRS on consolidation with that for derecognition.
 - (c) Option 3: to split the project into two parts, developing disclosure requirements as soon as feasible, and then working on the control model with a target of publishing a final IFRS on consolidation by mid-2011.

11. We believe that the following are relevant when considering each of the options:
 - (a) Both the consolidation and derecognition projects address the accounting and disclosures for off balance sheet vehicles. Many constituents believe that those two projects are inextricably linked and that we should ensure that the principles developed in one project are consistent with the principles developed in the other project before either project is finalised. The G20 and Financial Stability Forum have requested that the Board address the accounting and disclosure standards for off balance sheet vehicles, implying that the principles developed should work together to ensure the appropriate accounting and disclosure of those vehicles.
 - (b) The comments received on the consolidation exposure draft have identified that additional work is necessary in terms of clarifying the control model and its application. We think that we will be able to address a lot of the comments and concerns by improving the structure and drafting. However there are a number of issues that require further

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discussion by the Board, eg the control principle, power in the context of structured entities, agents in dual role situations.

- (c) Further, we agree with those constituents that have commented that illustrative examples are necessary in order to aid consistent application of the requirements. The new requirements will potentially ask preparers to assess control in a different way (particularly when assessing control of a structured entity). Consequently, preparers, auditors, regulators and others will be required to have a clear understanding of the appropriate application of those new requirements. Developing illustrative examples that are helpful and lead to more consistent application, without raising new issues or inadvertently creating rules within those examples, takes time.
- (d) We think that it would be helpful to test the requirements, application guidance and illustrative examples before publication of the final IFRS. Ideally, during the redeliberations and drafting stages, we would ask some constituents to test the draft requirements for the control model by applying those requirements to real fact patterns. We also plan to target users to assess the usefulness of any new disclosure requirements, and preparers in terms of the availability of the information to meet those disclosure requirements.
- (e) Option 1—a target publication date of the end of December 2009—assumes that the Board will reach decisions on all issues when discussing those issues for the first time, ie there is no time buffer in the project plan. At the March 2009 Board meeting, the FASB and the IASB agreed that the boards would work together to develop common requirements for consolidation. If the FASB are to become part of the deliberations, the project plan would also assume that the FASB could reach decisions on those issues when discussing for the first time. [The FASB members have not yet discussed control in the context of voting interest entities.]

- (f) The comment period for the derecognition exposure draft ends on 31 July 2009. Some respondents to ED10 noted that they may have additional comments on the proposed consolidation standard when reviewing the derecognition exposure draft.

Option 1: finalise by the end of 2009

12. The current IASB work plan includes a target completion date for the consolidation project of Q4 2009. Finalising the project by the end of 2009 would respond to calls for the Board to urgently address the weaknesses in the accounting and disclosure requirements of one of the two projects that relate to off balance sheet vehicles (derecognition being the other relevant project).

Option 2: to align the completion dates for consolidation and derecognition

13. Option 2 proposes to align the completion dates of the consolidation project with that of the derecognition project.¹
14. The staff recommend option 2 because:
- (a) we think that it is helpful to publish both sets of requirements relating to off balance sheet entities at the same time, ensuring that the requirements work together to require the ‘right’ accounting (in terms of recognition and derecognition) and disclosure for off balance sheet entities, as well as all other entities and financial instruments.
 - (b) option 2 allows the Board and staff more time to address the considerations noted in paragraph 11 without compromising the Board’s objective of responding quickly to calls to address the weaknesses in the accounting and disclosure standards for off balance sheet vehicles. We think that we will be able to address the concerns expressed by respondents to ED10 in that timeframe.

¹ The target completion date for the derecognition project is June 2010.

- (c) moving the completion date for consolidation may facilitate the completion of the Reporting Entity phase (phase D) of the conceptual framework project before or at the same time as the consolidation standard.

Option 3: split the project into two parts

- 15. Option 3 would mean addressing the disclosure requirements as a priority, and delaying the completion of the control aspects of the project. Consequently, the Board would not urgently address the accounting requirements for off balance sheet vehicles. Supporters of option 3 would, therefore, agree with those constituents that suggest that there is not an urgent need to replace the control requirements of IAS 27 and SIC-12.
- 16. In addition, option 3 would mean developing disclosure requirements on the basis of consolidation requirements that will change in the near future. This approach would still require a means of setting the scope of the disclosures, ie whether we use ‘structured entities’ or another term, we will need to find a means of ensuring that we are asking for additional information for those entities and transactions that are useful without asking for extensive disclosures that would not be useful. Addressing disclosures and the control model together presents us with the opportunity to ensure that the disclosures complement the accounting requirements, ie the accounting requirements tell users of the financial statements about the assets and liabilities that are controlled whereas the disclosure requirements tell users about a reporting entity’s exposure to risks.

Questions for the Board

Does the Board agree with the staff’s recommendation to align the completion dates of the consolidation and derecognition projects, ie option 2 in this paper? If not, which option do you prefer and why?

Do you agree with the topics identified for deliberation in the project plan included in the appendix?

Appendix—project plan for consolidation

Topic for discussion / additional information ²
Issue 1: The project—discussed in this paper
Issue 2: Basis for consolidation <ul style="list-style-type: none"> • Risks and rewards • Reputational risk
Issue 3: The control definition <ul style="list-style-type: none"> • Power to direct the activities • Returns • The link between power and returns
Issue 4: Assessing control (including illustrative examples) <ul style="list-style-type: none"> • Power with less than a majority • Options/convertible instruments • Power in the context of structured entities (including what activities matter, when power can be shared and silos) • Agent-principal (including dual role) • Protective/participating rights (to include testing of the requirements, guidance and examples)
Issue 5: Disclosures <ul style="list-style-type: none"> • Consolidated entities • Unconsolidated entities (to include testing of the requirements)
Other issues <ul style="list-style-type: none"> • Scope—investment companies • Transition

² Comments received relating to IAS 28 *Investments in Associates* will be discussed as part of the joint ventures project at the June 2009 Board meeting.