Project **Consolidation**

Topic **Continuous assessment of control**

Introduction

1. Paragraph 15 of ED10 requires a reporting entity to assess control continuously. Paragraph 16 states that:

   > 'A reporting entity's power to direct the activities of an entity can change as a consequence of actions by the reporting entity or because of changes in facts and circumstances. Fluctuations in the reporting entity's returns, without a change in the reporting entity's power to direct the activities of another entity, does not cause that reporting entity to obtain or lose control of that other entity. However, if the reporting entity ceases to receive returns from its involvement with an entity, it does not control that entity.'

Comments from respondents on the continuous assessment of control

2. Most respondents to ED10 did not comment on the requirement to assess control continuously, which we interpret as indicating their approval of the requirement. Some, however, feared that '[continuous assessment] creates the possibility that entities may move in and out of the consolidated group from one reporting period to the next, or twice within one period.' [CL44]. One respondent thought that the requirement 'could be interpreted to require preparers to document a clean sheet assessment of control each quarter similar to initial assessment. Such quarterly assessments would be very time consuming and not cost beneficial…We believe that the Board should revise paragraph 16 to indicate that the "continuous" assessment is event driven, with a reporting entity continuously monitoring events to determine if a

change in circumstances warrants a reconsideration of whether or not the reporting entity has the power to direct the activities of the investee.' [CL28]

3. Others questioned the wording of the last sentence of paragraph 16 of ED10 (reproduced above in paragraph 1 of this paper), noting that 'it is not that the returns are nil but that the reporting entity no longer has the rights to receive the returns. Instead the returns are being received by another party, thus, the reporting entity no longer controls the entity.' [CL93]

Staff analysis regarding the continuous assessment of control

4. When developing the proposals in the exposure draft, the Board noted that the assessment of control requires consideration of all relevant facts and circumstances. It would be impossible to develop reconsideration criteria that would apply to every situation in which a reporting entity obtains or loses control of another entity. The reassessment of control only when particular reconsideration criteria are met would inevitably lead to inappropriate consolidation in some cases and failure to consolidate in others. The Board also did not expect frequent changes in control as a result of changes in market conditions, because those changes do not often lead to a change in a reporting entity's power to direct the activities of an entity.

5. We agree with the Board's analysis; a reporting entity should assess control continuously and it would be inappropriate to require reassessment of control only upon the occurrence of a specified event or circumstance. However, we think that we should clarify the following (either in the standard or in the basis):

   (a) Control of an entity can change as a consequence of changes in the facts and circumstances that are relevant when assessing control. Continuous assessment requires the reassessment of control when there is a change in the relevant facts and circumstances. This is not restricted to occurring only at each reporting date, and nor does it require the reassessment of all control or potential control relationships at each reporting date.

(b) Control of an entity changes if either:

   (i) a reporting entity obtains or loses the power to direct the activities of an entity (assuming that it also has exposure to variability of returns).

   (ii) a reporting entity obtains rights or becomes exposed to variability of returns (assuming that it also has power).

   (iii) a reporting entity ceases to have rights or be exposed to variability of returns (assuming that it also had power).

(c) Control of an entity does not change simply because of fluctuations in the amount of returns a reporting entity receives.

6. In its amendments to FIN 46(R) *Consolidation of Variable Interest Entities* published within SFAS 167 in June 2009, the FASB changed the requirements regarding the assessment of control of variable interest entities that previously included specific reconsideration events. SFAS 167 requires ongoing or continuous assessment to determine whether an entity with a variable interest in a variable interest entity is the primary beneficiary of the entity.

Question for the Board: continuous assessment of control
Does the Board agree with the staff recommendations in paragraph 5 that a reporting entity be required to assess control continuously and that the final standard and basis should clarify the application of that requirement? If not, what do you propose and why?