



Project	Consolidation
Topic	Joint project

Introduction

1. The IASB published ED10 *Consolidated Financial Statements* in December 2008, and is in the process of deliberating the proposals in ED10, taking into account comments from respondents to the exposure draft, and input received at round tables held in Toronto, Tokyo and London in June 2009. ED10 proposed a control model that applies to all entities.
2. The FASB published SFAS 167 *Amendments to FIN 46(R) Consolidation of Variable Interest Entities* in June 2009. The FASB is currently working with the IASB to address the consolidation of “voting interest entities” as the IASB continues its project on consolidations of all entities.
3. The MOU progress report and timetable for completion issued by the IASB and the FASB in September 2008 stated the following regarding consolidation:

Ongoing projects—both Boards to issue exposure drafts in 2008/2009 and final standards in 2009/2010.

Next steps—decision in 2008 on a strategy to develop a common standard.
4. At the joint meeting in March 2009, both boards decided that they would deliberate the issues raised by constituents in comment letters with the objective of reaching common conclusions. At the conclusion of those redeliberations, the IASB would issue a final standard on consolidation and the FASB would publish an exposure draft.

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

Comments made in relation to the application of IFRSs or U.S. GAAP do not purport to be acceptable or unacceptable application of IFRSs or U.S. GAAP.

The tentative decisions made by the FASB or the IASB at public meetings are reported in FASB *Action Alert* or in IASB *Update*. Official pronouncements of the FASB or the IASB are published only after each board has completed its full due process, including appropriate public consultation and formal voting procedures.

IASB/FASB joint paper

5. The purpose of this paper is to set out the similarities of the consolidation approaches that have been developed by both boards to date, and to propose a plan to conduct the consolidation project jointly.

Summary of the control models included in SFAS 167 and ED10

6. Control is the basis for consolidation in both SFAS 167 and ED10. Both documents define control as having two elements—a power element and a returns or benefits/losses element. An entity controls another entity when it has both the power to direct the activities of that other entity and the ability to benefit from that power. Benefits include the ability to mitigate losses in situations in which a reporting entity has the obligation to absorb losses of an entity.
7. An entity must have some exposure to risks and rewards (or variable returns) in order to control another entity. The level of exposure to risks and rewards is an indicator of control. However, exposure to a particular level of risks and rewards without any power to direct the activities does not equate to control. Similarly, control does not equate to having the power to direct the activities of an entity without any variable returns (or without a variable interest). However, the staffs would expect that the reporting entity with “power” would have exposure to risks and rewards.
8. Power is used to mean ‘ability’—an entity meets the power element when it has the current ability to direct the activities of another entity; exercise of that power is not required. Power also need not be absolute in that protective rights held by other parties do not preclude an entity from controlling another entity.
9. The returns or benefits/losses element of both models require the controlling entity to receive or be exposed to variable returns from its involvement with (or have a variable interest in) the controlled entity. The returns element can be either positive or negative. ED10 describes returns broadly to include, for example, synergistic returns.
10. Although the principles are the same, the application of those principles is not identical. The left-hand column of the following table sets out the requirements

IASB/FASB joint paper

in SFAS 167; the right-hand column notes whether ED10 addresses the topic, and whether and when the IASB will deliberate the issue:

	Requirements of SFAS 167	Proposals in ED10—status of IASB deliberations
	Definition	
(a)	To meet the power element, the controlling entity must have the power to direct the activities of the variable interest entity that matter (ie the activities that most significantly impact the entity’s economic performance).	ED10 stated that the controlling entity must have the power to direct the activities of another entity to generate returns for the controlling entity. ED10 did not specifically refer to the activities being those that most significantly impact the economic performance. The IASB will deliberate the issue at the October 2009 Board meeting. IASB staff recommendation is to clarify that to meet the power element, the controlling entity must have the power to direct the activities of another entity that significantly affect the returns.
	Multiple parties have decision-making authority	
(b)	When multiple unrelated parties make decisions about the activities that matter and those decisions require the consent by each of the parties with power, power is considered shared and no party controls the entity.	This is joint control in IFRS. Similar outcome to the SFAS 167 approach in that power is shared and no party controls the entity.
(c)	When multiple parties direct the activities that matter and the nature of the activities that each party is directing is the same, then the party, if any, with the power over the majority of those activities is considered to meet the power element of the control model.	Not addressed in ED10. The IASB will deliberate the issue at the October 2009 Board meeting. IASB staff recommendation similar to, but not exactly the same as, the requirements in SFAS 167 as follows: in the situation described, the party with the power to direct the activities of the entity that <i>most</i> significantly affect the returns is considered to meeting the power element of the control model (ie power over the largest portion of those activities).
(d)	When multiple parties direct the activities that matter and the nature of the activities that each party is directing is not the same, then the party, if any, with the power to direct the activities that <i>most</i> significantly impact the entity’s economic performance is	Not addressed in ED10. The IASB will deliberate the issue at the October 2009 Board meeting. IASB staff recommendation is the same as the requirements in SFAS 167.

IASB/FASB joint paper

	considered to meet the power element of the control model.	
	Reputational risk	
(e)	SFAS 167 includes an example that refers to an entity’s implicit financial responsibility to ensure that an entity operates as designed (sometimes known as reputational risk). That example states that an entity with such implicit financial responsibility may have established arrangements that result in the sponsor being the entity that meets the power element of the control model.	Discussed only in the basis for conclusions of ED10. The IASB decided in July 2009 that the final standard would include a specific reference to reputational risk similar to the wording of SFAS 167 noting that, similar to other risks, exposure to reputational risk does not give an entity power. However the existence of reputational risk can give an entity an incentive to control another entity.
	Agency relationships	
(f)	An entity considers participating and kick-out rights only when these rights are held by a single party with the unilateral ability to remove the party that otherwise would have the controlling financial interest.	ED10 included removal rights as an indicator of an agency relationship, and did not specifically mention other participating rights (although it did discuss protective rights). The IASB will deliberate the issue at the October 2009 Board meeting. IASB staff recommendation is to clarify that substantive kick-out and other participating rights should be considered when assessing control. However, the staff recommendation is that the exercise of a substantive kick-out or participating right can require the agreement of more than one party.
(g)	A decision maker does not have a variable interest (and therefore acts as an agent) when, among others, the decision maker’s return is (a) at the same level of seniority as other operating liabilities of the variable interest entity, (b) is commensurate with the level of effort required and negotiated at arm’s length, and (c) is not monetarily significant and doesn’t absorb a significant amount of variability related to the anticipated economic performance of the variable interest entity. Additionally, a decision maker would have a variable interest in situations in which, along with its fee, it holds another variable interest that absorbs more than an insignificant amount of the variable interest entity’s	ED10 discussed the remuneration of an agent in the context of remuneration that was commensurate with the services performed. It also included a rebuttable presumption addressing dual role situations when a party acts both as an agent and as a principal. The IASB will deliberate the issue at the October 2009 Board meeting. IASB staff are divided in their recommendation—some propose a model similar to the SFAS 167 approach in this respect; some propose a model in which an agent could, in some circumstances, receive remuneration that is more than insignificant.

IASB/FASB joint paper

	expected losses or returns.	
(h)	SFAS 167 includes a list of related parties that are assumed to act as de facto agents of an entity. Therefore any variable interests held by those parties are considered to be variable interests of the entity when assessing control of a variable interest entity.	ED10 included a similar list of related parties, noting that those parties are examples of those that would often act for an entity. The IASB will deliberate the issue at the October 2009 Board meeting. IASB staff recommendation is to align the list of related parties with those in SFAS 167 but to retain the list as examples of parties that often act for an entity.
	Other	
(i)	Involvement in the design of an entity does not, in isolation, establish that an entity has the power to direct the activities that matter, but should be considered when assessing control.	Not specifically addressed in ED10. The IASB will deliberate the issue at the October 2009 Board meeting. IASB staff recommendation is the same as the approach taken in SFAS 167.

Issues relating to voting interest entities addressed in ED10

11. Because ED10 applies to all entities, ED10 includes proposals regarding the assessment of control of voting interest entities as follows:
 - (a) An entity with more than half of the voting rights in another entity would usually have the power to direct the activities of that entity.
 - (b) An entity with less than half of the voting rights in another entity can have the power to direct the activities of that entity either:
 - (i) if the entity has voting rights together with rights within other contractual arrangements that give it the ability to direct the activities of the entity; or
 - (ii) if the entity has more voting rights than any other party and those voting rights are sufficient to give it the ability to direct the activities of the entity.
 - (c) When assessing control, an entity considers whether its power from holding options or convertible instruments to obtain voting rights, taken in conjunction with other relevant facts and circumstances, gives it the power to direct the activities of another entity.

IASB/FASB joint paper

12. The IASB discussed these issues at its July 2009 meeting. The IASB decided that:
 - (a) if an entity holds less than half of the voting rights of another entity, the reporting entity can have the power to direct the activities of that other entity.
 - (b) if an entity holds options or convertible instruments to obtain voting rights in another entity, the entity can have the power to direct the activities of that other entity.
13. The IASB agreed to discuss the circumstances in which an entity can have the power to direct the activities of another entity with less than half of the voting rights of that other entity, and by holding options or convertible instruments, at future meetings.

Investment companies

14. ED10 carried forward the requirements in IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation—Special Purpose Entities* that states that the consolidation requirements apply to all entities, including those referred to as investment companies in other jurisdictions.
15. SFAS 167 does not apply to investments accounted for at fair value in accordance with the specialised accounting guidance in the AICPA Audit and Accounting Guide, *Investment Companies*.
16. The IASB received many comments from the investment management industry and some users about this issue. The IASB will deliberate the issue at future meetings. A number of industry bodies have submitted proposals suggesting ways in which the issue could be addressed.

IASB/FASB joint paper

Disclosures

17. Both SFAS 167 and ED10 identify similar disclosure principles/objectives. Differences between SFAS 167 and ED 10 exist because of the different scope of the disclosure requirements in both documents. ED10 applies some disclosure principles to both structured and voting interest entities, while the disclosure objectives in SFAS 167 apply to variable interest entities only.
18. The boards have also translated the disclosure principles/objectives into detailed requirements. We have identified the following disclosures that are currently not aligned:

	Requirements of SFAS 167	Proposals in ED10
(a)	An enterprise may provide disclosures on an aggregated basis, but must disclose how similar entities are aggregated.	ED 10 allows aggregated disclosures, but does not require disclosure of how entities have been aggregated.
(b)	The primary beneficiary must disclose (a) the carrying amounts and classification of a variable interest entity’s assets and liabilities that is consolidated; (b) the lack of recourse if creditors of a consolidated variable interest entity have no recourse to the general credit of the primary beneficiary; and (c) the terms of arrangements that could require the enterprise to provide financial support to the variable interest entity	N/A
(c)	N/A	The reporting entity must disclose for structured entities that is has set-up or sponsored the value of assets transferred to that entity and the income from its involvement with the structured entity.
(d)	N/A	Paragraph B46 of ED 10 contains an extensive list of examples that the reporting entity might disclose, if considered relevant to the assessment of risks from unconsolidated structured entities, including (a) the credit rating and average life of the structured entity’s assets; (b) information about the structured entity’s funding and loss exposure; and (c) the types of returns the reporting entity received during the reporting period.

IASB/FASB joint paper

19. The IASB staff are currently analysing the disclosure requirements in ED 10 in light of the comment letters received and the comments made at the round table meetings. We intend to present in November 2009 a preliminary analysis to the IASB as to whether and which disclosure requirements should be retained or modified. This analysis will also include an assessment of how the disclosure requirements in SFAS 167 and ED 10 could be aligned.

Items for Discussion***Joint Project***

20. The FASB has issued guidance on the consolidation of variable interest entities in Statement 167 (structured entities for the IASB) and is considering overall consolidation guidance for other entities not within the scope of Statement 167. The staff of the IASB and FASB are working closely to develop consolidation guidance that is similar for all entities, not only for structured entities. For the FASB to issue an exposure draft based on any final guidance issued by the IASB, the FASB will ultimately have to determine if they agree with the conclusions reached and guidance issued by the IASB. As previously communicated within this memo, the FASB has already issued guidance for the consolidation of variable interest entities and expects that several of the conclusions reached for variable interest entities could be equally applicable for entities currently outside of the scope of Statement 167. One approach that the FASB could take is to determine whether the guidance within Statement 167 can be extended to all entities.
21. The IASB and FASB staff note that many of the consolidation issues for which conclusions have already been reached by the FASB (kick-out rights, shared power, determining an agent versus a principal role, and others) will be deliberated by the IASB before the joint meeting. Ultimately, the staff believes that it is the intention of both boards to issue guidance that is consistent and yields similar consolidation results. In other words, the staff believe that the goal of both the IASB and the FASB should be to issue consolidation guidance

IASB/FASB joint paper

that identifies the same reporting entity as the party with the controlling financial interest in another entity.

22. The staff believe that to achieve convergence, the IASB and FASB should agree to conduct the consolidation project as a joint project in which the staffs develop views and recommendations on all issues requiring deliberation and present the issues to both boards at monthly joint meetings, that would be held during the IASB Board week. The staff believe that this approach will provide the boards with the most efficient opportunity to develop converged guidance.

Question for the boards

23. Do the boards agree that the IASB's and FASB's projects on consolidation should be conducted and deliberated jointly? [Note: the IASB will then need to modify the timetable for the consolidation project.]

Issues for Discussion

24. The staff's assessment of the conclusions reached to date on the respective consolidation projects is that the basic control models are converged, except that there are differences regarding kick-out rights and the remuneration of an agent.
25. Paragraphs 10-16 set out the topics relating to the control model that have yet to be deliberated by one or both of the boards. The staffs believe that, of those topics, there are five major issues to be deliberated by both boards as follows:
 - (a) Kick-out rights
 - (b) Remuneration of an agent
 - (c) Power with less than half of the voting rights of an entity
 - (d) Options and convertible instruments to obtain voting rights
 - (e) Investment companies
26. The IASB will also deliberate the proposed disclosure requirements.

IASB/FASB joint paper

27. The staff proposes that the following issues be discussed by the boards at the October joint meeting to make a preliminary assessment as to whether consensus is likely to be achievable:
 - (a) Kick-out rights
 - (b) Remuneration of an agent.
28. Agenda paper 3F *Agency relationships* prepared for the IASB October 2009 meeting discusses those issues.

Next steps

29. The staff will work together to prepare joint papers on the remaining issues to bring jointly to the boards in November and December 2009.