



Project **Consolidation**
Topic **The control model—views of power**

Attached is an addendum to agenda papers 8A and 8B that will be discussed by the boards on Tuesday 23rd March 2010.

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Addendum to Agenda papers 8A and 8B

Staff paper

Power with less than a majority of the voting rights

1. At the joint board meeting on 16th March 2010, a majority of each board expressed support for one of the following views:
 - (a) The ‘ability to’ view as set out in agenda paper 8A, which **embeds evidence of having the *ability to direct the activities of an entity*** (referred to as view 1 in this addendum).
 - (b) The ‘evidence’ view, which was referred to as the ‘ability to’ view— with evidence in agenda paper 8A, which requires **that a reporting entity is *directing the activities of an entity*** (referred to as view 2 in this addendum).
2. It should be noted that each of these views incorporate the ‘contractual rights’ view in that a reporting entity has power when it has the legal or contractual ability to direct the activities of another entity that significantly affect the returns (eg by holding more than half of the voting rights in an entity, or by having less than half of the voting rights together with contractual rights in other arrangements that give the reporting entity the contractual ability to direct the activities). There are a number of ways that a reporting entity that holds less than half of the voting rights in an entity can have that contractual ability: (a) the reporting entity might have an agreement with other vote holders that gives it the contractual right to exercise a majority of the voting rights. (b) similarly, other forms of contractual arrangement can give the reporting entity the ability to direct the activities of another entity that matter when combined with voting rights. For example, a cornerstone holding of voting rights might prevent other vote holders from changing the contractual arrangements the reporting entity uses to direct the activities of another entity.
3. This addendum deals only with situations in which no one party has the legal or contractual ability to direct the activities that significantly affect the returns (eg when an entity is controlled by voting rights, no shareholder holds more than half of the voting rights and there is no one that, by contract, has power to direct the activities).

Addendum to Agenda papers 8A and 8B

Staff paper

4. At the meeting on 16th March, the boards asked the staff to develop guidance to help them clarify what type of evidence would be required for each of the views set out in paragraph 1 above when a reporting entity does not have the legal or contractual ability to direct the activities that significantly affect the returns.
5. The ‘ability to view’ (view 1) requires evidence of having the *ability to* direct the activities. In the first instance, a reporting entity would consider the size of its voting rights relative to the size and dispersion of holdings of the other vote holders, together with the voting patterns at previous shareholder meetings. In some situations, looking at those factors alone would provide sufficient evidence of having the ability to direct the activities. For example, when the reporting entity holds 49% of the voting rights, the other 51% is widely held by numerous shareholders (none of which individually hold more than 1% of the voting rights), and the attendance at previous shareholder meetings has not been more than 70% for the past number of years. However, if having considered the spread of shareholdings and voting patterns it is still unclear whether the reporting entity has the ability to direct, the reporting entity would consider other indicators of power.
6. The ‘evidence’ view (view 2) requires evidence that demonstrates that a reporting entity *directs* the activities of another entity in order to conclude that the reporting entity has power. Paragraphs 7 and 8 of agenda paper 8B (and the table below) set out the actions and factors that the staff propose a reporting entity should consider when assessing whether there is evidence that demonstrates that the reporting entity directs the activities of another entity.
7. The left hand side of the following table sets out what the staff believe may provide evidence of having the *ability to* direct, and the indicators of power that the staff would propose to include as factors to consider when assessing evidence of having the *ability to* direct the activities of another entity (view 1). The right hand side of the table sets out the actions and factors in paragraphs 7 and 8 of agenda paper 8B (view 2)—being evidence of active direction.

Addendum to Agenda papers 8A and 8B

Staff paper

<p>Evidence of having the <u>ability to direct the activities</u> (view 1)</p>	<p>Evidence that demonstrates that a reporting entity <u>is directing</u> the activities (view 2)—set out in paragraphs 7 and 8 of agenda paper 8B</p>
	<p><u>Power might be demonstrated by a single factor or a combination thereof</u></p>
<p>A reporting entity’s voting rights are sufficient to give it power if the reporting entity can:</p> <p>(a) make the strategic decisions about the activities of the entity, or</p> <p>(b) nominate or appoint a majority of the members of the governing body that makes the strategic decisions about the activities of the entity.</p> <p>In some situations, considering the size of the reporting entity’s holding of voting rights relative to the size and dispersion of holdings of other vote holders, together with voting patterns at previous shareholders meetings, would provide sufficient evidence of having that ability. If not, consider other indicators of power.</p>	<p>The reporting entity has determined the entity’s strategic operating and financing policies.</p> <p>The reporting entity has appointed the majority of the members of the governing body, which makes the strategic decisions about the activities of the entity.</p>
<p><u>Indicators of power (indicators of having the ability to direct)</u></p>	
<p>The reporting entity <i>can</i> appoint or approve the entity’s key management personnel.</p>	<p>The reporting entity <i>has</i> approved or appointed the entity’s key management personnel.</p>
<p>The reporting entity <i>can</i> direct the entity to enter into, or veto any changes to, significant transactions that benefit the reporting entity.</p>	<p>The reporting entity <i>has</i> initiated, approved or vetoed any changes to significant transactions of the entity.</p>
<p>The majority of the members of the entity’s governing body are related parties of the reporting entity.</p>	<p>The majority of the members of the entity’s governing body are related parties of the reporting entity.</p>
<p>The majority of the entity’s key management personnel are current or previous employees of the reporting entity.</p>	<p>The majority of the entity’s key management personnel are current or previous employees of the reporting entity.</p>

Addendum to Agenda papers 8A and 8B

Staff paper

Evidence of having the <u>ability to direct the activities</u> (view 1)	Evidence that demonstrates that a reporting entity <u>is directing</u> the activities (view 2)—set out in paragraphs 7 and 8 of agenda paper 8B
<p>The entity’s economic performance is dependent on the reporting entity, including the following:</p> <p>(a) the entity is dependent on the reporting entity for funding its operations.</p> <p>(b) the reporting entity guarantees a significant portion of the entity’s obligations.</p> <p>(c) the entity is dependent on the reporting entity for critical services, supplies or raw materials.</p> <p>(d) the entity is dependent on the reporting entity for key management personnel, such as in situations in which the reporting entity’s personnel have specialised knowledge of the entity’s operations.</p> <p>(e) the reporting entity controls assets that are critical to the entity’s operations.</p>	<p>The entity’s economic performance is dependent on the reporting entity, including the following:</p> <p>(a) the entity is dependent on the reporting entity for funding its operations.</p> <p>(b) the reporting entity guarantees a significant portion of the entity’s obligations.</p> <p>(c) the entity is dependent on the reporting entity for critical services, supplies or raw materials.</p> <p>(d) the entity is dependent on the reporting entity for key management personnel, such as in situations in which the reporting entity’s personnel have specialised knowledge of the entity’s operations.</p> <p>(e) the reporting entity controls assets that are critical to the entity’s operations.</p>
<p>Contractual arrangements exist (other than those that give the reporting entity the ability to direct the activities that significantly affect the returns) that require substantially all of the entity’s activities to involve or be conducted on behalf of the reporting entity.</p>	<p>Contractual arrangements exist (other than those that give the reporting entity the ability to direct the activities that significantly affect the returns) that require substantially all of the entity’s activities to involve or be conducted on behalf of the reporting entity.</p>
<p>The reporting entity <i>can</i> dominate the nominations process of electing members of the entity’s governing body or obtaining proxies from other holders of voting rights.</p>	<p>The reporting entity <i>has</i> dominated the process of appointing the governing body, which makes the strategic decisions about the activities of the entity. Examples of indicators are:</p>
<p>The reporting entity <i>can</i> appoint members to fill vacancies on the entity’s governing body until the next election.</p>	<p>(a) dominating the nominations process of electing members of the entity’s governing body or obtaining proxies from other holders of voting interests.</p> <p>(b) appointing members to fill vacancies on the entity’s governing body until the next election.</p>

Addendum to Agenda papers 8A and 8B

Staff paper

Questions for the boards

1. Having seen the types of evidence that would be required, which of the two views of power referred to in the addendum do you support:

- the 'ability to' view, which embeds **evidence of having the ability to direct** (view 1)
- the 'evidence' view, which embeds requiring **evidence that demonstrates that a reporting entity is directing the activities** (view 2)?

2. If you support the 'ability to' view (view 1 in this addendum), do you agree with the staff recommendation as to what would provide evidence of having the ability to direct (as set out in the left hand column of the table after paragraph 7 of this addendum)? In particular, do you think that a reporting entity has power if it has the ability to nominate or appoint a majority of the members of the governing body of another entity as a result of the expected inaction of other shareholders (the staff have divided views in this respect—refer to agenda paper 8B, paragraphs 8-9)? If further evidence is required, are there indicators that you remove or are there others that you would add?

3. If you support the 'evidence' view (view 2 in this addendum), do you think that the list of actions and factors listed in the right hand column of the table after paragraph 7 of this paper either individually or in combination can demonstrate power? In particular, do you think that a reporting entity can demonstrate that it has power by actually nominating or appointing a majority of the members of the governing body of another entity (the staff have divided views in this respect—refer to agenda paper 8B, paragraphs 8-9)? Are there actions or factors that you remove or are there others that you would add?

Note: these questions replace questions 1 and 2 for the boards in agenda paper 8B.