



Project	Consolidation
Topic	Consistency within the control model

Introduction

1. At the January 2010 joint Board meeting, the boards discussed the concept of power in the context of power with less than half of the voting rights in an entity. It was apparent at that meeting that different Board members have different views of power as follows:
 - (a) The ‘ability to’ view (view expressed by 9 of the IASB members)—see paragraphs 6-9 of this paper.
 - (b) The ‘ability to’ view—with evidence (view expressed by some of the IASB and FASB members)—see paragraphs 10 and 11 of this paper.
 - (c) The ‘exercise of power’ view (view expressed by some of the IASB and FASB members)—see paragraphs 12 and 13 of this paper.
 - (d) The ‘contractual rights’ view (view expressed by 2 of the FASB members)—see paragraphs 14-17 of this paper.
2. Our objective is to develop a consistent notion of control. This should assist when working out how to deal with different fact patterns including when parties hold potential voting rights, kick-out rights and other participating rights. To help in developing such a consistent control model, the boards members suggested at the last meeting that we summarise how the staff believe the notions of power discussed in the context of voting rights at the January meeting apply in other scenarios, including those in which a party or parties hold kick-out rights.

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.

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3. This paper asks the board members to re-confirm which of the four views they support.

Differing views regarding power

4. This paper sets out four differing views regarding power that reflect what we believe to be the views expressed by the board members at the January 2010 joint Board meeting. The table after paragraph 17 sets out the four views, expressed in the form of examples. To put the table in context, each of the views of power is summarised in the paragraphs below.
5. The boards should also note that the consistency analysis deals with whether a reporting entity meets the *power* element of the control definition. It does not reach conclusions on whether the reporting entity controls the other entity in each of the examples discussed.

The 'ability to' view

6. Supporters of the 'ability to' view believe that a reporting entity has the power to direct the activities of another entity when it has the *current ability* to direct the activities that significantly affect the returns.
7. Therefore, to have power, a reporting entity does not necessarily need to have:
 - (a) exercised its power (having the *ability* to direct is sufficient).
 - (b) the legal or contractual right to direct (a reporting entity does not need to be able to perpetuate power in every possible scenario).
8. A reporting entity's power arises from rights that it has relating to the activities of the entity (eg voting rights, rights to obtain voting rights, rights within other contractual arrangements, or a combination of these). A reporting entity must assess whether the decision-making rights that it has relating to the activities of the entity are sufficient to give it the *current ability* to direct the activities that matter.
9. Determining whether a reporting entity has the current ability to direct includes an assessment of both the reporting entity's rights, and whether the rights held

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by other parties could prevent the reporting entity from having the ability to direct. The focus is on whether the reporting entity has the ‘ability to do what it wants to’ in directing the activities (within the boundaries of protective rights), even if those decisions were to be somewhat controversial. Therefore, for example, voting rights, options, kick-out rights or other participating rights held by more than one party would be considered if they are substantive, as follows:

- (a) If numerous parties must agree to exercise the rights (or to outvote the reporting entity), supporters of this view believe that those rights of the other parties are unlikely to prevent the reporting entity from ‘doing what it wants to do’ in directing the activities.
- (b) If relatively few parties must agree to exercise the rights (or to outvote the reporting entity), those rights of the other parties are considered to be likely to prevent the reporting entity from ‘doing what it wants to do’ in directing the activities. In this situation, the other parties have the collective ability to remove (or outvote) the reporting entity as and when they are unhappy with the reporting entity’s actions.

The ‘ability to’ view—with evidence

- 10. The ‘ability to’ view—with evidence is the same as the ‘ability to’ view with one exception: when a reporting entity does not have the legal or contractual ability to direct (eg when it holds less than half of the voting rights in an entity), evidence is required to demonstrate that the reporting entity directs the activities.
- 11. Supporters of this view note that, when a reporting entity holds less than half of the voting rights in an entity, it is very difficult to be confident that such a reporting entity really has power. To have power, the reporting entity relies either on other shareholders voting in the same way as it does, or on other shareholders not voting at shareholders meetings and exercising their rights. Therefore, in order to make the ‘ability to’ model operational in this situation, supporters of this view would require evidence that the reporting entity directs the activities in order to conclude that the reporting entity has power (refer to agenda paper 8B for a further discussion of what would constitute evidence).

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The 'demonstration of power' view

12. Supporters of the 'demonstration of power' view believe that if a reporting entity is actively directing the activities of an entity, that reporting entity has current power unless a single party has the legal or contractual ability to remove or otherwise prevent the reporting entity from directing the activities. If a single party has the legal or contractual ability to remove or otherwise prevent the reporting entity from directing, the reporting entity directing the activities does not have power. It is being permitted to do so by that single party who is likely to have power. However, if rights are exercisable on agreement by more than one party, they are not relevant when assessing control.
13. Supporters of this view also believe that, without the legal or contractual ability to direct, a reporting entity must have demonstrated that it directs the activities in order to conclude that it has power. Refer to agenda paper 8B for a further discussion of how power might be demonstrated.

The 'contractual rights' view

14. Supporters of the 'contractual rights' view believe that a reporting entity must have the legal or contractual right to direct in order to have power. Power means being contractually able to 'get done what you want to' in every possible scenario. Therefore a reporting entity with less than half of the voting rights in an entity would not have power without other contractual rights. This is because the other shareholders could collectively outvote the reporting entity.
15. A consistent application of this view to potential voting rights would conclude that, in the absence of other factors, the holder of an instrument that give it the right to obtain voting rights would not have power. This is because the right to obtain voting rights would not be viewed as giving the holder the current contractual right to direct the activities of the entity.
16. Some might argue that a consistent application of this view to kick-out rights would conclude that a decision-maker would *not* have power when substantive kick-out rights exist, regardless of the number of parties that must agree to their exercise. This is because those other parties could collectively agree to remove

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the decision-maker—the decision-maker does not have the ability to ‘get done what it wants to’ in every possible scenario.

17. However board members supporting this view would argue that a decision-maker that has been delegated decision-making authority to direct the activities of an entity has the *contractual right* to direct those activities, unless one other party has the contractual right to remove or otherwise prevent the decision-maker from directing the activities. Therefore, such a party directing the activities would have power unless one other party held a substantive kick-out right.

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Fact pattern	‘Ability to’ view	‘Ability to’ view—with evidence	‘Demonstration of power’ view	‘Contractual rights’ view
<p><i>Example 1: a shareholder owns 60% of the voting rights and demonstrates that it directs the activities (no other factors are relevant when assessing power).¹</i></p>	<p>60% shareholder has power.</p>	<p>60% shareholder has power.</p>	<p>60% shareholder has power.</p>	<p>60% shareholder has power.</p>
<p><i>Example 2: 2 shareholders own 60% and 40% respectively of the voting rights. The 40% shareholder demonstrates that it directs the activities; the 60% shareholder does not participate in directing the activities.</i></p>	<p>60% shareholder has power.</p>	<p>60% shareholder has power (evidence is required only when the reporting entity does not have the legal or contractual ability to direct).</p>	<p>60% shareholder has power (power must be demonstrated only when the reporting entity does not have the legal or contractual ability to direct). [The 40% shareholder does not have power because the 60% shareholder has the contractual ability to prevent the 40% shareholder from directing the activities.]</p>	<p>60% shareholder has power (it has the contractual right to direct the activities of the entity).</p>

¹ Examples 1-10 address situations in which the entity is controlled by voting rights (ie power to direct the activities does not arise from rights within other contractual arrangements).

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Fact pattern	‘Ability to’ view	‘Ability to’ view—with evidence	‘Demonstration of power’ view	‘Contractual rights’ view
<p><i>Example 3: 3 shareholders own 40%, 30% and 30% respectively of the voting rights. The 40% shareholder demonstrates that it directs the activities (no other factors are relevant when assessing power).</i></p>	<p>No shareholder controls (the 40% shareholding would not be expected to be sufficient to have the ability to enforce that shareholder’s will against the wishes of the other shareholders).</p>	<p>No shareholder controls (the 40% shareholding would not be expected to be sufficient to have the ability to enforce that shareholder’s will against the wishes of the other shareholders).</p>	<p>The 40% shareholder that has demonstrated its direction of the activities has power.</p>	<p>No shareholder controls (none of the shareholders have the contractual right to direct; the other shareholders collectively have the contractual right to outvote the 40% shareholder).</p>
<p><i>Example 4: 3 shareholders own 40%, 30% and 30% respectively of the voting rights. One of the 30% shareholders demonstrates that it directs the activities (no other factors are relevant when assessing power).</i></p>	<p>No shareholder controls (neither the 40% shareholding nor the 30% shareholding would be expected to be sufficient to have the ability to enforce that shareholder’s will against the wishes of the other shareholders).</p>	<p>No shareholder controls (the 30% shareholding would not be expected to be sufficient to have the ability to enforce that shareholder’s will against the wishes of the other shareholders).</p>	<p>The 30% shareholder that has demonstrated its direction of the activities has power. [It is assumed that the 40% shareholder does not have the contractual ability to prevent the 30% shareholder from directing the activities.]</p>	<p>No shareholder controls (none of the shareholders have the contractual right to direct; the other shareholders collectively have the contractual right to outvote the 40% shareholder).</p>

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Fact pattern	‘Ability to’ view	‘Ability to’ view—with evidence	‘Demonstration of power’ view	‘Contractual rights’ view
<p><i>Example 5: 1 shareholder owns 40% of the voting rights. The other shareholdings are widely dispersed (no individual shareholder holds more than 2% of the voting rights; they are unrelated and not organised to vote collectively). There is no evidence that the 40% shareholder directs the activities.</i></p>	<p>40% shareholder would usually have power regardless of whether there is evidence of active direction (the 40% shareholding would be expected to be sufficient to have the ability to enforce that shareholder’s will against the wishes of the other shareholders).</p>	<p>No shareholder controls because there is no evidence that the 40% shareholder directs the activities.</p>	<p>No shareholder controls because the 40% shareholder has not demonstrated its power to direct the activities.</p>	<p>No shareholder controls (none of the shareholders have the contractual right to direct; the other shareholders collectively have the contractual right to outvote the 40% shareholder).</p>
<p><i>Example 6: 1 shareholder owns 40% of the voting rights. The other shareholdings are widely dispersed (no individual shareholder holds more than 2% of the voting rights; they are unrelated and not organised to vote collectively). There is evidence that the 40% shareholder directs the activities.</i></p>	<p>40% shareholder would usually have power (the 40% shareholding would be expected to be sufficient to have the ability to enforce that shareholder’s will against the wishes of the other shareholders).</p>	<p>40% shareholder would usually have power (the 40% shareholding would be expected to be sufficient to have the ability to enforce that shareholder’s will against the wishes of the other shareholders, and there is evidence that the shareholder directs the activities).</p>	<p>40% shareholder that has demonstrated its direction of the activities has power.</p>	<p>No shareholder controls (none of the shareholders have the contractual right to direct; the other shareholders collectively have the contractual right to outvote the 40% shareholder).</p>

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Fact pattern	‘Ability to’ view	‘Ability to’ view—with evidence	‘Demonstration of power’ view	‘Contractual rights’ view
<p><i>Example 7: 2 shareholders own 60% and 40% respectively of the voting rights. The 40% shareholder has a currently exercisable option to buy 20% of the voting rights of the other shareholder for a nominal amount. The current 60% shareholder directs the activities.</i>^{2 3}</p>	<p>The 40% shareholder would have power because the combination of its voting rights and the option to obtain voting rights gives it the contractual <i>ability</i> to direct the activities as and when it chooses to (similar to a kick-out right or a majority holding of voting rights).</p>	<p>The 40% shareholder would have power because the combination of its voting rights and the option to obtain voting rights gives it the contractual <i>ability</i> to direct the activities as and when it chooses to (similar to a kick-out right or a majority holding of voting rights). [Evidence of directing the activities is not required because the option holder has the ability to obtain more than half of the voting rights.]</p>	<p>The 40% shareholder would have power because the combination of its voting rights and the option to obtain voting rights gives it the contractual <i>ability</i> to direct the activities as and when it chooses to (similar to a kick-out right or a majority holding of voting rights). [Demonstration of directing the activities is not required because the option holder has the ability to obtain more than half of the voting rights.]</p>	<p>The 60% shareholder has power (it has the contractual right to direct the activities). [The option is ignored even if it is exercisable for a nominal amount.]</p>

² Examples 7-10 discuss a reporting entity that has voting rights as well as options to obtain voting rights. The assessment of control would be similar for other instruments that give a reporting entity the right to obtain voting rights, eg convertible instruments.

³ Agenda paper 8B discusses if and when potential voting rights that are exercisable or convertible for a price that is not a nominal amount should be considered when assessing control of an entity.

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Fact pattern	‘Ability to’ view	‘Ability to’ view—with evidence	‘Demonstration of power’ view	‘Contractual rights’ view
<p><i>Example 8: 2 shareholders own 60% and 40% respectively of the voting rights. The 40% shareholder has a currently exercisable option to buy 20% of the shares of the other shareholder for a price that is expected to be considerably more than the value of the voting rights in any feasible scenario. The current 60% shareholder directs the activities.</i></p>	<p>The 60% shareholder would have power because the options are not considered to be substantive (the 40% shareholder is not considered to have the <i>ability</i> to direct because it would not exercise the option on the basis of current facts and circumstances).</p>	<p>The 60% shareholder would have power because the options are not considered to be substantive (the 40% shareholder is not considered to have the <i>ability</i> to direct because it would not exercise the option on the basis of current facts and circumstances).</p>	<p>The 60% shareholder would have power because the options are not considered to be substantive.</p>	<p>The 60% shareholder has power (it has the contractual right to direct the activities).</p>
<p><i>Example 9: 3 shareholders own 40%, 30% and 30% respectively of the voting rights. One of the 30% shareholders has a currently exercisable option to buy 15% of the voting rights from the 40% shareholder for a nominal amount. There is evidence that the 40% shareholder directs the activities.</i></p>	<p>No shareholder controls (the 30% shareholding plus the options would not be expected to be sufficient to have the ability to enforce that shareholder’s will against the wishes of the other shareholders).</p>	<p>No shareholder controls (the 30% shareholding plus the options would not be expected to be sufficient to have the ability to enforce that shareholder’s will against the wishes of the other shareholders).</p>	<p>The 40% shareholder that has demonstrated its direction of the activities has power. [It is assumed that the 30% shareholder with options does not have the contractual ability to prevent the 40% shareholder from directing the activities.]</p>	<p>No shareholder controls (no one has the contractual right to direct the activities).</p>

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Fact pattern	‘Ability to’ view	‘Ability to’ view—with evidence	‘Demonstration of power’ view	‘Contractual rights’ view
<p><i>Example 10: 1 shareholder owns 30% of the voting rights, and has a currently exercisable option to buy 15% of the voting rights from other shareholders for a nominal amount. The other shareholdings are widely dispersed (no individual shareholder holds more than 2% of the voting rights; they are unrelated and not organised to vote collectively).</i></p>	<p>The 30% shareholder with options would usually have power regardless of whether there is evidence of active direction (the 30% shareholding plus the option to obtain a further 15% would be expected to be sufficient to have the ability to enforce that shareholder’s will against the wishes of the other shareholders).</p>	<p>The 30% shareholder with options would usually have power, but only if there is evidence that it directs the activities (the 30% shareholding plus the option to obtain a further 15% would be expected to be sufficient to have the ability to enforce that shareholder’s will against the wishes of the other shareholders).</p>	<p>The 30% shareholder with options would have power, but only if it has demonstrated its power to direct the activities. [The 30% shareholder would have power if it has demonstrated that power, regardless of whether that shareholder also has options.]</p>	<p>No shareholder controls (no one has the contractual right to direct the activities).</p>
<p><i>Example 11: The party directing the activities can be removed by a single investor (owning a majority investment)—the kick-out rights are substantive in all other respects (no other factors are relevant when assessing power).</i></p>	<p>The kick-out rights are substantive and should be considered when assessing control. The investor with the unilateral ability to remove the other party has power. [Similar to the voting rights situation in example 2.]</p>	<p>The kick-out rights are substantive and should be considered when assessing control. The investor with the unilateral ability to remove the other party has power. [Similar to the voting rights situation in example 2.]</p>	<p>The kick-out rights are substantive and should be considered when assessing control. The investor with the unilateral ability to remove the other party has power. [Similar to the voting rights situation in example 2.]</p>	<p>The kick-out rights are substantive and should be considered when assessing control. The investor with the unilateral ability to remove the other party has power. [Similar to the voting rights situation in example 2.]</p>

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Fact pattern	‘Ability to’ view	‘Ability to’ view—with evidence	‘Demonstration of power’ view	‘Contractual rights’ view
<p><i>Example 12: The party directing the activities can be removed on agreement by two of three investors (owning 40%, 30% and 30% interests)—the kick-out rights are substantive in all other respects (no other factors are relevant when assessing power).</i></p>	<p>The kick-out rights are substantive and should be considered (together with other factors) when assessing whether the party directing the activities acts as an agent or principal. It is likely that the party directing acts as an agent and no one controls the entity (assuming no other factors to the contrary). [Similar to the voting rights situation in example 3.]</p>	<p>The kick-out rights are substantive and should be considered (together with other factors) when assessing whether the party directing the activities acts as an agent or principal. It is likely that party directing acts as an agent and no one controls the entity (assuming no other factors to the contrary). [Similar to the voting rights situation in example 3.]</p>	<p>The kick-out rights are not substantive because more than one party must agree to their exercise—similar to the voting rights situation in example 3. However other factors may indicate that the party directing is an agent and no one controls the entity.</p>	<p>The kick-out rights are not substantive because more than one party must agree to their exercise. However other factors may indicate that the party directing is an agent and no one controls the entity.</p>
<p><i>Example 13: The party directing the activities can be removed on agreement by numerous unrelated investors (who are not organised to vote collectively). Assume no other factors are relevant when assessing power.</i></p>	<p>The party directing is likely to have power (the kick-out rights are likely to be non-substantive. The party directing has the contractual ability to direct the activities that significantly affect the returns—the other parties cannot, in effect, take that ability away). [Similar to the voting rights situation in example 6.]</p>	<p>The party directing is likely to have power (the kick-out rights are likely to be non-substantive. The party directing has the contractual ability to direct the activities that significantly affect the returns—the other parties cannot, in effect, take that ability away). [Similar to the voting rights situation in example 6.]</p>	<p>The party directing is likely to have power (the kick-out rights are not substantive because more than one party must agree to their exercise. The party directing has the contractual ability to direct the activities that significantly affect the returns. [Similar to the voting rights situation in example 6.]</p>	<p>The party directing is likely to have power (it is assumed that the party has the right to direct by contract). [The investors collectively have the contractual right to remove the party directing. However this would not outweigh the contractual right of the party directing.]</p>

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Question for the boards

1. Which of the four views of power set out in the paper do you support:

- the 'ability to' view
- the 'ability to' view—with evidence
- the 'demonstration of power' view
- the 'contractual rights' view?

Please provide comments if we have mischaracterised your view of power in the paper.