



Project	Consolidation
Topic	Cover paper (including a summary of the control model)

Introduction

1. The IASB published ED10 *Consolidated Financial Statements* in December 2008. ED 10 addresses consolidation of all entities.
2. The FASB published Statement No.167, *Amendments to Interpretation No.46(R)*, in June 2009. Statement No.167 addresses consolidation of variable interest entities.
3. At the January and February 2010 joint board meetings, the boards made tentative decisions regarding entities controlled by voting rights and investment companies.
4. The papers to be discussed at this meeting are as follows:
 - (a) Agenda paper 8A: Consistency within the control models
 - (b) Agenda paper 8B: The control model—follow-up questions regarding voting rights
 - (c) Agenda paper 8C: Agency relationships
 - (d) Agenda paper 8D: Related parties
 - (e) Agenda paper 8E: Structured entities
 - (f) Agenda papers 8F-8J: Disclosures (refer to agenda paper 8F for an overview of the disclosures papers).

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5. These papers address all of the remaining issues to be discussed with the boards regarding the control model, with the exception of the investment company follow-up noted below. A summary of the control model that has been developed is set out as an appendix to this paper.

Next steps

6. We plan to bring papers on the following topics to the boards for discussion in April 2010:
 - (a) Investment companies—follow-up of some concerns raised at the February 2010 joint board meeting regarding the definition of an investment company and disclosures requirements for investment companies.
 - (b) Transition
 - (c) The scope and format of the IASB and FASB publications, including the length of the comment period.

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Summary of the control model being developed by the FASB and the IASB

7. This appendix sets out the decisions of the FASB and IASB in the consolidation project. The paper includes:
 - (a) decisions of the FASB when developing the requirements in Statement No.167 *Amendments to FIN 46(R) Consolidation of Variable Interest Entities*.
 - (b) tentative decisions of the IASB when deliberating the proposals in ED10 *Consolidated Financial Statements* at its July and October 2009 meetings.
 - (c) tentative decisions taken by both boards at the January and February 2010 meetings.
 - (d) staff recommendations included in the March 2010 agenda papers.

Definition and characteristics of control

8. Control is the basis for consolidation. The definition of control of an entity has two elements—a power element and a returns or benefits/losses element. A reporting 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.
9. Only one party, if any, can control another entity. Although control of an entity is not shared, other parties can share in the returns generated from the activities of the entity.
10. 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

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power is not necessarily required (see paragraph 18 of this paper for a further discussion of the exercise/demonstration of power in the context of voting rights). Power also need not be absolute in that protective rights held by other parties do not preclude an entity from controlling another entity.

11. 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, therefore, benefits or returns can include the obligation to absorb losses of an entity. Returns are described broadly to include, for example, synergistic returns.
12. A reporting entity is required to assess control continuously, on the basis of current facts and circumstances.

Exposure to risks and rewards

13. 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 (including reputational risk) 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)—agent/principal is discussed further in paragraph 26 of this paper.

Involvement in the design of an entity

14. Understanding the purpose and design of an entity is an important factor to consider when assessing control of that entity. However, involvement in the design of an entity is not, in isolation, sufficient to conclude that the reporting entity controls that entity.

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Participating and protective rights

15. The board members agree on the following:
 - (a) Substantive participating rights that are held by one party give that party the power to direct the activities of an entity that significantly affect the returns
 - (b) Protective rights do not prevent another party from controlling an entity.
 - (c) If a reporting entity has the right to 'step in' and make substantive decisions at the only time that substantive decisions are required to be made, the reporting entity has the current ability to direct the activities.

16. The board members have somewhat different views when the exercise of substantive participating rights requires the agreement of more than one party, or more than one party hold substantive participating rights:
 - (a) Some board members think that such substantive participating rights should be considered when assessing control. The more parties that hold the rights or must agree to their exercise, the less likely it is that those rights are substantive.
 - (b) Some board members think that such participating rights should not be considered when assessing control.

[Agenda paper 8A—consistency within the control model—sets out those differing views.]

Control through voting rights

17. The boards tentatively agreed that, when assessing control of entities controlled through voting rights, a reporting entity that holds more than half of the voting rights in an entity, or that otherwise has the legal or contractual ability to direct the activities of an entity that significantly affect the returns, meets the power element of the control definition.

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18. The board members have differing views when a reporting entity holds less than half of the voting rights in an entity:
- (a) Nine of the IASB members believe that such a reporting entity can have power if it holds significantly more voting rights than any other shareholder, and the other shareholdings are widely dispersed (the ‘ability to’ view in agenda paper 8A).
 - (b) Some of the IASB and FASB members believe that such a reporting entity can have power if it holds significantly more voting rights than any other shareholder, and the other shareholdings are widely dispersed but would also require demonstration that the reporting entity directs the activities that significantly affect the returns in order to conclude that the reporting entity has power (the ‘ability to’ view—with evidence in agenda paper 8A).
 - (c) Some IASB and FASB members believe that such a reporting entity can have power but only if it has demonstrated that it directs the activities of an entity that significantly impact the returns. They do not necessarily believe that the size of the reporting entity’s voting rights relative to the other vote holders should be considered in this situation. (the ‘demonstration of power’ view in agenda paper 8A).
 - (d) Two FASB members believe that such a reporting entity cannot have power without contractual rights to direct the activities within other contractual arrangements (the ‘contractual rights’ view in agenda paper 8A).
19. Examples 1-6 within agenda paper 8A illustrate situations in which differing outcomes might arise.

Potential voting rights (eg options and convertible instruments)

20. The boards tentatively decided that a reporting entity should consider potential voting rights when assessing whether it has the power through voting rights to direct the activities of an entity that significantly affect the returns.

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21. The application of this tentative decision results in different outcomes in some situations depending on the boards' views regarding control through voting rights. Examples 7-10 of agenda paper 8A illustrate situations in which differing outcomes might arise.
22. Agenda paper 8B also asks the board members to clarify in which situations options and convertible instruments should be considered when assessing control.

Multiple parties have decision-making authority

23. When two or more unrelated parties share power (or have joint control) of an entity, those parties collectively control the entity but none of the parties has control. Shared power (in the words of Statement No.167) or joint control (in the words of IAS 31) requires the unanimous consent of all parties sharing power.
24. When two or more unrelated parties each have unilateral decision-making authority over different activities of an entity, the party that has the current ability to direct the activities that *most* significant affect the returns meets the power element of the control definition. In situations in which the nature of the activities that each party is directing is the same, Statement No.167 concludes that any party that has the current ability to direct the majority of those activities meets the power element of the control definition.
25. Although the boards' decision is slightly different in situations in which the nature of the activities that each party is directing is the same, the staff do not anticipate outcomes in practice that would be different.

Agency relationships

Contractual agency relationships

26. The boards will deliberate guidance on agency relationships at this meeting. Agenda paper 8C sets out the staff analysis and recommendations regarding agency relationships. The staff recommend that when evaluating whether a

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decision maker is an agent or a principal, the overall relationship between a decision maker and other interest holders of an entity should be evaluated on a qualitative basis. The evaluation should focus on whether the decision maker has (1) the power to direct the activities of an entity (“power”), and (2) the ability to generate benefits (or limit losses) for itself through that power (“economics”). As such, the assessment should consider all of the following factors:

- (a) decision-making authority.
- (b) rights held by other parties.
- (c) remuneration of the decision-maker.
- (d) the decision maker’s exposure to variability of returns because of other interests that it holds in the entity.

Non-contractual agency relationships (related parties)

27. The boards will deliberate guidance on non-contractual agency relationships (related parties) at this meeting. Agenda paper 8D sets out the staff analysis and recommendations regarding related parties. The staff recommend that, when a reporting entity concludes that a related party (or parties) acts on its behalf, the involvement and interests that the reporting entity and the related party have in another entity are considered together when assessing control of that entity. A list of parties that often act for the reporting entity would be included in the consolidated standard.

Investment companies

28. The boards tentatively decided that there should be an exception to consolidation, whereby an investment company must measure investments in entities that it controls at fair value through profit or loss. The boards tentatively decided that the guidance currently in the US GAAP Codification (Topic 946) should be used as the basis for developing the attributes of an investment company. The boards asked the staff to do further work to remove any US specific references, and to address certain implementation concerns about that guidance—this will be brought back to the boards in April 2010.