



Project	Consolidation
Topic	Re-exposure and draft of the final consolidation and disclosure standards

Introduction

1. At the October 2009 joint board meeting, the IASB and FASB agreed to conduct their respective consolidation projects jointly. In making that decision, the boards committed to the following:
 - (a) The FASB would issue an exposure draft in the second quarter of 2010. [If possible and depending on the tentative decisions reached by the joint boards, that exposure draft would include guidance that applies to all entities, incorporating the requirements published by the FASB in Statement No.167 *Amendments to FASB Interpretation No.46(R)* in June 2009.]
 - (b) The IASB would not publish its final consolidation standard until it has considered, together with the FASB, comments received on the FASB's exposure draft. This approach would increase the chances of both boards publishing final consolidation standards for which the consolidation outcomes would not be different. The target date for publication of a final consolidation standard is Q4 2010.
 - (c) At the same time that the FASB issues its exposure draft, the IASB would put a draft of its final consolidation standard on the IASB website.

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

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in *IASB Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

IASB Staff paper

2. At the February 2010 IASB meeting, the Board also tentatively decided that it would publish a disclosure standard addressing a reporting entity's involvement with other entities. That disclosure standard would incorporate disclosure requirements relating to subsidiaries, associates, joint ventures and unconsolidated structured entities.
3. This paper asks the Board:
 - (a) to confirm whether any of the tentative decisions made when deliberating the proposals in ED10 require re-exposure.
 - (b) to confirm the status of the draft of the final consolidation standard that it will include on the IASB website in Q2 2010.
 - (c) to confirm the timing and status of the IASB disclosure standard.

Re-exposure

4. The IASC Foundation *Due Process Handbook* states that when considering the need for re-exposure, the IASB:
 - (a) identifies substantive issues that emerged during the comment period on the exposure draft that it had not previously considered.
 - (b) assesses the evidence that it has considered.
 - (c) evaluates whether it has sufficiently understood the issues and actively sought the views of constituents.
 - (d) considers whether the various viewpoints were aired in the exposure draft and adequately discussed and reviewed in the basis for conclusions in the exposure draft.
5. With the exception of the IASB's tentative decision regarding investment companies in February 2010, we believe that the other decisions made by the IASB during its discussions of the proposals in ED10 *Consolidated Financial Statements* from May 2009 to May 2010 would not warrant re-exposure because they clarify, rather than change, the proposals in ED10—refer to the appendix of this paper for a summary of the IASB's decisions. [The IASB has yet to

IASB Staff paper

complete its discussions of the disclosure and transition proposals in ED10—those decisions will be assessed for re-exposure when complete.]

6. The tentative decision to require an investment company to measure its investments in entities that it controls at fair value through profit or loss is a change from ED10, which proposed consolidating such controlled investments. Therefore this issue, in isolation, would require re-exposure. We expect to publish that exposure draft in June 2010; we are recommending a 90-day comment period.

The status of the draft of the final consolidation standard included on the IASB website

7. When considering the status of the draft of the final consolidation standard to be included on the IASB website, the staff believe that the following are relevant:
 - (a) It is not necessary to re-expose the proposals in ED10 from a due process perspective, with the exception of the investment company issue, as noted in paragraphs 4-6 of this paper.
 - (b) The commitments of the IASB (set out in paragraph 1) mean the following:
 - (i) The draft that the Board will include on its website in the second quarter of 2010 is, potentially, subject to change. By committing to considering comments received by the FASB on its exposure draft, the Board is acknowledging that the draft to be included on its website is not necessarily a near final draft. Nonetheless, had the Board not decided to conduct the project jointly with the FASB, that draft will represent what the Board would have published as a final consolidation standard (subject to fatal flaw and final Board review).
 - (ii) By including a draft of the final consolidation standard on our website, we are likely to receive comments on that draft, regardless of whether we solicit comments officially.

IASB Staff paper

- (c) The Board will publish exposure drafts on a number of major projects in the second quarter of 2010. We would not wish to request comments from constituents on an additional document if it is unnecessary to do so from a due process perspective.
8. Having considered the factors noted in paragraph 7, we recommend that:
- (a) the draft of the final consolidation standard included on the IASB website in the second quarter of 2010 is titled a ‘working draft of IFRS X *Consolidated Financial Statements*’ (this is similar to the status of the working draft of IFRS X *Liabilities* already included on the IASB website). It should be clear that the draft is *not* an exposure draft.
 - (b) we note on the website that this working draft represents what the Board would have published as a final consolidation standard had the Board not decided to conduct the consolidation project jointly with the FASB, subject to comments to be received regarding investment companies (and subject to fatal flaw and final Board review).
 - (c) we state clearly that we are *not* seeking comments from constituents on the working draft. However, should constituents wish to submit comments on the working draft, those comments will be considered by the IASB, together with the comments received from respondents to the FASB exposure draft, before finalising the consolidation standard.

Timing and status of the IASB disclosure standard

9. The proposed IASB disclosure standard relating to a reporting entity’s involvement with other entities combines:
- (a) the disclosure requirements for joint arrangements and associates, which are currently being discussed in the Board’s joint arrangements project; and
 - (b) the disclosure requirements for subsidiaries and unconsolidated structured entities, which are currently being discussed as part of the consolidation project.

IASB Staff paper

10. So far, we do not believe that the Board's tentative decisions in either of the projects warrant re-exposure of the disclosure requirements.¹ However, a potential difficulty arises because the projects have different completion dates. The Board intends to publish a final standard on joint arrangements in Q3 2010 [note: the balloting process for the final standard on joint arrangements will be complete in Q2 2010; publication in Q3 2010 takes account of the time required for editing and publication]. As explained in paragraph 8, the staff will have made publicly available a working draft of the final consolidation standard at this time. That working draft is subject to potential changes until its finalisation in Q4 2010.
11. Because of the timing differences between the two projects, we recommend a two-phased approach regarding the publication of the IASB disclosure standard. According to this approach:
- (a) The Board would publish in **Q3 2010** the introductory chapters (core principle, scope, aggregation, etc) and the specific disclosure requirements for joint arrangements and associates as final chapters of the disclosure standard [again, as noted above, the balloting process for those disclosures would be complete in Q2 2010]. In **Q2 2010**, we would make available on our website a working draft of the final disclosure standard, including the specific disclosure requirements for subsidiaries and unconsolidated structured entities. The principles discussed in paragraph 8 would also apply to the disclosure requirements for subsidiaries and unconsolidated structured entities within this working draft.
 - (b) The Board would complete the disclosure standard in **Q4 2010** by publishing the final disclosure requirements for subsidiaries and unconsolidated structured entities.
12. We recommend this approach because it:

¹ However, as noted previously, the need for re-exposure will be reassessed when the Board completes its discussions of the disclosure proposals in ED10.

IASB Staff paper

- (a) provides constituents with a complete set of accounting and disclosure requirements for joint arrangements and associates in Q3 2010; and
 - (b) gives the Board the flexibility to amend the disclosure requirements for subsidiaries and unconsolidated structured entities, in response to potential amendments to the consolidation standard until finalisation of that standard.
13. Alternatively, the Board could decide to publish the disclosure requirements for unconsolidated structured entities in Q3 2010. The definition of a structured entity is included within the draft of the final consolidation standard and, accordingly, has the potential to change until the consolidation standard is finalised in Q4 2010. Therefore, if the Board were to finalise the disclosure requirements for unconsolidated structured entities in Q3 2010, we would recommend that those disclosure requirements would apply to unconsolidated special-purpose entities (SPEs), as described in SIC-12 *Consolidation—Special Purpose Entities*, rather than applying to ‘structured entities’. If the new consolidation standard was not finalised or was delayed, this approach would mean that disclosure requirements for unconsolidated SPEs would be in place.

Questions for the Board
<p>Do you agree that:</p> <ul style="list-style-type: none"> (1) the investment company issue should be re-exposed as an isolated issue in Q2 2010? (2) the draft of the final consolidation standard to be included on the IASB website in Q2 2010 is titled a ‘working draft of the final consolidation standard’, stating that we are <i>not</i> seeking comments on the document but will consider any comments received before finalising the consolidation standard? (3) the final disclosure requirements relating to joint arrangements and associates should be published at the same time as the accounting requirements for joint arrangements (Q3 2010)? (4) a working draft of the final disclosure requirements relating to subsidiaries and unconsolidated structured entities should be included on the IASB website in Q2 2010, and finalised at the same time as the final consolidation standard (Q4 2010)? Alternatively, do you think that the final disclosure requirements for unconsolidated SPEs should be published in Q3 2010, together with the disclosure requirements relating to joint arrangements and associates? <p>If not, what would you propose and why?</p>

IASB staff paper

APPENDIX

Summary of the tentative decisions reached by the IASB relating to the proposals in ED10

14. This appendix sets out the Board's tentative decisions regarding the control model, the scope of the consolidation standard and disclosures for consolidated and unconsolidated structured entities during its discussions of the proposals in ED10 held from May 2009 to May 2010. [The Board has yet to complete its discussions of the disclosure and transition proposals in ED10.] The appendix also notes whether those decisions clarify or change the proposals in ED10.

The control model*Definition and characteristics of control*

15. Control is the basis for consolidation. A reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity to generate returns for the reporting entity. The definition of control of an entity has two elements—a power element and a returns or benefits 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.
16. 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.
17. 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 that significantly affect the returns; exercise of that power is not necessarily required. Power also need not be absolute in that protective rights held by other parties do not preclude an entity from controlling another entity.
18. Determining whether a reporting entity has the current ability to direct the activities of an entity includes an assessment of both the reporting entity's rights (and whether they are sufficient to give the reporting entity power), and

IASB staff paper

APPENDIX

whether the rights held by other parties could prevent the reporting entity from directing the activities.

19. The returns element of the control definition requires the controlling entity to receive or be exposed to variable returns from its involvement with 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.
20. A reporting entity is required to assess control continuously, on the basis of current facts and circumstances.

These decisions do not change the proposals in paragraphs 4-11, and 15-16 of ED10 regarding the definition and characteristics of control, but clarify those proposals.

Exposure to risks and rewards

21. 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 paragraphs 32-34 of this paper.

This decision does not change the proposals in paragraphs 12 and 13, and 33 of ED10 regarding a reporting entity's exposure to risks and rewards, and the link between power and returns, but clarifies those proposals.

Involvement in the design of an entity

22. Understanding the purpose and design of an entity is an important factor to consider when assessing control of that entity by helping to identify the activities that significantly affect the returns, who has power to direct those

IASB staff paper

APPENDIX

activities and who benefits from that direction. However, involvement in the design of an entity is not, in isolation, sufficient to conclude that the reporting entity controls that entity.

This decision does not change the proposal in paragraph 32 of ED10, but clarifies the proposal so that it applies to all entities and not only when assessing control of structured entities.

Participating and protective rights

23. Rights that are sufficient to give a reporting entity power must be substantive participating rights, although not all participating rights necessarily give a reporting entity power (eg a single voting right). Participating rights are legal or contractual decision-making rights relating to the activities of an entity that permit the holder or holders to participate in the operating and financing decisions that are made in the ordinary course of business
24. Substantive participating rights exercisable on agreement by more than one party should be considered when assessing control in terms of whether they prevent another party from having the power to direct the activities. The more parties that must agree to their exercise, the less likely it is that those rights are substantive and, therefore, the less likely those rights are to prevent another party from having the power to direct.
25. To be substantive, a participating right would usually be currently exercisable. However, if a reporting entity has the right to 'step in' and make substantive decisions at the only time that substantive decisions are taken, the reporting entity has the current ability to direct the activities.
26. Depending on the circumstances, rights that give a reporting entity power can arise from (either individually or in combination):
 - (a) substantive voting rights, or potential voting rights, of an entity (see paragraphs 28-30).
 - (b) other contractual rights that give the reporting entity the current ability to direct the activities that significantly affect the returns, such as

IASB staff paper

APPENDIX

determining or changing the strategic operating and financing policies of an entity, determining or changing the restrictions on an entity's activities, making strategic decisions about the use or disposal of the assets of an entity or making strategic decisions about the selection, acquisition or disposal of assets of an entity.

- (c) rights to appoint or remove a party that has the rights described in (b) above.

27. Protective rights do not prevent another party from controlling an entity.

These decisions do not change the proposals in paragraphs 8, 22, 34-38, and B14-B16 of ED10 regarding what rights might give a reporting entity power, but clarify those proposals so that they apply to all entities. Illustrative examples will also be included in the final standard.

Control through voting rights

28. When assessing control of entities controlled through voting rights:

- (a) A reporting entity that holds more than half of the voting rights in an entity generally meets the power element of the control definition in the absence of other factors. In this situation, holding more than half of the voting right provides sufficient evidence to conclude that the reporting entity has power. Further evidence is not required.
- (b) A reporting entity that has the legal or contractual ability to direct the activities of an entity that significantly affect the returns (eg by holding less than half of the voting rights in an entity together with other contractual rights relating to the activities) also meets the power element of the control definition. Again, in this situation, the combination of the voting rights and the other contractual rights provide sufficient evidence to conclude that the reporting entity has power. Further evidence is not required. This might be the case in situations in which the reporting entity holds voting rights together with potential voting rights that give it the contractual ability to direct the

IASB staff paper

APPENDIX

activities of another entity—refer to paragraph 30 for factors to consider when assessing the effect of potential voting rights.

- (c) In other situations, consideration of the relative voting rights and potential voting rights held by the reporting entity and other vote holders, together with previous voting patterns and other contractual arrangements, may provide sufficient evidence to conclude that the reporting entity has power, even in situations in which the reporting entity holds less than half of the voting rights. [For example, when a reporting entity holds 49% of the voting rights, the other 51% is widely held by thousands of shareholders (none of which 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. In contrast, when a reporting entity holds 49% of the voting rights of an entity, and the other 51% is held by three other parties each holding 17% of the voting rights, the reporting entity is unlikely to have power in the absence of other contractual arrangements.]
- (d) In other situations, there will be indicators that a reporting entity that holds less than half of the voting rights in an entity has the ability to direct the activities of the entity by, for example, appointing the majority of the members of the governing body or key management personnel, or by directing the entity to enter into significant transactions. Those indicators, considered together with the relative voting rights and potential voting rights held by the reporting entity and other vote holders, may provide sufficient evidence to conclude that the reporting entity has power.

Potential voting rights (eg options and convertible instruments)

29. A reporting entity considers potential voting rights that it holds, as well as potential voting rights held by other parties, when assessing whether it has the current ability to direct the activities of an entity.

IASB staff paper

APPENDIX

30. A reporting entity should consider the terms and conditions of those potential voting rights in assessing whether they give the reporting entity power (together with other rights that the reporting entity might hold). Factors to consider include, but are not limited to:

- (a) any restrictions on the timing of exercise or conversion.
- (b) who the counterparty to the instrument is.
- (c) whether the party or parties that hold the potential voting rights would benefit from their exercise or conversion, including consideration of the exercise or conversion price (for example, because the activities of the entity are dependent upon, or closely related to, the activities of the reporting entity).

These decisions do not change the proposals in paragraphs 23-28, B9 and B10, and B13-B16 of ED10 regarding when a reporting entity's voting rights or potential voting rights are sufficient to give it power, but clarify those proposals. Illustrative examples will also be included in the final standard.

Multiple parties have decision-making authority

31. When two or more unrelated parties each have unilateral decision-making authority over different activities of an entity that significantly affect the returns, the party that has the current ability to direct the activities that *most* significantly affect the returns meets the power element of the control definition.

*The decision set out in paragraph **Error! Reference source not found.** does not change the proposals in ED10 (or the requirements or proposals within IAS 31 and ED9 relating to joint control). ED10 did not directly address when multiple parties each have unilateral decision-making authority over different activities of an entity. The decision in paragraph 31 will be included in the final standard to address concerns raised by respondents.*

IASB staff paper

APPENDIX

*Agency relationships*Contractual agency relationships

32. When evaluating whether a decision maker is an agent or a principal, the overall relationship between a decision maker, the entity that is being managed 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 ('returns'). As such, the assessment should consider all of the following factors:
- (a) scope of the 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.
33. The standard will not specify any particular weighting that should be attached to any of the factors. However, when assessing potential agency relationships, different weightings will be attached to each of the factors depending on the circumstances (for example, if a decision-maker also holds other interests in an entity that exposes it to different risks than other parties (eg holds junior notes in an entity), significant weighting would be placed on this factor when assessing whether the decision-maker is an agent or principal).

These decisions do not change the proposals in paragraphs B3-B8 of ED10 regarding agency relationships, but clarify those proposals. The dual role proposals in B11 will not be carried forward in the final standard—control is assessed in such situations according to the general agent/principal guidance.

Non-contractual agency relationships (related parties)

34. When a reporting entity concludes that the relationship that it has with a related party (or parties) is such that the reporting entity has the ability to direct the

IASB staff paper

APPENDIX

related party to act 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 will be included in the consolidated standard.

These decisions do not change the proposals in paragraph B12 of ED10 regarding related parties, but clarify those proposals.

Scope of the consolidation standard—Investment companies

35. An investment company should measure investments in entities that it controls at fair value through profit or loss (this is an exception to the consolidation principle).
36. The Board has yet to complete its deliberations of the disclosures to be provided by an investment company.

This decision changes the proposals in ED10 that stated that a reporting entity consolidates all entities that it controls. The Board will publish an exposure draft asking for comments on this specific issue in Q2 2010.

Disclosures for consolidated entities

37. The Board has yet to complete its discussions of the disclosure proposals in ED10 regarding consolidated entities.

Disclosures for unconsolidated structured entities

38. The Board has yet to complete its discussions of the disclosure proposals in ED10 regarding unconsolidated structured entities.

Transition

39. The Board has yet to complete its discussions of the transition proposals in ED10.