Agenda Paper 5b

May 2011

Project Summary and Feedback Statement

IFRS 10 *Consolidated Financial Statements* and IFRS 12 *Disclosure of Interests in Other Entities*

At a glance

We, the International Accounting Standards Board (IASB), issued IFRS 10 *Consolidated Financial Statements* and IFRS 12 *Disclosure of Interests in Other Entities* in May 2011.

The standards are effective from 1 January 2013. Early application is permitted.

IFRS 10 provides a single consolidation model that identifies control as the basis for consolidation for all types of entities. IFRS 10 replaces IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation—Special Purpose Entities*.

IFRS 12 combines, enhances and replaces the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities.

The standards complete two important projects included in our Memorandum of Understanding with the US national standard-setter, the Financial Accounting Standards Board (FASB), to create a common set of high quality global accounting standards. The two standards are consistent with the requests by the Group of Twenty (G20) Leaders, the Financial Stability Board and others to improve the accounting and disclosure requirements for special purpose entities (described in IFRS 12 as 'structured entities').

The question that IFRS 10 addresses is:

Does the investor control the investee?

Project time line

2003

Comprehensive project on consolidation requirements added to the agenda

2008

July 2008
Staff draft of the exposure draft published

Sept 2008
Round tables on the staff draft

Dec 2008
Exposure draft published

2009

May 2009
Comment letter summary presented

June 2009
Round tables in London, Tokyo, Toronto

Oct 2009
FASB joins the project

2010

Sept 2010
Staff draft of IFRS 10 published

Oct 2010
Round tables in Norwalk

2011

May 2011
IFRS 10 and IFRS 12 issued

2013

1 Jan 2013
IFRS 10 and IFRS 12 become mandatory

2016

Post-implementation review

Why we undertook this project

In June 2003 we began a project to address diversity in practice related to consolidation, stemming from the definition of control. We set out to produce a single consolidation model that clarified the definition of control and provided additional guidance on the application of the model. The global financial crisis illustrated that the existing consolidation guidance was not fundamentally flawed but could be improved. Moreover, the global financial crisis highlighted the need for new disclosure requirements to provide users with better information.

Diversity in practice

Perceived inconsistencies between the consolidation guidance in IAS 27 and SIC-12 resulted in diversity in practice. IAS 27 used control as the basis for consolidation, while SIC-12 focused more on risks and rewards. Although the guidance in SIC-12 applied to special purpose entities, there was confusion over which entities met the definition of a special purpose entity and, thus, whether to apply IAS 27 or SIC-12.

Disclosures and the financial crisis

The global financial crisis highlighted the importance of enhancing disclosure requirements, in particular for special purpose or structured entities. The G20, the Financial Stability Board and others asked us to review the disclosure requirements regarding the risks to which entities are exposed from their involvement with structured entities. Users also asked for enhanced disclosures that would help them to understand the composition of a reporting entity, understand the relationships that an entity has with other entities and estimate the value of investments in other entities.

The 2008 exposure draft on consolidation initially contained disclosure requirements. In response to feedback received, we combined the disclosure requirements for interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities into a separate comprehensive disclosure standard, IFRS 12.

US GAAP convergence

We conducted much of our deliberations on this project in conjunction with the Financial Accounting Standards Board, the standard-setter responsible for developing US GAAP. Our aim was to issue a common standard. In January 2011 the FASB decided not to proceed with proposing changes to its consolidation requirements for voting interest entities. Instead, it decided to expose changes that would substantially align its consolidation requirements for special purpose entities with IFRS 10. Convergence is discussed in further detail in the 'other matters' section of this feedback statement (page 24).

Requirements of IFRS 10 and IFRS 12

IFRS 10 contains a single consolidation model that identifies control as the basis for consolidation for all types of entities.

The standard provides a definition of control that comprises the following three elements:

- power over an investee;
- exposure, or rights, to variable returns from an investee; and
- ability to use power to affect the reporting entity's returns.

The standard sets out requirements for situations when control is difficult to assess, including cases involving potential voting rights, agency relationships, control of specified assets (silos) and circumstances in which voting rights are not the dominant factor in determining control. The standard also contains accounting requirements and consolidation procedures, which are carried over unchanged from IAS 27.

IFRS 12 requires a reporting entity to disclose information that helps users to assess the nature and financial effects of the reporting entity's relationship with other entities. The standard establishes disclosure objectives that require an entity to disclose information that helps users:

- understand the judgements and assumptions made by a reporting entity when deciding how to classify its involvement with another entity;
- understand the interest that non-controlling interests have in consolidated entities; and
- assess the nature of the risks associated with interests in other entities.

Both standards will be effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

Improvements to accounting

Consistency and additional guidance

The application of IAS 27 and SIC-12 revealed inconsistent application in a number of areas:

- **Applying the definition of control:** the perceived conflict of emphasis between IAS 27 (power to govern financial and operating policies) and SIC-12 (risks and rewards) led to inconsistent application of the definition of control for different types of entities.
- **Control without a majority of voting rights:** because IAS 27 does not provide explicit guidance in this area, similar relationships between entities were being accounted for differently.
- **Agency relationships:** the lack of guidance for these relationships meant that similar transactions (eg those involving funds or investment conduits) were being accounted for differently.

Introducing a single control model that applies to all entities, and providing additional application guidance, will increase consistent application in these areas.

Removal of 'bright lines'

The focus on risks and rewards in the assessment of control in SIC-12 led to structuring opportunities for entities wishing to achieve particular accounting outcomes. A control model that is built on principles (ie power, returns and the link between those elements) rather than on bright lines will result in accounting that better reflects the economic substance of the underlying relationships between entities.

One disclosure package

To determine the value of a current or future investment in a reporting entity, users have consistently asked us to improve the information available about subsidiaries, joint arrangements and associates to help them identify the profit and cash flows available to the reporting entity.

Furthermore, users and others requested greater transparency of a reporting entity's exposure to risks from its involvement with structured entities. We responded to those requests for enhanced disclosures by requiring a reporting entity to disclose additional information about consolidated entities and its relationship with unconsolidated structured entities, and establishing one disclosure package for any special relationships a reporting entity has with other entities. We think the enhanced disclosure requirements and unified disclosure objectives in IFRS 12 will greatly improve disclosures in this area.

Changes in consolidation

IFRS 10 establishes a model for consolidation that integrates the principles in IAS 27 and SIC-12. When assessing changes in consolidation that result from the application of IFRS 10, we focused on the appropriateness of consolidation, rather than on whether IFRS 10 will result in more or less consolidation. In our view, IFRS 10 will result in more appropriate consolidation that will better reflect the economic substance of the relationship between a reporting entity and an investee.

Investees previously assessed under IAS 27

Investees previously within the scope of IAS 27 (ie traditional operating entities) will now be assessed using the consolidation model in IFRS 10. A reporting entity can have power over an investee even if the reporting entity holds less than 50 per cent of voting rights of that investee.

Power is not defined as the legal or contractual right to direct relevant activities but is based on the *ability* to direct relevant activities unilaterally. A reporting entity will need to exercise judgement in making consolidation decisions, but the results of those decisions will, in our view, better reflect the economic substance of relationships.

Investees previously assessed under SIC-12

Investees previously within the scope of SIC-12 (ie special purpose entities) will also be assessed using the consolidation model in IFRS 10:

- Investees will be consolidated when a reporting entity has the ability to direct the relevant activities (ie has power over the investee) and has some exposure, but not necessarily a majority of the exposure, to risks and rewards.
- Conversely, investees will not be consolidated when the reporting entity has no power over the investee, even if the reporting entity has some, or a majority, of the exposure to risks and rewards.

The consolidation model in IFRS 10 is not a quantitative model (based solely on risks and rewards) but a qualitative model (based on power, returns and a link between the two elements). Again, this model will require judgement in making consolidation decisions but will, in our view, better reflect the economic substance of relationships.

Interaction between consolidation and derecognition requirements

Although a reporting entity might not be required to consolidate an investee that was previously consolidated solely on the basis of the risks and rewards indicators in SIC-12, the effect of deconsolidation is mitigated because, in such situations, a reporting entity would typically not derecognise financial assets that it transferred to that investee according to the derecognition requirements in IFRS 9 *Financial Instruments*.

Examples

These examples illustrate the changes in consolidation decisions likely to result from the consolidation model in IFRS 10.

Example 1

An investment vehicle is created to purchase a portfolio of financial assets, funded by debt and equity instruments issued to a number of investors. The equity tranche is designed to absorb the first losses and to receive residual returns of the investee.

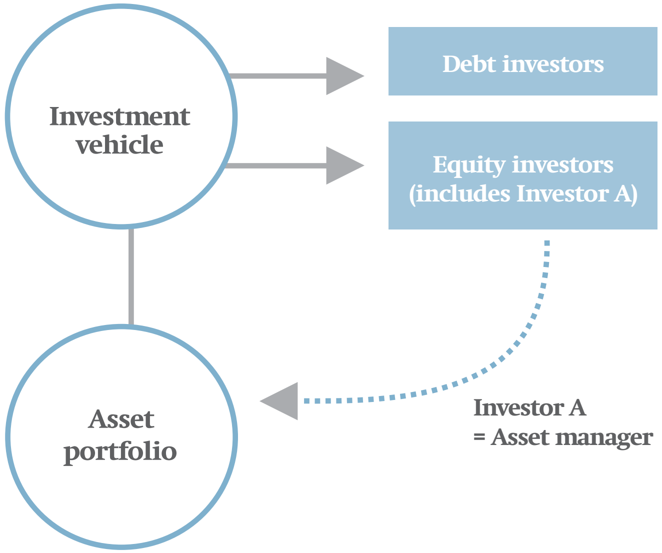
Investor A holds 30 per cent of the equity and is also the asset manager who manages the vehicle's asset portfolio within portfolio guidelines. This management includes decisions about the selection, acquisition and disposal of the assets within those portfolio guidelines and the management upon default of any asset in the portfolio.

SIC-12

In applying SIC-12, some would conclude that Investor A does not consolidate the investment vehicle. Investor A holds 30 per cent of the equity and therefore does not bear the majority of the risks and rewards. The investment vehicle was arguably created for the benefit of all investors, and not only for the benefit of Investor A.

IFRS 10

According to IFRS 10, Investor A controls the investment vehicle. Investor A has the ability to direct the relevant activities, has rights to variable returns from the performance of the vehicle and has the ability to use its power to affect its own returns.



Example 2

Entity A is created to provide investment opportunities for an institutional investor that wishes to have exposure to Entity Z's credit risk (Entity Z is unrelated to any party involved in the arrangement).

Entity A obtains funding by issuing to the Investor notes that are linked to Entity Z's credit risk (credit-linked notes) and uses the proceeds to invest in a portfolio of high quality financial assets.

Entity A obtains exposure to Entity Z's credit risk by entering into a credit default swap (CDS) at market rates with a bank. The CDS passes Entity Z's credit risk to Entity A in return for a fee paid by the bank. The portfolio of high quality financial assets serves as collateral for the bank.

There are very few, if any, decisions to be made after initially setting up Entity A. Neither the bank nor the Investor has any voting or other rights that give it the ability to direct activities that significantly affect Entity A's returns. The bank has the ability to switch the collateral within predefined parameters but that ability affects the returns of Entity A only to a small extent.

SIC-12

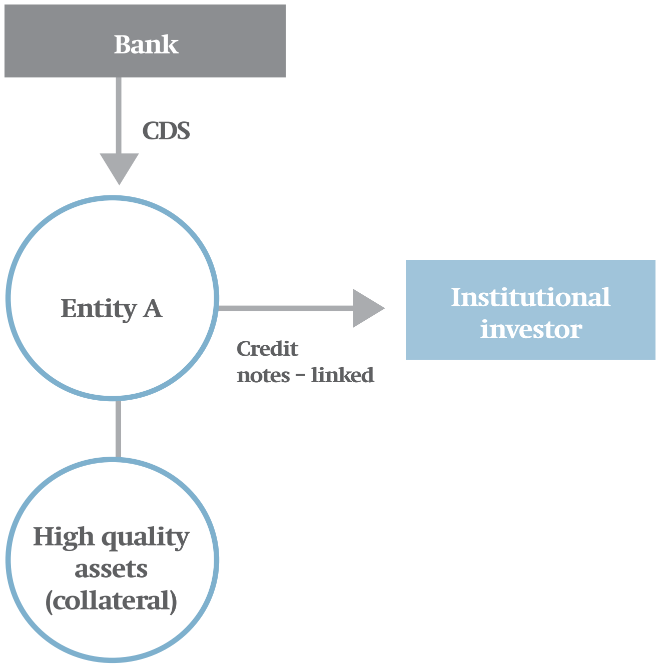
In applying SIC-12, the Investor controls Entity A. The Investor receives substantially all of the returns, and is exposed to substantially all of the risks of Entity A. Entity A was also created for the benefit of the Investor.

The Investor consolidates Entity A and recognises the high quality assets of Entity A and the CDS in its consolidated financial statements.

IFRS 10

According to IFRS 10, the Investor does not control Entity A. Although the Investor receives substantially all returns and is exposed to substantially all risks of Entity A, the Investor has no means of managing that exposure, or of accessing or directing the assets and liabilities of Entity A. The Investor has no power over Entity A, and thus does not control or consolidate Entity A.

According to IFRS 10 and IFRS 12, the Investor would recognise its investment in Entity A, and would also disclose information about its exposure to risk from that investment in Entity A (eg maximum and expected exposure to loss information).



Summary of the main changes from existing requirements

IAS 27 and SIC-12	IFRS 10 and IFRS 12
Control as the basis for consolidation IAS 27 identifies control as the basis for consolidation and focuses on the power to govern the financial and operating policies for assessing control of typical operating entities. In contrast, SIC-12 focuses on risks and rewards for assessing control of special purpose entities.	**IFRS 10 identifies control as the single basis for consolidation for all types of entities.** There is no separate guidance with a different consolidation model for special purposes entities; rather, this guidance is incorporated into the single consolidation model in IFRS 10. The new control definition reflects that an investor can achieve power over an investee in many ways, not just through governing financial and operating policies. The investor must assess whether it has rights to direct the relevant activities. Although exposure to risks and rewards is an indicator of control, it is not the sole focus for consolidation for any type of entity.
Control without a majority of voting rights Although the idea that an investor could control an investee while holding less than 50 per cent of the voting rights was implicit in IAS 27, it was not explicitly stated.	**IFRS 10 states that an investor can control an investee with less than 50 per cent of the voting rights of the investee.** IFRS 10 provides specific application guidance for assessing control in such cases.
Potential voting rights Only *currently exercisable* potential voting rights are considered when assessing control.	**Potential voting rights need to be considered in assessing control, but only if they are *substantive*.** Potential voting rights are substantive when the holder has the practical ability to exercise its rights and when those rights are exercisable when decisions about the direction of the relevant activities need to be made. Deciding whether potential voting rights are substantive requires judgement. Potential voting rights may need to be considered even if they are not currently exercisable.

IAS 27 and SIC-12	IFRS 10 and IFRS 12
Agency relationships IAS 27 has no specific guidance regarding situations when power is delegated by a principal to an agent.	**IFRS 10 contains specific application guidance for agency relationships.** When decision-making authority has been delegated by a principal to an agent, an agent in such a relationship does not control the entity. The principal that has delegated the decision-making authority would consolidate the entity. The application guidance offers a range of factors to consider and contains examples.
Disclosures IAS 27 and SIC-12 contain limited disclosure requirements for consolidated entities and no disclosure requirements for unconsolidated structured entities.	**IFRS 12 expands the disclosure requirements for both consolidated entities and unconsolidated structured entities.** The disclosure objectives in IFRS 12 will give preparers flexibility to tailor their individual disclosures to meet these objectives. IFRS 12 presents a single disclosure standard for reporting entities with special relationships with other entities, including subsidiaries, joint ventures, associates and unconsolidated structured entities.

Due Process and outreach activities

In 2003 we added to our agenda a comprehensive project to review consolidation requirements, with the aim of publishing a discussion paper in 2008. The financial crisis highlighted two things. First, there was a need for some improvements to accounting for consolidated and unconsolidated structured entities with increased transparency in disclosure sooner rather than later. Second, the fundamental principles of IAS 27 and SIC-12 worked well and we could build improved requirements from those instead of developing a fundamentally different model. These factors led us to proceed directly to the publication of an exposure draft.

Development of IFRS 10

We decided to make staff drafts of the exposure draft publicly available to keep interested parties informed of our progress and to ensure broad input into the drafting process. We also undertook extensive outreach activities early on and throughout the project to ensure sufficient consultation on our proposals.

We published exposure draft 10 *Consolidated Financial Statements* (ED 10) in December 2008 with a three-month comment period. We decided that a slightly shortened comment period was justifiable because staff drafts of the proposals had been available on the IASB's website since July 2008 and we had held public round tables in London in September 2008 to discuss those early drafts.

In June 2009 we held a second series of round tables in London, Tokyo and Toronto.

We received 156 comment letters on ED 10. A comment letter summary was presented to the Board at our meeting in May 2009. The Board also analysed comments received between July 2009 and July 2010.

The FASB joined the project in October 2009. We delayed finalising the project to allow the FASB to catch up with the goal of developing a common solution.

In September 2010 we made a staff draft of the IFRS available on our website. That draft was used as the basis for a public round table in Norwalk. That round table gave the FASB the opportunity to assess whether it should publish the IFRS model in the US, and provided the IASB with invaluable feedback.

By the time we finalised IFRS 10, the staff draft had been publicly available for seven months, providing time for interested parties to review and comment on it. Subsequent drafts of IFRS 10 were sent for editorial review to auditors and preparers. This was also done for IFRS 12.

Additional consultation

Field tests

We had the unique opportunity to conduct field tests on aspects of our requirements because many of the new requirements in IFRS 12 were already present in US GAAP. In meetings with representatives from the banking industry we reviewed existing relationships and structuring instruments to see how the proposals would apply. We also met banks and auditors before the publication of ED 10 and IFRS 10. In addition staff met representatives from audit firms to review early drafts of ED 10 and IFRS 10 and to hear auditors' concerns about the drafting and application of the proposals.

Working groups and other specialist advisory groups

We consulted the IFRS Advisory Council throughout the project. Specific papers on the project were discussed in June 2004, November 2004 and June 2008. In addition the project was also discussed in the sessions on the financial crisis in November 2008, February 2009 and June 2009.

Additional outreach activities

These more formal outreach activities were complemented by additional activities undertaken by the project team.

For instance, the team had many face-to-face meetings with banks, representative organisations (such as the International Swaps and Derivatives Association (ISDA)), insurance companies, hedge fund managers and audit firms from all around the world. This outreach was done at all stages of the project, from establishing the initial proposals to reviewing the final drafts of the standard. Some of the most helpful outreach resulted from constituents sending us examples based on actual contracts and relationships that we would then analyse to see how the proposed requirements would apply to these situations.

To keep interested parties up to date with the project, the team established a project-specific email alert.

Feedback Statement

We received broad support for our objective to improve the consolidation requirements and establish a single control model for consolidation that can be applied to all entities.

However, many respondents, felt that the wording in the exposure draft regarding the control principle and guidance on its application could be improved. Some respondents also noted that the guidance in the exposure draft was unclear.

In the pages that follow we outline the most significant matters raised with us and how we responded.

Testing the proposals

We liaised with many banks and other preparers to test our proposals. They sent us documentation of actual contracts so that we could test how our proposed guidance would apply to real-life examples. Those examples related to de facto control, agency relationships and 'autopilot' structures, among others. Preparers also shared with us their assessment of the effect the proposed guidance would have on their consolidated financial information. We were able to improve our guidance through this outreach.

A single consolidation model

IAS 27 provides a consolidation model with a definition of control but does not provide guidance for structured or special purpose entities. SIC-12 identifies four indicators of control in the case of special purpose entities. We noted that the two different sources of consolidation guidance created diversity in practice. The proposals in the exposure draft were designed to address this problem.

We proposed issuing a single standard that would provide one consolidation model with a definition of control that could be used for all entities. The exposure draft also contained specific guidance for structured entities, including a definition of a structured entity and a list of factors to consider when assessing control of those entities.

Respondents' comments

Most respondents to the exposure draft supported the use of a single consolidation model. However, some were concerned about the inclusion of special guidance that would apply only to a subset of entities. Respondents requested a single, cohesive standard for consolidation that would provide combined guidance on assessing control for all entities, rather than separate guidance for structured entities. Respondents also thought that special guidance for some types of entities could create structuring opportunities.

Furthermore, respondents expressed concern about the application of the control definition, stating that it could be difficult to apply the exposure draft's definition of control to structured entities.

Our response

We were persuaded by respondents' comments and removed the subsection for structured entities, combining all of the guidance for assessing control of an entity. We also clarified the definition of control and added application examples so that the control model can be more easily applied to all types of entities.

Control as the basis for consolidation

Although IAS 27 offers a consolidation model that focuses on control through the power to govern the financial and operating policies so as to obtain benefits, the guidance in SIC-12 often led to a focus on risks and rewards when assessing consolidation for special purpose entities.

In the exposure draft, we proposed that a reporting entity should consolidate all entities that it controls—ie the reporting entity should consolidate if it has the power to direct the activities of another entity to generate returns for the reporting entity.

Respondents' comments

Many respondents noted that they consider the concept of 'risks and rewards' to be integral to the control principle and stated that risks and rewards should be explicitly integrated into that principle. Respondents thought that this integration would combine the concepts in IAS 27 and SIC-12 and result in a conceptually robust principle of control.

Our response

We do not regard control and risks and rewards as competing models. The concept of risks and rewards is a part of the control model, ie reporting entity must have exposure to risks and rewards (or variable returns) in order to control another entity. This is now explicitly stated in IFRS 10. However, although it is an indicator of control, exposure to risks and rewards alone does not determine that a reporting entity has control because power and risks and rewards are not always perfectly correlated. Also, a focus on risks and rewards alone leads to a more quantitative assessment that is easier to manipulate. For those reasons, IFRS 10 identifies control (requiring both power and exposure to risks and rewards) as the single basis for consolidation.

Control definition

In the exposure draft we proposed a definition of control that focused on a reporting entity's power to direct the activities of another entity to generate returns for the reporting entity.

Respondents' comments

Many respondents supported control as the basis for consolidation but were confused about how to interpret the definition. Some respondents commented that the meaning of the term 'power to direct' was not articulated clearly and could be interpreted in different ways. Some respondents also asked for clarity about the meaning of 'returns' and more discussion of the variability of returns. Finally, some respondents asked for clarification of the term 'activities' and requested additional guidance on which activities a reporting entity would need to direct in order to have power.

Our response

In response to those concerns, we clarified that 'power' refers to having the *current ability* to direct the activities of an investee. We specified that returns must be variable and are defined broadly to include both traditional returns (eg dividends, increases/decreases in investment value) and synergistic returns. Finally, we specified that a reporting entity must direct the activities of an investee that *significantly affect the investee's returns* (ie relevant activities).

Application of the control definition

In the exposure draft we proposed guidance on how to apply the control definition and assess control. The guidance was provided for areas where control might be more difficult to assess, such as when an investor has power with less than a majority of the voting rights, structured entities, protective rights, agency relationships and options or convertible instruments.

Feedback focused on four main areas:

(a) power with less than a majority of voting rights

(b) options and convertible instruments

(c) agency relationships

(d) structured entities

Power with less than a majority of voting rights

Respondents' comments

Some respondents were concerned about the guidance relating to power with less than a majority of voting rights. Those respondents thought the guidance implied that a reporting entity need only hold the largest shareholding to meet the power criterion and thought this was inappropriate.

Other respondents did not think that an a reporting entity could ever have power without a majority of the voting rights or further contractual rights that guarantee power over the investee.

Some requested further clarification about other rights that would give an a reporting entity power.

Our response

Practice demonstrates that a reporting entity can have power with less than a majority of voting rights. Sometimes a reporting entity can direct the relevant activities of an investee without having an arithmetic majority shareholding. We retained this concept in IFRS 10.

We think that assessing power only on the basis of the majority of voting rights attached to shares creates artificial 'bright lines'. In some circumstances, such bright lines could provide entities with the opportunity to avoid consolidating entities they clearly control. However, we understand respondents' confusion regarding power with less than a majority of voting rights as the concept was expressed in the exposure draft. We added specific factors that an entity should consider when assessing power with less than a majority of voting rights. We provided additional guidance about the activities a reporting entity must be able to direct in order to have power and the different rights that could give a reporting entity power. We clarified that a reporting entity must always consider all its rights (not just voting rights) when assessing control. We also added several application examples.

Options and convertible instruments

Respondents' comments

Most respondents agreed with the proposal that options and convertible instruments should be considered when assessing control. However, respondents again thought that the guidance provided in the exposure draft in this respect was unclear and could lead to inconsistent application.

Our response

In response to these concerns, we included additional guidance and application examples to help preparers assess whether potential voting rights are substantive rights that contribute towards a reporting entity's control of an investee. Although that assessment requires judgement, we think that an investor should be able to apply the required judgement. This is because potential voting rights exist for a reason—the terms and conditions should help point to those reasons.

Agency relationships

Respondents' comments

Respondents also requested further clarification regarding the guidance about agency relationships in particular removal rights, performance-related fees, dual roles, and the principle supporting the agency guidance.

Our response

In response to these concerns, we included guidance in IFRS 10 about agency relationships, and the factors that are relevant when assessing whether an entity acts as an agent or a principal.

We also clarified that the general guidance in IFRS 10 on assessing control should be applied to agency relationships and added examples to illustrate its application.

Structured entities

Respondents' comments

Many respondents commented that the structured entity guidance should be clarified and have more examples illustrating how to apply that guidance. Respondents were also unsure if the factors for assessing control of a structured entity provided in the exposure draft were meant to be indicators of control or a presumption of features of structured entities.

Our response

As discussed previously, we removed the specific guidance for structured entities. The control model in IFRS 10 should apply to all entities.

We have included additional guidance and examples illustrating the application of the control model in cases where voting rights are not the dominant factor in assessing control. We think that the way in which control will be assessed will vary depending on the nature, and purpose and design, of an investee. An reporting entity will need to apply judgement in this assessment.

Disclosures

In the exposure draft, we included a disclosure objective and several specific disclosure requirements for reporting entities that have an interest in unconsolidated structured entities. The disclosure requirements illustrated the specific information that would be needed to meet the objective.

Respondents' comments

Users generally supported the proposed disclosure requirements. Many other respondents, however, were concerned that the disclosures were too prescriptive and would be costly and time-consuming for preparers to implement. Respondents were also concerned that the proposed disclosures were too voluminous and that important information would be difficult for users to identify. Respondents requested a disclosure principle that would clarify the purpose of the disclosure requirements. Respondents also expressed concerns about the feasibility of obtaining the information required to meet the proposed requirements.

Our response

We removed the disclosure requirements from the consolidation standard and created IFRS 12, which combines the disclosure requirements for special relationships with other entities. IFRS 12 includes disclosure requirements for interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities.

In response to respondents' comments, we added a disclosure principle. We clarified and strengthened the disclosure objectives and placed more emphasis on following those objectives. This will give preparers the flexibility to present the most relevant information.

Some of the disclosure requirements proposed in the exposure draft were removed, and we clarified that others are simply examples of disclosures that might be relevant in some situations (but are not mandatory requirements).

The new disclosure requirements address the requests of the G20 and Financial Stability Board to improve disclosures about an entity's exposure to risks from involvement with 'off balance sheet' vehicles. This information is useful to capital markets and is needed to improve transparency about an entity's exposure to risk.

Other matters

Investment entities

Later in 2011 we expect to publish an exposure draft jointly with the FASB proposing special accounting requirements for investments held by investment entities.

Significant influence

We received requests from some respondents to re-examine the requirements regarding significant influence as part of this project. We could have delayed the project to address this area. However, the consolidation project was identified as a higher priority as part of our comprehensive response to the global financial crisis. We will consider looking at the equity method and significant influence as we develop our new agenda.

Convergence with US GAAP

We think that IFRS 10, in essence, aligns the consolidation guidance for structured entities (or variable interest entities) with US GAAP. Those entities will now have the same basis for consolidation in IFRSs and US GAAP because the same control model is used in both regimes. However, this convergence is dependent on the FASB approving the agent-principal guidance that is included in IFRS 10. The FASB expects to publish that guidance as an exposure draft in the US shortly.

In the area of voting interest, or operating, entities we think that the assessment of control could be different in two areas: power with less than a majority of the voting rights, and the consideration of options or convertible instruments. US GAAP guidance in those areas follows a legal approach, whereas IFRS 10 provides more principle-based guidance focusing on the practical ability to control.

It is difficult to predict how different the accounting results will be because of these differences. However, our assessment is that different outcomes will arise only in a narrow set of circumstances.

Investor feedback

We consulted investors throughout the process that resulted in the publication of IFRS 10 and IFRS 12. We discussed disclosure requirements in particular but also consulted investors regarding various aspects of our proposals in the exposure draft, including de facto power with less than a majority of voting rights and agency relationships.

We considered investors' feedback in those areas during the course of our deliberations and think that we have responded to the requests from investors for better information relating to consolidated and unconsolidated structured entities and interests in subsidiaries. IFRS 12 contains those increased disclosure requirements.

Unconsolidated structured entities

The publication of the FASB Statement No. 167 (SFAS 167) in the United States offered a unique opportunity for investor outreach. SFAS 167 required increased disclosures regarding structured entities that are similar to the disclosures we proposed in the exposure draft. We asked US-based investors for their views about the quality of these new requirements. All those investors said that the new disclosure requirements were an improvement and gave them better information. We took those views into account when finalising the disclosure requirements and feel confident that investors support the increased disclosure requirements for unconsolidated structured entities.

Interests in subsidiaries

Throughout the project, investors have requested increased disclosures regarding subsidiaries within a parent's consolidated financial statements and, in particular, in situations where other parties own a significant portion of the equity of those subsidiaries. We increased the disclosure requirements pertaining to subsidiaries in response to those requests.

Effect analysis

We have analysed the likely effect of the main changes introduced by IFRS 10 and IFRS 12.

Consolidation decision

IFRS 10 requires an entity to consolidate any investee that it controls. IFRS 10 provides guidance on assessing control in circumstances where the assessment would be difficult. These circumstances include cases when a reporting entity might have power over an entity even though it does not hold a majority of the voting rights, circumstances where voting rights are not the dominant factor in assessing control, agency relationships and the presence of potential voting rights.

Even though a preparer incur costs on initial adoption of IFRS 10 by having to assess whether it controls an investee under the new control model, it will benefit over the long term by gaining a better understanding of the reasons for consolidation and the consolidation guidance itself due to the clarified, enhanced guidance in IFRS 10. Users will benefit from the increased comparability, usefulness and consistency that will result from the single consolidation model and enhanced application guidance in IFRS 10.

Additional disclosures

The disclosure requirements of IFRS 12 will improve, and increase, the financial information provided for an entity's interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. The new requirements seek to provide users with information to help them to gain a better understanding of the extent of the activities carried out by an entity through its relationships with other parties.

Again, there will be initial costs for preparers to provide the new disclosures required under IFRS 12. This cost should be mitigated partially because preparers should already be able to easily access some of the new information required (eg information about subsidiaries).

The new information that is disclosed will enable users to perform more thorough equity analysis and valuations. Users will be better able to evaluate the nature, extent and financial effects of an entity's interests with other entities and the nature of the risks associated with those entities. Users will also better understand the interests that non-controlling interests have in an entity.

Costs and benefits

Our assessment is that IFRS 10 and IFRS 12 will bring important and sustained improvements to financial reporting. We expect the revised definition of control, together with the application guidance, to lead to more appropriate and consistent consolidation decisions.

We also expect the new disclosure requirements to improve significantly the ability of users to understand and assess the risks of an entity in relation to special purpose or structured entities (such as securitisation vehicles) with which the entity has been or is currently involved.

The most significant costs for preparers will occur at transition when they will need to reassess their relationships with some entities to determine if they control the investee and in meeting the new disclosure requirements. However, our assessment is that the significant improvements in terms of comparability and transparency outweigh those costs.

A more complete effect analysis is provided in additional documentation, which is available on the IFRS Foundation website.

Important information

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Notes

International Accounting Standards Board (IASB)
The IASB is the independent standard-setting body of the IFRS Foundation

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