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Accounting  
Standards  
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# Consolidation

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*Project Updates are provided for the information and convenience of constituents who wish to follow the IASB's deliberations. All conclusions reported are tentative and may be changed at future IASB meetings. Decisions become final only after completion of a formal ballot to issue an International Financial Reporting Standard, Interpretation, or Exposure Draft.*

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## Introduction

This project report is structured as follows:

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## Objective

1. In June 2003, the IASB added a project on consolidation to its agenda. The objective of the project is to publish a single IFRS on consolidation to replace the consolidation requirements of IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities*. The project addresses the following aspects:
  - a. a revision of the control definition in order to apply the same control criteria to all entities. The work on the revised control definition will focus on, but is not limited to, the consolidation of structured entities.
  - b. to require enhanced disclosures about consolidated and unconsolidated entities.
2. In February 2010, the IASB decided to combine the disclosure requirements for subsidiaries, joint ventures, associates and unconsolidated structured entities within a

comprehensive disclosure standard that will address a reporting entity's interests in other entities. This comprehensive disclosure standard will also include disclosures related joint operations.

## Background

3. In June 2003, the IASB added a project on consolidation to its agenda. The Board has been developing the project with the following principles in mind:

Consolidation should be driven by the principle of reporting a parent and its subsidiaries as if they were a single entity.

Identifying whether an entity is a subsidiary should be based on control, ie an entity's control of another entity should be used as a proxy for identifying the assets controlled by the first entity.

Only one entity can control another entity. In other words, control cannot be shared.

Consistent control criteria and a single comprehensive IFRS on consolidated financial statements (to replace the consolidation requirements of IAS 27 and SIC-12) should apply to all entities.

4. In April 2008, in response to the global financial crisis and the recommendation of the Financial Stability Forum, the Board decided to accelerate the consolidation project and proceed directly to the publication of an exposure draft. The Board also decided to address disclosure requirements relating to off balance sheet entities.
5. The Board published an exposure draft in December 2008 (ED10). The comment deadline for the exposure draft ended on 20 March 2009.
6. Round tables were held in conjunction with the derecognition project in North America, Asia and Europe in June 2009.
7. The Board commenced deliberations of issues raised by respondents to the exposure draft in July 2009, and continued deliberations in October. At the October 2009 joint meeting, the IASB and the FASB agreed to conduct their respective consolidation projects jointly. From January to July 2010, the boards discussed the project jointly.
8. The FASB decided in January 2011 that it would not change the consolidation requirements relating to voting interest entities at this time. The FASB did however tentatively decide that it would propose changes to the consolidation requirements relating to variable interest entities in the context of assessing whether a decision-maker is a principal or an agent. Those proposals would be similar to the proposed requirements developed jointly by the IASB and the FASB regarding the principal agent assessment, which will be included in the IASB's forthcoming consolidation standard.

## Tentative Decisions to Date

### *The definition of control*

9. The Board has tentatively decided that a reporting entity controls another entity when it is exposed, or has rights, to variable returns from its involvement with the other entity and has the ability to affect those returns through its power over the entity.

### *Power*

10. A reporting entity has power over another entity when it has existing rights that give it the current ability to direct the activities that significantly affect the entity's returns (the relevant activities).
11. The Board has tentatively decided that the characteristics of power are as follows:
- Power arises from existing rights.
  - Power refers to a reporting entity's current ability to direct the activities of an entity that significantly affect the returns.
  - A reporting entity can have power over another entity by different means:
    - By having the contractual ability to direct the relevant activities, which can arise from having:
      - More than half of the voting rights in an entity controlled by voting rights
      - Contractual rights within other contractual arrangements that relate to the relevant activities of the entity
      - A combination of contractual rights within other contractual arrangements and holding voting rights in the entity.
      - By holding less than half of the voting rights in an entity considering relevant facts and circumstances.
    - The assessment of whether a reporting entity has power includes an assessment of both the reporting entity's rights (and whether they are sufficient to give the reporting entity power), and whether the rights held by other parties could prevent the reporting entity from having power.
    - In situations in which a reporting entity does not have the contractual ability to direct the activities (eg when it holds less than half of the voting rights in an entity), a reporting entity may need to rely on other evidence of indicators of power to provide evidence of having the ability to direct, such as whether it can obtain additional voting rights from holding potential voting rights or whether the entity's operations are dependent on the reporting entity. In some situations, considering the size of the reporting entity's holding of voting rights relative to the size and dispersion of holds of other vote holders could provide sufficient evidence that an investor has, or does not have, power.
  - power need not be absolute.
  - power is assessed on the basis of current facts and circumstances.
  - power need not have been exercised.

*Power through voting rights*

12. The IASB and the FASB tentatively decided that:
- a reporting entity that holds more than half of the voting rights in an entity meets the power element of the control definition, in the absence of other arrangements
  - a reporting entity (with less than half of the voting rights in an entity) that has the legal or contractual ability to direct those activities of the entity that significantly affect the returns meets the power element of the control definition.
13. For further tentative decisions taken by the Board about entities holding less than half of the voting rights in another entity, please refer to paragraph 11 of this document.

*Options and convertible instruments*

14. The boards tentatively decided that a reporting entity should consider potential voting rights (eg options and convertible instruments) when assessing whether it has the power through voting rights to direct the activities of an entity that significantly affect the returns. The consideration of whether a reporting entity has the power to direct the activities of the other entity would include not only a reporting entity's voting rights in another entity, but also an assessment of all the facts and circumstances associated with the options or convertible instruments.

### *Activities*

15. The Board tentatively decided to clarify that 'the activities' in the control definition are those activities of an entity that significantly affect the entity's returns.

### *Returns*

16. The Board has tentatively decided to retain a broad definition and description of returns, similar to the description included in paragraphs 10 and 11 of ED10, and has clarified the following regarding the returns element of the control definition:
  - a reporting entity must be exposed, or have rights, to variability of returns in the future
  - a reporting entity's returns can have the potential to be wholly positive, wholly negative or either positive or negative.

### *Purpose and design of an entity*

17. The Board tentatively decided to clarify that understanding the purpose and design of an entity is an important factor to consider when assessing control of that entity, but that involvement in the design of an entity is not, in isolation, sufficient to conclude that the reporting entity controls that entity.

### *Continuous assessment of control*

18. The Board tentatively concluded that a reporting entity should be required to assess control continuously and that the final standard should clarify that requirement.

### *Risks and rewards*

19. The Board tentatively decided that exposure to risks and rewards alone do not constitute control. Exposure to risks and rewards is an indicator of control because the greater a reporting entity's exposure to risks and rewards from its involvement with an entity, the greater the incentive for the reporting entity to obtain rights sufficient to give it the power to direct the activities of an entity.

### *Reputational risk*

20. The Board tentatively decided that reputational risk does not give a reporting entity the power to direct the activities of an entity. However, the existence of reputational risk can give a reporting entity an incentive to control another entity.

### *Protective rights and rights that give a reporting entity power*

21. Parties such as holders of non-controlling interests or lenders may have the right to veto decisions or their consent may be a prerequisite to some decisions. The Board has tentatively decided that veto rights, even if limited to the ability to block actions, might negate control if those rights relate to the relevant activities of an entity (and if they are substantive rights). To negate control those veto rights would usually relate to decisions in the ordinary course of business—rather than being limited to fundamental changes in the organisation (such as disposals of business units or acquisitions of significant assets). Veto rights limited to fundamental changes in the organisation often exist to protect the holders of those rights.
22. The Board has tentatively decided to retain the guidance on protective rights included in paragraphs B1 and B2 of ED10 (with some wording changes) and that the final standard should include guidance discussing rights that give a reporting entity power as follows:
  - rights that give a reporting entity power must be substantive rights. The final standards will include factors to consider when assessing whether rights are

- to be substantive, rights need to be exercisable when decisions about the direction of the relevant activities need to be made. For some entities (in particular, some structured entities), relevant activities might occur only when particular circumstances arise or events occur.

#### *Sharing of power*

23. The Board tentatively decided that when two or more parties have unilateral decision-making authority over different activities of an entity that significantly affect the returns, the party that has the ability to direct the activities that *most* significantly affect the returns meets the power element of the control definition.

#### *Principal-agency relationships*

24. The boards tentatively decided that
- a. when assessing whether a decision-maker is an agent or a principal, the assessment should be made on the basis of the overall relationship between the decision-maker, the entity being managed and the other interest holders, and should consider all of the following factors:
    - Scope of decision-making authority
    - Rights held by other parties
    - Remunerations of the decision-maker
    - The decision-maker's exposure to variability of returns because of other interest that it holds in the entity.
  - b. when assessing control, the involvement and interests of a related party should be considered to be those of the reporting entity when the nature of the reporting entity's relationship with that related party is such that the related party is acting on behalf of the reporting entity. The boards tentatively agreed that this would also be the case where those that direct the activities of the reporting entity also have the ability to direct another entity to act on behalf of the reporting entity. The boards also tentatively decided that the final standard will include a list of potential related parties.

#### *Application examples*

25. The Board tentatively decided to include examples within the application requirements that illustrate how the requirements should be applied in some situations.

#### *Investment entities*

26. Refer to the investment entity web page.

#### *Disclosures*

27. The Board tentatively decided to combine the disclosure requirements for subsidiaries, joint ventures, associates and unconsolidated structured entities within a comprehensive disclosure standard that would address a reporting entity's interests in other entities. Such a disclosure standard would also include the disclosure requirements for joint operations.

28. The Board tentatively decided that a reporting entity could provide the disclosures on an aggregated basis, unless separate disclosure would provide more decision-useful information. The final disclosure requirements will contain application guidance on how the information could be aggregated.
29. The Board tentatively decided that a reporting entity should disclose all significant judgements and assumptions in determining whether or not it controls another entity and any changes in its control assessments that require significant judgement.

*Subsidiaries*

30. The Board discussed a reporting entity's disclosures for interests in subsidiaries. The Board tentatively decided that, as a general disclosure objective, a reporting entity should disclose information that help users of financial statements:
- a. understand the composition of the group;
  - b. understand the interests that non-controlling interests have in the group's activities and cash flows; [An entity would be required to disclose, among others, summarised financial information for each subsidiary that has non-controlling interests that are material to the reporting entity.]
  - c. evaluate the nature and effects of significant restrictions on its ability to access and use assets of the group, and settle liabilities of the group; and
  - d. evaluate the nature of, and changes in, the risks associated with its interest in consolidated structured entities.

*Unconsolidated structured entities*

31. The Board discussed a reporting entity's disclosures for interests in unconsolidated structured entities. The Board tentatively decided that, as a general disclosure objective, a reporting entity should disclose information that helps users of financial statements:
- a. understand the nature and extent of its interests in unconsolidated structured entities; [An entity would be required to disclose, among others, income and asset information when a reporting entity has sponsored an unconsolidated structured entity but has no involvement with that entity.] and
  - b. evaluate the nature of, and changes in, the risks associated with its interests in unconsolidated structured entities. [An entity would be required to disclose, among others, information about its maximum exposure to loss and a comparison of that maximum exposure to the carrying amounts of assets and liabilities in the reporting entity's financial statements. The disclosure standard would also contain a list of examples of other disclosures that might be relevant to an assessment of the reporting entity's risk exposure depending on the circumstances.]
32. The Board discussed reputational risk in the context of requiring disclosures for implicit obligations of support that a reporting entity may have with another structured entity. The boards tentatively decided to require disclosures regarding the provision of support to structured entities when there was no contractual obligation to do so and whether it has any current intentions to provide support or other assistance to structured entities in the future.
33. The Board tentatively decided that a description of a structured entity should be included in the final disclosure standard. That description would incorporate some of the factors that describe a variable interest entity in US GAAP (ASC Topic 810-10, as amended by FASB Statement No.167), but the description would not include all of the current guidance that is in Topic 810-10.

## Next Steps

34. The Board has made available a staff draft of its proposed final standard on consolidation on 29 September 2010. The Board plans to issue a final standard on consolidation, IFRS 10 *Consolidated Financial Statements*, in the first quarter of 2011.
35. The Board plans to issue a comprehensive disclosure standard, IFRS 12 *Disclosure of Interests in Other Entities*, in the first quarter of 2011.
36. The Board tentatively decided that the proposals regarding investment entities will be exposed in the second quarter of 2011.
37. The FASB will decide whether to publish an exposure draft relating to the consolidation of voting interest entities in January 2011.

## Contact information

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