



International  
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 and associates within a comprehensive disclosure

standard that will address a reporting entity's involvement with other entities. This comprehensive disclosure standard will also include disclosures related to risks associated with structured entities that the reporting entity does not control.

## 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.

## Tentative Decisions to Date

### *The definition of control*

8. The Board has tentatively decided that 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.

### *Power*

9. A reporting entity must have the power to direct the activities of another entity. The Board has tentatively decided that the characteristics of power are as follows:
  - power refers to a reporting entity's current ability to direct the activities of an entity that significantly affect the returns
  - The reporting entity can have that current ability to direct the activities by different means:
    - By having the contractual ability to direct the 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 related to the substantive 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 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 whether the rights held by other parties could prevent the reporting entity from having the ability to direct.
  - 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 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, together with voting patterns at previous shareholders meetings, could provide sufficient evidence of having the ability to direct.
- 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*

10. 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.
11. For further tentative decisions taken by the boards about entities holding less than half of the voting rights in another entity, please refer to paragraph 9 of this document.

*Options and convertible instruments*

12. The IASB and the FASB tentatively decided that a reporting entity should consider 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*

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

### *Returns*

14. 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 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*

15. 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*

16. 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*

17. 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*

18. 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 and participating rights*

19. 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 activities of an entity that significantly affect the returns (ie if they are participating 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.
20. The Board has tentatively decided to retain the guidance on protective rights included in paragraphs B1 and B2 of ED10 and that the final standard should include guidance discussing participating rights as follows:
  - participating rights are rights that, if held by one party, are sufficient to give that party the ability to direct the activities of an entity that significantly affect the returns. If their exercise requires agreement by more than one party, participating rights can prevent other parties from controlling the entity to which they relate.

- participating rights must be substantive rights that are exercisable only when specified circumstances arise or events happen are participating rights in some circumstances and protective rights in others. The final standard will explain those circumstances.

#### *Sharing of power*

21. The Board tentatively decided that when two or more parties have discrete, 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*

22. 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. The boards tentatively agreed to include guidance in the final standard that is similar to that in ASC Paragraph 810-10-25-44 to address situations in which a reporting entity, together with its related parties, as a group, meets the control requirements.

#### *Structured entities*

23. The FASB tentatively decided that the guidance for variable interest entities in Codification Topic 810 (specific to US GAAP), except for the implementation guidance, would be replaced by the control principles established within this project with the expectation that the guidance established in this project will produce consolidation results consistent with those reached under the Variable Interest Entity subsections of Topic 810.
24. The boards tentatively decided that a description of a structured entity should be included in the next due process document. 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.

#### *Investment companies*

25. 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. 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.
26. The boards tentatively decided that an investment company should be required to provide additional disclosures about entities that it controls when it measures investments in those entities at fair value. The disclosures will be developed as part of the new disclosure requirements for involvement with consolidated entities.

*Temporary control*

27. The Board has tentatively concluded that the fact that control of an entity might be temporary does not of itself change the assets controlled by an entity. During the time that control is held and until such time as control ceases, the controlled assets are part of the group and should be recognised as such.

*Disclosures*

28. The boards discussed a reporting entity's disclosures for subsidiaries. The boards tentatively decided that, subject to wording changes, as a general disclosure principle, a reporting entity should disclose information that help users of financial statements to understand:
  - a. the composition (and changes in the composition) of the group;
  - b. the effect of legal structures within the group, and changes to those structures, on the reporting entity's ability to access and use assets and resources of consolidated entities;
  - c. the nature of, and changes in, the risks associated with the reporting entity's involvement with structured entities.
29. The boards also 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.
30. The boards tentatively decided that, to comply with the general disclosure principle, a reporting entity should disclose:
  - a. all significant judgements and assumptions in determining whether it controls another entity and any changes in its control assessments that require significant judgement and the reasons for those changes; and
  - b. the nature of restrictions that are a consequence of assets and liabilities by the parent or its subsidiaries.
31. The boards asked the staff to conduct further research on disclosures relating to:
  - a. summarised financial information on subsidiaries;
  - b. the interest that the non-controlling interests have in the group; and
  - c. a reporting entity's risk exposure from its involvement with subsidiaries.

32. The boards discussed reputational risk in the context of requiring disclosures for implicit obligations of support that a reporting entity may have with another entity. The boards tentatively decided to require disclosures regarding the provision of support to another entity when there was no contractual or constructive obligation to do so and whether it has any current intentions to provide support or other assistance in the future.
33. The boards will continue to deliberate disclosures for consolidated and unconsolidated entities at the April 2010 joint board meeting.
34. The Board tentatively decided to combine the disclosure requirements for subsidiaries, joint ventures and associates within a comprehensive disclosure standard that would address a reporting entity's involvement with other entities when such involvement is not within the scope of IAS 39 Financial Instruments: Recognition and Measurement or IFRS 9 Financial Instruments. Such a disclosure standard would also include the disclosure requirements for joint operations.

### Next Steps

35. The FASB set a goal of publishing an Exposure Draft in the second quarter of 2010 on consolidation. The IASB will make available a staff draft of its proposed final standard. After the public comment period for the FASB Exposure Draft ends, the two boards will jointly deliberate the issue with the expectation that they would produce improved and converged standards in the fourth quarter of 2010.
36. The IASB plans to issue the comprehensive disclosure standard in the second quarter of 2010.
37. The IASB tentatively decided that the proposals regarding investment companies will be re-exposed in the second quarter of 2010.

### Contact information

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