

February 2009

International Financial Reporting Standards

ED 10 *Consolidated Financial Statements*

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Why a project on consolidation?

Inconsistencies in practice

- Tension between the IAS 27 control model and the risk and reward emphasis in SIC-12
- Concerns that they are not being applied consistently

Credit crisis

- Timing
- Are the consolidation requirements for structured entities sufficient?
- Should reputational risk be a basis for consolidation?
- Are the current disclosure requirements adequate?



The consolidation project

Objectives

- Develop a cohesive control based model that encompasses structured financing and investment vehicles, replacing both:
 - IAS 27 *Consolidated and Separate Financial Statements*
 - SIC-12 *Consolidation – Special Purpose Entities*
- Provide clearer (and more explicit) principles of control and additional application guidance
- Provide information about structured entities that (correctly) are not consolidated but which create risks for the reporting entity
- Improve disclosures about restrictions on the assets and liabilities of the group



The consolidation project

What does not change

- No change to the consolidation procedures or accounting when obtaining control (IFRS3 revised in 2008) or on loss of control (IAS27 revised in 2008)
- No change to the requirement to prepare consolidated financial statements—eg no specific consolidation exemption for investment companies
- IAS27 will “survive”, but will deal only with the preparation of separate financial statements



Control of an entity

Definition

- 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 to direct activities

- Voting rights (eg governing body)
- Options or convertible instruments to obtain voting rights
- Contractual arrangements
- A combination of these

Returns

- Vary with the activities of the controlled entity
- Can be positive or negative



Control of an entity

Control with less than a majority of voting rights

- More voting rights than others and sufficient to determine the strategic operating and financing policies
- Options and convertible instruments
- Other arrangements

Agent/principal relationship

- Dual role (holding voting rights directly and on behalf of others as an agent)



Control of an entity

Structured entities

- A structured entity is an entity whose activities are restricted to the extent that those activities are not directed by traditional means (eg by its governing body)
- Apply control definition and identify power and returns
- Consider all facts and circumstances including:
 - Purpose and design
 - Returns (eg exposure to variability of returns)
 - Activities (eg are some or all(?) policies pre-determined?)
 - Related arrangements
 - Ability to change restrictions or pre-determined policies
 - Agents



Disclosures

Disclose information that enables users to evaluate:

- the basis of control and the related accounting consequences
- the interest that the non-controlling interests have in the group's activities
- the nature and financial effect of restrictions that are a consequence of assets and liabilities being held by subsidiaries
- the nature of, and risks associated with, the reporting entity's involvement with structured entities that the reporting entity does not control



Exposure draft

Ways to participate

- Comments on the ED can be submitted until 20th March 2009
- Further round tables after the end of the comment period

Next steps

- Publication date for an IFRS (second half of 2009)
- Co-operation with the FASB



Questions or comments?

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