

July 2010

International Financial Reporting Standards

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Consolidation

DSR Presentation 1 July 2010

The views expressed in this presentation are those of the presenter,
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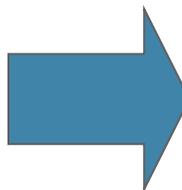
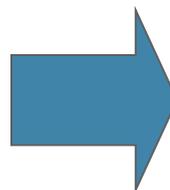


Reasons for proposals

Criticisms: Current accounting

- **Inconsistencies in practice**
- Tension between IAS 27 (control) and SIC-12 (risks and rewards)
- Concerns that they are not being applied consistently

- **Financial crisis**
- Was guidance for structured entities sufficient?
- Should reputational risk be a basis for consolidation?
- Concerns disclosure was inadequate?

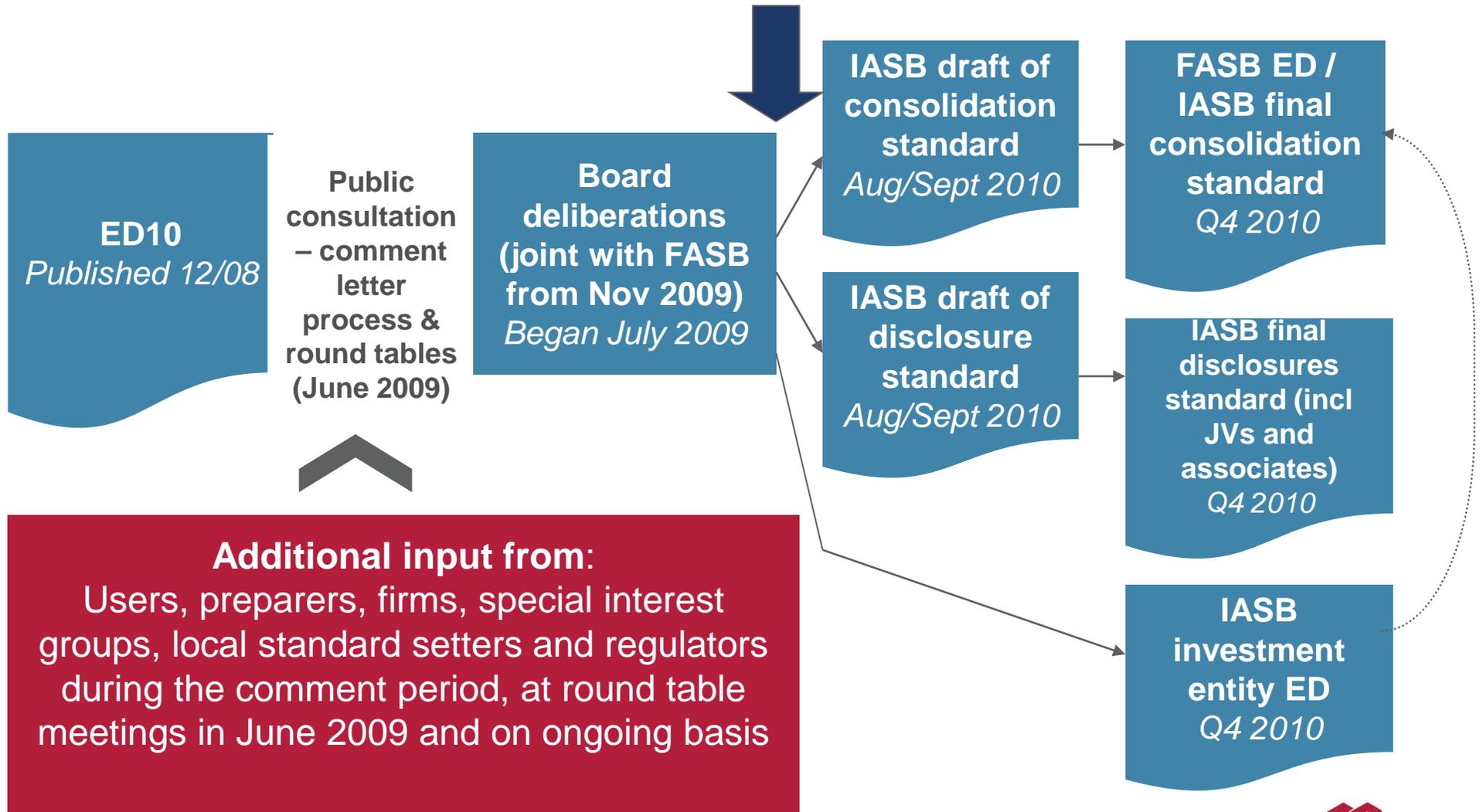


Solution: Proposed accounting

- Develop a single control model for all entities
- Provide clearer principles of control and additional application guidance
- SIC-12 performed well but proposals give more guidance on consolidation of SPEs
- Enhanced disclosure – particularly for unconsolidated structured entities



Where are we now?



The control model – overview

Definition of control

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

- Single consolidation model for all entities, including structured entities
- Consolidation based on control – ‘power so as to benefit’ model
- Controller must have some exposure to risks and rewards.
Exposure is an indicator of control but is not control of itself
- Power arises from contractual rights—voting rights (either majority or less than a majority), potential voting rights, other contractual arrangements, or a combination thereof.



Assessing control of an entity

Questions:

Are a reporting entity's contractual rights sufficient to give it power, ie the current ability to enforce its will in directing the activities of an entity that significantly affect the returns?

Does the reporting entity have the ability to benefit from that power?



“De facto Control”

Current IFRS:

- In practice, often no consolidation with less than 50%

ED10:

- Entity can control with less than 50%
- Feedback: operationality issues

Boards' tentative decisions:

- Entity can control with less than 50%. Factors to consider include:
 - Size of the holding rights relative to the size and dispersion of other vote holders
 - Voting patterns at previous shareholders meetings
 - Potential voting rights (see below)
 - Other contractual rights
- If those indicators are not conclusive consider additional indicators of power (eg appointment of management, etc)



Potential Voting Rights

Current IFRS:

- Currently exercisable potential voting rights give the holder power

ED10:

- Potential voting rights can give the holder power (examples listed)

Boards' tentative decisions:

- Substantive potential voting rights can give the holder power
- Determining whether potential voting rights are substantive requires judgement. Consider the terms and conditions of the instrument, including:
 - Whether the rights are currently exercisable
 - Whether exercise of the rights would be beneficial to the holder



SPEs / structured entities

Current IFRS:

- Indicators of control of an SPE:
 - purpose of SPE
 - decision-making powers
 - rights to majority of benefits
 - exposure to majority of risks

ED10:

- Apply general control definition—specific guidance included



SPEs / structured entities

Boards' tentative decisions:

- Apply general control definition
- Additional application guidance added to address:
 - the purpose and design of an entity
 - the activities that significantly affect the returns (including multiple parties involved)
 - rights that are available when particular events happen
 - participating and protective rights
 - agency relationships (see next slide)



Current IFRS:

- No specific guidance regarding agent/principal relationships

ED10:

- Removal rights and remuneration are indicators of an agency relationship

Boards' tentative decisions:

- Consider all of the following factors:
 - scope of the decision-making authority
 - rights held by other parties
 - remuneration of the decision-maker
 - the decision-makers exposure to variability of returns because of other interests that it holds in the entity
- List of examples of non-contractual agency relationships (related parties)



Investment companies

Current IFRS

- A reporting entity must consolidate all controlled entities

ED10

- Did not propose to change current requirements
- Respondents urged the Board to consider allowing investment companies to use fair value to measure investments in entities that are controlled
- Staff received industry input to develop criteria to define an investment company



Boards' tentative decisions to date

- **Investment company level:**
 - measure investments in controlled entities at fair value through profit or loss
 - measure investments in joint arrangements and associates at fair value through profit or loss
- **Parent level:**
 - consolidate all controlled entities, even if an entity is controlled through an investment company (unless the parent is also an investment company)
 - continue the use of fair value for investments in joint arrangements and associates (see above) held by an investment company subsidiary in its consolidated financial statements



Criteria to be an 'investment company'

- **Investment activity:** the entity does not have substantive activities other than investing for current income, capital appreciation, or both
- **Express business purpose:** investment activity is the sole purpose of the entity
- **Exit strategy:** the entity must have a documented exit strategy
- **Unit ownership:** represented by units of investments (ie ordinary shares) to which proportionate shares of the net assets can be attributed
- **Pooling of funds:** funds of the investors are pooled to avail the investors of professional investment management; the entity must have significant investment from unrelated investors
- **Fair value:** the investments of the entity are managed and their performance is evaluated on a fair value basis
- **Reporting entity:** the entity is a reporting entity (as discussed in Phase D of the conceptual framework project)



Current IFRS regarding disclosures:

- Limited disclosures for both consolidated entities and unconsolidated SPEs

ED10:

- Extensive disclosures for unconsolidated structured entities
- Feedback from users: generally agreed with proposals
- Feedback from others: generally, proposals were excessive

Staff recommendation (Board meeting May 2010):

- Develop a disclosures standard for a reporting entity's involvement with other entities, including subsidiaries, joint ventures, associates and unconsolidated structured entities
- Carry-over the disclosures in ED10, but give preparers more freedom to tailor disclosures according to their needs



Questions or comments?

Expressions of individual views by members of the IASB and its staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.

