

The IASB is developing a single consolidation model applicable to all entities that would be based on the concept of control and improve disclosures of consolidated and unconsolidated entities (replacing both IAS 27 and SIC-12).

The Board issued ED 10 *Consolidated Financial Statements* in 2008. The Board recently completed its redeliberations of ED 10 and in September 2010 published a staff draft of its forthcoming consolidation standard. The Board is also drafting a final standard on disclosure requirements for subsidiaries, joint ventures, associates and unconsolidated structured entities and is preparing to issue an ED on consolidation guidance specific to investment companies not included in the original ED.

At the 15 February 2011 IASB meeting, the Board decided that the effective dates of IFRS 10 *Consolidated Financial Statements* and IFRS 12 *Disclosure of Involvement with Other Entities* will be 1 January 2013 with early application permitted so long as IFRS 11 *Joint Arrangements*, IAS 27 *Separate Financial Statements* (revised 2011) and IAS 28 *Investments in Associates and Joint Ventures* (revised 2011) are also early adopted. Entities will be permitted to apply any of the disclosure requirements in IFRS 12 before the effective date.

Summary of tentative decisions

The following represents a summary of the decisions reached from the redeliberations of the proposals in the ED.

Definition

Control would be defined as power to direct the activities of another entity to generate returns for the reporting entity. Power would be the current ability to direct the activities of an entity that significantly affect the returns. Power need not be absolute, need not have been exercised and would be assessed on the basis of current facts and circumstances.

The activities' in the control definition are those activities of an entity that significantly affect the returns. The reporting entity must be exposed to variability of returns in the future and the returns can have the potential to be wholly positive, wholly negative or either positive or negative.

Consolidation guidance

The reporting entity can have the current ability to direct the activities by 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.

A reporting entity that holds less than half of the voting right in an 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, an entity could have the ability to direct if the reporting entity holds more voting rights relative to the size of any other party, the other voting rights are widely dispersed and the voting patterns at previous shareholders meetings indicate that the reporting entity has the current ability to direct the activities of the entity.

Potential voting rights such as options and convertible instruments should be considered when assessing whether a reporting entity has the power to direct the activities of an entity that significantly affect the returns.

Control may be negated by veto rights if those rights relate to the activities of an entity that significantly affect the returns. Veto rights may 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 and would therefore be considered protective rights.

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. Participating rights must be substantive rights that are exercisable only when specified circumstances arise or events occur. Facts and circumstances will dictate whether rights should be considered participating or protective rights.

Investment companies

An exemption from consolidation would be provided for *investment companies* that meet certain criteria related to its business purpose, investment activity, unit ownership, pooling of funds, use of fair value for internal and external reporting and the characteristics of debt.

The parent of an investment company (unless itself an investment company) would consolidate all controlled investees, including those held by investment company subsidiaries.

Other decisions

The controlled assets are part of the group and should be recognised as such during the time that control is held and until such time as control ceases.

The assessment of control for structured entities would not be based on voting rights but rather a qualitative analysis. The definition of a structured entity would be based on the variable interest entity guidance under U.S. GAAP (ASC Topic 810-10).

Restrictions placed on a fund manager's decision-making authority by law or regulation would not prevent the fund manager from controlling (and thus consolidating) the fund.

A reporting entity would be required to assess control continuously.

Transition

A reporting entity consolidates an entity that was previously not consolidated:

A reporting entity should measure the assets, liabilities and non-controlling interests of a previously unconsolidated subsidiary as if that subsidiary had been consolidated from the date when the reporting entity obtained control of the subsidiary, on the basis of the revised consolidation requirements. Alternatively, if this is impracticable, the reporting entity should apply the acquisition method in IFRS 3 *Business Combinations* at the beginning of the earliest period for which application of those requirements is practicable.

A reporting entity no longer consolidates an entity that was previously consolidated:

A reporting entity should measure the interest in a previously-consolidated entity as if the reporting entity had accounted for that interest from when it first became involved with, or no longer had control of, the entity. Alternatively, if this is impracticable, the reporting entity should derecognise the assets, liabilities and non-controlling interests of the previously-consolidated entity, and recognise any interest in the entity at fair value at the beginning of the earliest period for which application of those requirements is practicable.

The Board tentatively decided to permit early application of the revised consolidation requirements.

Disclosure

Significant disclosures would be required for consolidated and unconsolidated entities. Of particular note are disclosure requirements related to unconsolidated structured entities where the reporting entity has an

involvement and for unconsolidated structured entities in which the reporting entity is the sponsor but no longer has an involvement.

Effective Date

The Board decided that the effective dates of IFRS 10 *Consolidated Financial Statements* and IFRS 12 *Disclosure of Involvement with Other Entities* will be 1 January 2013 with early application permitted so long as IFRS 11 *Joint Arrangements*, IAS 27 *Separate Financial Statements* (revised 2011) and IAS 28 *Investments in Associates and Joint Ventures* (revised 2011) are also early adopted. Entities will be permitted to apply any of the disclosure requirements in IFRS 12 before the effective date.

Thinking ahead

- The new guidance may change a previous consolidation conclusion requiring either consolidation of a previously unconsolidated entity or deconsolidation of a previously consolidated entity. This may occur more often in those situations in which the current conclusion is based solely on risks and rewards or when a reporting entity holds less than a majority of the voting interests in an entity.
- An inventory of all interests and involvements in entities (whether consolidated or not) would be required to ensure that the correct population of entities is being assessed under the new guidance.
- A reporting entity would need to review the relevant documents and obtain a thorough understanding of its transactions. In particular, it will be necessary to identify which activities significantly affect the returns of the entity and which party directs these activities. Additionally, all rights held (potential voting rights, kick-out rights, participating rights) and commitments provided would need to be identified.
- Accounting policies and internal controls would need to be modified to ensure consistency in applying the requirements of the new standard.
- System modifications and enhancements may be required to address the change in guidance and to provide the necessary information for the new disclosure requirements.
- Debt covenants may need to be modified as a result of changes in previous consolidation conclusions.
- While the investment company exemption has been welcomed by the asset management industry, concern remains as to its “upstream” application by asset managers. The proposed consolidation exception at the investment company level would not be retained at the investment manager level unless that manager is an investment company itself. Therefore, an investment manager would consolidate all controlled investees, including those held by investment company subsidiaries. For a private equity asset manager required to consolidate an investment fund, that manager would consolidate both the fund and the underlying business controlled by the fund.

Next steps

The Board concluded its redeliberations on the consolidation project and has instructed the staff to finalise drafting of the final standard. The Board expects to issue final standards on consolidation accounting and disclosures for subsidiaries, joint ventures, associates and unconsolidated structured entities in late February 2011. The Board also intends to issue an ED for the proposed changes related to investment companies during the second quarter of 2011.

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