



Project	Consolidation
Topic	Summary of FASB Roundtable Meetings

Background and Purpose

1. On September 29, 2010, the IASB posted on its website a staff draft of its forthcoming IFRS on consolidation. The IASB's proposed consolidation guidance originally was exposed as Exposure Draft 10, *Consolidated Financial Statements*, with a comment period that ended in March 2009. The IASB's staff draft represents the IASB's cumulative tentative decisions to date and reflects the IASB's deliberations subsequent to the comment period. The IASB's staff draft represents a single standard on consolidation applicable to all entities and would replace the consolidation guidance in IAS 27 *Consolidated and Separate Financial Statements*, and SIC-12 *Consolidation — Special Purpose Entities*.
2. With the goal of developing a common, high-quality standard on consolidation, the FASB and IASB have deliberated jointly the IASB's proposed consolidation guidance since October 2009. However, as part of the FASB and IASB's modified strategy announced in June 2010, the IASB is working independently towards issuing an IFRS on consolidation.
3. To help the FASB decide whether it should proceed with an exposure draft consistent with the IASB's staff draft, the FASB hosted two roundtables on November 22, 2010, to discuss the IASB's staff draft. The first session focused primarily on evaluating whether a reporting entity's voting rights are sufficient to give it power when it holds less than a majority of the voting interests (the

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Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in *IASB Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

concept of “de facto control”) and the guidance related to potential voting rights. The second session, whose participants consisted mainly of preparers from the asset management industry, focused on the guidance within the staff draft related to assessing whether a decision maker is a principal or an agent. The following table summarizes the composition of the participants.

Participant Type	First Session	Second Session
Preparers	4	7
Accounting Firms	3	2
Users	3	1
Regulators	1	1
Total	11	11

4. The purpose of this memo is to summarize the feedback received from constituents participating in the roundtable discussions.

User Feedback

5. The users generally stated that although they support a model that requires more consolidation, they are more interested in detailed disclosure about consolidated and unconsolidated entities that are significant to the group, rather than in the assessment of which entities should be consolidated. Such supplemental disclosures would allow them to separate the financial results of consolidated entities or combine the financial results of unconsolidated entities, depending on the purpose of their analysis. Users of financial statements also stated that they would benefit from obtaining more detailed information about individual consolidated entities to better understand potential strategic, operational or financial differences within the consolidated group.
6. The user in the second session who focuses on the asset management industry also believes that additional disclosures would be beneficial, particularly with regard to the amount and nature of assets under management and the fee income derived there from. However, this user does not support consolidation by an

asset manager when the asset manager does not have exposure to the entity because consolidation would result in a loss of transparency of the fee information.

7. Users were also concerned if the consolidation model in the staff draft would require consolidation in one reporting period and not in another. They believe that volatility in the composition of the reporting entity would hinder the usefulness of the financial statements.

Single Model for Consolidation

8. Participants agreed that a single-model approach to the assessment of control would provide more consistent consolidation decisions for all types of entities, rather than maintaining separate models for voting interest entities and variable interest entities. Participants stated that they believe there are currently opportunities to structure an arrangement for an accounting result under U.S. GAAP because of the different consolidation guidance for voting interest entities and variable interest entities.

Control Model

Control Principle

9. Participants agreed that control should be the basis for consolidation. In addition, they agreed with the general control principle included in the staff draft and that consolidation should be required when a reporting entity has the current *ability* to direct the activities of another entity. Further, the participants agreed with the staff draft that consolidation is appropriate only when a reporting entity has unilateral control over the other entity.
10. Nevertheless, most participants had concerns about the application of the control model to voting interest entities in situations in which a shareholder is determined to have power even if it holds less than 50% of the voting rights and no other rights or contracts are in place. Specifically, they believe that there is an inherent conflict between the control principle and the application guidance

in the staff draft. The control principle in the staff draft requires an entity with unilateral control to consolidate, while the application guidance states that an entity may, in some circumstances, control a plain vanilla voting-interest entity (that is, with no additional contractual rights) with less than a 50% voting interest. Those participants insist that the inherent reliance on other voters to direct the activities does not represent the notion of a “unilateral” ability to direct the relevant activities (paragraph B37 of the staff draft).

11. Those participants believe that relying on the historical inactivity of voters and on an entity’s portion of the voting interest relative to other shareholders’ holdings, in and of itself, should not be determinative of an entity’s power. They stated that the passive nature of investors could merely be a result of their complacency or agreement with management’s decisions. However, should management suddenly adopt a new approach, the shareholder’s ‘control’ might be questioned. Participants also voiced concerns about the operability of this guidance because they anticipated that entities would be required to assess and reassess control as a result of changes in factors that are outside of their control.
12. Some participants agreed with the staff draft that there are situations in which a shareholder can control a voting interest entity with less than a 50% voting interest and without other contractual rights. However, these participants noted that this situation would only occur in rare circumstances in the U.S. Consequently, they questioned whether the cost of introducing a broader concept of control could be justified if only a small number of entities would be affected.
13. Participants also were concerned with paragraph BC84 of the staff draft, which notes although it may be difficult to determine whether an entity initially has power after the initial transaction (therefore, the entity may determine it does not have control), additional evidence in future periods may lead the entity to determine that it does have power. Participants questioned whether it makes sense to record a business combination in a period subsequent to the period in which the transaction actually occurred. They also questioned whether poor judgment would be the cause of a restatement or merely prospective application of the consolidation and business combination guidance.

14. Overall, participants agreed that in the U.S. there are very few circumstances in which an entity (holding less than a 50% voting interest) would be deemed to have control solely as a result of holding more voting rights relative to other shareholders and considering historical voting patterns because the entity would typically have other contractual rights to solidify its position. Some participants suggested that a “contractual rights” method is sufficient for evaluating U.S. reporting entity’s interests because the entity would typically have additional contractual rights in place in situations in which it wants the unilateral ability to direct activities and hold less than 50% of the voting rights. Accordingly, these participants believe that the example in the IASB staff draft in which the consolidation conclusion is based solely on a minority ownership interest held by an entity and the dispersion of the other shareholders would not likely exist in the U.S. because the reporting entity typically would have additional contractual rights.

Potential Voting Rights

15. Participants had mixed views about the potential voting rights guidance in the staff draft.
16. Some participants did not agree with the guidance related to potential voting rights. Those participants agree with the definition of control in the staff draft, in that a reporting entity must have the *current* ability to direct the activities of another entity to have power. However, they believe that in the absence of other contractual rights, unexercised options or conversion instruments would not provide an investor with the *current* ability to direct the relevant activities that significantly affect the investee’s returns. Nevertheless, those participants thought that potential voting rights should be considered when assessing control, if exercisable for a nominal amount.
17. Furthermore, those participants generally do not believe that the staff draft’s guidance and the related examples for determining when potential voting rights are considered substantive are sufficient to make the potential voting rights guidance operational. For example, participants were concerned that temporary changes in the value of potential voting rights (such as if a right becomes in-the-

money or less out-of-the-money) might affect the consolidation conclusion when it should not. Additionally, they noted that there likely would be practical difficulties in determining what is sufficiently in and out-of-the money on an ongoing basis, particularly for potential voting rights of unlisted entities.

18. Other participants either agreed with the treatment of potential voting rights in the staff draft or believe that the purpose and design should be considered when assessing potential voting rights. They noted that potential voting rights are usually acquired for a reason and that reason may be to affect the actions of those directing the activities of the entity. Assessing all facts and circumstances (including the terms and conditions of the instrument and the parties to the instrument) would usually provide information about the reason for their existence.
19. One participant indicated that he believes the staff draft sets out a consistent approach for assessing the effect of voting rights, potential voting rights and removal rights on the control decision. In all cases, an entity would consider the ability of the other voting shareholders, potential voting shareholders, or holders of the removal rights to get together and outvote, or remove, the reporting entity.

Principal versus Agent Analysis

Overall Comments

20. Overall, participants were more supportive of the qualitative assessment contained in the staff draft, compared to the analysis required in the FASB *Accounting Standards Codification*TM Variable Interest Entities Subsection of Subtopic 810-10, Consolidations-General.¹ The individuals representing the asset management industry, in particular, believe a principles-based qualitative approach is appropriate due to the complexity and uniqueness of asset structures within the industry. Specifically, this type of qualitative model allows for consideration of the different types of fee arrangements, the different types of

¹Originally issued as FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*.

interests that asset managers hold in particular funds, portfolio restrictions, etc. when evaluating these features and determining their purpose within particular structures.

21. Although participants agreed with the factors set out in paragraph B55 of the staff draft, many requested additional guidance regarding the application of different weightings to each of these factors. [Paragraph B56 of the staff draft states that, with the exception of a single party holding substantive rights to remove the decision maker, the conclusion of whether a decision maker is an agent requires an evaluation of all of the factors listed in paragraph B55. However, depending on the particular situation, some of the factors may be a stronger indicator of an agency relationship than others. As a consequence, different weight should be applied to each of the factors on the basis of particular facts and circumstances.]
22. Participants believe more guidance would be valuable, particularly given that a qualitative approach is different from the approach currently in U.S. GAAP. Several participants noted the need for illustrative examples to assist with consistent application of the model, similar to the examples in paragraph 21 of Agenda Paper 8C from the March 2010 joint Board meeting. One participant also commented that, in the absence of guidance on weighting these factors, it may be possible for entities to manipulate these factors in order to achieve a desired consolidation conclusion.
23. Several participants also noted that the staff draft is unclear as to how preparers would navigate through the guidance in the staff draft when performing their consolidation analysis. Specifically, some participants believe that the staff draft is unclear as to whether a decision maker would first determine whether it is an agent or a principal, or whether it has power over the relevant activities. Alternatively, other participants suggested that both of these evaluations would be performed simultaneously.
24. The remainder of this section discusses participants' comments on the factors included in paragraph B55 of the staff draft and is organized as follows:
 - (a) Scope of Decision Making Authority

- (b) Rights Held by Other Parties
- (c) Remuneration
- (d) Other Interests
- (e) Other Items Discussed.

Scope of Decision Making Authority

25. The staff draft requires a decision maker to evaluate its decision making authority by considering the range of activities it is permitted to direct according to the decision making agreement (including those specified by law), and the discretion it has when making decisions about those activities. All participants agreed that the range of decision making activity should be considered when determining if a decision maker is an agent. However, participants noted that additional guidance is needed in this area for several reasons.
26. Although the staff draft states that the decisions specified by law should be taken into account, it is not clear how to weight the decision-making authority when it is restricted by law or regulation. One participant identified a situation where there are no ongoing decision-making activities for the fund and the asset manager was involved only in originating the fund (that is, selecting the assets, determining founding documents, etc.). They questioned how the fact that the decision maker was involved only in setting up the fund should be taken into consideration. The participant stated that the treatment of restricted activities in such situations was unclear.
27. Similarly, there were differing views on how a decision maker of a fund registered under the Investment Company Act of 1940 (1940 Act) should be evaluated. Some participants believe that decision makers for 1940 Act funds should automatically be deemed agents due to the significant restrictions on the decision makers' authority in directing the activities of the fund and the strict requirements specified by the 1940 Act. These participants stated that if the significant restrictions imposed on decision makers by the 1940 Act are ignored within this evaluation, the guidance would be inherently communicating that the 1940 Act requirements are unnecessary and ineffective at protecting investors'

rights. On the other hand, several other participants stated that whether a fund is a registered 1940 Act fund should not determine whether the decision maker is an agent or a principal. These participants believe that all funds should be evaluated on the same basis.

28. Several participants reiterated that more guidance surrounding the purpose and design of the entity would be helpful when evaluating this criterion. They stated that, in addition to the range of activities, the level of fiduciary responsibility of the decision maker, its involvement with the Board of Directors, and the entire governance structure should be taken into account.

Rights Held by Other Parties

29. The staff draft states that when a decision maker has the ability to direct the relevant activities, substantive removal rights held by other parties (or similar rights such as some liquidation or redemption rights) may indicate that the decision maker is an agent. Situations in which a single party holds substantive removal rights and can remove the decision maker without cause, in isolation, would be sufficient to conclude that the decision maker is an agent. This is the only factor that, in isolation, can result in a conclusion that a decision maker is an agent. If numerous parties hold such rights those rights would not, in isolation, be conclusive in determining whether a decision maker is an agent.
30. Participants agreed that substantive removal rights held by a single party would be determinative that the decision maker is an agent. This is consistent with the evaluation of removal rights in the Variable Interest Entities Subsections of Subtopic 810-10. Similarly, participants agreed that substantive removal rights held by multiple parties should be considered in the analysis. One participant noted that the approach in the staff draft for evaluating removal rights is different than both of the models in Topic 810 (that is, model for evaluating removal rights for Voting Interest Entities (formerly ETIF 04-5, *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights*) and Variable Interest Entities (formerly FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*)), and additional illustrative

examples would be needed to reach appropriate and consistent conclusions.

That participant also expressed the view that the approach in the staff draft was an improvement on both models in Topic 810.

31. Participants held differing views regarding whether removal rights held by multiple parties should be determinative that a decision maker is an agent, rather than merely being a factor in the evaluation. Several participants stated that substantive removal rights should always be determinative, regardless of whether they are held by a single party or multiple parties. These participants explained that, within the asset management industry, removal rights are granted to multiple parties in response to investors' demands or regulatory requirements, rather than for accounting arbitrage purposes. They argued that the lack of significant precedence in the industry for exercising removal rights should not be viewed as evidence that the rights are not substantive. Additionally, one participant equated the evaluation of removal rights to the evaluation of voting rights. That is, if investors have the right and ability to remove the decision maker (or vote, in the case of the control model), those rights should be determinative.
32. Other participants agree with the staff draft that removal rights should not be determinative when held by more than a single party, but should be a factor in the overall principal agent analysis. These participants noted that removal rights should be weighted differently, depending on the number of parties holding those rights (agreeing with the guidance in paragraph B57 of the staff draft which states "...if a small number of parties hold substantive rights to remove a decision-maker, that factor would receive a greater weighting ... than if a large number of parties hold such rights"). However, participants agreed that illustrative examples should be included to help preparers with the evaluation.
33. Several participants also noted the need for additional guidance surrounding liquidation and redemption rights. Specifically, participants stated that it is unclear when such rights should be equated to removal rights. One participant questioned whether such redemption or withdrawal rights would be akin to removal rights, would hold more weight than removal rights, or how these

rights otherwise should be evaluated in situations in which investors could easily ‘vote with their feet.’

34. Lastly, many participants requested guidance on how to evaluate removal rights held by an entity’s board of directors. Specifically, constituents referred to the evaluation of removal rights held by a board of directors established in accordance with the requirements in the 1940 Act. Participants noted that typically no one investor controls the board of directors’ decisions. Accordingly, participants requested additional guidance about whether removal rights held by the board of directors would be considered as being held by a single party. Additionally, participants suggested removal rights held by an entity’s board of directors should be a strong indicator that the decision maker is an agent.

Remuneration

35. Participants agree with the staff draft that a decision maker’s exposure to the economic performance of another entity should be considered when determining whether a reporting entity is acting as an agent or a principal. In addition, there was support for separating the evaluation of economic performance into two factors: one focusing on remuneration (which has only positive returns) and another focusing on other interests (which can have both positive and negative returns or negative returns only).
36. Participants believe that when evaluating the factors related to the decision maker’s returns, exposure to variability in returns through other interests (which includes negative returns) should have a stronger weight than the decision-maker’s fee structure. A number of participants noted that investment managers receive fees that are market based and include market-related terms only. Accordingly, they believe that the purpose and the design of the fee, including if it is market based should be evaluated. If the fee is market based, the evaluation regarding the economics should focus on whether the entity has exposure to negative returns.

Other Interests

37. Participants were concerned that the staff draft does not provide guidance as to the level of economic exposure that would result in consolidation. They believe that, unless additional guidance is provided, constituents will not consistently interpret how much exposure is required in order to reach a consolidation conclusion. When asked what level of economic exposure should be required, participants agreed that it is difficult to establish a specific level of exposure that should result in consolidation, as the level could vary depending on the type or nature of the fund. Indeed, when asked, participants did not support specifying a particular 'bright-line' threshold. A number of participants believe that providing examples in this area (including traditional asset manager arrangements) is necessary, in order to avoid practice issues similar to those that developed subsequent to the issuance of Statement 167.
38. The participants also agree with the staff draft that when a decision maker's other interests are subordinate to interests held by other parties, and the decision maker's interest absorbs a greater level of the entity's variability, this would lead to a conclusion that the decision maker is acting as a principal. Alternatively, if the decision maker's interests are *pari passu* with the interests held by other parties and those other parties take the majority of the risk of the asset class, it is less likely that the decision maker is managing for reasons other than to receive a return that is aligned with other investors.
39. However, some participants did not believe that other interests in the form of a guarantee (that may expose the decision maker up to a specified amount) should be considered in the same way as a subordinated investment that also provides protection to other interest holders. They thought that a guarantee (that is, an obligation to fund losses that could result in potential cash outflows) was different from a subordinated investment because the subordinated investment may have more upside than the guarantee. Others thought guarantees and subordinated interests should be treated in a similar way because, in both cases, the reporting entity is exposed to the performance of the entity.

40. As noted above, the participants believe that examples illustrating how other interests would factor into the consolidation conclusion are required in order to ensure consistent application.

Other Items

41. One participant suggested including, as one of the factors for determining whether a decision maker is a principal or an agent, whether the fund being evaluated qualifies as an investment company. In situations in which the entity being evaluated by the decision maker qualifies as an investment company, the decision maker would be more likely considered an agent.
42. Participants also noted that they agree with the treatment in the staff draft of interests held by related parties of the decision maker. However, one participant recommended including guidance regarding whether an entity's pension plan would be considered a related party under the guidance in the staff draft.
43. Finally, the participants agreed with the requirement to continuously reassess whether the decision maker is acting as an agent or a principal. However, some participants believe guidance should be provided addressing whether changes in the economic factors should result in a different consolidation conclusion.