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Straight away

IFRS bulletin from PricewaterhouseCoopers

IASB staff draft of new consolidation standard changes definition of control

What is the issue?

The IASB's staff draft of the proposed new consolidation standard changes the definition of control so that the same criteria are applied to all entities to determine control. The definition will be supported by extensive application guidance that addresses the different ways in which a reporting entity (investor) might control another entity (investee).

The changed definition and application guidance is not expected to result in widespread change in the consolidation decisions made by IFRS reporting entities, although all entities will need to consider the new guidance. The core principle that consolidation presents a parent and its subsidiaries as if they are a single entity remains unchanged, as do the mechanics of consolidation.

The staff draft excludes disclosures and any guidance specifically for investment companies, and omits the previous guidance on preparation of separate financial statements. Disclosures will be included in a comprehensive disclosure standard to be published this year, which will cover disclosure principles for subsidiaries, joint ventures and associates. The IASB plans to issue an exposure draft in 2010 of guidance for investment companies. An investment company would be required to report investees that it controls at fair value rather than consolidate those investees. The status of the guidance on separate financial statements is unclear.

The new standard, when issued, will replace IAS 27, 'Consolidated and separate financial statements', and SIC-12, 'Consolidation – special purpose entities'. The staff draft includes the decisions made by the IASB following comment letters and the redeliberations of ED 10, 'Consolidated financial statements', which was published in December 2008. It is not a required due process document, but it has been published to facilitate upcoming roundtable discussions.

Revised definition of control

The revised definition will focus on the need to have both power and variable returns before control is present. Power is the current ability to direct the activities that significantly influence returns. Returns must vary and can be positive, negative or both.

The determination of power is based on current facts and circumstances and is continuously assessed. The fact that control is intended to be temporary does not obviate the requirement to consolidate any investee under the control of the investor. Voting rights or contractual rights may be evidence of power, or a combination of the two may give an investor power. Power does not have to have to be exercised. An investor with more than half the voting would meet the power criteria in the absence of restrictions or other circumstances.

The application guidance includes examples of when an investor may have control with less than half of the voting rights. When assessing if it controls the investee, it should consider potential voting rights, economic dependency and the size of its shareholding in comparison to other holdings, together with voting patterns at shareholder meetings. This last consideration will bring the notion of 'de facto' firmly within the consolidation standard.

The staff draft also includes guidance on participating and protective rights and agent/principal relationships. Participating rights give an investor the ability to direct the activities of an investee that significantly affect the returns. Protective rights (often known as veto rights) may restrict an investor's ability to control if the right apply to decisions in the ordinary course of business.

An investor (the agent) may be engaged to act on behalf of a single party or a group of parties (the principals). Certain power is delegated to the agent – for example, to manage investments. The investor may or may not have control over the pooled investment funds. The staff draft includes a number of factors to consider when determining whether or not the investor has control or is acting as an agent.

Am I affected?

The proposed standard has the potential to affect all reporting entities (investors) (other than investment entities) that control one or more investees under the revised definition of control. The determination of control and consolidation decisions may not change for many entities post adoption of the converged Indian accounting standards. However, the new guidance will need to be understood and considered in the context of each investor's business.

What do I need to do?

The IASB has not requested formal comments on the staff draft but would welcome input.

IFRS preparers should consider whether the planned standard will affect their control decisions and consolidated financial statements.

If you have questions about this issue, please contact PwC IFRS team.

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