

MINUTES



Financial Accounting
Standards Board

To: Board Members

From: Consolidations: Policy and Procedures
(Andrews, ext.354)

Subject: Minutes of the November 22
Roundtable on the IASB Consolidations **Date:** January 4, 2011
Staff Draft

cc: Mechanick, Bielstein, Chookaszian, Posta, Klimek, Gabriel, Lott,
Donoghue, Glotzer, Farber, Handy, Catalano

Topic: Consolidations: Policy and Procedures – Voting Interest
Entities

Basis for Discussion: [Agenda](#)

Length of Discussion: 8:00 a.m. to 11:00 a.m. (EST)

Attendance:

Board members present: Golden, Linsmeier (via phone), Seidman, Siegel,
Smith

Board members absent: None

IASB Board Members: König (via video)

Staff in charge of topic: Farber, Handy

Other staff at Board table: Stoklosa (via phone), Andrews

IASB Staff: Teixeira, Buchanan (via video), Streckenbach (via
video), Lloyd (via video)

Outside participants: [See Participant Listing](#)

Summary of Decisions Reached

The FASB held this public roundtable meeting with constituents to discuss the IASB Staff Draft, Consolidated Financial Statements. No decisions were reached during this discussion.

Objective of the Meeting

The objective of this meeting was to engage in a constructive dialogue about the IASB staff draft with a variety of stakeholders and provide the Board with additional information on its consolidation project in order to help the Board determine how to proceed with its consolidations project. This particular roundtable meeting focused on the views of users, preparers, and practitioners on the overall control model in the IASB staff draft.

Matters Discussed:

User Feedback

1. The user participants 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. One user participant acknowledged the difficulty in developing a consolidation standard to fit the needs of users because users often have different information needs depending on the facts and circumstances surrounding their analyses. Another participant further stated that users of financial statements would benefit from obtaining more detailed information about individual consolidated entities to better understand potential strategic, operational, or financial differences within the consolidated group.
2. User participants were also concerned that the consolidation model in the staff draft would require consolidation in one reporting period and not in another. These participants believe that volatility in the composition of the reporting entity would hinder the usefulness of the financial statements.

Single Model for Consolidation

3. 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 opportunities to structure an arrangement for an accounting result under current U.S. GAAP because of the different consolidation models for voting interest entities and variable interest entities.

4. Additionally, several participants stated that similar conclusions to those reached under current U.S. GAAP would likely be reached under the guidance in the staff draft. However, these participants believe that more research is required to determine the effect on consolidation conclusions that would result from the guidance in the staff draft on de-facto control, removal rights, potential voting rights, and ‘silos’ within voting interest entities.

Control Model

Control Principle

5. 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 another entity.
6. 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).

7. 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.
8. Further, several participants expressed concern regarding 'other rights' and additional evidence to consider when determining whether an entity holding less than a 50% voting interest controls another entity. These constituents noted that there is not guidance regarding the degree of evidence required, or how to weigh the relative significance of each indicator. Specifically, these participants noted that the examples in the staff draft do not include enough judgment, and are overly simplistic to be helpful in situations in which a significant degree of judgment is required. These participants were concerned that the lack of such guidance may create additional diversity in practice.
9. Several participants noted that the tension point lies in the difference between control through less than a 50% voting interest combined with contractual rights and control through less than a 50% interest combined with other non-contractual evidence of control.
10. Nonetheless, 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 believe that this situation would only occur in rare circumstances in the U.S. Consequently, they questioned whether the incremental consolidation that would result from this guidance outweighs the cost of introducing a broader concept of control if only a small number of entities would be affected. Further, these participants noted that it may be difficult for entities to obtain the necessary information to determine whether they have control.

11. Participants also were concerned with paragraph BC84 of the staff draft which notes that, although it may be difficult to determine whether an entity 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 is appropriate 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.
12. One participant stated that de-facto control is a broader issue as it relates to U.S. corporate issuers. The guidance in the staff draft states that an entity's relevant activities are controlled through voting rights and, in the U.S., shareholders do not directly control those activities. Control over the relevant activities is expressly reserved for the entity's board of directors. This participant believes that the relationship between the shareholders and the board of directors creates a number of implications that are not reflected in the guidance. As a result, this participant suggested additional guidance and examples about evaluating the role of an entity's board of directors.
13. 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 a 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

14. Participants had mixed views about the potential voting rights guidance in the staff draft.
15. 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. For example, in a situation where an entity holds penny warrants, and no barriers to exercise exist, these participants believe that those rights should be considered in the analysis.
16. Further, one participant believes that the analysis of potential voting rights should focus mainly on (1) whether the rights are currently exercisable, (2) if the rights are deeply in-the-money, and (3) whether other parties hold similar rights. Other participants added that the purpose and design of potential voting rights should be an important factor when evaluating those rights. This evaluation, in the context of the overall entity, will help to distinguish circumstances where, at formation of entity, the options were deeply in-the-money or exercisable for a nominal amount. These situations may indicate that the rights are fundamentally different than situations in which options to acquire shares in the future are at, or out of, the money upon formation. The rights would need to be reevaluated with changes in the purpose and design of the entity. This participant believes that options are economic rights and, unless those rights are combined with other rights or factors, they would not represent a controlling financial interest until such a time as the economic outlay is made and the rights are acquired.
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.

Agent versus Principal Analysis

Qualitative Model

20. Overall, participants were supportive of the more qualitative assessment contained in the staff draft, compared to the analysis required in the FASB Accounting Standards Codification™ Variable Interest Entities Subsection of Subtopic 810-10, Consolidations-General.¹ However, some participants were concerned that there is not enough guidance in this area to address the challenging judgments that exist, particularly in the asset management industry.
21. Specifically, one participant 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. Further, one participant commented that, in the absence of guidance on how to weigh the factors, it may be possible for entities to manipulate the factors in order to achieve a desired consolidation conclusion.

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

Scope of Decision Making Authority

22. 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.
23. 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. Specifically, one participant questioned whether, in such circumstances, one would only analyze the decision maker's involvement in determining which assets are put into a fund, or whether the decisions that are regulated by law should be considered as well.
24. Another participant suggested that more guidance about the purpose and design of the entity may be helpful in the agent versus principal analysis, specifically when evaluating this criterion and which decisions would impact the economics of that entity.

Removal Rights

25. 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. However, one participant stated that removal rights are not substantive unless held by a single party.
26. 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, the 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.

27. Another participant noted the need for guidance regarding how to weight removal rights in the analysis. This participant suggested that the weighting of this factor should change based on the number of parties holding removal rights. Other participants agreed with the guidance in 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
28. Another participant noted the need for guidance regarding how to evaluate removal rights held by an entity's board of directors. Specifically, whether these rights would be viewed as unilateral or non-unilateral rights.

Economic Factors (Remuneration and Other Interests)

29. Participants generally agreed with separating the assessment of economic factors into two evaluations; one focusing on the remuneration of the decision maker (which has only positive returns) and one focusing on other interests that the decision maker holds (which have both positive and negative returns or only negative returns). Several participants also stated that when evaluating these factors, exposure to variability in returns through other interests (which includes negative returns) should be weighed more heavily than the factor focusing on remuneration. Also, these participants believe that the purpose and the design of a fee should be evaluated, but if the fee is market based then the evaluation around the economics should focus on whether the entity has exposure to negative returns.
30. These participants also agreed with the guidance in the staff draft that if the 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 not acting as an agent. Alternatively, if the decision maker's interests are *pari passu* with the interests held by other parties, it is less likely that the decision maker is managing for reasons

other than to receive a return consistent with other investors. However, the participants did not agree on whether other interests in the form of a guarantee should be considered in the same way as a subordinated investment. Participants also suggested that examples illustrating how other interests would factor into the consolidation conclusion are required in order to ensure consistent application.

31. 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. Participants did not support specifying a particular 'bright-line' threshold, but noted that illustrative examples would be helpful and provide clarity in this analysis.

Continuous Reassessment

32. Participants were supportive of a continuous reassessment of the principal agent analysis, noting that this is consistent with the guidance in Subtopic 810-10. However, several participants stated that this determination should not change solely based on changes in economic or market factors.