

# To the Point

IASB – final guidance

The FASB and IASB will not issue converged consolidation accounting standards at this time.

## Key differences between IASB's new consolidation guidance and US GAAP

### What you need to know

- ▶ The IASB issued new consolidation accounting guidance establishing a single consolidation model for all entities.
- ▶ While consolidation accounting was once a joint project, the FASB will not issue consolidation guidance similar to the IASB's guidance at this time.
- ▶ In some respects, the IASB's new consolidation guidance is more similar to US GAAP than its current guidance. But the new standard also creates new differences between IFRS and US GAAP and allows others to continue.

### Overview

The International Accounting Standards Board (IASB) has issued new consolidation accounting guidance<sup>1</sup> that establishes a single consolidation model for all entities. The new guidance replaces or amends portions of the existing consolidation guidance under IFRS<sup>2</sup> and is effective for fiscal years beginning on or after 1 January 2013.

The Financial Accounting Standards Board (FASB) and IASB jointly deliberated much of the IASB's new consolidation guidance. However, after hearing from constituents in late 2010, the FASB decided earlier this year not to issue consolidation guidance similar to the IASB's guidance. The FASB disagreed with aspects of the IASB's new consolidation model, but said it plans to amend US GAAP to better align it with the IASB's new guidance related to the principal-agent determination.

The new IASB guidance is more similar to the guidance for the consolidation of variable interest entities (VIEs) in US GAAP than the current guidance, but it creates new differences between US GAAP and IFRS in some areas. Some longstanding differences also remain. This publication highlights some of the significant differences that exist between current US GAAP and the IASB's new guidance.

## Key considerations

Under both US GAAP and IFRS, the determination of whether a reporting entity consolidates an entity is based on control, but differences exist in the definition of control.

### IFRS

The following are the key provisions of the IASB's new consolidation guidance:

- ▶ All entities are subject to a single control model.
- ▶ A reporting entity controls another entity when it has rights (or exposure) to variable returns from its involvement with the entity and has the ability to affect those returns through its power.
- ▶ A reporting entity has power over an entity when it has the current ability to direct the activities that significantly affect the entity's returns.
- ▶ In some cases, a reporting entity has power over another entity when it holds less than a majority of the voting rights.
- ▶ In some cases, a reporting entity has power over an entity by holding potential voting rights (e.g., options, convertible instruments).
- ▶ A decision maker that acts on behalf of another party is deemed to be an agent and does not have control. A decision maker that acts on its own behalf is deemed to be a principal and may have power.
- ▶ Control is assessed continuously as facts and circumstances change.

For additional discussion of the IASB's new consolidation accounting guidance, refer to our publication, IFRS Developments Issue 1, *IASB issues three new standards: Consolidated Financial Statements, Joint Arrangements and Disclosures of Interests in Other Entities*.

### US GAAP

Two primary consolidation models exist in US GAAP – a model for VIEs and a model for voting interest entities. A VIE is an entity in which the equity investors do not have characteristics of controlling financial interest holders. An entity that is not a VIE is often referred to as a voting interest entity. The traditional voting interest consolidation model is considered only if an entity is determined not to be a VIE.

Control of a VIE results from a reporting entity having both:

- ▶ The power to direct the activities of the VIE that most significantly impact the VIE's economic performance
- ▶ The obligation to absorb losses of the VIE that potentially could be significant to the VIE or the right to receive benefits from the VIE that potentially could be significant to the VIE

Generally, control of a voting interest entity results from a reporting entity holding a majority of the entity's voting rights. However, for limited partnerships and similar entities (e.g., certain limited liability companies) that are not VIEs, there is a presumption that the general partner (or its equivalent) controls the entity, regardless of ownership percentage.

There are exceptions to these general rules (i.e., majority ownership and the general partner presumption) when other equity holders have rights to participate in decision making (i.e., participating rights) or, in the case of limited partnerships, can remove or “kick-out” the general partner.

## How we see it

The control principle in the IASB’s new consolidation guidance is largely consistent with the control principle for VIEs in US GAAP. The FASB and IASB also have indicated that they expect the requirements for consolidating VIEs in US GAAP to be converged substantially with the IASB’s new guidance.

However, because the IFRS and US GAAP models are not identical, differences not identified in the table in the Appendix may emerge as the IASB’s new guidance is implemented.

## What’s next

- ▶ The FASB has a project on its agenda that would amend the principal-agent guidance under US GAAP for VIEs and voting interest partnerships (and similar entities) that would more closely align US GAAP with the IASB’s new guidance.
- ▶ The FASB and IASB have a project on their agenda to converge the definition of an investment company. If finalized, investment companies would record all investments in entities at fair value under both US GAAP and IFRS. However, differences between US GAAP and IFRS may exist with respect to the accounting by the parent of an investment company (i.e., under IFRS, the parent of an investment company may not retain the investment company’s fair value accounting in consolidation for controlled entities).

## Endnotes:

<sup>1</sup> IFRS 10, *Consolidated Financial Statements*

<sup>2</sup> IAS 27, *Consolidated and Separate Financial Statements*, and SIC-12, *Consolidation – Special Purpose Entities*

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## Appendix: Key differences between US GAAP and new IASB guidance

The following table highlights some of the significant differences between current US GAAP and the IASB's new guidance.

	Current US GAAP	IASB's new guidance
<b>Consolidation model</b>	Two models – one for VIEs and one for voting interest entities	Single model for all entities
<b>Control with less than a majority of voting rights (de facto control)</b>	Concept does not exist	Control can result from holding less than a majority of voting rights based on the facts and circumstances
<b>Potential voting rights in control assessment</b>	Concept does not exist	May provide control if substantive
<b>Principal-agent evaluation in control assessment</b>	<ul style="list-style-type: none"> <li>▸ VIEs – based primarily on economic considerations</li> <li>▸ Voting interest entities – no explicit concept exists</li> </ul>	Based on combination of economic considerations, rights held by others and scope of decision-making authority
<b>Consideration of kick-out rights and participating rights in control assessment</b>	<ul style="list-style-type: none"> <li>▸ VIEs – substantive if unilaterally exercisable by a single party</li> <li>▸ Voting interest entities – generally substantive if exercisable by a simple majority of parties</li> </ul>	The more parties that are required to agree to exercise the rights, the less likely that those rights are substantive
<b>Consideration of related parties in control assessment</b>	<ul style="list-style-type: none"> <li>▸ VIEs – aggregate interests of related parties and de facto agents in certain cases</li> <li>▸ Voting interest entities – no explicit consideration exists</li> </ul>	Aggregate interests of parties acting on behalf of the investor when evaluating control
<b>Investment company accounting</b>	Investment companies (as defined) record all investments in entities at fair value	Concept does not currently exist – all reporting entities consolidate controlled investments

	Current US GAAP	IASB's new guidance
<b>Decrease in ownership provisions (with and without loss of control)</b>	<ul style="list-style-type: none"> <li>▸ Guidance applies to businesses and non-profit activities</li> <li>▸ Scope excludes sales of in-substance real estate and conveyances of oil and gas mineral rights</li> </ul>	Guidance applies to all subsidiaries (including those that are not businesses, have non-profit activities, involve sales of in-substance real estate or involve conveyances of oil and gas mineral rights)
<b>Different reporting dates of parent and subsidiary</b>	The effects of significant events occurring between reporting dates when different dates are used are disclosed in the financial statements	The effects of significant events occurring between reporting dates when different dates are used are adjusted for in the financial statements
<b>Different accounting policies of parent and subsidiary</b>	The reporting entity and subsidiary are not required to have the same accounting policies	The accounting policies of the subsidiary are required to be the same as those of the reporting entity