



Project	Consolidation
Topic	Comment letter analysis – ED 10 Consolidated Financial Statements

Introduction

1. The purpose of this paper is to provide a summary and preliminary analysis of the comments received on Exposure Draft 10 *Consolidated Financial Statements* (the ED). The ED was published in December 2008 and the comment period ended on 20 March 2009; we received 148 comment letters.
2. Attachment A lists the respondents that commented on the ED, classifying them by type of respondent and geographic region.
3. We are not asking the Board to reach any tentative conclusions at this meeting on any of the matters raised in this paper. However, we will ask the Board to confirm the project plan and the issues proposed for re-deliberation in Agenda Paper 4. In the light of the comments received, we plan to explore further all major issues before we ask the Board to reconsider its preliminary views set out in the ED. We will also include in the Board papers for re-deliberation any input received at the roundtables to be held in June.

Summary of comments received

4. This paper summarises the main comments received; it is not a comprehensive list although it does address all questions included in the Invitation to Comment. During the re-deliberations, the staff will present the relevant sections with a more detailed comment letter analysis at each Board meeting. The following is a list of the major issues the staff identified from the comment letters received:
 - (a) The project
 - (b) Basis for consolidation

This paper has been prepared by the technical staff of the IASB for the purposes of discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper and do not purport to represent the views of any individual members of the Board or the IASB.

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Official pronouncements of the IASB are published only after the Board has completed its full due process, including appropriate public consultation and formal voting procedures.

- (c) Control of an entity; components of the definition
- (d) Application of definition and principle of control of an entity
 - (a) Assessing control for traditional operating entities
 - (b) Assessing control for structured entities
- (e) Disclosures
- (f) Significant influence and the equity method
- (g) Other issues not addressed in the ED's invitation to comment

General comments

5. Virtually all respondents supported the project objective and agreed that a single control model should be applied to all entities. Many also supported the inclusion of guidance on areas not addressed in IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation—Special Purpose Entities*, such as agency relationships and protective rights. However, virtually all respondents were of the view that the wording in the ED does not clearly communicate the control principle or provide enough guidance on how that control principle is to be applied to all entities. Some respondents commented that the draft IFRS does not meet the objective of developing a single control model that applies to all entities because it identifies a subset of entities—structured entities—to which separate guidance applies when assessing control.
6. Respondents in general were concerned that much of the guidance in the ED is unclear and, if not addressed by the Board, would lead to inconsistent application of the requirements and might create structuring opportunities.

Issue 1. The project

7. Respondents commented on several aspects of the consolidation project itself; the accelerated timetable, the interaction with other current IASB projects and convergence with US GAAP.
8. While many respondents recognised the need to accelerate work on the consolidation project because of the financial crisis and in response to comments from the G20 and the Financial Stability Forum, concern was expressed about the shortened due process in publishing an exposure draft without publication of a discussion paper. Many are of the view that IAS 27 and SIC-12 are not

fundamentally flawed in the context of the entities that are and are not being consolidated at present. Therefore, they do not agree that the control aspects of IAS 27 and SIC-12 require an urgent fix.

9. Some of those respondents proposed splitting the project into two parts; the first to address the additional disclosures needed for on and off-balance sheet entities as soon as possible and the second to continue with the final IFRS at a slower pace that allows for a more thorough review of the issues identified in the comment letters.
10. Some respondents noted the link between consolidation and other IASB projects, namely the Reporting Entity phase (phase D) of the conceptual framework project, revenue recognition and, in particular, the derecognition project. Many viewed consolidation and derecognition as being inextricably linked and suggested that the timetable of the two projects be aligned. Respondents commented that the Board should ensure that the consolidation and derecognition requirements interact in a consistent manner before publication of a final IFRS on consolidation.
11. Respondents also urged the Board to consider field testing the proposed principles and disclosures before publishing a final IFRS and adding illustrative examples of the application of the control definition and guidance.
12. Many respondents were concerned about the timing of the project in relation to convergence with the FASB. Those respondents acknowledged that in their current respective projects, the IASB and the FASB came to similar conclusions with respect to the consolidation of structured entities. However, they noted that the IASB's ED 10 and the FASB's proposed amendments to interpretation FIN 46(R) *Consolidation of Variable Interest Entities* were not fully converged and that differences in applying the proposals remain.
13. In the Memorandum of Understanding between the IASB and the FASB the boards have committed to work towards developing common standards on consolidation by 2011. Therefore, with the timelines of the current respective projects of both boards, the amended US GAAP requirements in FIN 46 (R) are likely to be effective for one year only before further change would be required on publication of final requirements for consolidation by both boards.

14. Therefore, respondents requested that the Board deliberate all parts of the consolidation project jointly to ensure that the final IASB and FASB standards contain identical and not only similar requirements to the extent possible.

Issue 2. Basis for consolidation

15. The ED states as its core principle that ‘a reporting entity presents financial statements that consolidate its assets, liabilities, equity, income, expenses and cash flows with those of the entities it controls’.
16. Some respondents identified the need for a core principle stating *why* consolidated financial statements should be prepared, rather than the core principle in the ED that addresses *how* consolidated financial statements should be prepared. This core principle would ideally be addressed in the Reporting Entity phase (phase D) of the conceptual framework project and should be established before moving forward with the revised consolidation standard.

<p>Q2. Is the control principle as articulated in the draft IFRS an appropriate basis for consolidation?</p>

17. Most respondents were in favour of a control principle as the basis for consolidation of an entity and most agreed that such a principle should incorporate power and returns. However, they did not feel the wording in the ED clearly articulated this principle.
18. Respondents commented that, in general, there is too much ambiguity in the guidance. For example, the terms ‘power’, ‘right’, and ‘ability’ are used interchangeably with no clear definition. Also, respondents did not see a consistent link between the guidance for power with a dominant minority, a passive majority and the assessment of options.

Risk and rewards

19. Respondents commented on a control principle for consolidation versus a risks and rewards approach. Many consider the concept of ‘risks and rewards’ to be integral to the control principle. This concept, if articulated appropriately, would serve to combine the concepts in IAS 27 and SIC-12 together into a single model and would give a conceptually robust principle of control. Many

respondents believed that the Board should make more explicit the role of risks and rewards within the control principle.

20. Respondents offered a variety of suggestions as to how the Board should integrate risks and rewards into the control principle:
- (a) Risks and rewards are integral to power—power only exists if it gives the holder of that power the ability to affect or influence its risks and rewards (risks and rewards is a part of control and not separate from it).
 - (b) The identification and evaluation of risks and rewards should be an indicator of control.
 - (c) If the reporting entity is exposed to the majority of risks and rewards the reporting entity should be presumed to control unless otherwise demonstrated.
 - (d) Risks and rewards should be included as a ‘fall back’ test for control.¹

Q8. Should the IFRS on consolidated financial statements include a risks and rewards ‘fall back’ test? If so, what level of variability of returns should be the basis for the test and why? Please state how you would calculate the variability of returns and why you believe it is appropriate to have an exception to the principle that consolidation is on the basis of control.

21. The vast majority of respondents opposed a risk and rewards ‘fall back’ test and felt that it was unnecessary if the risks and rewards concept was well integrated into the control principle. Most thought a ‘fall back’ test would go against the idea of a principles-based standard and would create structuring opportunities.
22. A few respondents, while supportive of integrating risks and rewards with control, wanted the final IFRS to make clear that control is not necessarily commensurate with the level of risks and rewards to which an entity is exposed. Not clarifying this point might lead to a presumption that a quantitative analysis would be needed to assess control.
23. Those respondents that supported a risks and rewards ‘fall back’ test did so in order to consolidate those entities, which in their view, should be consolidated

¹ This issue was addressed in question 8 of the ED. A reporting entity would consolidate another entity if it is exposed to a particular level of variability of returns of a structured entity if power cannot be assessed.

because they felt the current control principle and guidance would not do so adequately. Without such a ‘fall back’ test, it would be too easy to avoid consolidation. In this respect, they agreed with the alternative views expressed in paragraphs AV8 – AV12 of the ED.

Reputational risk

Q11(a). Do you think that reputational risk is an appropriate basis for consolidation? If so, please describe how it meets the definition of control and how such a basis of consolidation might work in practice.

24. The vast majority of respondents agreed that reputational risk is not an appropriate basis for consolidation.² However, some pointed out that in the context of evaluating ‘risks and rewards’ within a control model, reputational risk (together with other risks) should be evaluated as an indicator of control, but in and of itself should not be considered as a basis for consolidation.

Issue 3: Control of an entity; components of the definition

25. Issue 3 addresses the control definition as articulated in the ED. Control of an entity is defined in paragraph 4 of the ED:

4. A reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity to generate returns for the reporting entity.

Q1. Do you think that the proposed control definition could be applied to all entities within the scope of IAS 27 as well as those within the scope of SIC-12? If not, what are the application difficulties?

26. There were mixed views on the control definition—some agreed that the definition of control of an entity in the ED could be applied to all entities, while others believed the opposite. Some respondents felt that the definition was much easier to apply to traditional operating entities than to structured entities (as defined in the ED). All of those opposed to the definition believed that the ED does not include sufficient guidance to apply the definition consistently to all entities. In particular, respondents described application difficulties when

² The disclosures relating to reputational risk are discussed later in Issue 5.

assessing control, especially assessing power to direct the activities of structured entities. These application difficulties are discussed in more detail in issue 4.

27. Respondents also commented on specific aspects of the definition, such as the actual terms used as well as the interaction of the terms with each other. The following terms are discussed below in greater detail:

- (a) Power
- (b) Returns
- (c) Activities

Power

28. Many respondents commented that the principle behind the term ‘power to direct’ is not clearly articulated and could lead to inconsistent application. They questioned if the term should be interpreted as the ‘legal or contractual power to direct activities’, ‘the current direction of activities’, ‘the effective ability to direct activities’ or ‘the future ability to direct activities’. They referred to the alternative views (paragraphs AV2 – AV7 of the ED) that address the same issue. Respondents urged the Board to clarify and to provide additional guidance as to what the control principle is and thus what would constitute power. This issue is relevant when assessing control, addressed later in this paper (issue 4).

29. Respondents agreed that only one party should control an entity and that it is possible for no one to control an entity. Most respondents were also supportive of the concept that a passive majority shareholder generally has power; an entity would not have to exercise its power in order to control the entity in this situation.

Returns

30. In the revised control definition the term ‘benefits’ was replaced with ‘returns’ in order to better convey that the returns an entity receives as a result of controlling an entity can be both positive and negative. Respondents had mixed views on the use of ‘returns’ and many asked for a clearer definition of the term. Some were confused by the variability criterion—should absolute returns be considered or only variable returns? Are returns already received relevant when

assessing control or only returns to be received in the future? Is any exposure to variability adequate to meet the returns criterion or is a threshold of variability required?

31. Some other respondents commented that the term's current description of returns is so wide that it is not operational; while others noted that it should be clear that returns are not limited to financial returns.
32. A few respondents were opposed to changing the term 'benefits' and did not think that the change to 'returns' was appropriate. They were of the opinion that 'returns' could also be viewed as 'positive'—it was used in a positive context in other IFRSs, and that 'benefits' is an established term and changing it will only cause confusion.

Activities

33. Along the same lines as the comments on 'returns', the guidance for what constitutes 'activities' to be assessed was questioned. Respondents requested additional guidance on which activities a reporting entity needs to direct in order to meet the power criterion. Many respondents suggested that only those activities that are significant to the entity, or that significantly affect the returns of the entity, are relevant when assessing the power criterion.

Issue 4. Assessing control

<p>Q3. Are the requirements and guidance regarding the assessment of control sufficient to enable the consistent application of the control definition? If not, why not? What additional guidance is needed or what guidance should be removed?</p>
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34. In general, respondents did not think that the requirements and guidance for assessing control were sufficient to enable consistent application of the control definition. Their views mainly stemmed from the structured entity section which will be discussed in greater detail in paragraphs 60 – 76 of this paper.
35. Many respondents commented that effectively splitting the document into two distinct sections—structured entities and all other entities—would only serve to create inconsistent practice and does little to promote a single cohesive control model.

36. In general, respondents felt that until the ambiguities addressed in the definition of control of an entity were clarified (ie in relation to power, returns and activities), the control definition could not be applied consistently to all entities.
37. Respondents gave comments on the following areas in relation to assessing control:
- (a) Continuous assessment (paragraphs 38 – 39 of this paper)
 - (b) Returns (paragraphs 40 – 41 of this paper)
 - (c) ‘Power with less than a majority’ (paragraphs 42 – 44 of this paper)
 - (d) Options and convertible instruments (paragraphs 45 – 50 of this paper)
 - (e) Agency relationships (including dual role situations) (paragraphs 51 – 58 of this paper)
 - (f) Protective and participating rights (paragraph 59 of this paper)
 - (g) Assessing control for structured entities (paragraphs 60 – 76 of this paper)

Continuous assessment (paragraphs 15 – 16 of the ED)

38. The ED requires the continuous assessment of control. While the Basis for Conclusions explicitly states that this should not result in frequent changes in control, respondents remarked that the wording in the ED leads to the conclusion that if an entity ceases to receive a return, it no longer controls that entity. Rather, the final IFRS should clarify that it is the *right* to receive a return that should be considered and not necessarily the actual receipt of a return.
39. Some respondents suggested that control should only be reassessed on the occurrence of events that could affect the current control assessment, while others suggested reassessment of control only at specific time intervals, ie reporting dates.

Returns (paragraphs 19 – 20 of the ED)

40. As mentioned in issue 3, some respondents were confused about assessing returns as part of the assessment of control of an entity. Respondents commented that the wording in the ED was unclear as to whether absolute returns should be assessed (as long as the returns are variable) or if the actual variability of the returns should be assessed. Clarity is also needed in the

guidance for *what* returns should be assessed; any return, fixed returns, returns that are commensurate with services provided or only significant returns. Some respondents were of the view that a reporting entity should be exposed to significant returns in order to meet the returns criterion of the control definition.

41. Respondents were concerned that there appears to be different guidance for structured entities when assessing returns, ie paragraph 33 of the ED discusses the level of returns an entity receives in relation to the total returns of the entity. Some thought this guidance was relevant for all entities, but more application guidance would be needed to apply this concept.

Assessing control for traditional operating entities (entities within IAS 27)

Power with less than a majority (paragraphs 26 – 29 and B9 – B13 of the ED)

42. Respondents were generally in favour of including the principle that an entity can control another entity without having a majority of the votes. However, many raised concerns about the guidance provided in paragraphs 27 and 28 of the ED, and in particular the example included in paragraph 28.

27. A reporting entity with less than half of the voting rights has the power to direct the activities of another entity if:

- (a) the reporting entity has more voting rights than any other party; and
- (b) the reporting entity's voting rights are sufficient to give the reporting entity the ability to determine the entity's strategic operating and financing policies.

28. For example, a reporting entity can have the power to direct the activities of another entity if the reporting entity is the dominant shareholder that holds voting rights and all the other shareholders with voting rights are widely dispersed and are not organised in such a way that they actively co-operate when they exercise their votes so as to have more voting power than the reporting entity.

43. Many disagreed with what the example in paragraph 28 implied—that holding a 'dominant' shareholding (a large shareholding bigger than anyone else's), in and of itself, was sufficient to meet the power criterion. Some thought that control should only arise if a reporting entity with less than a majority of votes could contractually prevent others from taking power away. Many suggested that evidence of actual control should be required.
44. Others questioned whether this guidance meant that a reporting entity had to have the ability to dominate the votes at a meeting or is having the most shares

of a shareholders' listing enough to say that the biggest shareholder controls? Would this criterion then depend on who attends decision-making meetings, such that a reporting entity's dominance would be dependent on the participation or non-participation of others?

Options and convertible instruments (paragraph B13 of the ED)

45. The ED includes guidance on assessing control when a reporting entity holds options or convertible instruments to obtain voting rights.

B13. When assessing control, a reporting entity considers whether its power from holding options or convertible instruments to obtain voting rights, taken in conjunction with other relevant facts and circumstances, gives it the power to direct the activities of another entity. A reporting entity that holds options or convertible instruments has power to direct the activities of another entity if (a), (b) or (c) applies:

- (a) the governing body of that entity determines strategic operating and financing policies in accordance with the wishes of the reporting entity. This might be the case if, for example, the reporting entity holds voting rights together with options or convertible instruments to obtain voting rights that, if exercised or converted, would give the reporting entity voting rights sufficient to determine the entity's strategic operating and financing policies.
- (b) any party with voting rights that is the counterparty to an option agreement acts as an agent for the reporting entity and those voting rights are sufficient to give the reporting entity the ability to determine the entity's strategic operating and financing policies.
- (c) the option or conversion agreement gives the reporting entity particular rights relating to the strategic operating and financing policies that enable the reporting entity to have the power to direct the activities of the entity.

Q4. Do you agree with the Board's proposals regarding options and convertible instruments when assessing control of an entity? If not, please describe in what situations, if any, you think that options or convertible instruments would give the option holder the power to direct the activities of an entity.

46. Most respondents agreed that options and convertible instruments should be considered when assessing control. Many also agreed with the principle included in the first sentence of paragraph B13 in the ED. Those respondents noted that currently exercisable options should not automatically give the holder

control of an entity and that it is consistent to consider all facts and circumstances. However, in general, respondents felt that the application guidance in B13(a), (b) and (c) was unclear and added to the possible inconsistency in applying the control definition.

47. Some of those who agreed with the first sentence of B13 thought that the situations described in B13(a), (b) and (c) were unclear. For example, many noted that it would be very difficult to assess whether a governing body is acting in accordance with the option holder's wishes or if the entity is merely coincidentally acting in the same way as the holder's wishes because of market or other circumstances. The final IFRS would have to go further and say that there must be evidence of this power or that the governing body is contractually obliged to act in accordance with the holder's wishes in order to make this point clear.
48. Most respondents agreed that in the situations described in B13(b) and (c) control would exist for the reporting entity in question. However, many of those same respondents also believed that B13(b) and (c) effectively by-pass the option itself and, without the option, power would still exist in these situations.
49. Some thought that the guidance in the Basis for Conclusions was clearer than in the application guidance and suggested including paragraphs from the Basis in either the standard or application guidance.
50. Others disagreed with the ED, preferring the guidance in IAS 27 and agreeing with the alternative views; they view a currently exercisable option as giving the holder the current ability to direct the activities.

Agent and dual role (paragraphs B3 – B8 of the ED)

51. The ED includes guidance to help identify whether a reporting entity is acting as an agent or a principal.
52. The vast majority of respondents supported the inclusion of agency guidance, noting that a party can have the ability to, and can actively, direct the activities of an entity, but to generate returns for another party or parties. However, many suggested that the guidance needs to be clearer, specifically in the following areas:

- (a) Is the agency concept to be a legal or an ‘in substance’ notion?
 - (b) Are removal rights necessary in order to identify an agency relationship or are they an indicator of control?
 - (c) If required, do removal rights need to be substantive or only held by one party?
53. Some respondents requested further clarification about performance-related fees and when they might indicate a control relationship. Some questioned the performance-related fee guidance included in paragraph B8 of the ED.³ Some asked if agent fees would be considered part of ‘returns’. Respondents also suggested including guidance on identifying the principal(s) as well as identifying the agent.
54. Some thought that the guidance in the Basis for Conclusions was clearer than in the application guidance and suggested including paragraphs from the Basis in either the standard or application guidance.
55. There were mixed views on the dual role guidance (paragraph B11 of the ED) that effectively includes a rebuttable presumption in voting entity situations.

B11. Sometimes it can be difficult to identify whether a reporting entity that holds voting rights, both directly and on behalf of other parties as an agent, uses the voting rights of the other parties for its own benefit or for the benefit of those other parties. In such circumstances, in assessing whether it has voting rights sufficient to control another entity, the reporting entity excludes the voting rights it holds as an agent only if the reporting entity can demonstrate that it is obliged to act in the best interests of those other parties or has implemented policies and procedures that ensure the independence of the decision-making in its role as an agent from that as a holder of voting rights directly.

Q5. Do you agree with the Board’s proposals for situations in which a party holds voting rights both directly and on behalf of other parties as an agent? If not, please describe the circumstances in which the proposals would lead to an inappropriate consolidation outcome.

³ Paragraph B8 states: A performance-related fee of an agent is often distinguishable from the returns of the investors for whom the agent is acting. For example, an investor in a fund will benefit from increases in the value of the fund and suffer from decreases in the value of the fund. In contrast, an agent might be paid a performance-related fee for a specified period and the agent is unlikely to be required to contribute to the fund (ie refund fees already received) if the value of the fund decreases.

56. The majority of respondents were supportive of providing guidance for situations involving an agent that also has a direct investment in an entity, although views were mixed on the effectiveness of the application guidance. Some respondents argued that the guidance in B11 created a presumption that could easily be rebutted in almost all cases. Those respondents noted that an agent, even if it holds an investment, will be bound by a fiduciary duty (often a contractual obligation) to act in the best interest of the principal(s). Thus, they thought that the presumption could easily be rebutted and did not see the purpose of including this in the document.
57. Other respondents, however, thought that the presumption would be very difficult to rebut because they read the guidance to require actual evidence of not acting in one's own best interest. They noted that because the interests of an agent and other investors are often aligned, it would be very difficult to provide such evidence.
58. Others noted that the ED addressed dual role only in situations in which power comes from holding voting rights, eg a fund manager that holds voting rights in a traditional operating entity and also exercises votes on behalf of investors in a fund that holds voting rights in that entity. The ED does not, but needs to, address situations in which power comes from arrangements other than voting rights, eg a fund manager that holds a direct investment in a fund that it manages.

Protective and participating rights (paragraphs B1 – B2 of the ED)

59. Respondents were supportive of including guidance on protective rights and generally agreed with the guidance provided. Some commented that the definition of protective rights is circular [protective rights are defined in the ED as 'rights of a party relating to the activities of an entity that do not give the party control of the entity, nor do they prevent another party from controlling that entity']. Many expressed the view that including guidance on protective rights alone was not enough; participating rights should also be defined and addressed in the final standard to better identify what rights might be considered substantive when assessing control.

Assessing control for structured entities (entities within SIC-12) (paragraphs 30 – 38 of the ED)

General

60. The vast majority of respondents opposed creating a ‘subset’ of entities within the ED. Respondents commented that a specific definition for structured entities creates the same problems that IAS 27 and SIC-12 now create—inconsistent application and potential regulatory arbitrage by identifying entity-specific characteristics.
61. Respondents requested that the final IFRS not have separate guidance on structured entities in order to have a single, cohesive standard for consolidation. Respondents felt that the guidance provided for structured entities could almost always be applied to all entities. They, therefore, suggested that there should be one section that includes combined guidance on assessing control for all entities.
62. Respondents also comment that, in general, the structured entity section included too many of what appear to be presumptions. Presumptions that respondents identified are:
- (a) the party that has more returns than any other party is likely to have control;
 - (b) the party that was involved in the set-up of the entity or in the predetermination of its policies is likely to control the entity; and
 - (c) the entity that has the ability to manage assets only in default or has the power to liquidate the entity is likely to be in control (both representing what they consider to be ‘contingent control’).
63. Respondents argued that the presumptions listed above present structuring opportunities and are inconsistent with the principle of considering all facts and circumstances.
64. To add clarity, many respondents requested illustrative examples demonstrating the application of the control definition and guidance to structured entities.

Definition

65. Respondents were asked to comment on the definition of a structured entity in paragraph 30 of the ED.

30. A structured entity is an entity whose activities are restricted to the extent that those activities are not directed as described in paragraphs 23 - 29.

Q6. Do you agree with the definition of a structured entity in paragraph 30 of the draft IFRS? If not, how would you describe or define such an entity?

66. The majority of respondents did not agree with the proposed definition of a structured entity. Most were against it because, as mentioned above, they did not agree with creating a subset of entities within the document and therefore felt there was no need for a definition. Others disagreed with the definition because it is a ‘negative definition’ that does not give guidance about the type of entity to be classified as a structured entity.
67. Respondents commented that if this particular type of entity is going to be defined, it should not just be a residual set of entities that does not fall into the category of traditional operating entities. The definition should give these entities a specific set of characteristics—some preferred the characteristics defined in SIC-12 (a narrow and well-defined purpose) for special purpose entities and questioned why the term SPE was not retained. They also requested that the final standard make clear that the absence of voting rights does not automatically mean that an entity is a structured entity.
68. Respondents also voiced concerns about defining structured entities for disclosure purposes. With an unclear definition of a structured entity, entities might have greater incentive to structure around the definition and avoid having to comply with the disclosures, which many respondents viewed as onerous (disclosures are further discussed in issue 5).
69. Some respondents supported defining structured entities and thought that these entities needed to be identified separately from operating/voting entities. They were in favour of defining structured entities by using broad characteristics (not a negative definition) and stating that the assessment of control for these entities may be more difficult than for operating/voting entities.

Application of the control principle

Q7. Are the requirements and guidance regarding the assessment of control of a structured entity in paragraphs 30–38 of the draft IFRS sufficient to enable

consistent application of the control definition? If not, why not? What additional guidance is needed?

70. Many respondents did not think the guidance in paragraphs 31 – 38 of the ED was sufficient to enable consistent application of the control definition to structured entities. Most of the opposition related to the inclusion of a separate section for structured entities, as noted earlier in the paper.
71. The majority of respondents commented that, in general, the guidance for structured entities is unclear and ambiguous. They note that SIC-12 has performed well in the financial crisis—in general, the right entities are being consolidated or not consolidated.
72. Many respondents do not view the proposals as being an improvement on SIC-12. Some are supportive of including an ‘in substance’ control principle, similar to that in paragraph 8 of SIC-12.⁴ Others highlighted that well-established practical application guidance has developed over the years when applying SIC-12 and any new approach needs to be accompanied by clear guidance that prevents inconsistent application.
73. Respondents were generally unclear about how to apply the guidance in paragraphs 31 – 38 of the ED. They questioned whether each piece of guidance was intended to be an indicator, a presumption or simply an example. Should one indicator have more weight than others and, if not, could more than one entity conclude that it controls an entity? If the guidance was intended to be a presumption, how is this consistent with the principle to consider all facts and circumstances?
74. There were also concerns about how to determine power both in situations in which strategic policies have been predetermined and in which more than one party is involved in directing the activities of a structured entity.
75. Respondents requested that activities, returns and decisions assessed for a structured entity be those that are significant or substantive to the entity. By not

⁴ Paragraph 8 of SIC-12 states: An SPE shall be consolidated when the substance of the relationship between an entity and the SPE indicates that the SPE is controlled by that entity.

including this modifier, respondents were concerned that insignificant returns or day-to-day administrative decisions would be used to assess control of a structured entity.

76. Some respondents also requested that the factors listed as indicators of control in paragraph 31 of the ED should be either given a weight or the final IFRS should explicitly say that all factors are of equal importance. They believe that no guidance for the weighting of these indicators creates ambiguity.

Issue 5. Disclosures

The disclosure requirements (paragraphs 48 and B30 – 49 or the ED)

77. Respondents were asked for their opinion on the usefulness of the proposed disclosures, the difficulty for reporting entities to meet the requirements and the sufficiency of the disclosures.

Q9. Do the proposed disclosure requirements described in paragraph 48 provide decision-useful information? Please identify any disclosure requirements that you think should be removed from, or added to, the draft IFRS.

78. Most respondents were generally supportive of the Board addressing additional disclosures to meet the needs of users in light of the recent financial crisis; they agreed that the crisis had identified a need for additional disclosure of off-balance sheet activities. However, many of those respondents voiced concerns about the proposed disclosures—mainly that they are too prescriptive and so voluminous they have the potential to obscure key information for users.
79. Some respondents commented that the disclosures should have a clear guiding principle. Without this, the disclosures are somewhat ambiguous, which might lead to inconsistent application of the requirements. Some suggested that paragraph B31 of the ED should be the principle to be followed with other requirements included as examples rather than requirements.⁵

⁵ Paragraph B31 states: A reporting entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of this [draft] IFRS, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics. It is necessary to strike a balance between

80. Many respondents believed that the proposals duplicate requirements within other IFRSs, mainly IAS 1 *Presentation of Financial Statements* and IFRS 7 *Financial Instruments: Disclosures*. IFRS 7 was cited frequently as already capturing the risk disclosures required by the ED. Respondents suggested removing any duplicate disclosure requirements in order to keep the ever increasing disclosure requirements for financial statements to a minimum.
81. Many respondents were also opposed to the ‘look through’ nature of the disclosures relating to the basis of control (paragraphs B32 – B43 of the ED). The disclosures seem to second guess the judgement of management to consolidate or not consolidate an entity. Respondents commented that disclosures should not act as a substitute for consolidation. Likewise, some disclosure requirements for consolidated entities were seen as potentially excessive (eg to disclose the extent to which non-controlling interests can restrict the activities of subsidiaries).
82. Although respondents acknowledge the need to understand an entity’s involvement with unconsolidated structured entities, many voiced concerns about the specific disclosures for structured entities. Respondents believed that the disclosures should be focused on the risks involved rather than the form of the entity with which the reporting entity has involvement.
83. Many respondents agreed with the disclosure objective in paragraph 48(d) of the ED—that a reporting entity shall disclose information that enables users of its financial statements to evaluate the nature of, and risks associated with, the reporting entity’s involvement with structured entities that the reporting entity does not control. However, most respondents commented on the scope of those disclosures because of the use of the word ‘involvement’—any involvement would have to be disclosed (eg interest rate swaps). This risks obscuring important information with volumes of unimportant information. They

burdening financial statements with excessive detail that may not assist users of financial statements and obscuring important information as a result of too much aggregation. For example, a reporting entity shall not obscure important information by including it among a large amount of insignificant detail. Similarly, a reporting entity shall not disclose information that is so aggregated that it obscures important differences between the types of involvement or associated risks.

suggested that entities that have little to no involvement with an unconsolidated structured entity should not have to provide the disclosures because they are likely to have very little exposure to risk from that entity. Respondents requested that entities need only report significant involvement with unconsolidated structured entities.

84. Some respondents suggested either including all risk disclosures in IFRS 7 or including any such disclosures in a stand-alone standard, similar to IFRS 7, but for off-balance sheet entities.

Availability of information to meet disclosure requirements

Q10. Do you think that reporting entities will, or should, have available the information to meet the disclosure requirements? Please identify those requirements with which you believe it will be difficult for reporting entities to comply, or that are likely to impose significant costs on reporting entities.

85. The vast majority of respondents were concerned about the feasibility of obtaining information to meet the proposed disclosure requirements, especially the requirements relating to unconsolidated structured entities. Respondents do not think entities will have all information available to them (especially information about assets and liabilities of the structured entities) or it will be very difficult to obtain because they do not control those structured entities.
86. Respondents commented that not only would preparers find the requirements burdensome and difficult to comply with, but that auditors would have difficulty auditing the disclosures. In addition, respondents questioned the Board's intentions behind the requirements in paragraphs B40 – B42 of the ED—to disclose the nature of involvement with an unconsolidated structured entity. If the disclosure requirements address risk, why would we ask for disclosures even if a reporting entity had no continuing involvement? If the requirements are addressing more than risk, that should be more clearly explained noting the

benefit of such disclosures. Additionally, why ask for more than one year of comparatives when all other IFRSs require only one year?⁶

87. Respondents supported the requirement to disclose why an entity found it impractical to obtain the information needed and how it manages its exposure to risk from unconsolidated entities for which the information could not be obtained.
88. Respondents requested field testing of the disclosures to better evaluate if the costs will outweigh the benefits of the proposed disclosures.

Disclosure about reputational risk

Q11(b). Do you think that the proposed disclosures in paragraph B47 are sufficient? If not, how should they be enhanced?

89. The majority of respondents were supportive of the disclosure requirements about reputational risk, although some asked for clarity as to what we meant by ‘support’ provided to structured entities.

Issue 6. Significant influence and the equity method

90. Respondents were asked to consider if the Board should add to its agenda a project on IAS 28 *Investments in Associates*, particularly with regard to the definition of significant influence and the use of the equity method.

Q12. Do you think that the Board should consider the definition of significant influence and the use of the equity method with a view to developing proposals as part of a separate project that might address the concerns raised relating to IAS 28?

91. Respondents’ comments to this question were mixed—some did not view IAS 28 as being a topic that needed to be addressed at this time given the other priorities of the Board; others were in favour of reviewing IAS 28 at this time. Those in favour noted the overlap between ‘power with less than a majority’ and significant influence and question what significant influence means in the

⁶ Paragraph B42 of the ED requires two years of comparatives for information about unconsolidated structured entities that the reporting entity has set up or sponsored (requirements from paragraph B41).

context of structured entities. Others in favour requested that IAS 28 be addressed before the release of the consolidation standard.

92. Respondents also noted that since IAS 27, IAS 28 and IAS 31 *Interests in Joint Ventures* have multiple concepts that are interrelated, the Board should consider all three standards at the same time to ensure consistency in principle and application.
93. The staff notes that some constituents have also recently asked the Board to clarify the implications of the revision of IFRS 3 *Business Combinations* and IAS 27 in phase II of the business combinations project for the equity method. In particular constituents have asked the Board to clarify how an entity should account for the following situations:
- (a) An entity obtains significant influence over another entity in stages (step acquisition of an associate);
 - (b) An entity acquires or disposes of ownership interests in an associate without the loss of significant influence;
 - (c) The classification of an associate changes to a jointly controlled entity and vice versa.

These issues are also addressed in Appendix C of agenda paper 13.

Other issues

Scope

94. The scope of the draft standard was explicitly addressed by some respondents suggesting that investment companies should be scoped out of the proposed standard. Respondents asked the Board to reconsider the consolidation of investments by investment companies, noting that in their view such consolidation does not provide meaningful, relevant information to users of the financial statements and therefore conflicts with the general principles of the framework.

Silos

95. Appendix A of the ED introduces the term ‘silo’—an entity within a legal structure—but does not provide a definition. Respondents commented that Phase D (the reporting entity) of the conceptual framework project introduces a

similar concept, but that standards-level guidance will be necessary for this concept to be implemented effectively. Respondents recommend this concept, and term, either be deleted from the final standard or more guidance be provided in order for it to be applied effectively in practice. Some respondents also believed that if this concept is to be used, a definition of an entity would also be required.

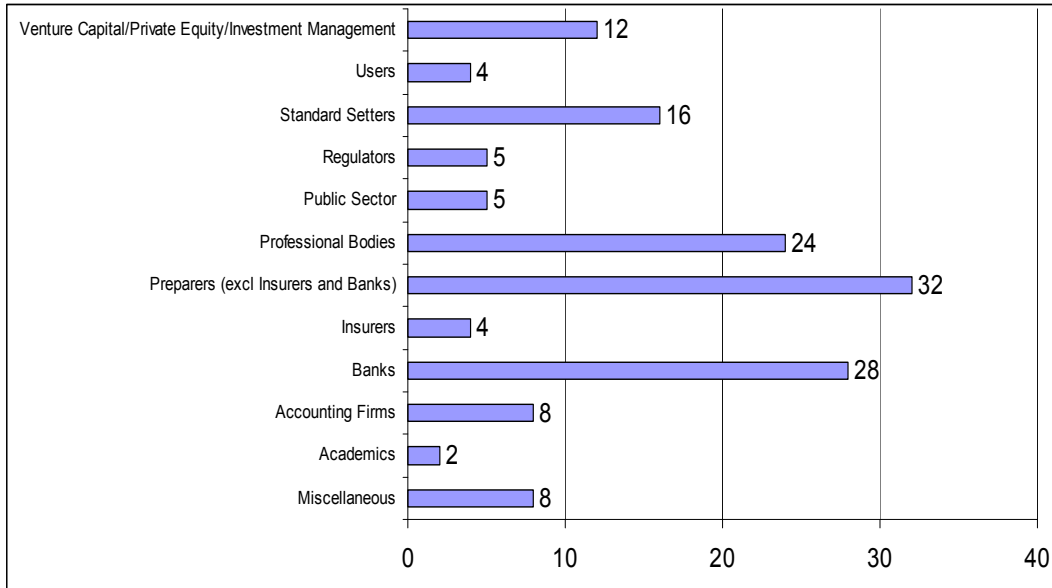
Transition guidance

96. Many respondents expressed concern about the lack of transitional guidance provided in the ED, especially when applying IFRS 3 *Business Combinations*. Paragraph 52 of the ED states that if an entity is consolidated for the first time as a result of applying this standard, the date of first applying the standard is deemed the acquisition date and the entity would consequently follow IFRS 3. Two main concerns have been raised: 1) additional clarification is needed to determine the fair value of the consideration; and 2) some consolidated entities (especially structured entities) may not meet the definition of a business.
97. Respondents also identified concerns when applying IFRS 1 *First-Time Adoption of International Financial Reporting Standards*. One respondent commented that the Board should allow early adoption of the standard to avoid countries potentially having to applying existing standards (IAS 27 and SIC-12) for one year before applying the new IFRS.

Appendix A Analysis of comment letters by type and region

A1. 148 comment letters have been received.

By type of respondent



By geographic region

