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Project **Consolidation**

Topic **Disclosures**

Introduction

1. ED10 *Consolidated Financial Statements* was published in December 2008 as part of the Board's **Consolidation** project (see Agenda paper 2A). The objectives of the project are to:
 - (a) provide clearer and more consistent requirements for identifying whether a reporting entity (a parent) controls another entity (a subsidiary) than we currently have in IFRS; and
 - (b) improve the information available to investors about the risks a reporting entity has from its involvement with entities that it does not control (such as securitisation and investment vehicles).
2. This paper focuses on objective (b)—the disclosure requirements proposed in ED10. The paper asks for your views on some aspects of those disclosure proposals. We will incorporate your views into the Board papers that are prepared regarding disclosures.
3. This paper was prepared by the staff and does not necessarily reflect the views of the Board—the Board have not yet redeliberated the disclosure proposals in ED10.

This paper has been prepared by the technical staff of the IASCF for discussion at meeting of the World Standard Setters.

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

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.

Disclosures in ED10 *Consolidated Financial Statements*—off balance sheet entities

4. ED10 proposes, among others, that a reporting entity should 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. The application guidance to ED10 includes extensive requirements detailing how to meet that disclosure objective. Those requirements (in paragraphs B38-B47 of ED10) are set out in the appendix to this paper.

The principle

5. ED10 requires disclosure of the reporting entity's involvement with structured entities that the reporting entity does not control. ED10 describes involvement with a structured entity to include both contractual and non-contractual involvement that exposes the reporting entity to variability of returns of the structured entity. 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 of ED10 (in effect, the activities are not directed through voting rights or the appointment of a governing body).
6. The Board decided to propose disclosure of a reporting entity's involvement with unconsolidated structured entities rather than proposing disclosure of every involvement with unconsolidated entities, which would not be feasible or meaningful. The Board thought that those restrictions would limit the disclosure requirements to those relationships with unconsolidated entities that are at the heart of the financial crisis and would avoid unduly burdensome disclosures for other types of involvements with unconsolidated entities.
7. The Board also acknowledged that IFRS 7 *Financial Instruments: Disclosures* requires similar risk disclosures. However IFRS 7 focuses on risk disclosures about financial instruments and does not necessarily identify an entity's risk exposure from involvement with what are often described as 'off balance sheet entities'.

Comments from respondents to ED10

8. Most respondents were generally supportive of the Board addressing additional disclosures to meet the needs of users in light of the financial crisis. However, many of those voiced concerns that the proposed disclosure requirements are too prescriptive and so voluminous they have the potential to obscure key information.
9. Some respondents agreed with the underpinning principle of the proposed disclosure requirements because they thought that to obtain a better understanding of the risk associated with a reporting entity's involvement with unconsolidated structured entities a user would need information about the activities, the assets and, if relevant, liabilities of the structured entity that affect the reporting entity's risk exposure. In addition a user would need information about the contractual terms of the reporting entity's involvement with the structured entity (eg triggers for providing financial support; ranking in terms of absorbing losses).
10. Other respondents disagreed with this view and argued that the counterparty should not matter for the analysis of the reporting entity's risk exposure. Those respondents believe that a risk analysis should focus on the instruments that create risk, regardless of whether the risk is associated with a reporting entity's involvement with a structured entity or a traditional entity. They believe that instead of expanding the disclosure requirements in the consolidation standard, the Board should focus on improving the risk disclosure requirements in IFRS 7. Those respondents suggested that this would avoid duplicating disclosures already required by IFRS 7.

Question 1:

Do you think that a reporting entity should provide specific disclosures about its risk exposure from its involvement with unconsolidated structured entities (as proposed in ED10), or should the disclosures be focussed on the risks to which an entity is exposed, irrespective of the nature of the counterparty? Give reasons to support your view. If you support disclosures of a reporting entity's risk exposure from its involvement with unconsolidated structured entities, how would you propose that we deal with the potential duplication of risk disclosures already required by IFRS 7?

The nature and extent of involvement with unconsolidated structured entities

11. Paragraphs B40-B42 of ED10 propose disclosures about the nature and extent of a reporting entity's involvement with unconsolidated structured entities that the reporting entity set up or sponsored, and with which it has involvement at the date of the consolidated financial statements. Those requirements are reproduced in the appendix to this paper.

Question 2:

The requirements proposed in B41-B42 ask for disclosures when a reporting entity set up or sponsored a structured entity, irrespective of whether the reporting entity has any ongoing involvement with the structured entity. Do you think that the proposed disclosures are useful? Give reasons to support your view.

Balancing the needs of users and concerns of preparers

12. Many preparers have commented that it would either be very difficult or very costly to obtain some of the information required to provide the proposed disclosures for all unconsolidated structured entities with which a reporting entity is involved. Many referred to the requirement in paragraph B44(c) to disclose the reported amount of assets of unconsolidated structured entities as an example.
13. In contrast, user groups responding to ED10 were generally supportive of the proposed disclosures. Although not always the case, users tend to find that preparers disclose the minimum that is required. Therefore users generally have a preference for prescriptive disclosure requirements that meet clearly-defined disclosure principles and objectives, rather than having principles-based disclosures only. They also often prefer prescriptive disclosure requirements for comparative reasons. We are in the process of gathering additional input from users on the disclosure proposals.
14. One way to address the differences of opinion in this respect is to retain many of the disclosure proposals but include an impracticability clause as was done in ED10. B39 of ED10 states the following:

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If obtaining any of the information for the disclosures required by this [draft] IFRS is impracticable, the reporting entity shall disclose why it is impracticable to obtain the information, and how it manages its exposure to risk from its involvement with unconsolidated structured entities for which it is impracticable to obtain the information.

15. Some respondents however were concerned that the impracticability threshold was too high of a hurdle.
16. Another way is to give prescriptive examples of the types of disclosures that are required to meet the disclosure principle, if such disclosures are relevant for users of the financial statements. In this way, a preparer would not be required to provide long lists of disclosures if that information was not relevant. Paragraph B46 of ED10 attempted to do this by suggesting disclosures that might be made if relevant to an assessment of the risks to which the reporting entity is exposed. Many respondents, however, read this paragraph as a prescriptive list of mandatory disclosures, which they thought would not always be relevant and some of which would be difficult and costly to provide.

Question 3:

- (a) Do you think that including an impracticability clause is an appropriate way to address the concerns expressed by preparers? Give reasons for your view.
- (b) Would you support the inclusion of disclosure examples, which are not mandatory, but indicate the type of disclosures required if they are relevant for users as a way of balancing the needs of users and the concerns of preparers? If not, what approach would you suggest and why? How could we make clear that the requirements are not mandatory but only required if relevant?

Appendix—Extract from ED10: Disclosure requirements

Involvement with unconsolidated structured entities and associated risks (paragraph 48(d))

B38 To achieve the disclosure objective in paragraph 48(d), a reporting entity shall disclose information that enables users of its financial statements to evaluate:

- (a) the nature and extent of the reporting entity's involvement with structured entities that it does not control;
- (b) the nature and extent of, and changes in, the market risk (interest rate, prepayment, currency and other price risk), credit risk and liquidity risk from the reporting entity's involvement with structured entities that it does not control. This exposure may arise from both contractual and non-contractual commitments, and from past and present activities.

B39 If obtaining any of the information for the disclosures required by this [draft] IFRS is impracticable, the reporting entity shall disclose why it is impracticable to obtain the information, and how it manages its exposure to risk from its involvement with unconsolidated structured entities for which it is impracticable to obtain the information.

Nature and extent of involvement (paragraph B38(a))

B40 In accordance with the disclosure objective in paragraph B38(a), a reporting entity shall disclose information about its involvement with unconsolidated structured entities that the reporting entity set up or sponsored, or with which it has involvement at the date of the consolidated financial statements. This includes summary information about the nature, purpose and activities of the structured entities.

Structured entities set up or sponsored

B41 A reporting entity shall disclose for unconsolidated structured entities that the reporting entity has set up or sponsored, in tabular format, unless another format is more appropriate, a summary of:

- (a) income from the reporting entity's involvement with structured entities, including a description of the types of income presented in the summary; and
- (b) the value of assets transferred to those structured entities, at the date the transfers were made.

The summary shall separate the activity into relevant categories (such as by type of structured entity or asset that exposes the reporting entity to different risks). The reporting entity shall also identify the extent to which the activity relates to structured entities with which the reporting entity has involvement at the date of the consolidated financial statements and those with which the reporting entity has none.

B42 A reporting entity shall disclose the information in paragraph B41B41 for the current reporting period and the preceding two reporting periods. A reporting entity shall assess whether this information meets the disclosure objective in paragraph B38(a), and provide comparative information for additional reporting periods if that information is necessary to meet the objective.

Nature of risks (paragraph B38(b))

B43 To achieve the disclosure objective in paragraph B38(b), a reporting entity shall disclose information about its exposure to risks from its involvement with unconsolidated structured entities. The disclosure requirements in paragraphs B44-B47 supplement the disclosure requirements in IFRS 7 *Financial Instruments: Disclosures*.

B44 A reporting entity shall present in tabular format, unless another format is more appropriate, a summary of:

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- (a) the carrying amount of the assets and liabilities recognised in the reporting entity's consolidated financial statements relating to the reporting entity's involvement with structured entities.
- (b) the line items in the consolidated statement of financial position in which those assets and liabilities are recognised.
- (c) the reported amount of assets held by structured entities with which the reporting entity has involvement, measured at the date of the reporting entity's consolidated financial statements. The reporting entity shall disclose the measurement basis of the assets presented in the summary, distinguishing between assets originated by the reporting entity and those originated by other entities.
- (d) the amount that best represents the reporting entity's maximum exposure to loss from its involvement with structured entities, including how the maximum exposure to loss is determined.

B45 The information required in paragraph B44 should be classified into categories that are representative of a reporting entity's exposure to risk (such as by type of structured entity or type of asset).

B46 In addition, a reporting entity shall disclose other information that is relevant to an assessment of the risks to which the reporting entity is exposed. That other information might include any of the following:

- (a) In relation to structured entities' assets, their categories and credit rating, their weighted-average life, and whether any assets have been written down or downgraded by rating agencies.
- (b) In relation to funding and loss exposure:
 - (i) the forms of structured entities' funding (eg commercial paper, medium-term notes) and their weighted-average life. That information might include maturity analyses of the assets and funding of structured entities if the structured entities have longer-term assets funded by shorter-term funding.

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- (ii) any difficulties structured entities have experienced in financing their activities during the reporting period.
 - (iii) losses incurred by the reporting entity during the reporting period relating to its involvement with structured entities.
 - (iv) estimated exposure to loss or range of outcomes of that loss that were reasonably possible at the date of the reporting entity's consolidated financial statements, if the reporting entity believes that the maximum exposure to loss is not representative of the estimated exposure to loss. The reporting entity shall explain the methodology used to determine the estimated exposure to loss or range of that loss.
 - (v) whether the reporting entity is required to bear any losses before other investors in the structured entity, the ranking and amounts of losses borne by each category of party involved, and the maximum limit of such losses.
- (c) The types of returns the reporting entity received during the reporting period from the financial instruments it holds in structured entities.
- (d) The nature and terms of any obligation of the reporting entity to provide liquidity support to structured entities (eg to purchase assets or commercial paper of the structured entity), including:
- (i) a description of any triggers associated with the obligation.
 - (ii) whether there are any terms that would limit the obligation.
 - (iii) whether there are any other parties that provide liquidity support and, if so, how the reporting entity's obligation ranks with those other parties.
- (e) In relation to support that has been provided by a reporting entity to structured entities during the reporting period whether:
- (i) the reporting entity purchased any debt or equity interests in structured entities, and whether any agreement required the reporting entity to make these purchases.

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- (ii) other assistance was provided to structured entities in obtaining any other type of support.
- (iii) there are any current intentions to provide support or other assistance to structured entities in obtaining any other type of support.

B47 If during the reporting period, a reporting entity has, without having a contractual or constructive obligation to do so, provided support to structured entities that were not consolidated at the time of providing the support, it shall disclose:

- (a) the extent of support provided, including its nature and amount, including situations in which the reporting entity assisted the structured entity in obtaining another type of support, or in which there are current intentions to do so;
- (b) an explanation of why the support was provided;
- (c) an explanation of how the provision of the support resulted in the reporting entity controlling the structured entity, if applicable.