16 March 2011

Mr David Sidwell
Chairman - Due Process Oversight Committee
Trustees of the IFRS Foundation

Dear David

Towards the end of March the Board is planning to issue three new IFRSs and two amended IASs:

IFRS 10 *Consolidated Financial Statements*

IFRS 11 *Joint Arrangements*

IFRS 12 *Disclosure of Interests in Other Entities*

IAS 27 *Separate Financial Statements*

IAS 28 *Investments in Associates and Joint Ventures*

The five new standards ('the five IFRSs') are part of a suite of related improvements to IFRSs.

I am writing to you to summarise the steps the Board has taken to ensure that the five IFRSs have been developed in full compliance with the Board's due process requirements. I have also identified the steps the Board and staff have taken to address concerns raised during the development of the IFRS.

Overview of the improvements

IFRS 10 *Consolidated Financial Statements*

IFRS 10 replaces IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation—Special Purpose Entities*. It provides a single consolidation model based on the principle of control and contains requirements relating to the preparation of consolidated financial statements.

As a consequence of the new consolidation standard, the consolidation requirements were removed from IAS 27, and a revised IAS 27 *Separate Financial Statements,* will be published. The revised IAS 27 will only contain matters relating to separate financial statements.

Areas likely to be controversial

Some have questioned why we are replacing the current consolidation requirements when they seem to have been relatively robust during the financial crisis. The Board's assessment is that the new model provides a more cohesive model, bringing together the control based IAS 27 with the risk and reward based SIC-12. The Board anticipates that IFRS 10 will remove accounting arbitrage opportunities and provide clearer and more consistent guidance for more complex structures and arrangements.

Due Process Concerns

The comment period for the exposure draft was three months rather than four months. The reasons for the shortened period are explained later in this report. I am also aware that some respondents will question whether we did sufficient field work in relation to the definition of control and the application of the definition to delegated power (which relates to special purpose vehicles). I am confident that we have done sufficient work and I have outlined the steps taken in this report.

These are the only matters that the Due Process Oversight Committee should be concerned about in relation to the forthcoming IFRS 10.

IFRS 11 *Joint Arrangements*

IFRS 11 replaces IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities—Non-monetary Contributions by Venturers*. It establishes principles for financial reporting for parties in joint arrangements.

As a consequence of the new joint arrangements standard and the withdrawal of IAS 31, the accounting requirements for joint ventures will be incorporated into IAS 8. The revised version of IAS 28 will be published as *Investments in Associates and Joint Ventures*.

Areas likely to be controversial

One of the objectives of the project was to improve consistency by removing the accounting choice currently available in the joint ventures standard. Around half of entities use proportionate consolidation and half use the equity method when they account for jointly controlled entities. Removing the ability to use the proportionate consolidation method will therefore cause about half of the entities to change their accounting. Many of those entities, having selected that method ahead of the equity method, will be unhappy with having to make a change. The Board is confident that the change will improve financial reporting.

Due Process Concerns

The time between publication of the exposure draft and finalising the IFRS 11 has taken longer than usual. However, this delay was to allow the Board to publish IFRS 11 with IFRS 10 and IFRS 12 and not because of anything controversial in the project.

IFRS 12 *Disclosure of Interests in Other Entities*

IFRS 12 sets out the disclosure objectives and minimum disclosure requirements when a reporting entity has interests in other entities. These interests include interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities.

IFRS 12 arose from the deliberations surrounding the consolidations and joint arrangements projects. In the course of its deliberations, the Board identified an opportunity to create a standard providing consistent disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities. These disclosure requirements had previously been located in different standards.

Areas likely to be controversial

The new disclosure requirements are consistent with the recommendations made by the Financial Stability Forum in 2008. The final requirements are less onerous than originally proposed. Our assessment is that the new IFRS will be positively received by users and the changes made from the exposure drafts will be positively received by preparers.

Due Process Concerns

I am not aware of any matters that the Due Process Oversight Committee should be concerned about in relation to the forthcoming IFRS 12.

Due process

The IASB Due Process Handbook includes mandatory and non-mandatory steps that need to be considered before an exposure draft is published or a new IFRS or amendments to existing IFRSs are issued. The Board is required to explain why it has not undertaken any of the non-mandatory steps (ie the ‘comply or explain’ approach).

Mandatory steps

Publishing an exposure draft, with a basis for conclusions and alternative views if relevant

IFRS 10: The Board published ED 10 *Consolidated Financial Statements* in December 2008.

ED 10 had a three-month comment period, with comments due in March 2009. The Board approved this shortened comment period because a staff draft of ED 9 had been available on the IASB's website for six months prior to its publication. Additionally, public roundtables had been held in September 2008 which provided many parties with the opportunity to give feedback on the drafting of ED 10.

Ten Board members approved ED 10. Three Board members (Robert Garnett, James Leisenring and John Smith) dissented to the publication. Their alternative views were published in ED 10.

IFRS 11: The Board published ED 9 *Joint Arrangements* in September 2007. ED 9 included a basis for conclusions. It had a four-month comment period, with comments due in January 2008. Eleven Board members approved the publication. Stephen Cooper and Wei-Guo Zhang abstained in view of their recent appointment to the Board.

IFRS 12: The Board did not publish a separate ED for IFRS 12. However, both ED 10 and ED 9 contained disclosure requirements that were incorporated into IFRS 12. Therefore, the requirements in IFRS 12 were exposed for public comment through EDs 9 and 10. It was in the course of redeliberating EDs 9 and 10 that the Board decided to combine the disclosure requirements for interests in other entities into a single standard.

Reviewing comments made within a reasonable period on documents published for comment

IFRS 10: 148 comment letters were received on ED 10. The comment period ended on 20 March 2009; a comment letter summary was presented to the Board at the May 2009 Board meeting. The Board also analysed comments received in further detail between July 2009 and July 2010.

IFRS 11: 111 comment letters were received on ED 9. The comment period ended on 11 January 2008; a comment letter summary was presented to the Board at the April 2008 Board meeting. Outreach was performed between April 2008 and April 2009. The Board decided to delay further deliberations to align the deliberations with those of ED 10 and to address the pressing issues related to the 2008 financial crisis. After this delay, the Board analysed comments received in further detail between May 2009 and March 2010.

Consulting the Advisory Council on major projects

> <u>IFRS 10:</u> Staff brought specific papers on the consolidation project to the Advisory Council in June 2004, November 2004 and June 2008. The consolidation project was also discussed in the sessions on the financial crisis in November 2008, February 2009 and June 2009.
>
> <u>IFRS 11</u>: The joint arrangements project was discussed through the Advisory Council's overview of the work plan throughout the project life.

Including a basis for conclusions in the IFRS

> IFRS 10, 11 and 12 all include a basis for conclusions. No Board members have dissented to the publication of the five IFRSs.

Non-mandatory steps

Publishing a discussion document (eg a discussion paper)

<u>IFRS 10:</u> The Board decided not to publish a discussion paper. The financial crisis in 2008 highlighted the need for some improvements to accounting for consolidated and unconsolidated structured entities and increased transparency in disclosure. However, the financial crisis also illustrated that the fundamental principles of IAS 27 and SIC-12 worked well and that only more minor adjustments were needed. The Board felt that these were very high priority improvements to make and, given the fact that fundamental changes were not necessary, the improvements could be made relatively quickly.

<u>IFRS 11:</u> The Board decided not to publish a discussion paper as this was a narrowly scoped project. In the joint arrangements project, the Board only wanted to eliminate the choice of accounting for joint ventures present in IAS 31 and to clarify the definitions of the different types of joint arrangements in order to improve consistency in application.

Establishing working groups or other types of specialist advisory groups

<u>IFRS 10:</u> The Board decided not to form a working group for similar reasons as to their decision not to publish a discussion paper.

<u>IFRS 11:</u> The Board decided not to form a working group for similar reasons as to their decision not to publish a discussion paper.

Holding public hearings

<u>IFRS 10:</u> Public roundtables were held in September 2008, June 2009 and November 2010. The September 2008 roundtable (London) offered participants a chance to offer input regarding the drafting of the proposals in ED 10. The June 2009 roundtables (London, Tokyo and Toronto), offered participants a chance to provide feedback on

those proposals. The November 2010 roundtable (Norwalk) centered on a staff draft of IFRS 10 and was held to give the FASB the opportunity to assess whether it should expose the IFRS model in the US.

IFRS 11: The Board decided that more targeted outreach would be appropriate for the joint arrangements project. Although formal public hearings were not held, staff met with many respondents to the exposure draft to test the proposals. Given the nature of the joint arrangements project, the Board concluded that targeted outreach would be a more efficient use of resources.

Undertaking field tests (both in developed countries and in emerging markets)

IFRS 10: Outreach was undertaken with banks and auditors prior to the publication of ED 10 and IFRS 10. Staff met with representatives from the banking industry to review existing relationships and structuring instruments to see how the proposals in ED 10 and IFRS 10 would apply. Staff also met with representatives from audit firms to review early drafts of ED 10 and IFRS 10 to hear auditors' concerns about the drafting and application of the proposals.

IFRS 11: Extensive outreach was undertaken between the ED 9 comment letter deadline in January 2008 and when deliberations restarted in May 2009. Staff liaised with approximately 40 constituents who shared actual examples and contractual documentation to test the application of the proposals in ED 9. The parties we spoke to were selected from respondents who had sent in comment letters. The issues that came up from this field testing were redeliberated and resolved.

Additional steps taken

In addition to the activities outlined in the due process handbook, the staff and board members undertook additional outreach.

> IFRS 10: The project team had many face-to-face meetings with banks, representative organisations (such as ISDA), insurance companies, hedge fund managers and audit firms.
>
> IFRS 11: Extensive outreach was undertaken throughout the deliberations of IFRS 11. As explained earlier, staff liaised with preparers from a variety of industries and geographic locations in order to gather their concerns and analyse how the proposals would apply to real life transactions. As a result of this outreach, the proposals in ED 9 were improved and constituents gained a better understanding of the proposals.
>
> Staff also met with user groups and national standards setters throughout IFRS 11 project life. These groups provided valuable feedback for the Board as they deliberated various issues.

Staff and Board members also attended quarterly public meetings with the oil and gas industry and gave presentations at IFRS Conferences and World Standards-setters Meetings regarding the joint arrangements project.

Drafts of the IFRSs were sent for a fatal flaw review to a selected group of audit firms and preparers. Again, these preparers were from a variety of industries and geographic locations. National standard-setters were also given access to the drafts.

These topics were regularly on the agenda of the Analysts Representative Group and Global Preparers Forum. Staff and Board members also discussed the topics at conferences hosted by the IASB and other organisations.

Project summaries, feedback statements and effect analyses of the IFRSs will also be provided as public documents to accompany the publication of the IFRSs. These documents will explain in simple language the improvements made to IFRSs and the effects these changes will have for preparers, auditors and users.

Re-exposure

The IASB Due Process Handbook states that the Board must consider whether a proposal should be re-exposed by:

- Identifying substantial issues that emerged during the comment period on the exposure draft that it had not previously considered;
- assessing the evidence that it has considered;
- evaluating whether it has sufficiently understood the issues and actively sought the views of constituents; and
- considering whether the various viewpoints were aired in the exposure draft and adequately discussed and reviewed in the basis for conclusions on the exposure draft.

The Board has considered the changes made from ED 9 and ED 10 and decided that it was not necessary to re-expose any aspects of the proposals. The main changes from the exposure drafts are:

IFRS 10: Application guidance was added to IFRS 10 regarding many different topics, including the definition of control, the assessment of control, and principal/agency relationships. Specific guidance regarding structured entities was removed from the standard. Those changes were a direct result of comments received from respondents. The changes were also related to drafting rather than a change in the proposals (ie how the model was expressed rather than a different model). The changes clarified and strengthened the proposals in ED 10 for one control model for consolidation and re-exposure was therefore not considered to be necessary.

IFRS 11: Application guidance was incorporated IFRS 11 to assist entities in the classification of their joint arrangements. Terminology was changed from ED 9, and the number of types of joint arrangements was narrowed from three to two. The Board believes that these changes are refinements and clarifications and do not represent major changes to the proposals in ED 9 and in fact make the proposals easier to follow. The changes were also a direct response to comments from respondents. Therefore, the Board decided that re-exposure was not necessary.

IFRS 12: The main change from ED 9 and ED 10 was to incorporate the disclosure requirements for interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities into one disclosure standard. This is a simple case or 'geography'.

Summary

The Board considered all of these matters at a public meeting on [date] and decided to ask the staff to prepare the IFRS for balloting. The staff are in the process of preparing those ballot drafts and our plan is to issue the documents on [date].

Yours sincerely

Alan Teixeira
Director of Technical Activities