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Rome, March 2nd 2009

Re: Comments on IASB's Exposure Draft 10 - Consolidation

Dear Sir,

The OIC appreciates the efforts made by the IASB to speed-up the conclusion of the consolidation project, taking into consideration the recent and still running financial markets turmoil and the consequent necessity to answer as fast as possible to the need for actions such as those expressed by the Financial Stability Forum in April 2008. However, as expressed in this letter and in the accompanying Appendix A, we have certain serious concerns that we believe should be taken into consideration.

Our most significant concerns are the following:

We understand that the consolidation project is firstly focused on combining the criteria — presently set forth in the IAS 27 and the SIC 12 — in a unique and comprehensive IFRS, amending the current criteria in order to make them coherent. Given this goal, we believe that the proposed standard should not have the potential effect of reducing the extent of the consolidation area in comparison to that resulting by the current dispositions of both IAS 27 and SIC 12.

In pursuing its objective, the Board has considered necessary to have a unique definition of “control”. The Exposure draft proposes a definition of control by saying that 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.

We believe that such definition could lead to situations where certain entities — namely off-balance sheet entities — currently included in the consolidation area on the basis of the *risk and rewards* trigger would/could no longer be consolidated. OIC believes that this would not meet the expectations of the users of the financial statements.

We believe that the proposed changes to the current dispositions should be revisited in order to ensure that they would not result in a lesser number of entities being consolidated. We also believe that the appropriateness of the proposed changes should be supported by an adequate and reasonably extensive field test. Absent such a test, we are unable to determine whether the proposed approach will result in consolidated financial statements including the right entities, or, at least, those entities currently included in the consolidation. Although the

current standard and interpretation may need to be improved, up until now the current dispositions have certainly limited the cases of *unconsolidated* vehicles bearing significant risks for the reporting entity.

We appreciate the IASB's work in responding to the request of the Financial Stability Forum ("*standards should require the risk exposures and potential losses associated with off-balance sheet entities to be clearly identified and presented in financial disclosures*"). Although the disclosures proposed by the ED 10 are very extensive and could be onerous for the entity to obtain all necessary information, the proposed disclosures fill areas uncovered by the SIC 12. Hence, we believe the proposed changes represent an improvement to the current disclosure requirements. We understand that the Board had this purpose in expanding and redefining such disclosures, and that its intention was not to adopt extensive disclosure to make up for the possible reduction in the consolidation area, since in our opinion a disclosure cannot be taken as a substitute of an accounting recognition.

We think that the Board might review its approach distinguishing the project in two distinct steps: (a) implementation of the proposed disclosures for the (unconsolidated) off-balance sheet entities and (b) definition of a unique consolidation standard with the aim to include all the right entities. The step (b) should then be conducted in strict cooperation with the FASB and supported by an appropriate field test.

Finally, as you certainly know, in Europe the EFRAG has already launched a similar project. We believe that the IASB could benefit by such experience in reviewing its approach.

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The OIC comments as to the specific questions asked by the ED 10 are included in the attached Appendix A, as well as some additional comments from us..

Hoping the foregoing will contribute to your efforts, we remain

Yours sincerely

Angelo Casò
(OIC Chairman)

Question 1

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?

Question 2

Is the control principle as articulated in the draft IFRS an appropriate basis for consolidation?

In pursuing its objective, the Board has considered necessary to have a unique definition of “control”. The Exposure draft proposes a definition of control by saying that 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. We believe that such definition could lead to situations where certain entities — namely off-balance sheet entities — currently included in the consolidation area on the basis of the *risk and rewards* trigger would no longer be consolidated. We also believe that any of such conclusions should be supported by an appropriate and reasonably extensive field test. Absent such a test, we are unable to determine whether the proposed approach will result in consolidated financial statements including the *right entities*, or, at least, those entities presently included in the consolidation.

We noted certain terminological inconsistencies in the ED 10 text. Particularly, the term *power*, as opposed to the term *ability*. The ED 10 uses the term *power* in defining the control (ED 10, paragraph 4) and then paragraph 11 uses the term *ability* with respect to the matter of *Returns*. The term *ability* is also used elsewhere in the ED, for example in paragraph 27 (b). Given the different meanings of the two words, and taken into consideration that the term *ability* represents a larger notion than *power*, we suggest that the term *ability* be used consistently in the ED, including the definition of control.

The ED paragraph 5 states that “*a parent does not share control of a subsidiary. The parent’s power to direct the activities of a subsidiary precludes others from controlling the subsidiary*”. Then, the Basis for Conclusions make reference to the IAS 31 (Interest in Joint Ventures) with respect to a case of shared control. As a general rule, we believe that exceptions to the stated principle should be clearly included in the text of the Standard, rather than in other sections, unless such section forms an integral part of the Standard.

Question 3

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?

The proposed guidance on the assessment of the control does not appear sufficiently clear in illustrating the various possible aspect of the protective rights. We believe the guidance should include an illustration of those cases where they do limit the reporting entity control. For example, the guidance might be extended to include the situations where the presence of protective rights leads to assume a joint venture (e.g.: the existence of a third party right of veto on budgets or operating plans implies the party involvement in the operating decisions). Additionally, the illustration could be extended to embrace other situations, for example the case of golden shares.

Question 4

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.

Under IAS 27, potential voting rights should be taken into consideration to determine whether an entity has the majority of voting rights. In the presence of options to purchase additional shares, the entity should determine if such options are immediately exercisable. Should this be the case, there are circumstances in which the entity should consider the relevant shares as issued. ED 10 does not include a (rebuttable) presumption that options immediately exercisable are taken as issued (see paragraph B 13).

We therefore suggest that in reviewing paragraph B 13 of the ED 10, the IASB revamps paragraph IG 6 of the IAS 27, which is essential in a context in which only the exercisable rights are considered, since it imposes to consider as already acquired (and often to be consolidated) the investments included in financial portages. For example, this is the case of cross put and call in which the option are European-type and do not meet the definition of potential voting rights.

Question 5

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.

It is not clear if the purpose of the guidance relating to the agency relationships is aimed to identify whether an entity acts as an agent or as a principal. We note that in the annual improvement 2008 a guidance on agency relationships has been included in the IAS 18, stating that "*an entity is acting as a principal when it has exposure to the significant risk and rewards associated with the sale of goods or the rendering of services*". We therefore believe that the relevant ED 10 guidance should be further developed to better define its purpose as well as the assessment for defining whether an entity is acting as an agent or as a principal, taking into consideration the IAS 18.

Question 6

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?

In our opinion, the definition of a structured entity is excessively vague. The definition is of a "residual" type ("*a structured entity is an entity whose activities [...] are not directed as described in paragraphs 23-29*"). This kind of definition leaves open a large room and therefore may be source of misinterpretations. We do not believe that a univocal definition of a structured entity is appropriate, given that a specific instrument might have characteristics not to meet the definition. Since the SIC 12 includes several examples of special purpose entities, we suggest that additional illustrations be added to the proposed one.

Question 7

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?

Question 8

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.

As already expressed both in the accompanying letter and in this appendix, in our opinion the revised standard should represent an improvement over the present one and should not permit a reduction of the consolidation area. For example, based on paragraph 38 of the proposed Standard, certain vehicles (so-called *autopilot*) might be excluded from consolidation, although the reporting entity is exposed to significant risks. The present financial market bad conditions lead us not to believe that this is the intention of the Board.

In order to obviate these problems, a risk and rewards “fall back” test might be useful at least to ensure that vehicles exposing the reporting entity to significant risks be not excluded from consolidation. In the case it is felt appropriate to establish a variability level of returns upon which the consolidation is mandatory, this — we believe — could be determined solely by means of flied tests.

We concur with the view expressed by one dissenting Board member (see AV 12).

Question 9

Do the proposed disclosure requirements described in paragraph 23 provide decision-useful information? Please identify any disclosure requirements that you think should be removed from, or added to, the draft IFRS.

Question 10

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.

In our opinion, the disclosures provided by the ED 10 appear to be generally appropriate. However, given the amount and the nature of quantitative information to be disclosed, we believe there are situations in which the reporting entity might find difficulties to obtain the information (an example is the requirement to disclose “*the reported amount of assets held by structured entities with which the entity has involvement, measured at the date of the reporting entity’s consolidated financial statements*”).

In addition, we wish to note that an excess of information does not simplify the users’ understanding of the entity’s exposure to the risk of the financial instrument.

Question 11

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

We concur with the Board's position not to consider reputational risk as a basis for consolidation. We also agree with the proposed disclosure (paragraph B47) in those cases where the reporting entity provides support to a structured entity in absence of a constructive obligation. However, we would feel appropriate for the Standard to include such case as an indicator of possible volatility of the vehicle returns. Hence, we believe that an assessment should be required to determine whether the vehicle should be consolidated.

Question 12

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?

In our opinion, a revision of the IAS 28 is appropriate, in the light of the changes proposed by ED 9 and ED 10.

Nevertheless, we are not certain that the changes provided by ED 10 can be considered definitive. Hence, we believe the priority should be given to execute a field test on consolidation in order to stabilise such Standard and only after that result is obtained to move to the revision of the IAS 28. Moreover, we feel that other major projects are strictly connected with the consolidation and we recommend that their process be accelerated to the possible extent. We make reference to the projects on Common Control Transactions and to a Standard specifically addressed to the separate financial statements.

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Other comments:

Consistent with our suggestion to proceed with a comprehensive review of the entire matter regarding consolidation (and not just the definition of control) we take the opportunity given by this comment letter to recommend that a project on consolidation should include also the following :

- **Scope exemption.** The Board did not feel appropriate to review its position and to establish an exemption from consolidation of investment entities (private equities), given that (a) all subsidiary entities are part of the holding group, including both private equities and their subsidiaries, and (b) a worldwide unique definition of such entities does not appear feasible. Although we appreciate the wide variety that such structures can take, we think that the issue of an unfeasible unique definition should not affect the determination of the appropriateness of consolidating investment entities.
- **Derecognition.** The ED 10 did not address the issue of derecognition, which maintains the present discipline. We believe that the Board should include in its agenda the preparation of a comprehensive guide on such matter.