



# Accounting Standards Board

Aldwych House, 71-91 Aldwych, London WC2B 4HN  
Telephone: 020 7492 2300 Fax: 020 7492 2399

[www.frc.org.uk/asb](http://www.frc.org.uk/asb)



Stig Enevoldsen  
European Financial Reporting Advisory Group  
Avenue Des Arts 13-14  
1210 Brussels  
Belgium

[commentletter@efrag.org](mailto:commentletter@efrag.org)

18 March 2009

Dear Stig

## **EFRAG's Draft Comment Letter on the IASB's Exposure Draft 10 'Consolidated Financial Statements'**

Thank you for providing the Board with the opportunity to comment on your draft response to the International Accounting Standards Board's (IASB) exposure draft (ED) 10 'Consolidated Financial Statements'

The Board has responded directly to the IASB and a copy of our letter is attached.

We broadly agree with the conclusions EFRAG has reached in its draft comment letter. We note, however, that in our view the ED does not explicitly state that it blends the control model and a risk and rewards model as suggested by EFRAG. In our view the ED should be more explicit in discussing how risks and rewards fit with the control principle articulated in the ED.

We agree with EFRAG that as drafted the ED does not represent an improvement on existing financial reporting standards. We also agree that the current consolidation requirements do not give rise to a significant deficiency (albeit we recognise a need to improve disclosures) in financial reporting. We are not, however, in agreement with EFRAG that the IASB should divide the project into two.

Should you have any queries regarding our response please contact me, or Michelle Crisp Project Director, on +44 20 7492 2432 or by email [m.crisp@frc-asb.org.uk](mailto:m.crisp@frc-asb.org.uk).

Yours sincerely

### **Ian Mackintosh**

Chairman

DDI: 020 7492 2434

Email: [i.mackintosh@frc-asb.org.uk](mailto:i.mackintosh@frc-asb.org.uk)

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International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH

18 March 2009

Dear Sirs

## **Exposure Draft 10 'Consolidated Financial Statements'**

I am responding on behalf of the Accounting Standards Board (ASB) to the Exposure Draft (ED) 10 'Consolidated Financial Statements'.

The ASB supports and commends the International Accounting Standards Board (IASB) in the efforts it has made to respond quickly to the world financial crisis which has highlighted concerns regarding arrangements with structured entities. The ASB notes that perhaps some of improvements suggested in this response are a consequence of the speed with which the proposals have been developed.

The ASB also supports the aims outlined in ED 10 to improve the definition of control and ASB agrees with the IASB that a single principle of control that can be applied to all entities would be a conceptual improvement on the guidance provided by IAS 27 'Consolidated and Separate Financial Statements' and SIC-12 'Special Purpose Entities'. The ASB considers that to achieve this conceptual improvement clearly defining control and providing clear guidance on the application of the definition is a fundamental requirement. The ASB is of the view that ED 10 does not yet meet this fundamental requirement.

The ASB's detailed responses to the individual questions set out in ED 10 are attached in Appendix to this letter. The ASB's more serious concerns relate to:

- (a) the variability of returns; the ASB considers that variability of returns is in essence a risk and rewards principle whereby variability refers to the risk attached/associated with returns and that power is the ability to direct activities to manage the variability of returns. The ASB believes the standard should discuss risk and rewards;
- (b) the assumption that power can be always be determined; the ASB considers that in some circumstances it is not possible to determine power to direct activities. In these circumstances it is necessary to refer to risks and rewards(variability of returns);

- (c) the application guidance regarding agency relationships; the ASB is of the view that the principle to be applied in identifying agency relationships are not well articulated;
- (d) power without a majority of voting rights; whilst the ASB is in agreement with the IASB's view that a reporting entity that holds less than half of the voting right in another entity can control that other entity in some situations it considers that the guidance in the ED is not sufficient to ensure consistent application. In this regard the ASB supports the alternative views set out in paragraph AV6 and considers that it should be clarified that power refers to the right to exercise a dominant influence; and
- (e) the disclosure requirements; the ASB considers that the disclosure requirements proposed in the ED lack clarity and appear to be cumbersome. The ASB suggests the requirements are field-tested before being included in a final IFRS.

Should you have any queries regarding our response please contact me or Michelle Crisp, Project Director, on 020 7492 2432 or by email [m.crisp@frc-asb.org.uk](mailto:m.crisp@frc-asb.org.uk).

Yours faithfully



**Ian Mackintosh**

**Chairman**

DDI: 020 7492 2434

Email: [i.mackintosh@frc-asb.org.uk](mailto:i.mackintosh@frc-asb.org.uk)

## Draft ASB response to IASB ED 10

### Appendix One: Response to IASB Invitation to Comment on ED 10 'Consolidated Financial Statements'

#### Definition of control

##### 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?

#### *Response to Question 1 and 2*

In responding to questions 1 and 2 the ASB would like to set out its views regarding the current requirements and related guidance provided by IAS 27 'Consolidated and Separate Financial Statements' and SIC-12 'Special Purpose Entities' in relation to consolidated financial statements.

The ASB considers that the current guidance provided by IAS 27 and SIC-12 result in the appropriate entities being consolidated and hence correctly defines the boundaries of a reporting entity. Consequently, in the ASB's view, the ED should not result in the boundaries of the reporting entity being redefined and give rise to more/or less entities being consolidated. The ASB does, however, agree with the IASB that a single definition of control that can be applied to all entities would be a conceptual improvement to existing standards (since all guidance would be located within one standard and hopefully improve consistency of application). In seeking to achieve this conceptual improvement the ASB considers that clearly defining control and providing clear guidance on the application of the definition is fundamental to the project.

In view of the ASB's support for current standards it believes that the ED should aim to address areas where guidance is presently lacking, such as providing clearer guidance on entities to be consolidated where the reporting entity does not have a majority of the voting rights and improving disclosures relating to off balance sheet arrangements.

The ASB considers the proposed control definition could be applied to all entities, however, it does have some concerns regarding the guidance on how to apply the definition. Its concerns relate to some of the assumptions that underlie the control principle as articulated in the ED particularly the need for returns to be variable and that power can always be determined.

### *Variability of returns*

The ASB considers the requirement for returns to be variable is actually a requirement that returns have an element of risk associated with them. Although it is understood from discussions with IASB staff that the intention of the IASB is that returns should incorporate risks, the ED does not specifically state that returns must have risk associated with them. The ASB considers that guidance would be improved if the ED clearly explained how risk and returns are related to the control definition.

As noted in its response to the IASB Discussion Paper 'Preliminary Views on an Improved Conceptual Framework for Financial Reporting: The Reporting Entity' the ASB does not believe that the IASB should remove the notion of risk and rewards from the definition of control at this time. In its view the risk and rewards model continues to play a key role in providing answers in the more difficult cases for consolidation. In reviewing the proposals in the ED with its constituents it was noted that the removal of risks and rewards could give rise to less entities being consolidated. As already noted the ASB supports the current consolidation requirements and therefore does not consider that the proposals in the ED should result in fewer entities being consolidated. The ASB therefore retains its view that the IASB should not abandon the risk and reward model completely at this time.

The ASB also notes it is unable to locate in the ED whether it is the IASB's intention to draw-in the boundaries of a reporting entity, if this is the case, then it considers the IASB should discuss why it believes a narrower definition is appropriate.

### *Power can always be determined*

The ASB is concerned by the assumption in the ED that it is always possible to determine whether a reporting entity has power to direct activities. The ASB agrees with the IASB that identifying whether an entity has power to direct activities can be difficult. It does not, however, agree that power to direct activities can always be determined. The ASB considers that where it is not possible to determine whether an entity has power to direct activities it is necessary to revert to assessing how risks and returns are shared.

### *Power to direct activities*

In addition the ASB does not support the proposal in the ED that power should be determined by considering the activities that remain in the entity. In its view an entity could be structured such that only administration activities remain in the entity and such activities are not relevant for determining whether this is power to direct activities exists. In its view determining power to direct activities should require an assessment of whether powers can affect the variability of returns; the focus should be on strategic activities (which represent substantive powers).

## Assessing control

### 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?

### *Response to question 3*

The ASB is generally supportive of the approach taken in the ED to provide guidance on how to assess control. That said, as noted in its response to questions 1 and 2, the ASB has some concerns regarding the application of the control definition. In part some of these concerns relate to the guidance for assessing whether a reporting entity has control of another entity.

#### *Related Arrangements*

The ASB agrees with paragraph 17 of the draft IFRS that a reporting entity shall consider the terms and conditions of all arrangements with the entity when assessing control. The ASB, however, does not consider that the arrangements with an entity have to be related as prescribed in paragraph 18. The ASB suggests that paragraph 17 should clarify that when assessing control the aggregate affect of all arrangements is taken into consideration. The ASB considers that the guidance on multiple arrangements should be retained only to assess whether a reporting entity has lost control of another entity via a multiple arrangement.

#### *Assessing Returns*

Paragraphs 19 and 20 of the draft IFRS provide guidance on which returns a reporting entity takes into consideration when assessing control. The ASB agrees with the guidance that all returns from an entity should be assessed but notices that there is no link between these paragraphs and the definition of control; which requires returns to be variable. The ASB assumes a reporting entity is required to assess whether it has control of another entity only by reference to whether it has variable returns, if this is the situation then the text of the standard should clarify this matter.

The ASB also notes that the ED, whilst discussing returns, does not make a distinction between a reporting entity that has the greatest variability attached to the returns it receives or simply has the greatest absolute returns. The ASB suggests that it should be made clear whether a reporting entity controls another entity where it has the greatest variability (risk) of returns and therefore the power to control that variability or the entity that has the greatest absolute returns. The ASB considers that it is the entity with the greatest variability of returns that is more likely to have power to control.

#### *Assessing power to direct activities*

The ASB has set out below some of its concerns regarding the assessment of power to direct activities. The ASB acknowledges that many of these matters can be addressed in drafting.

The ASB first notes that the guidance for assessing power to direct activities is divided into two parts; power to direct activities by having voting rights or other arrangements and structured entities. Whilst the ASB acknowledges that assessing power for certain entities is difficult, it questions whether it is helpful to create a separate class of entities (structured entities). The ASB's views are discussed in more detail in its response to question 6.

In relation to entities controlled by voting rights or other arrangements the ASB notes that paragraphs 23 to 29 of the draft IFRS provide guidance on when a reporting entity *can* have power and when a reporting entity *has* power to direct activities. The ASB considers that these paragraphs are not particularly clear; for example paragraph 22 provides an entity *has* power to direct activities when it can determine strategic operating and financing policies. In contrast paragraph 23 provides a reporting entity *can* have the power to direct the activities of another entity if it controls the governing body that determines strategic operating and financing policies. It appears to the ASB that the IASB is attempting to identify circumstances that give rise to a reporting entity having power to direct activities of another entity through the determination of that entity's strategic operating and financing policies. Assuming the ASB is correct then it is suggested that the drafting of the standard should clearly identify the circumstances when an entity has power to direct activities of another entity through the determination of the entity's strategic operating and financing policies including:

- (i) appointment or removal of the members of the entity's governing body where that body determines the strategic operating and financing policies;
- (ii) where the entity has more than half of the voting rights which are used to appoint or remove members of the governing and that body determines the strategic operating and financing policies;
- (iii) where the entity has power to direct more voting rights than any other party and voting rights are sufficient to give the reporting entity the ability to determine the entity's strategic operating and financing policies;
- (iv) by other arrangements including agreements between the reporting entity and other vote holders; and
- (v) from its use of another party to act on its behalf (agents).

In relation to the assessment of power to direct activities without a majority of voting rights, the ASB supports the IASB in its attempts to address de-facto control and agrees that an entity can have the power to direct the activities of another entity without the majority of the voting rights.

In relation to the proposals in paragraph 27 of the draft IFRS the ASB notes, firstly, that a reporting entity might have more voting rights than any other entity and because the shareholding is widely dispersed may be able to determine the entity's strategic, operating and financing policies. The reporting entity, such as an investment fund, may however only have very small shareholdings such as 5-6 per

cent of the shares. The ASB questions whether consolidation in these circumstances provides useful information to users of financial statements.

The second concern of the ASB relates to reference in paragraph 27(b) that an entity needs only to have the *ability* to determine the entity's strategic operating and financing policies (i.e. the *ability* to direct activities). The ASB also notes that paragraph 8 of the ED provides that "a reporting entity need not have exercised its power to direct the activities of an entity to control that entity". It appears to the ASB therefore that the ED is based on the model that an entity has power to direct activities of another entity where it has the "*ability to direct activities*" rather than the "*demonstration of actual power to direct activities*".

The ASB is of the view that when using the term "ability to direct activities" the ED is actually referring to what the UK FRS 2 'Accounting for Subsidiary Undertakings' defines as 'dominant influence'. Dominant influence is defined in FRS 2 as an influence that can be exercised to achieve the operating and financial policies desired by the holder of the influencing, notwithstanding the rights or influence of any other party. In these circumstances an entity has a power that cannot be taken away by another party whereas 'ability to direct' is considered by the ASB to be a weaker notion and to which the ASB has some concerns with.

The ASB questions whether a reporting entity will always know when it has the "ability" to direct another entity - an entity may not know if it has more voting rights than any other party or whether its voting rights are sufficient to give the reporting entity the ability to direct activities without actual exercise of those powers. It may be for example the reporting entity can only make an assessment of its powers once it has demonstrated control by voting in an annual general meeting. Consequently the ASB questions the enforceability of the proposals in the ED.

The ASB also notes that some IASB members consider the proposals in the ED are not applied consistently. The ASB acknowledges that the IASB has attempted to address this concern in paragraphs BC47 to BC51 by noting that different fact patterns need to be taken into consideration when assessing power to direct activities. Whilst it acknowledges the comments made in these paragraphs the ASB has sympathy with the view in paragraph AV6 that there are inconsistent conclusions and that the IASB has not resolved whether the principle for consolidation is in fact being "in control" or having the "ability to control".

#### 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.

#### *Response to question 4*

The ASB supports the IASB in its attempts to provide guidance on the treatment of options and considers guidance is required in this area and is in agreement with the IASB that options and convertible instruments should be treated consistently in assessing power to direct activities without a majority of the voting rights.

The ASB notes that paragraph B13 provides that 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. The ED does not, however, identify where the power from the option or convertible instrument is derived from. It appears to the ASB, though its reading of paragraphs BC81 and BC82, that the IASB considers that the holding of options can (but not always) affect a reporting entity's power to direct the activities of another entity, consequently a reporting entity considers if options or convertible instruments it holds in an entity provide it with "additional powers" such that the reporting entity is able to direct the activities. It is noted in the basis for conclusions that the IASB did not consider options always provided power to direct activities and so chose to provide general guidance that a reporting entity assess whether options or convertible instruments can affect power, without establishing the reasons why options can affect the power to direct activities. The ASB considers that it is the "threat" that underlies the options that affects reporting entities' powers and that the IASB should discuss this matter in its basis for conclusions.

In relation to the guidance provided, the ASB considers that paragraph B13(a) requires some clarification. Paragraph B13(a) provides that a reporting entity that holds options or convertible instruments has power to direct the activities of another entity if the governing body of that entity determines strategic operating and financing policies *in accordance with the wishes* of the reporting entity. Paragraph 22 of the draft IFRS states, however, that a reporting entity has power to direct activities of another entity *if it can determine* that other entity's strategic operating and financing policies. It appears to the ASB there is a drafting inconsistency between these two paragraphs and that paragraph B13(a) should read that where a reporting entity considers all facts and circumstances including powers from the holding of options it has power to direct activities if it can determine the other entity's strategic operating and financing policies.

The ASB is also concerned that further application guidance regarding the treatment of options or convertible instruments is contained in paragraph BC85 and BC86. In BC85 it is noted that in the Board's (IASB) view a reporting entity that is required to transfer little or no consideration to exercise an option over shares is likely to have

control of the entity. In addition BC86 provides that options at fair value fail the second part of the control test. The ASB has two concerns with these paragraphs:

- (a) In the ASB's view the basis for conclusions should set out the IASB's reasoning to the proposals in the draft IFRS and not include guidance on the proposals in the draft IFRS. The ASB therefore recommends that this material is removed from the basis for conclusions and included in the application guidance; and
- (b) The ASB is not convinced that BC85 and BC86 are consistent with B13. The ASB interpreted the principle in paragraph B13 to be 'considered if the holding of options and convertible instruments provides power to direct activities', however, paragraphs BC85 and BC86 appear to be refining this principle to 'consider only if options and convertible instruments not a fair value provide power to direct activities'. The ASB considers that the IASB should clarify what the principle is - in its view the principle should not be restricted to considering only options not at fair value.

### **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.

### **Response to question 5**

In relation to the guidance on agency arrangements the ASB considers the guidance is an improvement to existing material. It is, however, concerned that the principles are not well articulated in the ED.

The application guidance provides information as to the role of agents (paragraph B3). This guidance discusses removal rights and remuneration of an agent. The ASB assumes that the purpose of the guidance is to assist in identifying agency relationships; however, this is not explicitly stated.

Further the ASB has been unable to identify within the guidance the principle to be applied in identifying whether a party is acting as an agent. It appears that paragraphs BC89 and BC90 set out the IASB's conclusions in relation to identifying when a reporting entity has power to direct activities through the use of an agent. It is recommended that the text included in BC89 and BC90 should be developed into a principle identifying when a reporting entity has power to direct activities via the use of an agent; for example (using the material in BC90) a principle might be:

A reporting entity has power to direct activities through the use of an agent where it controls the agent via an agreement or ongoing relationship where the agent must act in accordance with and where the reporting entity can exercise its powers to direct the activities by removing the agent.

The principle should then be included in the standard itself or, if not, in the application guidance. The existing material could then be used to provide guidance on applying the principle. This includes:

- the terms and conditions that govern the relationship;
- the terms and conditions of appointment and the right to replace or remove the agent; and
- how the agent is remunerated including whether the remuneration is in accordance with the level of services performed.

We agree with paragraph BC91 that in some cases the relationship between principal and agent is blurred. We note that paragraph BC95 provides:

Because the reporting entity has the power sufficient to direct the entity's activities, the Board decided to place the onus on the reporting entity to demonstrate that it does not use the power it has as an agent for its own benefit, rather than the opposite.

This conclusion is included in the application guidance at paragraph B11 which provides a 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 interest of those other parties or has implemented policies and procedures that ensure the independence of decision making. We understand that paragraph B11 therefore requires an agent to rebut the presumption that it uses the powers it holds as an agent for its own benefit. We are in agreement with the rebuttable presumption.

Finally, the ASB notes that in November 2008 the IASB issued an 'Exposure Draft of Improvements to IFRS' which proposes to insert in IAS 18 'Revenue' guidance on determining whether an entity is acting as principal or agent. The proposal in the ED uses a risk and rewards approach to determine agency relationships. The ASB considers that any changes introduced to IAS 18 through the annual improvements process should ultimately be consistent with any new IFRS on consolidation.

## Structured entities

### 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?

### *Response to question 6*

In relation to the definition of a structured entity the ASB appreciates that the IASB's aim is to ensure that the proposals in the ED permit application of the principle of control as articulated in the ED to all types of entities. It appears that this aim has given rise to the usual situation whereby the definition of a structured entity in the ED does not identify the attributes of a structured entity but provides that a structured entity is everything not already addressed in the standard.

The ASB questions if defining a structured entity is useful. Although it agrees that application of the control principle is more difficult to apply to some entities it is not sure that attempting to define such entities assists in the application of the principle. In the ASB's view it should be possible to provide guidance on the application of the principle to all entities, without the need to define structured entities separately.

### 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?

### *Response to question 7*

The ASB notes that it has already highlighted its concerns regarding the power to direct activities in response to question 1 and 2, which are also applicable in responding to question 7.

In considering the guidance for the assessment of whether a reporting entity controls a structured entity, paragraph 34 of the draft IFRS proposes that a reporting entity identifies how returns from the entity's activities are shared and how decisions, if any, are made about the activities that affect those returns. The ASB is concerned that it is not clear from the ED what decisions are being referred to in this paragraph. The earlier text in the ED refers to power to direct activities that determine an entity's strategic operating and financing policies (although it is noted that the application guidance also refers to protective powers) whereas paragraph 31 (and again in paragraph 35) seem to be referring to "day-to-day operating powers" rather than the ability to direct strategic operating and financing activities. The ASB is of the view that the powers that should be considered are those strategic powers (substantive powers) that can affect returns. In the example in paragraph 35 the ASB does not consider the party with the power to manage how any defaulting receivables are recovered is necessarily the party which has the strategic power; arguably in such an arrangement it is the party that decided which receivables to acquire and assessed the credit rating that has the strategic powers. Consequently

the ASB considers a better analysis of which powers are being referred to is required in the ED and that power should only be assessed in relation to power to direct activities that have an ability to affect returns – strategic powers and not day-to-day operating powers – should be used in the determination of control.

The ASB considers that paragraphs 31 to 38 might in practice be applied as a set of rules rather than guidance on application of the control principle to structured entities. This is because paragraph 31 provides a list for the entity to consider without stating what the objective of the list is. Should this be the situation then the ASB is concerned that attempts will be made to design structured entities around these rules.

In its view the standard should contain a high level description of how the principle of control should be applied to all entities. The material in paragraphs 31 to 38 should be included in the application guidance rather than the standard. The ASB considers that restricting the material in the standard to interpretation of the control principle will result in a more principle-based standard which presents less structuring opportunities.

The ASB considers that paragraph BC121 attempts to provides an interpretation of how the IASB considers the control principle should be applied to structured entities. Paragraph BC121 states:

If a reporting entity has no means of directing or managing the activities, or assets and liabilities, of an entity, it does not have any ability to affect its returns from its involvement with that entity. In that situation, the reporting entity does not have the power to direct the activities and would not control the entity, even though it might be exposed to risks associated with the structured entity.

Assumptions that underlie the ED imply that power and returns are correlated and that a real autopilot does not exist because power must always exist where there are returns. The ASB is confused as to why the IASB considers an entity would expose itself to risk from a structured entity that it does not have the power to control – unless the risks and corresponding returns are insignificant. This statement, therefore, appears to conflict with the assumption in the ED that power and returns are correlated.

**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.

***Response to question 8***

The ASB has set out its response to question eight in its response to question one. In summary it considers that the control principle should incorporate risks and rewards. The ASB considers that variability of returns is in essence a risk and rewards principle whereby variability refers to the risk attached/associated with returns and that power is the ability to direct activities to manage the variability of returns.

The ASB does not consider the principle requires quantification of amounts of returns as it is an enhancement of the proposed control principle in the ED and specifically the correlation between risk and reward. As a consequence it considers that the level of variability of returns to form the basis of the test for control should be whether a reporting entity has the majority of the returns from the entity.

In relation to the ASB's earlier concerns regarding the definition of control and whether it should incorporate a risks and rewards notion as part of variability of returns it considers a definition of control that incorporates risks and rewards is more suitable when assessing control of structured entities. In this regard the ASB notes the alternative view of Mr Smith that an entity that clearly and obviously has the majority of the risks and rewards of a structured entity can easily avoid consolidation by circumventing the power criterion.

*Disclosure*

**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.

*Response to question 9*

The ASB acknowledges that it has proposed in response to question 6 that it should be possible to develop a control principle to be applied to all entities without the need to define structured entities and that this proposal has consequential effects on the ED's proposed disclosure requirements. The ASB notes, however, that disclosure objective attempts to capture information about a reporting entity's exposure to risk associated with that entity's involvement with the structured entities. The ASB considers that this problem could be addressed by requiring information about an entity's involvement with an entity that has restricted activities and is not controlled by voting rights.

The ASB agrees with the IASB that the global financial crisis has highlighted a need for better disclosure about the nature of, and risks associated with, a reporting entity's involvement with structured entities that the reporting entity does not control. Whilst it is important that financial statements provide disclosures regarding risks that may not be reflected in the financial statements the ASB considers that the emphasis should remain on ensuring that the standard is sufficiently robust that financial statements correctly recognise the boundaries of a reporting entity and that it does not permit structuring opportunities.

In relation to the disclosures proposed in the ED, the ASB agrees with paragraph B31 that a reporting entity decides how much detail to provide. Paragraph B30, however, states an entity "must" disclose the information in paragraph B32-B49. In its view these two paragraphs are inconsistent – and it should be made clear whether the application guidance is 'compulsory' or 'recommending' disclosures.

Further it is not clear in the application guidance whether the proposed disclosures are compulsory or not (for example paragraph B33 says such information might include). We consider that the guidance should be redrafted to provide clarity as to minimum disclosure requirements which can be supplemented should an entity consider it necessary and compulsory disclosure. We also note that the disclosure objective in paragraph 48(d) of the draft IFRS is expanded on in paragraph B38, in our view it would reduce complexity if all of the disclosure objectives were included in the standard itself.

In relation to paragraphs B38 to B47 the ASB considers that the proposals in the ED could be made clearer if they were to explicitly refer to the need to improve disclosures regarding off balance sheet activities. In its view some of the requirements, specifically those in paragraphs B40 to B47 are very detailed and could be simplified, especially if the recommendations in paragraph B31 were emphasised.

In conclusion the ASB considers that the drafting of the disclosure requirements needs to be reconsiders to; (i) relocate the disclosure objectives in one place; (ii) identify the compulsory and recommended disclosures and (iii) simplify requirements.

**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.

***Response to question 10***

In relation to the availability of information we consider that some of the disclosures that are being proposed will require alternations to be made to existing reporting systems. We consider that this will need to be addressed as part of the transition provisions.

*Other matters*  
**Reputational risk**

**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?

*Response to question 11*

The ASB is in agreement that reputational risk alone is not an appropriate basis for consolidation.

In relation to part (b) of this question the ASB is generally content with the disclosures in paragraph B47 but does not consider that providing support necessarily always results in the reporting entity controlling the structured entity. The ASB considers that there may be circumstances where an entity provides support but there is not a change in its powers and therefore the control definition is not met.

**Accounting for associates and the equity method**

**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?

*Response to question 12*

The ASB considers that the IASB should follow its normal due process in identifying whether to undertake a separate project regarding IAS 28.

The ASB accepts there are arguments both for and against adding an additional project to the Board's active agenda. The ASB accepts that at present the Board is addressing (in various projects) the boundaries of a reporting entity and therefore reconsideration of the principles associated with equity accounting might be timely. The ASB also believes that permitting projects to run simultaneously may have the advantage that each project may seek to inform the other and that projects might overall develop at a faster pace. The ASB considers, however, that the conceptual framework project must ultimately provide the overriding principles. To this end the ASB would prefer resources be directed at completion of the conceptual framework project.

In relation to the resources available to the IASB it is noted that the Board is under pressure to respond to the current financial crisis and that this may not therefore be an appropriate time to divert resources to a new project that is not considered to be an urgent issue. On balance therefore the ASB considers that the IASB should not undertake such a project at this time.

**Appendix Two: Other matters in relation to ED 10**

We are concerned that the guidance on assessment of the power to direct activities does not clearly explain what 'other arrangements' in paragraph 21 refer to. Although a reference is made to paragraphs 23-29 these paragraphs do not refer to other arrangements that provide an entity with power to direct activities; these paragraphs refer to other circumstances in which an entity may have power to direct (or in the case of paragraph 25 where there is no power to direct activities). We note, however, that paragraphs B14 to B16 of the application guidance provide clarification on other arrangements. In our view the standard would be improved if it was referenced to these paragraphs.