



24 March 2009

Mr. Stig Enevoldsen
Chairman
Technical Expert Group
EFRAG
Square de Meeûs 35B-1000 BRUXELLES

E-mail: commentletter@efrag.org

Ref.: ACC/MB/SS/LF/SH

[Final draft 2]

Dear Mr. Enevoldsen,

Re.: FEE Comments on EFRAG's Draft Comment Letter on IASB Exposure Draft ED 10 Consolidated Financial Statements

- (1) FEE (the Federation of European Accountants) is pleased to provide you below with its comments on the EFRAG Draft Comment Letter on the IASB Exposure Draft ED 10 *Consolidated Financial Statements* (the "ED").
- (2) In general:
 - We support the objectives of the ED in principle. In particular, like EFRAG we support the objectives of issuing a single standard for consolidation and improving disclosures.
 - We also believe that the Board is choosing the right direction by incorporating the risks and rewards notion within a control model and we are in agreement in this respect with the EFRAG draft comment letter.
 - We acknowledge that some of the aspects of existing IFRS that are causing uncertainty currently (for example "de facto control") are clarified in the proposals of the ED. We welcome the discussion of options, contractual arrangements and agents.
 - However we have to point out areas where the model needs to be refined as we share EFRAG's view that there is currently a number of concerns about the clarity, the consistency and the appropriateness of the ED's material in major areas such as definition of control: absolute power versus current ability, treatments of options, agency relationship, reporting entities with dual role and we would suggest to add a definition of protective rights. In the area of structured entities the control principle as articulated in the draft IFRS may not lead to consistent application.



- We are not convinced that the proposals have been properly worked through so that they can be interpreted in a coherent manner. If the ED was published as a standard in its current form, we strongly think that problems of interpretation will be arising. According to these reservations, we are unsure at present that the new model proposed in the ED will be an improvement of the existing IFRS and that it will meet the concerns expressed by the Financial Stability Forum that certain structured entities are inappropriately non-consolidated and left off-balance sheet. In our view, the approach on consolidation should be reconsidered. If the project on consolidation is a matter of priority, we advise to focus on disclosures.
 - Like EFRAG we are broadly in agreement with the general direction of the new disclosures proposed, although we are concerned about the volume and level of details of information required. The disclosures are not sufficiently focused on significant and relevant matters. In some cases, obtaining the required level of information to meet the disclosure requirements may be difficult in practice.
- (3) The core principle proposed in the ED indicates *how* consolidated financial statements should be prepared (i.e. by grouping entities that are under the control of the parent) rather than the more fundamental issue of *why* consolidated financial statements should be prepared.
- (4) Accordingly, we believe that further work is needed which may be difficult to achieve in a very short time frame and we would therefore suggest, like EFRAG, that the Board may wish to decide to separate the project into:
- Issuing in the short term the part dealing with enhanced disclosures;
 - Taking time to solve certain aspects and perform appropriate field-testing in order to ascertain that all concerns expressed have been addressed and in particular that off-balance sheet structures which appear to have been inappropriately left non-consolidated will now be fully integrated in the financial statements. This two step approach would also permit to issue a jointly agreed project with the FASB on this major topic and to better link this new approach with other major projects such as derecognition of financial assets and jointly controlled entities (ED9) and associates.
- (5) In addition, one example of issues that we believe should be considered by the IASB as part of the second part of the consolidation project is the establishment of combined financial statements under IFRS. We note that ED 10 on Consolidated Financial Statements is not addressing this issue. We encourage EFRAG to include this consideration in its letter to the IASB too.

Our responses to the questions in the Invitation to comment of the ED are included as an Appendix to this letter.

For further information on this letter, please contact Ms. Saskia Slomp from the FEE Secretariat.



Yours sincerely,

Hans van Damme
President



Comments on Appendix 1, 2 and 3 of the EFRAG draft comment letter including the Responses to the questions in the Invitation to comment of the IASB Exposure Draft ED 10 Consolidated Financial Statements

Comments on the EFRAG draft comment letter – Appendix 1

- (6) Before addressing the appropriateness of the control definition, we believe one should consider the objectives of consolidated financial statements, which have not been addressed neither in the reporting entity phase D of the framework nor in this ED. The core principle proposed in the ED indicates *how* consolidated financial statements should be prepared (i.e. by grouping entities that are under the control of the parent) rather than the more fundamental issue of *why* consolidated financial statements should be prepared. We agree with EFRAG that the decision-usefulness of the consolidated information needs to be considered and determine the consolidation principles on this basis.
- (7) At the Framework level, the Board has retained a control approach and rejected a “risks and rewards approach” and seems now to be forced to introduce the risks and rewards notion in the proposed model at least in order to deal with structured entities. The Board further seems to have to propose a fall back test in order to be sure that the proposed principles would appropriately capture all off-balance sheet structures which would need to be consolidated.
- (8) We believe that the Board is choosing the right direction by incorporating the risks and rewards notion within a control model; we agree with EFRAG that the aim of achieving an appropriate mix of some of the aspects of the control based model and risks and rewards model into a new approach is a good objective. However, the ED does not explain in a clear manner how the proposed approach could work in practice. In the case of regulated entities for example, the balance between a control model and risks and rewards model is not clear. It would be helpful including an example to illustrate the application of the proposed approach in a regulated entity.
- (9) We agree with paragraphs A1.7 and following of the draft EFRAG letter that in order to answer whether the proposed principle is the “right” one, it is necessary to consider first the information needs of users and how best to meet those needs.
- (10) Moreover, we question whether the definition of control is sufficiently robust to determine the boundaries of a group reporting entity.
- (11) Most of the other FEE comments on Appendix 1 of EFRAG’s draft comment letter are addressed in the comments included in the covering letter and the appendix to this letter.



Comments on Appendix 1, 2 and 3 of the EFRAG draft comment letter including the Responses to the questions in the Invitation to comment of the IASB Exposure Draft ED 10 Consolidated Financial Statements

- (12) As a drafting comment, we encourage EFRAG to restructure its letter in order to make it more user-friendly and easier to read. For instance, Appendix 1 of EFRAG's letter might not be needed if some of the fundamental concerns raised here are incorporated either in their covering letter or in the responses to the Questions in Appendix 2. This might also help better understand the reasoning in the responses to the invitation to comment.

Comments on the EFRAG draft comment letter – Appendix 2

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?

- (13) We agree with EFRAG that a key objective of the consolidation project is the development of a single universally-applied principle.
- (14) We agree with EFRAG that the consolidation principle proposed in the ED could result in certain entities (which would currently fall within the scope of SIC 12 and be consolidated) not being consolidated under this ED.
- (15) However, at present, the ED does not sufficiently expand on the “returns” assessment and on the link between the power/control notion and the returns. At present, the ED expands on the notion of returns principally in relation to “structured entities” and this may lead some to believe that this notion is relevant only to structured entities and that the Board has developed a model specific to structured entities. In order to rectify the situation, one of the key aspects of the definition of control that needs to be improved is the articulation of the manner in which risks and rewards are integral to control, in particular the interaction between the “power to direct the activities” of an entity and “exposure to risks and rewards” of that entity as the two elements that yield control. We suggest to EFRAG to raise this point as well in their comment letter.

Comments on Appendix 1, 2 and 3 of the EFRAG draft comment letter including the Responses to the questions in the Invitation to comment of the IASB Exposure Draft ED 10 Consolidated Financial Statements

- (16) In some entities, such as the “traditional” operating entities, control can readily be established by determining who directs the activities of the entity. In other entities, exposure to risks and rewards provides an unambiguous indication of the party that controls the entity. This would be the case, for example, for entities established by the reporting entity clearly for its own benefit.
- (17) However, between these two ends of the spectrum there exists a variety of entities for which the identification of the controlling party is not clear because indicators of control may point in different directions. This would be the case, for example, when several parties participate in the establishment of an entity, each with its own objectives and specific exposures to risks and rewards. In order to ensure appropriate and consistent consolidation of these “intermediate” entities, it is necessary that the future standard properly establishes the relationship between the “power to direct” and “exposure to rights and rewards” and the balance between these two elements that may sometimes appear to contradict each other.
- (18) ED 10.35 tries to illustrate power to direct the activities with an example where managing defaulting receivables is the only activity that causes the returns to vary. We believe that in this case the power to direct how any defaulting receivables are managed is not crucial for the assessment of control. Relevant facts are mainly the purpose and design of the structured entity (ED 10.31(a)) and in whose interest the structure has been set up, the extent to which the strategic operating and financing policies have been predetermined (ED 10.31(c)) and who has the ability to change the restrictions or predetermined strategic operating and financing policies (ED 10.31(e)). Therefore ED 10.35 should be deleted and replaced by a more convincing example (see also ED 10.BC48(d) and ED 10.BC51).

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?



Comments on Appendix 1, 2 and 3 of the EFRAG draft comment letter including the Responses to the questions in the Invitation to comment of the IASB Exposure Draft ED 10 Consolidated Financial Statements

- (19) Generally, the proposed control definition could be applied but we are not sure like EFRAG that it will lead to more coherence than the current definition. The current definition of control appears to be working satisfactorily, also in the circumstances of the financial crisis, and resulted in consistent application by various preparers and auditors; in our opinion there are no serious inconsistencies with the current definition and application of IAS 27 and SIC 12. There is no evidence that we are aware of that companies are left off balance sheet under the existing requirements. Field testing and further analysis of user needs may be needed to ensure that the future standard will not result in unintended recognition or derecognition of assets and liabilities. The ED needs to better demonstrate why the resulting standard as a whole would be more useful to users.
- (20) We agree with EFRAG that:
- There is some confusion in the current draft between “the power to direct” and “the power to determine the strategic operating and financing policies” and;
 - There is some confusion as to whether it is “a power to direct” or “an ability to direct” that needs to exist.

Relationship between the power to direct and the power to determine the strategic operating and financing policies of an entity

- (21) We agree with EFRAG that the ED is not clear as to whether the power to determine the strategic operating and financing policies is sufficient to give an entity control of a second entity. Indeed the current drafting of the ED appears to indicate that having the power to determine that another entity’s strategic operating and financing policies might, but might not result in having the power to direct the activities of that other entity.
- (22) If there is a difference between the “power to direct” and the “power to determine the strategic operating and financing policies of an entity”, the Board should make it clearer that there is a difference and explain why.

Comments on Appendix 1, 2 and 3 of the EFRAG draft comment letter including the Responses to the questions in the Invitation to comment of the IASB Exposure Draft ED 10 Consolidated Financial Statements

- (23) There is a need for a clear principle of what is meant by protective rights. The ED offers some examples but there is no clear underlying principle. In our view, this could be a real question in practice. Additional guidance is therefore required with respect to protective and participating rights. First of all, we note that the definition provided in Appendix A of protective rights (defined as “rights [...] that do not give the party control of the entity, nor do they prevent another party from controlling that entity”) is circular. This definition indicates simply that a protective right is not a participating right, while a participating right is not defined in the ED. Given the absence of guidance on what is a participating right, it is difficult to understand when a right goes beyond being protective and is instead participating in substance. Further, we find the wording in paragraph B2(a) ambiguous: it indicates that protective rights protect one party by prohibiting the controlling party from making fundamental changes to the activities of an entity. The ED should explain or illustrate what constitutes a fundamental change. We would like to suggest to EFRAG that they add this comment in their letter.

‘Power to direct’ versus ‘ability to direct’

- (24) **Meaning of directing the activities:** In order to ensure that the concept of “directing the activities of an entity” is appropriately interpreted in practice, the Board should clarify the difference, if any, between directing the activities of an entity and determining an entity’s strategic operating and financing policies and explain how one may exist without the other. We agree with the developments in paragraphs A2.11 to A2.14 of the draft EFRAG letter.
- (25) In addition, paragraph 22 indicates that “a reporting entity has the power to direct the activities of another entity if it can determine the other entity’s strategic operating and financing policies.” Paragraph BC44 confirms that paragraph 22 should be read as indicating that determining the strategic operating and financing policies of an entity is one means of having the power to direct the activities of another entity, but that it is not necessarily the only means by which this power may be obtained. As an example, paragraph BC44 indicates that the power to direct the activities of an entity may also be obtained through contractual arrangements. However, this paragraph does not specify which rights (other than the right to determine the other entity’s strategic operating and financing policies) would need to exist under the contractual arrangement in order for the reporting entity to have the power to direct the activities of the entity.
- (26) Although we welcome having a principles based control definition, we are not sure that the underlying principles are properly explained so that they will lead to a consistent application of these principles. The “power to direct” may not necessarily be the “ability to change the strategic operating and financing policies”.



Comments on Appendix 1, 2 and 3 of the EFRAG draft comment letter including the Responses to the questions in the Invitation to comment of the IASB Exposure Draft ED 10 Consolidated Financial Statements

- (27) Concerning de facto control, BC 48 and BC 49 justify the proposed conclusion that a reporting entity has power to direct the activities of another entity when it holds less than the majority of the voting rights in that entity (and as long as the other shareholders choose not to organise themselves to prevent the reporting entity from directing the activities) because it directs the activities and other parties cannot take that power away without further action. There is however no clear definition if this means that there is “absolute” control. Further examples would be helpful.
- (28) Concerning the Power to control vs. current exercise of power, we share the concerns expressed by the EFRAG draft response (paragraphs A2.11 and following) that according to the application guidance and other material in the ED, the power criteria are not consistently assessed. Examples of situations with dominant shareholders and passive holdings in determining the current exercise of power would be helpful.
- (29) In principle, we agree that elements other than voting rights should be considered to conclude on whether an entity directs another entity. However, in practice we do not necessarily believe that a reporting entity holding less than the majority of the voting rights in an entity directs the activities of that entity simply on the basis that other parties cannot take that power away without further action. In practice, other shareholders can always take that power away through the normal process of annual general meetings of shareholders, so it would be inappropriate to anticipate that this power cannot be taken away; in our view the normal process of annual general meetings does not fall in the category of “further action”. In our view, there is some confusion between the power and ability to control; we think that additional guidance is needed to clarify this. While an unorganized dispersed shareholding may permit a dominant shareholder to take decisions over the activities of an entity, we do not believe, in the absence of other facts and circumstances, that this should be equated to control by the dominant shareholder. We are concerned that, unless the position of the Board is more clearly expressed, the resulting standard will be difficult to interpret.

Comments on Appendix 1, 2 and 3 of the EFRAG draft comment letter including the Responses to the questions in the Invitation to comment of the IASB Exposure Draft ED 10 Consolidated Financial Statements

- (30) In addition, relying on the assumption that unless further action is taken, a reporting entity holding less than the majority of the voting rights in an entity directs the activities of that entity, could result in year on year inconsistencies if one year further action is taken and another year not. This would not be practicable and would not provide useful information. We are not sure whether the guidance provided in the ED is intended to mean that a reporting entity with less of the majority of the voting rights in an entity has power to direct the activities of that entity until the other shareholders are organised to prevent the reporting entity from directing the activities. It would be helpful to clarify this further.
- (31) We also believe that the condition in paragraph B2(a)(ii) should be clarified in order that to avoid unintended consequences for entities that are regulated by the state (for example, in certain jurisdictions, entities in the utilities industry are subject to strict governmental regulations) and in which the state holds a non-controlling interest. Often, the investment capacities of these entities are extremely supervised and their returns are predetermined. When paragraph B2 is considered along with paragraph 25 in the context of a regulated entity, does this mean that regulated entities will no longer be consolidated nor does it mean that such entities would necessarily be considered structured entities?
- (32) Application guidance: Like EFRAG (paragraph 12.25) we are concerned that significant guidance is included in the BC (for example, BC 80 to BC 86 or BC 89 and BC 90 on agent relationship) and we strongly encourage the Board to revisit the structure of the document to ensure that all relevant guidance is included in the standard and not in the BC. The break down between the standard and the related guidance needs to be revised. As an illustration, the more detailed definition provided in BC106 is helpful and we suggest including it in paragraph 30 of the draft IFRS.

Other matters

- (33) In some areas, for example the discussion of options, contractual arrangements and agents, the control principle appears to have improved in the sense that these situations are explicitly covered. However, as already noted in the area of structured entities the control principle as articulated in the draft IFRS will not lead to consistent application.

Comments on Appendix 1, 2 and 3 of the EFRAG draft comment letter including the Responses to the questions in the Invitation to comment of the IASB Exposure Draft ED 10 Consolidated Financial Statements

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.

- (34) We agree with EFRAG (paragraph A2.21) that the situation in which a reporting entity holding options and /or convertible instruments (that would allow it to obtain the majority of voting rights of another entity if exercised) has not currently the power to direct the activities of that second entity should not consolidate that second entity is relatively straightforward.
- (35) However, we believe that in other situations, the Board's proposals regarding options and convertible instruments suffer some lack of clarity in relation to the definition of control and seem to be inconsistent with the existence of actual power or ability to direct the activities of an entity. This is in particular the case in the situation described by EFRAG in paragraph A2.21(b). We are of the opinion that determining whether the option holder has control over the entity should be based on the situation that exists currently (i.e. giving recognition to the fact that the options are not yet exercised). Accordingly, holding options would yield control only if they currently provide the holder with an effective means of imposing its wishes over the manner in which the activities of the entity are directed and that this ability can be demonstrated. In particular, the Board should clarify whether paragraph BC81 would apply only in situations where the power is derived from a contractual agreement or whether it would also apply where a practice exists and how that situation should be demonstrated.
- (36) We would also encourage the Board to explain the difference if any between a passive shareholder and the holder of currently exercisable options. It seems that both parties could readily impose their decisions over the activities of the entity if, and when, they wish do to so.
- (37) In our view the guidance provided is helpful but we would welcome more guidance to ensure consistent application in particular by providing additional examples. Like pointed out by EFRAG, we agree that it is not clear if a reporting entity holds options and/or convertible instruments to obtain voting rights in a second entity, whether the mere fact that it has those options and/or convertible instruments means it has a power to direct the activities of a second entity that it would not have had had it not have had the options and/or convertible instruments. We agree with EFRAG that paragraph 13 gives rise to further questions more than what it clarifies.



Comments on Appendix 1, 2 and 3 of the EFRAG draft comment letter including the Responses to the questions in the Invitation to comment of the IASB Exposure Draft ED 10 Consolidated Financial Statements

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.

Removal rights and remuneration of an agent

(38) BC3 of the application guidance indicates that the agent must use any decision-making ability delegated to it to generate returns primarily for the principal. It is not clear what primarily means and this needs to be clarified. The guidance provided for situations in which a party holds voting rights both directly and on behalf of other parties as an agent is very helpful though.

Identifying whether a party is acting as an agent

(39) BC 57 explains that the proportion of voting rights needed to direct the activities of another entity and the proportion of returns available to an entity with power might vary depending on the circumstances. There is a need for a clearer principle to ensure consistent application; "depending on the circumstances" is too vague and will lead to a significant degree of interpretation.



Comments on Appendix 1, 2 and 3 of the EFRAG draft comment letter including the Responses to the questions in the Invitation to comment of the IASB Exposure Draft ED 10 Consolidated Financial Statements

Reporting entities with dual roles

- (40) Paragraph B95 appears to create a rebuttable presumption that an agent in a dual role would act in its own best interest. Would it be sufficient for the agent to hold a contractual agreement that stipulates that it must act in the best interest of other parties or would there also be a need to show other evidence to that effect? If so, what is the nature of this other evidence? We believe that this rebuttable presumption will hardly work in practice and we agree with EFRAG (paragraphs A2.31 to A2.34) that this presumption should be removed from the standard.
- (41) Where an entity has an investment in a limited mandate fund and at the same time acts as the fund manager, would the assessment of whether the entity controls the fund be different than the assessment required for agents acting in a dual role? What would be the impact of the percentage of interest held by the entity in the fund?
- (42) What parameters should be used to assess whether fees are representative of the fair value of the services rendered? We believe that in practice it will often be difficult to assert whether or not fees are reflective of the market. Also, what weight should be given to the various indicators provided in paragraph B6 when only some of the factors are present?
- (43) We principally agree with the Board's proposal. However, it should be clarified that although an agent does not have control because he is acting on behalf of the principal a parent of a subgroup is still treated as controlling its subsidiaries so that consolidated financial statements of the parent of a subgroup are still in accordance with IFRS. In our opinion, the examples in ED 10.B12 about parties that act on behalf of a reporting entity are not appropriate. We therefore suggest to delete ED 10.B12.



Comments on Appendix 1, 2 and 3 of the EFRAG draft comment letter including the Responses to the questions in the Invitation to comment of the IASB Exposure Draft ED 10 Consolidated Financial Statements

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?

- (44) We understand the definition of a structured entity is included in the draft IFRS to identify, in paragraph 30, the entities for which specific guidance is necessary to better assess control and determine the scope to which additional disclosures are required.
- (45) We agree with EFRAG that the definition of structured entity should be aimed only at responding to the disclosures need and that the proposed model should be robust enough to apply to all form of entities. In particular, if the role of “risks and rewards within the control model was better articulated, it would not be necessary to differentiate between entities in applying the consolidation model.
- (46) If the definition were considered as being needed for consolidation purposes, we would suggest reviewing this definition in order to bring more clarity in it and clearly identify what are the attributes of a structured entity. Currently, a structured entity is more defined by what it is not rather than by what it is.
- (47) We believe that the negative definition of “structured entities“ in ED 10.30 and ED 10. Appendix A (“an entity whose activities are not directed as described in paragraphs 23–29”) is not helpful. Although we agree that it might be difficult to identify attributes that distinguish structured entities from all other entities (ED 10.BC106) the term should be defined in a positive way. We would suggest that the ED defines structured entities using on the basis of the criteria for special purpose entities in SIC-12. However, it should be clarified that structured entities not only refer to “autopilot” mechanisms.

Comments on Appendix 1, 2 and 3 of the EFRAG draft comment letter including the Responses to the questions in the Invitation to comment of the IASB Exposure Draft ED 10 Consolidated Financial Statements

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?

- (48) We agree with EFRAG (paragraph A2.41 of the draft response) that in the absence of a robust definition of control, the guidance set out in paragraphs 31 to 38 might in practice be applied as a set of rules rather than guidance on application of a principle that the assessment of risks and rewards is needed to determine power to direct the activities. This is illustrative of the concerns previously expressed that guidance on how to assess the link between power and risks and rewards is missing and consequently it becomes very difficult to determine whether a structured entity should or should not be consolidated.
- (49) Furthermore, we believe that clarification is required with respect to the guidance in these paragraphs and the related guidance in other sections of the ED.
- (50) Paragraph 33 is ambiguous. It states “a reporting entity is likely to have power to direct the activities of a structured entity if it is exposed to the variability of returns that are potentially significant to the structured entity and the reporting entity’s exposure is more than that of any other party”. We question whether this establishes a presumption that exposure to the majority of returns automatically means that the reporting entity controls the structured entity. If this is the case, this paragraph would then appear in contradiction with paragraph BC56 which states that “the right to receive return is not a sufficient condition to control” and paragraph BC121 which 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 and would not control the entity even though it might be exposed to risks associated with the structured entity”. We suggest that paragraph 33 should be further explained (in the main body of the Standard) to remove this apparent contradiction.

Comments on Appendix 1, 2 and 3 of the EFRAG draft comment letter including the Responses to the questions in the Invitation to comment of the IASB Exposure Draft ED 10 Consolidated Financial Statements

- (51) Paragraph 36 states that “predetermined policies can give a reporting entity control” but it fails to clarify how and when control is obtained through predetermined policies. In particular, the paragraph should establish a link between the predetermination of the policies and the on-going entitlement to returns from the entity by the party who established these policies. If we take the example of X which has determined the policies of a structured entity and at the same time holds the notes issued by that structured entity. X can be said to have the power to direct the activities. But what if X later sells the notes to Y? Does Y have control or not? Some clarification would be needed in the cases where a party that has preset the activities retains only a portion of its initial interest and another party becomes exposed to greater variability in returns.
- (52) We share the concern expressed by EFRAG (paragraph A2.42 of the draft response) that the IASB should clarify how control should be applied to structured entities in particular in the light of the statement contained in BC 121 where a reporting entity would not have the power to direct the activities of the structured entity and would not control it, even though it might be exposed to risks associated with that structured entity. We agree that this adds confusion and provides further evidence that field testing of the proposals would need to be undertaken, as mentioned earlier.

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.

- (53) We do not believe that the Standard should include a risks and rewards fall back test. As previously indicated in this letter, we believe that risks and rewards are integral to the control model. Incorporating a separate fall back test would move away from consolidation based on control, which we do not believe is the direction the IASB should be moving towards.

Comments on Appendix 1, 2 and 3 of the EFRAG draft comment letter including the Responses to the questions in the Invitation to comment of the IASB Exposure Draft ED 10 Consolidated Financial Statements

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.

- (54) Like EFRAG we are in broad agreement with the general direction of the new disclosures which deal with two different objectives: (i) providing better disclosure where significant judgment was used in determining whether to consolidate (or not consolidate) certain entities and (ii) providing more general disclosures related to the reporting entity's business risks taken through its involvement in non consolidated entities.
- (55) However, we are concerned that the required disclosures seem likely to be too voluminous. It appears that paragraph B31 should be read as providing the guiding principle that the reporting entity should use in establishing what information to disclose. We note that this paragraph rightly indicates that an appropriate balance is required to avoid providing neither not enough nor too much information. However we question whether the requirements listed in paragraphs that follow respect this principle.

Information relating to consolidation

- (56) We generally agree with the disclosures allowing users of financial statements to understand the judgments made by the management in assessing the existence of control over an entity and the related accounting consequences. This is consistent with the disclosure on estimates, uncertainties and judgments required by IAS1.
- (57) However, for these entities, we question whether providing information in aggregate (as per paragraphs B33 and B34 in the ED) is necessarily informative to the users of the financial statements and therefore the implementation cost of such disclosure seem to be disproportionate. We believe that it may be more useful if separate disclosure was provided for each entity that is consolidated or not consolidated as a result of a decision requiring significant judgment.

Comments on Appendix 1, 2 and 3 of the EFRAG draft comment letter including the Responses to the questions in the Invitation to comment of the IASB Exposure Draft ED 10 Consolidated Financial Statements

Information relating to business risks

- (58) The same comment as set out above under paragraph 57 applies to the additional disclosure on off- balance sheet activities. While we support the objective of improving the disclosure on business risk, we question the need to provide all of the information listed in the ED. For example, paragraph B38 gives a too much broad definition of the structured entities for which the reporting entity must give additional disclosures as we have the impression that this definition could encompass all structured entities with which the reporting entity has transactions.
- (59) As we indicate in our response to Question 10 some of the disclosure requirement may be onerous and/or extremely difficult to obtain. In order to be consistent with the principle established in paragraph B31, the objective should be for the reporting entity to disclose sufficient and appropriate information to provide a meaningful appreciation of its exposure to business risks to the users of the financial statements. The detailed information on non-consolidated entities that is currently proposed as being required by the ED could instead be turned into suggestions of the information that may allow the reporting entity to meet this objective.

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.

REPUTATIONAL RISK

- (60) We believe that preparing the following disclosure would be onerous and/or that the required information would be extremely difficult to obtain:
- B32(c): We question whether an entity will always have the information to determine whether returns are significant to the structured entity.
 - B37(b): This paragraph appears to require the disclosure of all covenants. This appears very onerous given that IFRS 7 does not require such disclosure.

Comments on Appendix 1, 2 and 3 of the EFRAG draft comment letter including the Responses to the questions in the Invitation to comment of the IASB Exposure Draft ED 10 Consolidated Financial Statements

- B40-41: To the extent that a reporting entity no longer has any involvement with a structured entity, we believe these disclosures are onerous and we question the relevance of the information.
- B42: The requirement to provide two years of comparative information appears burdensome and inconsistent with the general requirements of IAS 1.
- The information required in B44c), B46a) and B46b) might be difficult to obtain from non controlled entities in which the reporting entity is involved.

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?

ACCOUNTING FOR ASSOCIATES AND THE EQUITY METHOD

- (61) We agree that reputational risk is not an appropriate basis for consolidation.

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?

- (62) We believe that it would be appropriate for the Board to undertake a project on the equity method in broad terms (i.e. what is the meaning of significant influence and how is it best reflected in the financial statements of a reporting entity).
- (63) However, like EFRAG, we consider that the relative importance of this project should be considered in light of the other current priorities of the Board.



Appendix

Comments on Appendix 1, 2 and 3 of the EFRAG draft comment letter including the Responses to the questions in the Invitation to comment of the IASB Exposure Draft ED 10 *Consolidated Financial Statements*

Comments on the EFRAG draft comment letter - Appendix 3

Some more detailed comments

(64) We have no specific comments to make.