



20 March 2009

International Accounting Standards Board  
1<sup>st</sup> Floor 30 Cannon Street  
London EC4M 6XH  
United Kingdom

*(By online submission)*

Dear Sir

**RESPONSE TO EXPOSURE DRAFT 10 CONSOLIDATED FINANCIAL STATEMENTS**

The Accounting Standards Council (ASC) appreciates the opportunity to comment on the Exposure Draft of *Consolidated Financial Statements* issued by the International Accounting Standards Board (IASB) in December 2008.

2. Our comments below address the specific questions set out in the “Invitation to Comment” section.

**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?

**Whilst we generally agree with the principle that “control” should be a key factor within the scope of IAS27 and SIC-12, we believe that the proposed control definition in ED 10 may be subject to inconsistent application and may not be suitable for all entities.**

**In deciding on the appropriate definition of control, we believe there are certain issues that need to be reviewed, and these are set out below:**

**Guidance on determination of governing body**

**In relation to powers to direct activities without a majority of the voting rights, B9 in ED 10 stipulates that one of the indicators of power to direct the activities of the entity is to determine if the reporting entity can dominate the governing body, and therefore determine the strategic and financing policies of that entity.**

**In this aspect, we would like to highlight that determining the governing body is not a straight forward assessment for a range of corporate structures. For**

example, it could pose a real practical challenge for Real Estate Investment Trusts.

In the unique situation applicable to Real Estate Investment Trusts (REITs), special purpose entities are usually set up by the sponsor (who is usually the property developer) of the REITs to manage the Trust. Where the sponsor appoints itself to be the manager of the REITs, its primary role is to set the strategic direction of the Trust and make recommendations to the trustee of the Trust on the acquisition, divestment or enhancement of assets of the Trust in accordance with its stated investment strategy. Accordingly, the Manager manages the financing and operating policies of the REITs and obtains benefits from the entity (through a management fee). However, the Manager would still require the trustee's approval for actions to be taken; the Trustees being independent of the sponsor.

As for the role of the Board of directors of the Manager, it is primarily responsible for the overall management and the corporate governance of the Manager and the Trust, including establishing goals for management and monitoring the achievement of these goals.

In such a REIT setup, substantive business decisions, including acquisitions, disposals, property optimization and tenancy renewals need to be made. Depending on the nature of the decision and the magnitude, such decisions are made by different parties: the Board of directors of the Manager, the Manager, the Trustee or the unitholders. In such a situation, it is not uncommon that power/control is shared amongst/between the Board of directors of the Manager, the Manager, the trustee or the unitholders.

The guidance in ED 10 does not appear sufficient to enable one to arrive at a conclusive decision when determining the governing body. Accordingly, we propose that additional guidance be provided that would rest the definition of "control" with the final approving authority.

#### **Conflict with legal framework**

There could be an impediment to the consistent adoption and application of this consolidation standard in the various jurisdictions. There is currently an issue of conflict in the definition of "control" between the accounting standards and the legal framework. With the proposed control definition in ED 10, this issue continues to prevail.

We would like to bring to the Board's attention the link with the recent IASB discussion paper on the reporting entity and this exposure draft, ED 10. In our submission dated 10 December 2008, we have highlighted that the proposed definition of control may not be in line with a country's legal definition of control. In certain jurisdictions, having over 50% of the voting rights would clearly demonstrate control (i.e. a parent-subsidiary relationship). Under ED 10,

the holder of less than a majority voting interest (for example a 40% voting interest) in a legal entity (say Entity A) is presumed to control that Entity A if, say, the holder had more voting rights than any other party and the its voting rights are sufficient to give the holder the ability to determine Entity A's strategic operating and financing policies. This might result in the said holder consolidating Entity A and accounting for the remaining 60% as non-controlling interests. However, under the legal framework, a parent-subsidiary relationship would not have been established between the 40% holder and Entity A which would therefore not allow for consolidation as a common group. Thus, there is a variance between the legal definition of subsidiary as implied by majority ownership of equity versus accounting definition which is by implied control. This could lead to confusion and in some instances, depending on whether the legal framework or accounting standards definition prevails, different reporting entities may end up consolidating the same subsidiary.

## Question 2

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

**Control is defined in ED 10 to be the power to direct the activities of another entity so as to generate returns for the reporting entity.**

Whilst we believe the control principle (that is, inclusion of the 2 elements that are necessary for control to exist – power and returns) as articulated in the exposure draft is an appropriate basis for consolidation, it is unclear if there is a clear, established link between power and returns. This is likely to result in implementation difficulties.

Although ED 10 para 13 states that “A reporting entity’s power to direct the activities of another entity is generally correlated with its exposure to the variability of returns from the other entity”, it is unclear to what extent should the correlation be in determining which party should be the governing body. We are proposing that the link between power and returns be further clarified; including guidance in determining which level of returns (i.e. on a continuum of 0% to 100%) would be the appropriate tipping point.

## 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?

**We generally agree with the application of the de facto control concept as described in the ED. However, having dominant power does not automatically lead to the ability to direct the activities of the company, as the non-controlling interests, acting together, may still be able to thwart the exercise of that power should they decide to vote against. Practices have evolved such that looking at the historical voting records at the Annual General Meetings is one of the commonly used bases of determining de facto control. In**

such instances, application of the de facto concept might result in consolidation of an entity in one year and deconsolidation in the following year should voting behaviour change. Secondly, a new entity would not have the historical evidence for determining whether the dominant party was able to exercise control.

We believe that consolidation should apply in principle only where there is continuous and sustained control, and by definition temporary control is not effective control. As demonstrated above, the application of the proposed de facto control definition may result in consolidation and deconsolidation at different times, depending on whether the ability to control an entity exists at any given date.

#### 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.

**Yes, we agree.**

#### 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.

**Yes, we agree with the broad principles in relation to agency relationship in ED 10. However, the current guidance (B6 in ED 10) in relation to indications that the fees/remuneration received of an agent may not commensurate with the services performed makes reference to the term "large" such as in B6 paragraphs (b) and (c) which states that:**

**"(b) The fees are large relative to the total expected returns of the entity to which the services are provided**

**(c) The expected variability in the fees is large relative to the total expected variability of the returns of the entity to which the services are provided"**

**In percentage terms, returns can ranged from negligible (i.e. close to 0%) to that of 100%. It is not clear how the term "large" is meant to fit in between the 2 ends of the continuum. In such cases, without additional guidance in the standard, the judgment applied by different reporting entities may result in inconsistent practices. We proposed that the Board includes the appropriate guidance in this aspect.**

#### 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?

**Yes, we agree.**

#### **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?

**Yes, it is sufficient.**

#### **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.

**Yes, the IFRS should include a risks and rewards ‘fall back’ test. As we have seen in the recent turmoil, where risks are not appropriately ring-fenced and could outstrip rewards, the consolidation of such entities would serve to disclose potential liabilities of the group. We believe that this “fall back” test could be an additional consideration in the event of ambiguity in determining control.**

#### **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, and

#### **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.

**No, the proposed disclosure requirements do not appear to provide decision-useful information.**

**B34 in ED 10 requires disclosure in aggregate, in relation to unconsolidated entities where the reporting entity is the dominant shareholder, information to assist users in evaluating the accounting consequences of its assessment that it does not control such entities. Such information might include total assets, liabilities, revenue and profit or loss of those entities. We have concerns of the practicality of this requirement. The presumption that a dominant shareholder is possibly an almost-controlling shareholder is not so clear-cut. The generally accepted accounting principles (GAAP) differences,**

**the different accounting year-ends and the information confidentiality restrictions will all make this a highly cumbersome disclosure requirement. If disclosures must be made, we are recommending that the standard make it possible for different GAAP bases and different financial year ends to be accommodated.**

**Further, the ED proposed in paragraph 23(d) that for entities where there is no significant control but is somewhat involved in the entity, disclosures should be made as long as there are risk exposures. In practice, this would be difficult to implement as it would be difficult to assess and obtain information on the “nature, extent and risk factors” of unconsolidated structured entities. We are of the view that where a reporting entity is involved in the entity but does not control the entity, it may not be able to obtain all the disclosure information required.**

#### **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.

**We do not believe that reputational risk is an appropriate basis for consolidation. It should however, be taken into consideration in the due process of assessing risks and rewards.**

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

**In relation to the proposed disclosures in paragraph B47, there should be more guidance on the format of disclosure with regard to disclosures required of structured entities that are not 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?

**Yes, it should be considered as a separate project.**

3. Should you require any further clarification, do contact me. Thank you.

Yours faithfully,

Dexter Tan  
Secretary, Accounting Standards Council