



10 December 2008

International Accounting Standards Board  
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United Kingdom

(By email: [CommentLetters@iasb.org](mailto:CommentLetters@iasb.org))

Dear Sir

**RESPONSE TO DISCUSSION PAPER ON PRELIMINARY VIEWS ON AN IMPROVED CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING: THE REPORTING ENTITY**

The Accounting Standards Council (ASC) appreciates the opportunity to comment on the discussion paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity* issued by the International Accounting Standards Board (IASB) in May 2008. We provide our views on the following questions:

**Question 4**

**Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that:**

- (a) **control should be defined at the conceptual level?**
- (b) **The definition of control should refer to both power and benefits?**

**If not, why? For example, do you have an alternative proposed definition of control?**

2. A working definition of *control* is set out in para 49 of the discussion paper which reads – “Control of an entity is the ability to direct the financing and operating policies of an entity, so as to access benefits from that entity (or to reduce the incidence of losses) and increase, maintain or protect the amount of those benefits (or reduce the amount of those losses)”.

3. It was noted that *control* as defined in para 7 of the IASB staff working draft for the International Financial Reporting Standard (IFRS) on Consolidated Financial Statements as - “A party controls an entity when it currently has power to enable it to manage the economic activities of that entity for its benefits by generating returns from those activities.” Para 14 further states - “A party is presumed to have power over an entity if it has the right to cast a

majority of the entity's voting interests. In such cases the party will control the governing body of the entity and, therefore, its strategic operating and financing policies. By controlling the strategic operating and financing policies of an entity a party can direct the day-to-day activities that affect the performance of the entity – whether that is achieved by making those decisions directly or by delegating that responsibility to management or others.”

4. In deciding on the appropriate definition of *control* that is to be included at the conceptual framework level, we urge that the Board gives appropriate consideration to the deliberations and developments of the on-going consolidation project which objective is to publish a single IFRS on consolidation to replace IAS 27: Consolidated and Separate Financial Statements and SIC-12: Consolidation – Special Purpose Entities. We believe that there is a range of issues that need to be reviewed, and these are set out below:

- The proposed definition of *control* included in the discussion paper and the draft IFRS for Consolidated Financial Statements may not be in line with a country's legal definition of control. In many jurisdictions, having over 50% of the voting rights would clearly demonstrate control (i.e. a parent-subsidary relationship). Under the accounting standard, the holder of less than a majority voting interest (for example a 25% voting interest) in a legal entity (say Entity A) is presumed to control that Entity A if, say, the holder has the ability under a statute or an agreement 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 75% holders as non-controlling interests. However, under the legal framework, a parent-subsidary relationship would not have been established between the 25% holder and Entity A. Thus, the said 25% holder would not have consolidated Entity A. 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, different entities consolidating the same subsidiary.
- There is a need for clarity over the extent of benefits. We would propose that the definition of control be revised to: “Control of an entity is the ability to direct the financing and operating policies of an entity, so as to access **substantial benefits** from that entity (or to reduce the incidence of **substantial losses**) and increase, maintain or protect the amount of those benefits (or reduce the amount of those losses)”. We are of the view that this inclusion of the term “substantial” could help address the possible inconsistent applications of the quantum of benefits obtained in applying this definition.
- Closely linked to the above point is the impact of the proposed definition of *control* on the accounting treatment for special vehicles such as Real Estate Investment Trusts (REITs). In making reference to the “ability to **direct** the financing and operating policies of an entity, so as to access **benefits** from that entity.....”, some accountants believe that under current standards REITs should be consolidated even if the property company owns a small percentage of equity, on the basis that REITs operate on autopilot arrangements that are designed to

entrench the previous controlling rights of the sponsor, even though there is no existing arrangement to control the Board and the extent of equity holdings in the REIT is not significant. It is not clear that such an interpretation is consistent with the Board's intended application of the definition of control in the conceptual framework and the draft IFRS for Consolidated Financial Statements, and we recommend that the Board paper deals more directly with this situation.

- In the case of a REIT, we believe it is not appropriate to consider the REIT to be a special purpose entity (SPE) operating on autopilot, since the trust makes many substantive business decisions, including acquisitions, disposals, property optimisation and tenancy renewals that cannot be pre-determined by autopilot. Depending on the nature of the decision and the magnitude, such decisions are made by different parties: the Manager, or the Trustee or the unitholders in general meeting.
- Where a sponsor appoints itself as Manager of the trust, this is not an entrenched appointment if the votes held by the sponsor in a general meeting cannot prevent a replacement of the Trustee. Such ability to effect a replacement of the Trustee will remove the presumption of pre-planned control being perpetuated. The ABILITY TO DIRECT the policies of the entity should be clearly defined to refer to the power of the majority of the unitholders to appoint, direct or remove a manager. The ability to MANAGE the REIT as a manager should be clearly distinguished as different from and not tantamount to the ability to DIRECT the policies of the REIT. With this approach, a REIT should be consolidated only where the parent holds enough unitholder votes to control unitholder decisions, and whether the parent is also the REIT manager is not relevant.
- This approach will also ensure that the "benefits" leg of the test is a meaningful one. The ability to direct the policies of the REIT would derive from a controlling block of unitholdings, with significant benefits accruing thereto. The benefits that the parent would receive would then be SIGNIFICANT benefits. This will avoid an interpretation where a sponsor consolidates a REIT in which it has an insignificant stake of units, it remains as a manager and it has insignificant (but some) benefits.
- Whilst we support the principle that control should be defined at the conceptual level and the definition of control should refer to both control and benefit, we strongly urge the Board to develop a sufficiently robust definition of control at the conceptual level such that it does not result in an operating business such as REITs being consolidated by its sponsor even where equity interests held are not significant and there is no ability to control the REIT by the sponsor.
- In the IASB publication of Observers' Note (November 2007 meeting), it was discussed that in considering securitisations, conduits, structured investment vehicles (SIVs) and similar arrangements, there is a continuum of indicators. At one end of the continuum, there are operating subsidiaries that would clearly be controlled by one party through strategic power. At the other end, the activities of

a structured arrangement would be entirely predetermined and it would be necessary to consider the rights and responsibilities of each party. These are known as securitised type of arrangements. For entities that fall in between the two ends of the continuum, judgment must be applied to determine whether it should be accounted for as an operating subsidiary or a securitised type of arrangement.

<b>Operating subsidiary</b>	<b>Securitisation*</b>
Operates as a business	Does not have qualities of a business
Significant variability in activities undertaken	Little or no variability in activities and has a very narrow purpose
Very few, if any, predetermined policies	All policies are predetermined
Has sufficient equity	Little, if any, equity
Has assets of an operating nature (for e.g. specialised machinery) that are used with other assets of the entity	Has assets with contractual cash flow streams that are independent of other assets of the entity (e.g. risk-free securities; other debt securities)
* This continuum can also be applied more generally to other types of arrangements, such as conduits, collateralised debt obligations, etc.	

5. We note that these considerations are not included in the Draft IFRS for Consolidated Financial Statements. We propose that the standard includes the above considerations when determining whether an entity should be considered an operating business or a securitisation vehicle. Judgment should be allowed to make the determination.

### **Question 8**

**Do you agree that consolidated financial statements should be presented from the perspective of the group reporting entity, not from the perspective of the parent company's shareholders? If not, why?**

6. We agree that consolidated financial statements should be presented from the perspective of the group reporting entity. We would recommend that certain of the existing financial statements disclosure requirements specific to the parent company approach should be maintained at the accounting standards level. For example, presentation of earnings per share information, allocation of net income between controlling and non-controlling interest would provide useful information to financial statement users.

## Question 10

**Do you agree that the conceptual framework should not preclude the presentation of parent-only financial statements, provided that they are included in the same financial report as consolidated financial statements? If not, why?**

7. We agree that the conceptual framework should not preclude the presentation of parent-only financial statements as the parent-only financial reports are significant and useful to certain users of financial statements. For example, for purposes of paying dividends, our current law requires dividends to be paid out of the profits of the individual entity. In addition, given that each and every entity has a separate legal personality, it is essential that parent-only financial information be made available to the users of financial statements.

8. We would like to take this opportunity to seek the following clarification: As the conceptual framework stipulates that parent-only financial statements can be presented provided they are included in the same financial report as the consolidated financial statements, it is unclear if this requirement is consistent with the provisions in IAS 27 para 10 which exempts certain qualifying parent entity from the preparation of the consolidated financial statements.

## Question 11

**With regard to the concept of control, in the context of one entity having control over another, do you agree that:**

(a) **establishing whether control exists involves assessing all the existing facts and circumstances and, therefore, that there are no single facts or circumstances that evidence that one entity has control over another entity in all cases, nor should any particular fact or circumstances—such as ownership of a majority voting interest—be a necessary condition for control to exist? If not, why?**

9. Please refer to our response to question 4.

(b) **the concept of control should include situations in which control exists but might be temporary? If not, why?**

10. We agree that the concept of “control” should include temporary control and is of the view that some specific guidance for situations involving temporary control be included at the accounting standards level.

11. Further, where entities know that control is temporary at reporting date, entities should be making the relevant financial statement disclosures. This would be in line with IAS 10 – Events after the Balance Sheet Date. In such events, it would also be imperative to consider the treatment upon de-consolidation.

(c) **the control concept should not be limited to circumstances in which the entity has sufficient voting rights or other legal rights to direct the financing and operating policies of another entity, but rather should be a broad concept that encompasses economically similar circumstances? If not, why?**

12. We agree with this statement.

(d) **in the absence of other facts and circumstances, the fact that an entity holds enough options over voting rights that, if and when exercised, would place it in control over another entity is not sufficient, in itself, to establish that the entity currently controls that other entity? If not, why?**

13. In principle, we agree with this statement. The fact that an entity holds enough options over voting rights that, if and when exercised, would place it in control over another entity should, in the absence of other circumstances, be distinguished from actually having control. Options over voting rights which are yet to be exercised should not be regarded as ownership rights, and the choice of obtaining control, in itself, is not sufficient to establish control.

(e) **to satisfy the power element of the definition of control, power must be held by one entity only? In other words, do you agree that the power element is not satisfied if an entity must obtain the agreement of others to direct the financing and operating policies of another entity? If not, why?**

14. In so far as the term “control” refers to unilateral control and not joint control, we agree that power must be held by one entity only, and that there must be a singular line of power between the controlling entity and the entity being controlled.

(f) **that having ‘significant influence’ over another entity’s financing and operating policy decisions is not sufficient to establish the existence of control of that other entity? If not, why?**

15. We agree that significant influence is not sufficient to establish existence of control.

16. We are generally in agreement on the other questions raised.

17. Should you require any further clarification, please contact me. Thank you.

Yours faithfully,

Dexter Tan  
Secretary, Accounting Standards Council