



IASB – International Accounting Standards Board  
Comment letters  
30 Cannon Street  
London, EC4M 6XH  
United Kingdom

19 March 2009

Dear Sir or Madam,

RE: CONSOLIDATED FINANCIAL STATEMENTS

BUSINESSEUROPE welcomes the opportunity to comment on ED10 Consolidated Financial Statements.

We approve of the efforts carried out by the IASB to both respond to the needs of users that the financial crisis has enlightened and clarify the existing requirements in IAS 27 and SIC 12.

We believe, however, that some more work is necessary before the future standard can be finalised if the IASB wishes to avoid undermining the quality of IFRS present consolidation requirements.

BUSINESSEUROPE therefore recommends that the IASB responds to the needs for supplementary information for users as swiftly as envisaged, while taking more time before finalising the consolidation requirements. In doing so, the IASB should ensure that requirements are set in such a manner that information provided to users is limited to relevant information and collection of that information is feasible. Also, potential overlaps with other standards should be carefully avoided.

We provide more detailed comments in the appendix to this letter.

Should you wish to comment on the above further, please do not hesitate to contact us.

Yours sincerely,

Jérôme P. Chauvin  
Director  
Legal Affairs Department  
Internal Market Department



## **Appendix to BUSINESSEUROPE letter of comments on ED10 Consolidated Financial Statements.**

### **1- Preliminary Comments**

Any decision the IASB has to make on this project should be made, having in mind that IFRS consolidation requirements have proven rather robust in the financial turmoil. The IASB itself acknowledges that IAS 27 and SIC 12 taken together are not flawed, and that the main objective pursued where recognition requirements are concerned is to ensure easier application and the elimination of potential divergent interpretations of the existing standards.

BUSINESSEUROPE approves of the efforts the IASB has made to have all consolidation requirements be derived from a single control principle. Our own interpretation of SIC 12 is not that it is based on anything but the IAS 27 control principle. (SIC 12 consensus clearly refers to that principle (par 9)). However we are aware, as the IASB mentions, that other interpretations may have cause divergence in practice.

BUSINESSEUROPE supports the IASB efforts to develop more guidance, some of which is particularly welcomed (agency relationships, protective rights, related arrangements...).

However, we believe that more work and field testing is required to ensure that implementation of the future standard will not result in unwarranted recognition or derecognition of assets and liabilities which would be detrimental to the quality of the information provided to users.

Moreover, we believe useful to link final decisions made by the Board on ED 9 and ED10. Both sets of requirements would lead to exclude from the financial statements of a reporting entity assets and liabilities which:

- on a stand-alone basis or in combination with the assets and liabilities of the entity have an influence on the cash flow prospects of the entity;
- will in most cases not be reported to users in financial markets as they relate to unlisted entities (joint ventures, structured entities...) and, according to the Board's preliminary decisions, constitute reporting entities on their own, while the design and the set up of the entity result from the reporting entity exercising its power. We recommend that the Board fully develop and explain why financial reporting would as a result be more useful to users.

As a result we believe that further work is required that cannot be achieved in the timeframe that the IASB has set for this project. We therefore recommend the Board to finalise the future standard in two steps:

- the first step could be finalised as quickly as planned and include the revised disclosure requirements only;
- the second step would require more time although we believe it can be achieved before the June 2011 deadline.

## **2- Answer to the Invitation for Comment**

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

BUSINESSEUROPE approves of the definition of a single control principle to be applied to all entities today encompassed in the scope of both IAS 27 and SIC 12 and we agree with the principle being based on the three identified elements, power, returns and the link between them.

Nonetheless ED10 proposals raise concern as we do not believe that the guidance provided is in all aspects the best possible application of the core principle. We detail our reasoning below:

- *Although the return criterion is given more emphasis than it used to, it is not referred to in the guidance as it should*

Beyond paragraphs 19 and 20 which develop the return criterion as part of the core principle, and par 33 which relates to structured entities, there is no guidance referring to the assessment of returns or of the influence the power of the reporting entity may have on the returns.

We believe the development of guidance related to the assessment of returns would be helpful in the following areas:

- In assessing how significant the returns should be to the reporting entity: paragraph 11 lists all forms that returns may take; we believe it would be useful that the standard indicates that returns must be the returns any holder of the group of assets and liabilities would receive once deducted the costs inherent to services received in relation with the group; if there are other limitations involved, we believe that an asset or a liability may have to be recorded and the assets and liabilities in the group should not be consolidated (the reference to remuneration commensurate with the services provided in the guidance on agency relationships is consistent with that principle);





- in assessing the role potential voting rights may play in the assessment of control; reference to the return criterion is made in BC 85 only; B13 focuses on the assessment of power only;
  - in assessing whether a reporting entity in a dual role as investor or an agent controls in another entity controls that other entity;
  - in the assessment of control of structured entities, control is denied if the entity has not retained any form of power to direct the activities, although the structured entity has been set up in the state it is as a result of the reporting entity exercising its power and the reporting entity is the entity most exposed – or solely exposed – to the returns of the structured entity. We believe that SIC 12 present requirements (although not necessarily SIC 12 as applied in practice) are consistent with the core control principle proposed and should not be departed from. Similarly to past returns which may have to be considered in the assessment of returns, we believe that past exercise of power should have a role to play in the assessment of power.
- *To provide a fully principle-based approach to consolidation, the future standard should provide basis for an open analysis in all circumstances. However the guidance points here and there to ready conclusions, rebuttable or not;*

BUSINESSEUROPE approves of the efforts made to ensure that the future standard would be principle-based. We note however three areas where conclusions seem to be pre-defined:

- B13 (a) and (c) describe elements of facts and circumstances which taken in isolation from all other facts and circumstances would designate situations in which potential voting rights would give the reporting entity power; we disagree that no room is left for judgement in the assessment of power; we believe that an in-substance analysis is necessary in all circumstances as described in B13 (b);
- B11 sets a rebuttable presumption, i.e. a predefined conclusion in every situation of dual role as agent and investor. We believe the analysis and exercise of judgement should be more open. Most often all investors in a fund for example do share interests in strict proportion to the level of interests they hold. It is therefore impossible to differentiate the interests of the entity as an investor and the interests of other investors. All facts and circumstances ought to be taken into consideration in the consolidation decision;
- Paragraph 33 states a likelihood based on the significance of returns; it is difficult though to identify the role this likelihood is supposed to play;



in addition, we do not see why this likelihood would play a role in structured entities and not in others.

- *The notion of “ability to direct the activities” does not seem to be consistent throughout the standard. It should be straightened up and the reasoning fully explained.*

The standard is clear in defining the power as “the ability” to direct the activities of the entity. There is however no reasoning of what ability the entity should have at the reporting date, at the time control needs to be assessed if the continuous assessment principle is to be effective. We note that the ability may designate:

- the ability to direct if I so wish (a passive shareholder being one that has decided against exercising its ability);
- the ability to direct because I have the ability of making a decision that would enable me to direct (the holder of a call option having to decide to exercise its option).

BUSINESSEUROPE believes that the future standard will be consistent if the ability to direct the activities of the entity is not determined taking into account what the entity might have done however has not done, when there is a difference in economic substance in one situation and the other, in terms of both power and returns.

- *In the absence of conceptual reference in the DP Reporting entity, the standard should develop some reasoning on why consolidated financial statements are useful to users and how in this context the control principle brings the best answer possible. Such reasoning would prove useful material in difficult consolidation decisions.*

The Board has re-affirmed that financial reporting was useful to users when it helped capital providers to assess the future cash flows of an entity. It is relatively easy to understand how the return element of the control definition plays a role in making financial statements useful to capital providers. It is not as easy to explain how the power element makes such a big difference, especially if power is defined as never being shared. We believe that the IASB should fully develop its reasoning on this question, one to which preparers, auditors and enforcers could relate when assessing a difficult set of circumstances.

In making cash flow predictions users need to rely on assumptions and if the rationale behaviour has to be one of the assumptions used, we see that the power element is necessary to ensure that the entity is not playing against its interests. If that is the reasoning of the Board though, we do not understand



why the Board excludes shared control. As we have already indicated, shared control is control and the entity does have the power to ensure that no decision is made which would not be in the best of its interests. A partner in a joint venture is likely to have been chosen (exercise of power by the reporting entity) because its interests are congruent with the interests of the reporting entity, not contrary to them, so that shared control within the joint venture would not end up being a series of compromises, i.e. a series of half reasonable economic behaviour. We can understand why with its priority given to the entity perspective the Board would want to eliminate proportionate consolidation; we cannot see why the Board would exclude consolidation of a joint venture with 50% of shared control interests.

## ***2.2 Are potential voting rights dealt with adequately?***

In the developments above we have already given a hint of where our thinking was on this question.

BUSINESSEUROPE believes that there may be circumstances where potential voting rights are an indicator of an entity having indeed the power to direct the activities as if it was already the holder of the voting interests. We therefore agree with the Board that care in the analysis is required – and understanding of the rationale of the transaction leading to these potential voting rights is needed – before concluding whether the reporting entity has control over an entity. We agree with B13 (b) because it calls for the necessary analysis in substance. We would also agree that where there are potential voting rights and evidence of effective control by the entity (both power and returns), circumstances trigger consolidation and agree with the spirit of BC84.

We however have areas of disagreement with the position the Board has taken in this area:

- We have already indicated why we disagreed with B13 (a) and (c);
- BC 85-87 adds to the proposed guidance although it is placed in the basis for conclusions (where requirements are supposed to be explained, not stated);
- We believe that non exercisable instruments deny the existence of “potential” voting rights at the balance sheet date, i.e. are contrary to the continuous assessment principle.

## ***2.3 Are the conclusions drawn by the IASB on the dual role as an investor and an agent appropriate?***

BUSINESSEUROPE agrees with the IASB that the two positions – investor and agent – need to be considered in aggregate. We believe – as already indicated – that there should not be any room for a rebuttable presumption in the final



standard. We believe that the circumstances should not be assessed from the power criterion only and that the significance of the exposure of the reporting entity to the variability of returns of the other entity should have a weight in the decision whether to consolidate.

Furthermore we understand that B11 does not apply to structured entities because B11 deals with voting rights and that a structured entity is one to which paragraphs 23-29 do not apply. We would appreciate if the final standard could be 100% clear on this issue.

***2.4 Is the definition of a “structured entity” necessary and appropriate? Are the requirements regarding the assessment of control in structured entities appropriate?***

BUSINESSEUROPE understands the definition as ensuring that no entity falls out of scope and therefore supports it. We also see the usefulness of the definition in the Board’s attempt to identify the need for useful disclosures. We however believe that the lay-out of the standard, as well as the breakdown between standard and guidance need to be revised:

- the standard seems to introduce two sets of distinct requirements, one for entities directed by way of voting rights, the other for structured entities;
- because of insufficient cross-referencing between the standard and the guidance, it is difficult to understand whether the guidance applies generally or to a sub-set of entities;
- both power and returns should be clearly assessed, and assessed in the same fashion – though on the basis of different sets of circumstances - whatever the entity.

As indicated earlier in our response, we believe that the exercise and outcome of past power should be taken into consideration in the analysis of whether a structured entity is consolidated.

Drafting note: we recommend clarifying the wording of the definition of a structured entity. Paragraphs 23-29 refer to “the reporting entity having power”. Paragraph 30 defines a structured entity by reference to having activities not directed as described in paragraphs 23-29. Taken together those paragraphs could imply that structured entities are all entities in which the reporting entity does not have power by exercise of voting rights.

***2.5 Are the disclosure requirements likely to meet users’ needs?***

BUSINESSEUROPE supports the IASB in its efforts to respond positively and swiftly to the needs of supplementary information that the financial crisis has



enlightened. However we believe that no disclosure can compensate for inadequate accounting. We therefore believe that it is of the utmost importance that the basis for consolidation that the IASB retains in the final standard is at least as sound as the existing IAS 27/SIC 12 requirements. Moreover we do not support disclosures which seem to be designed to help users to second guess management in its consolidation decisions.

We therefore:

- support the disclosure requirements related to restrictions on consolidated assets and liabilities and interests that the non-controlling interests have in the group's activities (B35-37),
- support the disclosure requirements principles related to involvement with unconsolidated structured entities and associated risks. However we believe that all details described should – in conformity with the spirit of B31 – be provided as examples of what may be useful to meet the principle, instead of being set as a list of detailed requirements. In addition we note that supplementary requirements should not replicate or duplicate information required in other standards (B38-B47) or call for information that cannot be obtained or may be excessive such as:
  - B44(c) as the reporting entity has neither power nor influence to collect those data and impose that they are compliant with IFRS valuations and available at the reporting entity's reporting date,
  - The requirement in B42 to provide comparatives for two years minimum of all data described in B38 a).
- disagree with the disclosure requirements related to the basis of control and the impact of those decisions on the financial statements of the entity; we believe these disclosures are unnecessary if the final standard on consolidation is robust. Such disclosures are likely to suggest uncertainty and hence suspicion or lack of confidence by users (B32-B34).