THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

20 March 2009

Our ref: ICAEW Rep 34/09

Your ref:

Mr. Stig Enevoldsen
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EFRAG
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By email: commentletter@efrag.org

Dear Stig

EXPOSURE DRAFT ED 10 *CONSOLIDATED FINANCIAL STATEMENTS*.

The Institute of Chartered Accountants in England and Wales (the ICAEW) welcomes the opportunity to comment on EFRAG's draft comment letter, published in March 2009, on the International Accounting Standards Board Exposure Draft ED 10 *Consolidated Financial Statements*. Our responses to the main issues highlighted by EFRAG are set out below. Our response to the IASB, which gives further explanations of our views, is attached to this letter.

EFRAG's Main Points

- **We support the objectives of the ED.**

  We do not oppose the attempt to apply a single control model to structured and other entities, but only if it is accepted that such a model cannot be made operational without the application of risks and rewards concepts. It is difficult to oppose an objective of 'improved disclosures', but it is not apparent that this is what the exposure draft does. As we set out in paragraph 5 of our response to the IASB, it is not clear to us whether the Board's objective is to achieve more precision and consistency in the present framework, or to make a more fundamental change to existing practice.

- **The debate about consolidation models has essentially been one about whether to adopt a control-based model or a risks and rewards-type model. However, we think the approach proposed in the ED blends aspects of the two approaches in a control-based model that incorporates, through its focus on variable returns, elements of a risks and rewards approach. We think this is an imaginative approach and it is one we support in principle.**

We do not agree with EFRAG that the proposed control-based model blends elements of the risks and rewards approach. As set out in, particularly, paragraph 9 of our response to the IASB, we believe that a more explicit reference to the use of risks and rewards as an indicator of where control lies is required for when other tests fail.

- **However, we are concerned about the actual consolidation principle proposed, because we think it will not always result in the right entities being consolidated and the right ones remaining off-balance sheet. In addition, we also have a number of concerns about the clarity, consistency and/or appropriateness of the ED's material on the control model, the treatment of options and convertible instruments, agency relationships, and reporting entities with dual roles. As a result, our view is that the ED 10 as drafted does not represent an improvement on existing IFRS. Furthermore, we are not convinced the consolidation principle proposed in the ED is an improvement on the principles in existing IFRS.**

  We agree. Moreover, we believe that this statement more accurately reflects the substance of EFRAG's response than the two quasi-supportive statements that precede it.

- **We are broadly in agreement with the general direction of the new disclosures proposed, although we are concerned that they seem likely to be voluminous and it is not clear which disclosures are intended to be mandatory and which are not.**

  We do not support the new disclosures, as we believe that the deficiencies noted by EFRAG (with which we agree) are deal breakers. As set out in paragraph 13 of our response, the disclosure requirements are too extensive and prescriptive, and thus fail to distinguish important messages concerning key risks. The sheer volume of data is likely to be onerous for preparers and confusing for users. In many instances, no case is made to support the usefulness of the required information. It would be preferable for the approach to focus on the principles set out in paragraph 48, with perhaps some limited required elements. In our view, the overriding principle should be that the disclosures should reflect the risks the business is exposed to and the way they are managed.

- **We believe the IASB should divide the consolidation project in two and address the urgent need for enhanced disclosures and greater clarity as a matter of the highest priority. That would allow much-needed additional time to be spent on a single universally-applied consolidation principle, where we believe a more comprehensive analysis and debate is needed on the information needs of users and on how best to meet those needs in terms of consolidations and group reporting entities. It would also allow time for the thorough field-testing that we think is necessary for a new principle of this kind.**

  We would agree with EFRAG's suggested approach, although we have not suggested it explicitly ourselves in our response. We do suggest a number of areas in which the current model could be improved (see paragraph 51 of our response). We agree that a more comprehensive analysis and debate are required - preferably in a discussion paper - and that thorough field testing is essential.

Please contact me if you would like to discuss any of the points raised in this response.

Yours sincerely

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20 March 2009

Our ref: ICAEW Rep 33/09

Your ref:

Sir David Tweedie
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Dear David

ED 10 - CONSOLIDATED FINANCIAL STATEMENTS

The Institute of Chartered Accountants in England and Wales (the Institute) is pleased to respond to your request for comments on the exposure draft ED 10 *Consolidated Financial Statements* published in December 2008.

Please contact me if you would like to discuss any of the points raised in the attached response.

Yours sincerely

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THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW Representation

ICAEW REP 33/09

ED 10 - CONSOLIDATED FINANCIAL STATEMENTS

Memorandum of comment submitted in March 2009 by The Institute of Chartered Accountants in England and Wales, in response to the exposure draft ED 10 *Consolidated Financial Statements* published in December 2008.

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on Exposure Draft 10 *Consolidated Financial Statements* published by International Accounting Standards Board (IASB) in December 2008.

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

4. Our members occupy a wide range of roles throughout the economy. This response was developed by the Financial Reporting Committee of the Institute, which includes preparers, analysts, standard-setters and academics as well as senior members of accounting firms.

MAJOR ISSUES

Need for a revised standard

5. Given the current climate and pressures put on the Board, we understand the Board's desire to act quickly to address perceived problems in relation to consolidation under IFRS. However, while there has been a well documented issue under US GAAP in respect of qualifying special purpose entities, we are not aware of major problems or failings in IAS 27 and SIC-12. We therefore believe that further clarification is needed as to the purpose of the exposure draft. Is it intended to achieve more precision and consistency in the present framework, or is it intended to make a more fundamental change to existing practice? As this is not a convergence project and the proposals are significantly different from US GAAP, the Board needs to make a clear statement of its objectives. If the Board is aiming for a more fundamental change, it needs to be more explicit as to the changes in current practice it envisages, for example, the Board should make clear which entities it wishes to see consolidated that are currently omitted, and which entities it wishes to see omitted from consolidation that are currently included. If not, we suggest that a more appropriate course might have been simply to address certain problem areas of IAS 27 and SIC-12.

6. Based on our experiences in practice, we do not, in fact, believe that a fundamental change to existing practice is required, because the existing framework represented by IAS 27 and SIC 12 is well understood, and generally consistently applied. In particular, we consider that the drafting of SIC-12 achieves the objective of providing succinct principles around which a body of well understood practice has developed, which is essential for consistent application. We accept that there are limited problem

areas (see paragraph 52 below), but in general entities are included in, or excluded from, consolidation correctly. Most of the inconsistencies of application between different reporting jurisdictions that we are aware of arise from whether funds should be consolidated where the fund manager has an investment in the, and we do not believe that this exposure draft deals effectively with this issue.

7. We understand the motives of the Board in accelerating its consolidation project by issuing an exposure draft in response to the global financial crisis. However, in our view, the resulting proposals suffer from not having been exposed by way of a discussion paper, and lack both conceptual and practical robustness. The application guidance is confused and needs to be expressed more clearly, with the material allocated more consistently between the standard itself and the Basis for Conclusions. Whilst we have not attempted to comment on the drafting of the exposure draft, we believe that the poor drafting is sufficiently significant to seriously impede the operability of the standard and to cause significant scope for divergence of application and provide structuring opportunities.

Main objectives of the project

8. ED 10 states that the main objectives of the project are:

- to enable a control model to be applied to all entities, and
- to improve the relevant disclosure requirements.

We have previously responded to the Board indicating that we do not believe that a model relying solely on the power to direct activities can always be used to determine the composition of a group reporting entity. This is because the power to direct activities can often be disguised and some application of the risk and rewards concept (which we see as a strong indicator of control and integral to the control model) is required in order to make the model fully operational. This is discussed in relation to the current exposure draft in paragraph 23 below. We are also concerned at the extensive disclosures required under the proposals. This is discussed in paragraphs 13 and 40 - 47 below and the appendix.

Control

9. A consolidation approach based purely on control, as articulated in the exposure draft, could lead to increased structuring opportunities (for an example, see paragraph 19(a) below) and uncertainty, rather than greater consistency in the consolidation assessment. We agree that the control principle should be dominant, and in most cases control will be evident from the legal power of voting control. In cases that involve warrants, options and other contracts, it will usually be possible to take a holistic view of the arrangements in order to determine where power lies. Where these tests fail, in particular in cases where the levers of power are unusual, such as in auto-pilot arrangements, other indicators of where control lies are required. Risks and rewards would be a particularly important indicator in these circumstances, because risks and rewards will generally derive from control, and therefore provide a strong indicator of where that control lies. However, we have a fundamental uncertainty over which concept of control the Board intends to be applied. This might be:

- actual (exercise of) control; or
- right to control.

Use of the term ‘power’ implies a right to control - a legal ability that results when all parties exercise the rights available to them, and which cannot be removed by any other party. While the Board appears to imply this in places (eg, paragraph 8 last sentence), it implies actual control in other places (eg paragraph 28). If, as we suppose, the Board intends ‘power’ to mean ‘actual control’ then it would be preferable to use this term consistently and limit confusion. However, we strongly believe that the appropriate concept is the ‘right to control’ (see paragraphs 20 and 21 below).

Options

10. Overall, we support the approach adopted by the Board regarding options and convertible instruments. We believe that the Board is right to try and move away from the ‘currently exercisable’ bright line rule. We agree with the principle in B13: ‘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.’ We suggest that this would be easier to apply if the final standard were less prescriptive in how to apply this principle.

Agency relationships

11. While we agree in general with the approach to holdings as agent, we believe that it is necessary to bring more clarity to the drafting. Moreover, we do not believe the proposals deal effectively with the main area of concern, which is funds under management (see our comments in paragraphs 26 - 33 below).

Structured entities

12. We do not agree that a definition of a structured entity is necessary in a single consolidation model under which structured and non-structured entities are treated in the same way. The exposure draft does not adequately address issues such as temporary control, ‘auto-pilot’, who controlled the setting of the terms of the original arrangement etc. We believe that it will often be necessary to use risks and rewards as an indicator of where control might lie in these circumstances. There are also difficulties in relation to the consideration of returns in determining control.

Disclosures

13. The disclosure requirements are too extensive and prescriptive, and thus fail to distinguish important messages concerning key risks. The sheer volume of data is likely to be onerous for preparers and confusing for users. In many instances, no case is made to support the usefulness of the required information. In addition:

(a) many of the proposed disclosures (notably those around the risks associated with unconsolidated entities) would be better included within a comprehensive reconsideration of IFRS 7 - not as a separate and uncoordinated set of disclosures;

(b) in a single consolidation model we do not believe that there should be special accounting for structured entities, so there are no grounds in principle for special disclosure provisions either;

(c) providing disclosures in respect of all (structured) entities with which the reporting entity has ‘involvement’ is far too wide and will bring a huge number of entities within the disclosures, with the effect of obscuring the key risks and judgements.

The Board should only press ahead with new disclosure requirements after extensive field-testing by preparers and users, and a stringent cost/benefit analysis. (See paragraphs 40 - 47 below and the appendix for our comments on the disclosure requirements.)

Power to remove

14. The power to remove can be an important indicator of control and is referred to in the exposure draft in the context of the power to appoint or remove the members of that entity's governing body (paragraph 32) and of the right to remove an agent (paragraph B4). There needs to be clear guidance on how substantive such 'kick-out' rights would need to be - including whether there needs to be a likelihood they will be exercised and whether they need to be exercisable by a single party - in order for them to be taken into account.

Silos

15. The exposure draft is unclear on the subject of silos, and does not directly address the accounting implications. Silos are referred to in a footnote to the definition of subsidiary and in BC 31, where the Board notes that 'when assessing control each silo could be treated as a separate entity.' This appears to accept the concept of silos and to imply that different entities might consolidate different parts of a single legal entity. It is important that the Board should elaborate on the definition of silos and the appropriate accounting treatment for them.

SPECIFIC QUESTIONS

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?

16. No, we do not believe that the proposed definition of control alone as articulated can be applied to entities within the scope of IAS 27 and SIC-12. In particular, we do not believe that it can be made operational for structured entities without some application of risks and rewards concepts, because in many cases control is difficult to pin down because 'power' is negligible or is equally dispersed. This remains true even though we suggest that separate consideration of structured entities should not be necessary in a single consolidation model. Our detailed comments on the proposed definition of control are set out in answer to Question 2.

Question 2 Is the control principle as articulated in the draft IFRS an appropriate basis for consolidation?

17. No, we do not agree that the control principle as articulated in the exposure draft provides an appropriate basis for consolidation. We do agree that a control principle should be dominant, but control as articulated in the exposure draft could lead to increased structuring opportunities and uncertainty, rather than greater consistency. We can see no real problem with the content and application of IAS 27. SIC 12 works similarly well in practice – it describes clear principles succinctly that result in consistent application.

18. Under paragraph 10, control exists when the reporting entity has the power to direct the activities ... to generate returns for the reporting entity. Returns are so widely defined (to include all returns not just ownership type returns) that many parties are likely to have 'returns'. This places increased pressure on the 'power to direct' part of the definition, which is likely to be easy to manipulate - particularly where activities are pre-determined.

Power

19. We are concerned about the reliance on power in determining control.

(a) We particularly agree with the comment in the alternative view that a judgement based on power will give rise to structuring opportunities, and that some reporting entities may take great advantage of these in practice. For example, a reporting party that was exposed to the risks and rewards of an entity might wish to avoid consolidation of the entity. In a pure control model this could potentially be achieved if the entity was structured so as to require only a very limited degree of control and management. The reporting party might then be willing to cede this control (together with a small exposure to the variability of the entity) to another participant, accepting the marginal loss of control as a price for the balance sheet benefits of not consolidating the entity.

(b) The power model, as articulated, tends to entertain the concept of 'effective control', which we do not see as a sound basis for consolidation on a consistent basis (see paragraph 20 below). We accept that there can be de facto control, but this occurs where control is exercised without a majority of the votes but due to other factors such as the right to appoint those exercising votes, ie, an agency. It should not rely on holders of equity interests failing to exercise their legal rights.

(c) It is difficult to integrate the notions of 'power' and 'returns', when faced with circumstances in which the reporting entity has power but minimal returns (and the reverse). How low do the returns have to be for the reporting entity with power over another entity to be considered to retain control over that entity?

20. The exposure draft needs to be clearer on how to deal with situations - which occur in practice - where there is no substantive power observable in a structure. Essentially, in that case, there are three alternatives:

(a) consolidate based on who has the minor residual elements of actual or potential decision-making that do exist (which is where we believe structuring opportunities will occur - as a party exposed to risks and rewards may be willing to give up this sort of 'power' in order to avoid consolidation);

(b) look to risks and rewards as an indicator of where power is likely to exist in some way (either as a presumption or as a rebuttable presumption); or

(c) simply accept that in these cases nobody should consolidate.

At present, it would be possible to interpret the guidance in the exposure draft to justify any of these approaches. We suggest that where control cannot be identified through other analysis, alternative (b) (using risks and rewards as an indicator) is the most appropriate solution, and it follows most closely the current guidance in SIC 12.

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?

21. No. We agree that a reporting entity should:

(a) consider all relevant facts and circumstances (paragraph 14); and

(b) assess control continuously (paragraph 15).

However, assessment of control should be continuous only to the extent that factors leading to control have changed. Control should not change merely because market conditions have changed, resulting in returns varying between participants or because other shareholders have decided to start or stop exercising their voting rights. If this is the intention of the words in paragraph 16 (ie, if control can change only as a result of 'the actions of the entity or changes in facts and circumstances'), then this should be made clear. Reassessment could perhaps be limited to when the factors that led to a particular accounting conclusion have changed, a similar principle to impairment testing for tangible fixed assets.

22. We have concerns about paragraph 28. This indicates that the dominant shareholder has control in circumstances where other widely dispersed shareholders do not co-operate with each other in such a way as to exercise their power to vote. This may amount to effective control for the dominant shareholder, but we do not believe that effective control is a sound basis for consolidation. Other shareholders may or may not join together to exercise their power, depending on what issues arise and are presented to them for their vote. In reality, we do not consider that such shareholders need to act in an organised way – they merely need to be presented with a sufficiently important motion about which they feel strongly. It is the notion that the widely dispersed shareholders have the ability to exercise power to control that is important, not the actual exercise of it, otherwise the accounting treatment will change depending on whether the shareholders do or do not exercise their voting powers given a particular situation, and the reporting entity would be forced to reassess the consolidation decision every time a decision is put to a vote by members. This suggests the Board has not identified the correct 'activities' over which power is exercised. In our view, the ability to control is paramount and unless there are legal or contractual restrictions in place preventing the widely dispersed shareholders from exercising their power, any effective control by a dominant shareholder is not sufficient for consolidation. Moreover, an approach based on ability to control assuming all shareholders use the rights available to them is likely to lead to more consistent classification.

23. We do not believe that the guidance in the exposure draft on assessing control is sufficient to ensure consistent application. In most cases, we agree that control will be evident from the legal power of voting control. In cases which involve warrants, options and other contracts, it will usually be possible to take a holistic (ie, 'in conjunction with other relevant facts and circumstances') view of the arrangements in order to determine where power lies. Where these tests fail, in cases where the levers of power are unusual, such as in auto-pilot arrangements, it will be more difficult to determine control. At this point, other indicators of where control lies come into play. Risks and rewards would be a particular important indicator in these circumstances. This is consistent with the Board's view that consolidation should not be based on risks and rewards, but also consistent with the notion that risk and

rewards will flow from control (which the Board appears to acknowledge, at least in part, in paragraph 33).

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.

24. The existing provisions in IAS 27 in relation to potential voting rights are unsatisfactory and so we believe that the Board is right to try and move away from the 'currently exercisable' bright line rule. However, we fear that in moving from something that was clear but possibly wrong the Board has put forward a solution that is less clear and potentially difficult to apply. It seems likely that there will be circumstances in which there is no hard evidence of control and the decision will be based on an assessment of whether the other party believes a control relationship exists. We therefore have reservations about the implication of paragraph BC 84 that it is the relationship between the option holder and the counterparty that is important.

25. Overall, we are supportive of the approach adopted by the Board regarding options and convertible instruments, but we have some reservations about the way it is expressed. We suggest that it would be better if paragraph B13 were to set out a principle that would allow sensible application. Accordingly, we believe that sub-paragraphs (a), (b) and (c) should be examples or indicators, rather than rules.

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.

26. We agree in general with the approach to holdings as agent, but we believe that it is necessary to bring more clarity to the drafting. While it is possible to use the proposed wording to arrive at the correct answer, we are concerned that the agent/principal distinction may be less clear under the proposals, leading to uncertainty and inconsistency. Moreover, there appears to be a rebuttable presumption in practice that fund managers always act as agent, which may not be what the Board intended. As a result, we do not believe the proposals deal effectively with the main area of concern, which is funds under management (see our comments in paragraph 27 and 28 below).

27. In the context of managed funds where the fund manager has dual capacity, as both a principal with 'some skin in the game' and as an agent, it would be too easy to assert that the manager is acting in a fiduciary capacity. As they stand, the proposals are likely to lead to structuring opportunities to avoid consolidation. A reporting entity might be exposed to the returns of an investment vehicle and have significant power to direct its activities, but because it has a contractual duty to act in the best interest of the principals it might be able to claim that it is acting as an agent. We therefore fear that the proposals may result in entities being excluded from consolidation where this is not appropriate.

28. It would have been helpful if the Board had fully explored more of the issues surrounding fund management, such as:

- investors often require the fund manager to have a stake in the investments they manage: this is precisely to align interests so that no risk of conflict arises;

- performance fees are designed to align interests of manager and investor so it will often not be possible to distinguish between the manager acting in its own interest and in the interest of the investors, as these interests will be broadly the same;

- determining whether the reporting entity has exposure to the returns of the investment vehicle;

- the extent to which removal rights should be taken into account by a fund manager in assessing whether a control relationship exists;

- the percentage of an entity a principal would typically need to own to have to consolidate when also acting as an agent.

29. The statement in paragraph B3 that the agent must use any decision-making ability delegated to it to generate returns 'primarily' for the principal implies that up to 49.9 per cent is allowable to the agent provided the principal takes 50.1. Was this bright line intended by the Board?

30. Although agency is (rightly) dealt with from a fund management perspective, the provisions will apply to agents acting in different roles. It would have been helpful if the Board had given more explicit consideration of the implications of the agency proposals in other contexts.

31. We are also unclear whether the proposals relate to both structured and non-structured entities. Paragraph 9 points to paragraphs 31(f) and B3 - B8, which deal with structured entities. Is this deliberately intended to exclude non-structured entities? We believe that the same principles should apply in all cases, and that this should be made clear in the standard.

32. This is important because, for example, a general partner (in relevant jurisdictions) has the power to direct by definition. It would not be possible to apply the agency provisions of the exposure draft to a general partner in a non-structured entity if they apply only to structured entities.

33. We note that paragraph B12 derives from FIN 46(R) *Consolidation of Variable Interest Entities*, which requires an entity to treat the variable interests of its related parties and de facto agents as its own. [FIN 46(R), paragraph 16.] While the voting interest held by parties that act or are perceived to act in accord with the reporting entity may need to be considered, the requirement stands without sufficient context to the other requirements in this proposal, making it difficult to understand and apply. Subparagraph (c) is particularly problematic. The Board should explain how these requirements fit in with the other provisions of the proposal and provide examples to demonstrate how the requirement should be applied under IFRS.

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?

34. No, we do not agree with the proposed definition of a structured entity in paragraph 30. If the principle is to arrive at a single model under which structured and non-structured entities are treated in the same way, a definition of a structured entity

should not be necessary for the consolidation assessment. It may be that the Board intended this definition to distinguish structured and non structured entities for disclosure purposes only; however, this is not apparent from the way that the ED is drafted and, as described in paragraph 46 below, we do not consider this to be appropriate either. In any event, the phrase 'An entity whose activities are restricted to the extent that those activities are not directed as described' defines by exception, is difficult to understand and is likely to be inconsistently applied.

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?

35. No, we do not believe that the requirements and guidance regarding the assessment of control of a structured entity in paragraphs 30–38 are sufficient to enable consistent application.

36. The exposure draft does not adequately address issues such as temporary control, 'auto-pilot', who controlled the terms of the original arrangement etc. As set out in paragraph 23 above, we believe that it will often be necessary to use risks and rewards as an indicator of where control might lie in these circumstances.

37. We have identified a number of difficulties in relation to the consideration of returns in determining control:

- While an entity's power may 'generally' be correlated with its exposure to the variability of returns from a structured entity, this would not invariably be true. A party exposed to the variability of returns might be willing to accept these being pre-determined, as opposed to under its control, although it would not be willing to accept another party having control of the entity in this case.

- It is unclear whether there can be 'deemed control' based on a given level of returns.

- What is 'variability' of returns measured against and how are "returns" defined? One approach might be to make a consolidation decision based on expected returns, but this would need to be reassessed against actual returns.

- The control arrangement is established by the original assessment of returns, including the allocation of losses, as recognised in paragraph 16 ('Fluctuations in the reporting entity's returns, without a change in the reporting entity's power to direct the activities of another entity, does [sic] not cause that reporting entity to obtain or lose control of that other entity.'). So control is not reassessed because of losses.

- Structured entities can confer a shared benefit. This might lead to problems in establishing control based on returns, because some returns are non-financial and the parties may not be fully aware of returns accruing to other parties.

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.

38. As set out in paragraph 23 above, we envisage a hierarchy of tests, so that if control could not be determined by the usual means of voting control or control through options or contracts, then additional indicators should be used to determine where power lies. A risks and rewards test would comprise a relatively strong indicator in these circumstances, and one which could generally be assessed on a qualitative basis, so that problems arising in relation to 'variability' of returns would assume less importance.

39. We do not believe that a fall back test would be possible as suggested. Clarification is needed, given the range of things which can constitute a return and the lack of clarity as to whether it is the *level* of returns or the *variability* in returns that is the driver, both types of wording being used in the exposure draft.

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.

40. Our detailed comments on the disclosure requirements are set out in an appendix. Our general comments are set out in paragraphs 41 - 47 below.

41. The disclosure requirements are too extensive and prescriptive, and thus fail to distinguish important messages concerning key risks, and will fail in the objective of providing decision-useful information. The sheer volume of data is likely to be onerous for preparers and confusing for users. It would be preferable for the approach to focus on the principles set out in paragraph 48, with perhaps some limited required elements. As drafted, the detailed requirements are not always consistent with the basic principles.

42. In our view, the overriding principle should be that the disclosures should reflect the risks the business is exposed to and the way they are managed. The Board should ensure that the general principle results in all meaningful information being provided without over-loading annual reports with many pages of needless data.

43. In many instances, no case is made to support the usefulness of the required information. The disclosure requirements should be field-tested by preparers and users, and the IASB should base the final standard on a stringent cost/benefit analysis.

44. To the extent that the items in paragraphs B32 - B49 are described as minimum required disclosures, they should be included in the body of the standard, not in application guidance.

45. Many of the proposed disclosures (notably those around the risks associated with unconsolidated entities) would be better included within a comprehensive reconsideration of IFRS 7 - not as a separate and uncoordinated set of disclosures.

46. As set out in paragraphs 12 and 34 above, in a single consolidation model we do not believe that there should be different accounting requirements for structured entities, as currently defined in the exposure draft,, including special disclosure requirements for such entities. We are aware that some users of financial statements believe that it would be desirable to obtain more detailed information on certain unconsolidated entities, however, as noted above in paragraph 45 we believe that such concerns should be addressed in a comprehensive reconsideration IFRS 7 instead. We further note that having special disclosures for a particular type of entity will lead to

application issues around whether particular entities meet the relevant definition and need to be disclosed. It is not made clear enough in the exposure draft why disclosures that relate only to a sub-set of unconsolidated entities will necessarily be useful. Instead, we suggest that the disclosures should focus on the key risks and judgements affecting the reporting entity regardless of the status of the unconsolidated counterparty.

47. The notion of providing disclosures in respect of all (structured) entities with which the reporting entity has ‘involvement’ is far too wide. As defined, involvement could extend to simply having interest rate swaps with or holding securities issued by these entities. The effect of this will be to bring a huge number of entities within the disclosures, with the effect of obscuring the key information reported in the accounts. Disclosures should be limited to providing details of significant risks that are not otherwise fully reflected in the financial statements.

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.

48. See our detailed responses in the appendix.

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.

49. We agree that reputational risk is not an appropriate basis for consolidation. However, where an entity considers that it may provide support to another entity for what are described as ‘reputational’ reasons, this would justify some disclosures to ensure that there are no contractual or implicit factors which would actually drive the decision to provide the support and which cannot be avoided by the ‘supporting’ entity.

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

50. Please see our detailed comments in the appendix.

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?

52. We agree that there are problems with IAS 28 and we question the usefulness of equity accounting. We think that the Board should eventually address these issues, but we do not consider it is a project that deserves priority.

OTHER MATTERS

Problems with the existing consolidation model

53. As set out in paragraphs 6 and 17 above, we believe that the framework provided by IAS 27 and SIC 12 is operational, although it does have some problem areas. The chief amongst these are as follows.

- As discussed in ED 10, the treatment of fund managers with a dual role can create application issues - particularly relating to the level of interest that a fund manager can hold before consolidating.
- The rule on currently exercisable potential voting rights in IAS 27.14 can give rise to unexpected consolidation answers in some cases.
- The situation where two banks set up an SPE through which transactions pass from one bank to the other can cause difficult consolidation decisions around who consolidates the SPE.

54. In addition, SIC 12 and IAS 27 currently lack guidance in the following areas where some additional clarity may be helpful:

- De facto control;
- Agency; and
- Continuous assessment of control.

Other matters

55. We refer briefly below to a number of other matters.

- Derecognition needs to be dealt with before deconsolidation can be addressed. The definition of control and how it is applied will apply equally to the derecognition model and there will need to be consistency between the two models
- There needs to be a fuller consideration of non-controlling interests and the treatment of put options over non-controlling interests.
- There is important information in the Basis for Conclusions and illustrative examples which should form part of any eventual standard. BC 121, which implies that auto-pilot SPEs would not be consolidated, is one such example.
- Clarification is required as to whether it is ever appropriate for an entity to be consolidated by two reporting entities. ED10.5 states that 'The parent's power to direct the activities of a subsidiary precludes others from controlling the subsidiary', indicating that it is not possible for more than one entity to consolidate. If this is the Board's intention, it would be helpful if it was stated explicitly.
- Too much of the drafting is vague, so that it is not always possible to distinguish examples, indicators, presumptions etc. For example, paragraph 33 seems to imply that risks and rewards (or at least variability in returns)

follow control but states this by way of a casual observation, leaving the reader unclear as to whether this paragraph has the status of an observation, a rule or an indicator.

APPENDIX:
DETAILED CONSIDERATION OF THE PROPOSED DISCLOSURES

DISCLOSURES (APPLICATION OF PARAGRAPHS 48–50)

B30 To meet the disclosure objectives in paragraph 48, a reporting entity must disclose the information set out in paragraphs B32–B49.

B31 A reporting entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of this [draft] IFRS, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics. It is necessary to strike a balance between burdening financial statements with excessive detail that may not assist users of financial statements and obscuring important information as a result of too much aggregation. For example, a reporting entity shall not obscure important information by including it among a large amount of insignificant detail. Similarly, a reporting entity shall not disclose information that is so aggregated that it obscures important differences between the types of involvement or associated risks.

A1 Paragraphs B30 and B31 appear to be contradictory. Paragraph B30 says that information 'must' be provided, while B31 implies that reporting entities should use judgment as to how best to report in order to meet the disclosure requirements. The latter approach seems the more appropriate one, but it is inconsistent with the later detailed requirements. For example, the requirements at B41 and B42 do not use the wording 'in the light of its circumstances' as B31 does. Given that the guidance in B31 is general in nature and would apply to other disclosure standards as well, such as IFRS 7, the Board might consider incorporating it into IAS 1 instead of retaining it here. Regardless, the list of areas to be covered by disclosures should be consistent with the general principles.

BASIS OF CONTROL (PARAGRAPH 48(A))

B32 To help meet the objective in paragraph 48(a), a reporting entity shall describe the basis for its assessment and any significant assumptions or judgements when the reporting entity has concluded that:

A2 The disclosure requirements in B32 - B34 effectively require the directors to justify their assessments in these cases and to attribute amounts to results of the assessments. The effect appears to be to allow users to reperform the consolidation making different assumptions, and so allow users to second guess the results. As the consolidation will have been audited anyway, we do not believe it is appropriate to require these additional disclosures. Furthermore, we do not believe such disclosure adds useful information. It would be more useful to know about the relationship with the entity, the activities of the entity and potential exposures of the reporting entity. We would therefore dispense with these proposed requirements.

(a) it controls an entity whose activities are directed through voting rights even though the reporting entity has less than half of that entity's voting rights.

(b) it does not control an entity whose activities are directed through voting rights even though the reporting entity is the dominant shareholder with voting rights.

A3 As we set out in paragraph 20 above, we do not agree with the principle of effective control of an entity by a dominant shareholder, so we do not accept that this disclosure is necessary. Perhaps a requirement covering situations in which an entity does not control another entity despite having a majority of the voting rights would be more appropriate.

(c) it does not control a structured entity from which the reporting entity receives returns that are potentially significant to the structured entity.

A4 As set out in paragraphs 12 and 34 above, we do not believe that it is necessary to have a definition of a structured entity in a single consolidation model, and it may not be appropriate to include disclosure requirements in relation to a subset of unconsolidated entities in the final standard. Instead we recommend a comprehensive reconsideration of IFRS 7. It is not clear from the exposure draft why the disclosure is limited to unconsolidated structured entities when other unconsolidated counterparties may expose the reporting entity to similar risks.

A5 Assuming this requirement is retained, we understand why it may be important to look at the consolidation assessment from the perspective of the structured entity rather than the reporting entity. However:

(a) the reporting entity may not be necessarily in a position to assess whether returns are potentially significant to the structured entity since it may not be able to get the necessary financial information in the absence of control;

(b) the proposed disclosure is potentially misleading in that it would still be required even if the exposure to the structured entity is completely insignificant for the reporting entity. In this context, it would make more sense to limit disclosure to where returns and exposures are potentially significant to the reporting entity;

(c) with regard to returns in the context of the consolidation assessment, it would make more sense if the disclosure referred to a majority of variability in returns rather than just significant returns.

A6 On a drafting point: we assume B32 should refer to significant assumptions <u>and</u> judgements.

B33 A reporting entity shall disclose, in aggregate in relation to the subsidiaries identified in accordance with paragraph B32(a), information to assist users in evaluating the accounting consequences of its assessment that it controls such entities. Such information might include the amounts in the consolidated financial statements relating to total assets, liabilities, revenue and profit or loss of those subsidiaries.

A7 We do not believe that this disclosure would yield useful information. It would, however, require considerable additional work by the reporting entity, since it appears to require dual accounting for these entities in order to be able disclose the requisite lines in the balance sheet and income statement. There are also a number of unresolved accounting issues, such as whether to disclose the alternative accounting consequences based on equity accounting or accounting as an investment and how to deal with intercompany transactions, on which guidance would be needed.

B34 A reporting entity shall disclose in aggregate, in relation to the entities identified in paragraph B32(b), 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.

A8 As noted in paragraph A2 above, we do not agree that this information should be required. In the case of uncontrolled entities, particularly, the disclosures run the risk of being either massively voluminous (a discussion of the rationale for consolidation or otherwise of numerous individual entities) or simply general/ boiler plate assertions that 'consolidation is based on consideration of all relevant factors' (or similar).

A9 As in the case of paragraph B33, it would require dual accounting in order to disclose the required information, and there are a number of unresolved accounting issues, particularly in relation to intercompany transactions that would qualify as intercompany were the entity to be consolidated.

THE INTEREST THAT THE NON-CONTROLLING INTERESTS HAVE IN THE GROUP'S ACTIVITIES (PARAGRAPH 48(B))

B35 To meet the objective in paragraph 48(b), a reporting entity shall disclose information to enable users to evaluate the interest that the non-controlling interests have in the performance, cash flows and net assets of the group. Such information includes, for example:

(a) the non-controlling interests' share of the group profit or loss and comprehensive income; the non-controlling interests' proportionate interest in dividends paid by subsidiaries; and

(b) the non-controlling interests' proportionate interest in dividends paid by subsidiaries; and

(c) the business activity or segment to which the non-controlling interests relate.

A10 This information should be generally available and it is appropriate to require disclosure. These items should be the information to be provided, rather than 'examples', as there is no obvious other information that needs to be given and if there were any other relevant information it would be covered by the general principles in paragraph 48(b) underlying the disclosures.

B36 A reporting entity shall disclose the date of the financial statements of a subsidiary when such financial statements are used to prepare consolidated financial statements and are as of a date or for a period that is different from that of the consolidated financial statements. The reason why the subsidiary uses a different date or period shall also be disclosed.

A11 We do not believe this information is particularly useful.

RESTRICTIONS ON CONSOLIDATED ASSETS AND LIABILITIES (PARAGRAPH 48(C))

B37 To meet the objective in paragraph 48(c), a reporting entity shall disclose the nature of restrictions that are a consequence of assets and liabilities being held by subsidiaries, including:

(a) the extent to which non-controlling interests can restrict the activities of subsidiaries.

A12 We are not clear how this provision is intended to be interpreted. The powers of non-controlling shareholders will have been evaluated in the consolidation assessment, and may include, for example, the power to call meetings or to block certain resolutions. Possibly the intention is to disclose protective rights over the acquisition and disposal of assets. We suggest that this requirement should be amplified and clarified with examples of what is intended to be disclosed.

(b) legal, contractual and regulatory restrictions, such as:

> **(i) those that restrict the ability of subsidiaries to transfer cash to entities within the group; and**
>
> **(ii) guarantees that may restrict dividends being paid to entities within the group.**

A13 We are not clear why B37(b)(ii) refers only to guarantees, while debt covenants, for example, might also restrict dividends. . Information about restrictions on dividends may be useful, however, it is not clear how these disclosures sit with existing requirements, for instance under IAS 7 paragraph 48 in respect of restrictions on cash and cash equivalents. Including similar disclosure requirements in different standards may add unnecessary complexity for preparers.

(c) the carrying amount in the consolidated financial statements of the assets and liabilities to which those restrictions apply.

INVOLVEMENT WITH UNCONSOLIDATED STRUCTURED ENTITIES AND ASSOCIATED RISKS (PARAGRAPH 48(D))

B38 To achieve the disclosure objective in paragraph 48(d), a reporting entity shall disclose information that enables users of its financial statements to evaluate:

A14 Many reporting entities have some involvement with thousands of counterparties. It is not clear from the exposure draft whether a reporting entity would need to assess all of its counterparties to determine whether they meet the definition of a structured entity, which would clearly be impracticable and ineffective. . It therefore seems necessary to clarify the extent and nature of involvement that would trigger an assessment. Subject to this clarification the disclosure requirements should apply to all such unconsolidated entities, but need to be focused on and limited to the significant risks that the reporting entity is exposed to, the involvement that gives rise to that risk and the current or expected impact on the financial statements.

A15 Paragraph 48(d) refers to involvement. It would be more practical to refer to significant involvement. Involvement with a structured entity the reporting entity does not control could merely be along the lines of an interest rate swap and disclosures on this basis could lead to excessive disclosure of structured entities where a reporting entity's involvement is minimal.

(a) the nature and extent of the reporting entity's involvement with structured entities that it does not control;

A16 As stated above, the disclosures should be focused on significant risks that the reporting entity is exposed to, and not limited to structured entities.

(b) the nature and extent of, and changes in, the market risk (interest rate, prepayment, currency and other price risk), credit risk and liquidity risk from the reporting entity's involvement with structured entities that it does not control. This exposure may arise from both contractual and non-contractual commitments, and from past and present activities;

A17 B38(b) would benefit from some clarification. Is the requirement intended to relate to financial instruments giving rise to market, credit and liquidity risk that are held by a structured entity, but which can affect the reporting entity because of contractual or non-contractual arrangements between the two entities? IFRS 7 should already cover risks where the reporting entity has a financial instrument with the structured entity. It is unclear how the last sentence of (b) extends the scope of IFRS 7 and also fits in with the reputational risk disclosures.

A18 It is also unclear why it will be relevant to provide details of risks arising from transactions with a sub-set of counterparties. The relevant disclosure is the reporting entity's overall risks: taking a sub-set of these risks is of little value to users and potentially misleading and this data is likely to be very difficult to produce in practice.

B39 If obtaining any of the information for the disclosures required by this [draft] IFRS is impracticable, the reporting entity shall disclose why it is impracticable to obtain the information, and how it manages its exposure to risk from its involvement with unconsolidated structured entities for which it is impracticable to obtain the information.

NATURE AND EXTENT OF INVOLVEMENT (PARAGRAPH B38(A))

B40 In accordance with the disclosure objective in paragraph B38(a), a reporting entity shall disclose information about its involvement with unconsolidated structured entities that the reporting entity set up or sponsored, or with which it has involvement at the date of the consolidated financial statements. This includes summary information about the nature, purpose and activities of the structured entities.

A19 Assuming the principles and requirements in B38 are appropriate, this additional detail should not be needed (or to the extent it is needed it can be incorporated into B38). The fact that the reporting entity 'sponsors' (see below) an entity should not trigger disclosure. If that sponsorship results in risks, disclosure should be made on the basis of B38.

A20 The terms 'set up' and 'sponsored' both need additional guidance, as they will be taken to mean different things by different people.

A21 The implication is that a reporting entity should provide details of structured entities that it has set up or sponsored, even if it has no involvement at all with the entities at the date of the consolidated financial statements. It is not clear why this information would be of value to users of the accounts and it may be difficult to access this data for entities with which the reporting entity has no continuing involvement. Disclosure should be focused on the significant risk the reporting entity is exposed to. We suggest limiting the disclosure to where the reporting entity has a current involvement with and/or has set up or sponsored the structured entity in the current financial period. If the IASB is trying to capture entities where the reporting entity will potentially step in to provide support, then this needs to be linked to the reputational risk disclosures.

Structured entities set up or sponsored

B41 A reporting entity shall disclose for unconsolidated structured entities that the reporting entity has set up or sponsored, in tabular format, unless another format is more appropriate, a summary of:

(a) income from the reporting entity's involvement with structured entities, including a description of the types of income presented in the summary; and

A22 We are not clear why this information is only relevant to structured entities that were sponsored or set up by the reporting entity. To the extent that this requirement provides any useful information beyond that required by IFRS 7, and it is not clear that it does, it would appear to be equally useful in respect of any entity in which the reporting entity has an involvement.

(b) the value of assets transferred to those structured entities, at the date the transfers were made. The summary shall separate the activity into relevant categories (such as by type of structured entity or asset that exposes the reporting entity to different risks). The reporting entity shall also identify the extent to which the activity relates to structured entities with which the reporting entity has involvement at the date of the consolidated financial statements and those with which the reporting entity has none.

A23 We assume that the intention is to capture originated loans that are transferred to a structured entity. There is no evident reason to require disclosure of all transfers.

A24 These disclosures should be limited to entities with which the reporting entity has ongoing involvement. It is not clear, for example, why a past transfer of an asset in a 'standard terms' sale of a bond which the entity holds as collateral should require ongoing disclosure in respect of an entity.

A25 Securitisation vehicles are generally unable legally to transact with all market counterparties. As such, it is likely that the reporting entity will have to purchase the assets in the market on behalf of the structured entity. Would this meet the definition of transferred when it is economically the same as the structured entity buying directly in the market? It is somewhat different to the reporting entity transferring originated assets.

A26 It is also necessary to clarify whether the 'value' to be given is the carrying value, the fair value or the transfer value.

B42 A reporting entity shall disclose the information in paragraph B41 for the current reporting period and the preceding two reporting periods. A reporting entity shall assess whether this information meets the disclosure objective in paragraph B38(a), and provide comparative information for additional reporting periods if that information is necessary to meet the objective.

A27 We oppose this new requirement to provide comparative data for more than one period. No case has been made for this additional disclosure, and we cannot see that it is useful.

A28 Producing information for past reporting periods may be very difficult so, at the very least, there needs to be an exemption from providing more than one year of comparative data in the year of adoption of the standard.

NATURE OF RISKS (PARAGRAPH B38(B))

B43 To achieve the disclosure objective in paragraph B38(b), a reporting entity shall disclose information about its exposure to risks from its involvement with unconsolidated structured entities. The disclosure requirements in paragraphs B44–B47 supplement the disclosure requirements in IFRS 7 Financial Instruments: Disclosures.

A29 Our general comment applies: that these risks should be disclosed in respect of all entities, not just structured entities, and disclosures should be restricted to significant risks, because requiring disclosures for all entities for which the reporting entity has an 'involvement' will lead to disclosures that are too extensive to be of value to users.

A30 This appears to be a significant extension of the disclosure requirements in IFRS 7, rather than just a supplement. The disclosure requirements should capture the credit risk, market risk and liquidity risk the reporting entity is exposed to from financial instruments held by an unconsolidated structured entity, not the risks that the structured entity itself is exposed to.

B44 A reporting entity shall present in tabular format, unless another format is more appropriate, a summary of:

(a) the carrying amount of the assets and liabilities recognised in the reporting entity's consolidated financial statements relating to the reporting entity's involvement with structured entities.

A31 Our general comment applies: that these risks should be disclosed in respect of all entities, not just structured entities, and disclosures should be restricted to significant risks, because requiring disclosures for all entities for which the reporting entity has an 'involvement' will lead to disclosures that are too extensive to be of value to users.

A32 We suggest that a requirement in respect of provisions and retained risks should be included at B38.

A33 The meaning of 'relating to the involvement' is unclear. The disclosure requirement needs to be more specific - for example, similar to the disclosure requirements for related party transactions under IAS 24.

(b) the line items in the consolidated statement of financial position in which those assets and liabilities are recognised.

A34 See our comment on B44(a).

(c) the reported amount of assets held by structured entities with which the entity has involvement, measured at the date of the reporting entity's consolidated financial statements. The reporting entity shall disclose the measurement basis of the assets presented in the summary, distinguishing between assets originated by the reporting entity and those originated by other entities.

A35 This disclosure requirement is not practical and will not yield useful information. As the reporting entity has no control over the structured entity, it may well be unable to get the required information. For example, some entities may have no obligation to provide financial reports at all and certainly no obligation to provide them to parties with whom they may have done no more than transact a derivative. Where there are reports, the two entities may have different reporting dates, and they may adopt different measurement bases. Moreover, it will be difficult to measure assets held by the structured entities that are originated by other entities, when there is no information about impairments, etc.

A36 The important information for the user is the amount recorded by the reporting entity and the total and total exposure. It is not useful to know the total amount of assets held by the structured entity. For example, reporting entity A holds 5x £25m senior notes in different collateralised debt obligation (CDO) vehicles each with £10bn of assets, and would report total assets of £50bn. Reporting entity B holds 3x £200m senior notes in different CDO vehicles each with £5bn of assets, and would report total assets of £15bn. What do the total asset figures tell the user about the risks that reporting entities A and B are exposed to?

(d) the amount that best represents the reporting entity's maximum exposure to loss from its involvement with structured entities, including how the maximum exposure to loss is determined.

A37 Details of maximum exposure to loss should be available, as the entity will need this to manage its risk, and it is not unreasonable to request these disclosures, assuming that the population of entities for which reporting is to be provided is more clearly defined.

A38 However, it should be noted that figures for 'maximum' exposure to loss will often not be available as there is no upper limit to the potential loss under many types of derivative (eg, written options, interest rate swaps). If this disclosure is to be provided it should be permissible or required to take account of any related hedging arrangements (whether or not with structured entities) that mitigate the exposure. This will reflect the reporting entity's economic exposure - without this, figures for maximum loss are meaningless and misleading.

B45 The information required in paragraph B44 should be classified into categories that are representative of a reporting entity's exposure to risk (such as by type of structured entity or type of asset).

B46 In addition, a reporting entity shall disclose other information that is relevant to an assessment of the risks to which the reporting entity is exposed. That other information might include any of the following:

A39 The information required by B46(a) and B46(b) may not even be produced by the structured entity and, even if it is, that entity is unlikely to have any requirement or inclination to provide it to the reporting entity. Accessing this information is likely to be difficult or impossible for any entities that are not actually controlled by the reporting entity.

(a) in relation to structured entities' assets, their categories and credit rating, their weighted-average life, and whether any assets have been written down or downgraded by rating agencies.

A40 This exceeds the disclosure requirements on credit losses in IFRS 7. The requirement, if retained, should be limited to any credit risk disclosures required under IFRS 7.

(b) in relation to funding and loss exposure:

(i) the forms of structured entities' funding (eg commercial paper, medium-term notes) and their weighted-average life. That information might include maturity analyses of the assets and funding of structured entities if the structured entities have longer-term assets funded by shorter-term funding.

(ii) any difficulties structured entities have experienced in financing their activities during the reporting period.

A41 The disclosure requirements should not exceed the requirements of IFRS 7, IAS 7 and other applicable guidance.

(iii) losses incurred by the reporting entity during the reporting period relating to its involvement with structured entities.

A42 We agree with this disclosure requirement, but suggest that it should fall into paragraph B38. Alternatively, paragraph 20 of IFRS 7 could be expanded to cover other items of significance.

(iv) estimated exposure to loss or range of outcomes of that loss that were reasonably possible at the date of the reporting entity's consolidated financial statements, if the reporting entity believes that the maximum exposure to loss is not representative of the estimated exposure to loss. The reporting entity shall explain the methodology used to determine the estimated exposure to loss or range of that loss.

A43 This requirement seems to duplicate the requirements of B44(d) but with an added sensitivity analysis, so our comments at paragraphs A37 and A38 above apply. Some application guidance may be needed as in the material on credit risk and market risk sensitivity analysis under IFRS 7.

(v) whether the reporting entity is required to bear any losses before other investors in the structured entity, the ranking and amounts of losses borne by each category of party involved, and the maximum limit of such losses.

(c) the types of returns the reporting entity received during the reporting period from the financial instruments it holds in structured entities.

A44 There is no need for this separate requirement. The results of the structured entity are incorporated in what is being reported and if they are material enough they would have to be separately identified under IAS 1. There is no need for this separate requirement. It also seems an unnecessary duplication of the disclosures provided under B41(a).

(d) the nature and terms of any obligation of the reporting entity to provide liquidity support to structured entities (eg to purchase assets or commercial paper of the structured entity), including:

(i) a description of any triggers associated with the obligation.

(ii) whether there are any terms that would limit the obligation.

(iii) whether there are any other parties that provide liquidity support and, if so, how the reporting entity's obligation ranks with those other parties.

A45 Disclosure of liquidity support obligations is a reasonable requirement.

(e) in relation to support that has been provided by a reporting entity to structured entities during the reporting period whether:

A46 Disclosure of support actually provided is a reasonable requirement, provided that the population of entities for which reporting is to be provided is more clearly defined.

(i) the reporting entity purchased any debt or equity interests in structured entities, and whether any agreement required the reporting entity to make these purchases.

(ii) other assistance was provided to structured entities in obtaining any other type of support.

(iii) there are any current intentions to provide support or other assistance to structured entities in obtaining any other type of support.

A47 We do not believe it is reasonable to require disclosure of 'current intentions'. Companies would not want to document that they might step in and potentially create a constructive obligation if they are not definitely going to step in. Current intentions might not be clear cut. We suggest that 'intentions' should be 'commitments', with other actions captured by post balance sheet events. This also applies to paragraph B47(a).

B47 If, during the reporting period, a reporting entity has, without having a contractual or constructive obligation to do so, provided support to structured entities that were not consolidated at the time of providing the support, it shall disclose:

(a) the extent of support provided, including its nature and amount, including situations in which the reporting entity assisted the structured entity in obtaining another type of support, or in which there are current intentions to do so;

A48 See our comment on current intentions in paragraph A47 above.

(b) an explanation of why the support was provided;

(c) an explanation of how the provision of the support resulted in the reporting entity controlling the structured entity, if applicable.

A50 The current wording could be read to capture relationships where the reporting entity has no reputational risk, but has financed an entity because it believe the returns to be suitable compensation for the risk - that is, where the transaction is on commercial terms. It is extremely common for financial institutions to finance other entities where there is no pre-existing contractual or constructive obligation. Transactions on an arms-length basis need to be excluded. Specific reference should be made in paragraphs B46 and B47 to the reporting entity transacting to protect its reputation where no one else was prepared to transact on similar terms, and/or the requirement should be limited to cases where the provision of finance has resulted in the entity providing the support incurring a loss - otherwise this could capture many purely commercial investments

ACCOUNTING CONSEQUENCES OF CHANGES IN A REPORTING ENTITY'S OWNERSHIP INTEREST WITHOUT LOSS OF CONTROL (PARAGRAPH 48(E))

B48 To meet the objective in paragraph 48(e), a reporting entity shall disclose a schedule that shows the effects on the equity attributable to the owners of the parent of any changes in the ownership interest of the parent in a subsidiary that do not result in a loss of control.

A51 It would be helpful to illustrate this requirement with a disclosure example in the Application Guidance.

ACCOUNTING CONSEQUENCES WHEN A REPORTING ENTITY LOSES CONTROL OF A SUBSIDIARY (PARAGRAPH 48(F))

B49 To meet the objective in paragraph 48(f), a reporting entity shall disclose the gain or loss, if any, recognised in accordance with paragraph 46, and:

(a) the portion of that gain or loss attributable to recognising any investment retained in the former subsidiary at its fair value at the date when control is lost; and

(b) the line item(s) in the statement of comprehensive income in which the gain or loss is recognised (if not presented separately in the statement of comprehensive income).

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