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Le Président

JFL/VR/IGG
N° 17

PARIS, 20 MARCH 2009

IASB
30 Cannon Street
LONDON EC4M 6XH
UNITED KINGDOM

Re: Exposure Draft "ED10 Consolidated Financial Statements"

Dear Sir or Madam,

I am writing on behalf of the Conseil National de la Comptabilité (CNC) to express our views on the above-mentioned Exposure Draft.

The IASB initiated its project on consolidated financial statements with the objective of a single standard on consolidation to replace the consolidation requirements in IAS 27 and SIC 12. In April 2008, in response to the global financial crisis and the recommendations of the Financial Stability Forum, the IASB decided to accelerate the consolidation project and proceed directly to the publication of an ED.

The CNC had expressed its full support for the objective of developing a new control model (definition of control and related application guidance) that can be applied to all entities (structured entities and others) ; however the CNC does not believe that the proposed ED achieves this objective and even wonders whether such objective is achievable, although that does not mean that we believe the IASB should not try.

The CNC strongly supported the IASB in its efforts to address as a matter of priority certain elements of the project, such as the additional disclosures, as these are urgently required by users of financial statements in the context of the global financial crisis.

The CNC is far less convinced that the same urgency applies to the reconsideration of the control model as, even if certain inconsistencies could be perceived between IAS 27 and SIC 12, the implementation of these standards was globally satisfactory and their revision is therefore less urgent.

For various reasons explained below, the CNC concluded that the ED, as drafted, does not represent an improvement over the existing Standard (except for the new disclosure requirements).

Whereas it is mentioned in § 9 of the introduction of ED10 that the aims of this project were i) to address the inconsistencies between the application of IAS 27 and SIC 12 due to diversity in practice and ii) to reduce the structuring incentives that those inconsistencies might have created, the CNC finds it difficult to identify the clarification brought by this new project as the Board did not demonstrate how the application of ED 10 would resolve those inconsistencies.

The CNC is not convinced that the new proposed control concept will always result in the right entities being consolidated with the risk that certain structured entities consolidated under SIC 12 would no longer be consolidated under the new Standard. (Please refer to issues developed in question 7 regarding the assessment of control of a structured entity).

The current draft includes a number of inconsistencies which lead us to believe that the new Standard will result in practical implementation and interpretation difficulties over and above those raised at present by IAS 27 and SIC 12 and will result in increased diversity of practice and is not robust enough to enable consistent application. (Please refer to question 3 which describes the lack of clarity and consistency related to the assessment of the power criteria, the assessment of the return criteria and the link between power and returns; to issues developed in question 4 on the guidance regarding options and convertible instruments and in question 5 on the guidance on agency arrangements).

Some of those inconsistencies may be drafting problems only which could be solved easily, however, we are convinced that some are more serious and result, in particular, from a lack of adequate coordination with other IASB projects.

For these reasons the CNC recommends that the IASB divide the project into two parts:

- a short-term priority project dealing with issues related to the financial crisis (essentially additional disclosures).

- a long-term project which would start from scratch at the conceptual level and be fully coordinated with other IASB projects. Such a long-term project should include:

  - a far more thorough analysis of what could work better with IAS 27 / SIC 12

  - what are the users needs and therefore the objectives of consolidated financial statements

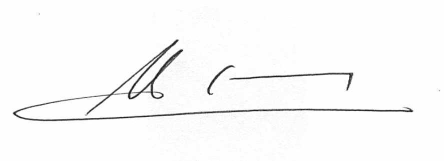
  - links with the definition of assets and liabilities, the new derecognition project, control of an asset vs control of an entity, control vs risks and rewards.

Such a long-term project should also deal with the accounting for joint ventures and associates. It should be organized as a real joint project with the FASB in order to achieve a converged approach between IFRS and US GAAP

Further details are provided in the Appendix I to this letter.

We hope you find these comments useful and would be pleased to provide any further information you might require.

Yours sincerely,



Jean-François Lepetit

Appendix I

Questions 1 -2

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?

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

As mentioned in our cover letter, the CNC considers that, in order to answer question 1 and 2 correctly, the fundamental objectives of consolidated financial statements need to be defined first, and that the core principle set out in § 1 i.e " a reporting entity presents financial statements that consolidate its assets, liabilities, equity, income, expenses and cash flows with those of the entities that it controls" is not clear enough in respect of the stated objective.

The CNC's position is that the current ED is not sufficiently robust in its link to the following major issues which must be dealt with first, based on the objectives which would have been decided for the consolidated financial statements.

- <u>Control of an asset vs control of an entity:</u>

The Exposure Draft does not elaborate on the differences which may exist between the control of an asset and the control of an entity.

Whereas the consolidation and derecognition projects are closely related in a number of areas, we would like to underline that the debate concerning the articulation between the two projects is still ongoing at the IASB: in one of the agenda papers of the derecognition project presented but not discussed at the 2009 February Board meeting, the staff of the IASB clearly specified that in some circumstances, depending on the order used for the application guidance of the proposed derecognition and consolidation projects, the result could lead to different conclusions and that further clarifications are needed.

- <u>Assessment of power vs risk and rewards approach:</u>

The CNC points out that it is also important to bring the Discussion Paper Preliminary Views on an improved Conceptual Framework for Financial Reporting in the discussion.

In the memorandum summarising the comments received from constituents on the Reporting entity Discussion Paper, presented to the Board in November 2008, it is mentioned that most respondents agree with the view that the risks and rewards model (or the notions included in that model) should be used to complement the controlling entity model.

The CNC's position is that, as concerns the consolidation project, the following point has not been satisfactorily developed and should be further looked into :

in what way should the risks and rewards to which a reporting entity can be exposed and which could have an impact on future cash flows be assessed in order to define the borders of a group?

Therefore, the CNC considers that the preliminary debate is not conclusive enough to replace the notion of control as defined by IAS 27 and the control indicators in SIC 12 with respect to "Special Purpose Entities" with a single definition of control that would be sufficiently robust to be applied consistently to all entities.

Moreover, the manner in which the proposed Standard is currently drafted (a general principle developed for "traditional" entities and different additional specific principles for structured entities) appears to be more a juxtaposition of two different approaches than a new consistent Standard governed by a clear principle allowing consolidation of all types of entities using one single consolidation principle.

Please refer to issues developed in questions 3, 4 and 7.

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?

While we welcome the intention of the IASB to provide clarifications/guidance that would help preparers in applying the control definition and to address some particular situations, we believe that, to be useful, guidance should be unambiguous and sufficiently clear to avoid any misinterpretation on the manner the concept developed in the standard should be applied. This seems not to be the case.

The CNC considers that there are inconsistencies and/or inaccuracies between the proposed definition of control in paragraph 4: "A reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity to generate returns for the reporting entity" and the guidance provided in the appendix to assess control in different situations.

In certain cases, we believe that the inconsistencies may be easily resolved by re-drafting the current project, nevertheless in other cases our concerns are more fundamental and result from the fact that the single principle proposed by the exposure draft is not robust enough to enable consistent application. Particularly, some of the concepts of the general definition of control which are set out in the guidance may present some contradictions in respect of some of the situations developed in the draft (dual role, structured entities).

The lack of clarity and the inconsistencies we have identified in the current project as it is drafted are described below and relate to:

- assessment of the power criteria

- assessment of the return criteria

- the link between power and returns

- **<u>Assessment of the power criteria</u>**

- Power to direct/ability to direct versus demonstration of the ability to direct through the effective exercise of that power

The CNC considers that the application guidance of the power criteria is not consistent when considering situations that should be assessed similarly.

Some paragraphs of the Exposure Draft clearly refer to the need to demonstrate the ability to direct the activities while others do not require such a demonstration even if the power is not effectively exercised (Please refer to question 4 which describes our concerns with the difference made between a passive shareholder and an option holder).

Furthermore, the CNC thinks that drafting inconsistencies may exist as far as for assessing the power criteria, in some paragraphs the term used is "Has the power" (paragraphs 4, 22, 24, 27) whereas in others the term used is "Can have the power" (paragraphs 9, 23, 29). Similarly, while some paragraphs of the Basis for Conclusions (BC 47, 51) clearly refer to the ability to direct the activities as a condition of control and make a distinction between the ability and the effective exercise of power (BC 47), others seems to require that the power must be exercised (see BC 50).

- *Power to direct the activities by determining the strategic operating and financing policies*

The way paragraph 22 is written may contradict other paragraphs of the guidance or some of the comments provided in the Basis for Conclusions.

Indeed, it is indicated that the power to determine the strategic operating and financing policies is only one way to direct the activities (BC 44) and the condition set out in that paragraph does not seem to be a sufficient condition in assessing whether an entity that holds options can direct the activities (please refer to question 4).

The CNC therefore suggests adding “for example” in paragraph 22.

- *Majority of the voting rights but no control*

Paragraph 25 indicates that a reporting entity is prevented from having the power to direct the activities of an entity that is placed under legal supervision and does not control that entity.

The CNC suggests to the Board to include a clarification that the term « legal supervision » as stated in that paragraph means that the entity is subject to control of a government, court, administrator or regulator if it is the intention of the Board to carry forward the guidance already provided under IAS 27. This would avoid any misinterpretation when applying the guidance.

- *Guidance on protective rights*

Paragraphs B1 to B2 provide preparers with guidance on the manner to address protective rights that other parties may hold over an entity and state that this cannot impede a reporting entity from having control.

The CNC supports the Board’s proposal to include such guidance on protective rights (paragraphs B1-B2) when assessing the impact of veto rights on control over an entity. However, the CNC believes that the draft should have considered the whole guidance provided in EITF 96-16 on participating rights as this would reduce subsequent misinterpretations (in particular, EITF 96-16 provides guidance about assessing whether participating rights are substantive or not).

- **<u>Assessment of the return criteria</u>**

- *Variability of the returns versus absolute returns*

Whereas some paragraphs of the ED (the definition of control in paragraph 4 and 19) seem to refer to the exposure of the total returns generated for the reporting entity (ie absolute economic outcome) some other paragraphs indicate that the assessment should be performed by reference to the variability of those returns (ie assessing exposure to variability of the returns involves looking at a risk weighted analysis of those potential returns).

Furthermore, the definition of returns refers to the requirement for the fees to vary, which implies that any fixed fee does not constitute an element of returns. This is contradictory with the guidance of § 20 which refer to returns and includes '*fixed fees in conjunction with variable returns from related arrangements…*'

As a result, the CNC is concerned about the way the returns component of control should be assessed. In other words, the CNC is wondering what is the underlying rationale and whether for assessing the control one should appreciate the greatest variability attached to the returns received or the greatest absolute returns as there may be some cases where a reporting entity is exposed to a low level of the total returns (because of significant upfront fees, or fixed fees) but is nevertheless the most widely exposed to the variability of those returns.

- *Variability of returns Vs Risks and rewards*

Although it is understood from discussions with IASB staff that the intention of the IASB is that variability of positive and negative returns is actually a requirement that returns have an element of risk associated with them, the CNC would like to emphase that the Exposure Draft as drafted does not specifically state that returns must have risk associated with them. Conversely, some of the guidance provided do not seem to require such an association as some fixed up front fees for which no risk is expected to be incurred, may be included in the returns definition (see paragraph 20).

The CNC suggests that the Standard clearly explains in paragraph 11 how risks and returns are related to the control definition, and clarify the way some fees should be taken into account when assessing the second component of the control definition (see the comments below).

- *Returns from related arrangements that are or are not commensurate with the services performed*

There seems to be a lack of consistency between paragraph 11(b) and the paragraphs B5 to B8. Paragraph 11 (b) seems to include fees related to arrangements that involve the performance of services or not and that may be commensurate with those services or not while the guidance provided in the paragraphs B5 to B8 indirectly indicate that fees that are fixed or variable, but negotiated on an arm's length basis, and commensurate with the services performed (BC 54) should not be taken into consideration when assessing control. This is also confirmed by paragraph BC 54 which adds that "returns differ from fees paid in exchange for services".

The CNC believes that this inconsistency should be addressed by clarifying the scope of the returns that are part of the definition of control (paragraph 11) as it might create confusion when analysing the nature of returns generated for the reporting entity.

- *Positive and negative returns*

According to paragraphs 10 and BC 52, the term "returns" has been used in the control definition instead of benefits to clarify that those could be positive as well as negative. Furthermore, the CNC understands from paragraph B8 that the fact that an agent is not exposed to the negative returns (because it is unlikely to be required to contribute to the entity by refunding the fees previously obtained) is an indicator that the fees it receives do not satisfy the returns criteria included in the control definition.

The CNC is wondering to which extent this guidance should be applied by analogy to situations where there is no such clarification. For example in the case of a fixed exercise price option holder who is only exposed to the loss of the option premium[1], whereas he might benefit from all the positive impacts when the option has been exercised.

[1] If the option is not exercised because of the shortfall of the market value of the underlying shares

- **Link between Power and Returns**

The CNC believes that the draft gives too much weight to the power criteria when assessing control over a structured entity especially in the cases where such power is difficult to determine (Please refer to question 7).

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.

Overall, the CNC finds the discussion about options and convertible instruments confusing and contradictory, thereby making it difficult to conclude what role such instruments have in the assessment of control.

Furthermore the CNC believes that the principle set out in paragraph 8 that a « reporting entity need not have exercised its power to direct the activities of an entity to control that entity » is not applied consistently in situations which appear to be similar.

Whereas for the passive investor, assessment of power is based on the ability to vote and choose at any time to direct the activities by exercising the voting rights, for the option holder, assessment is based on the effective exercise of power (because in that case power can only be evidenced by the fact that decisions made by the board of directors correspond to the wishes expressed by the investor). In other words, the option holder will be required to show that it effectively has the power through the nature of the decisions that are made.

Besides the fact that the CNC is convinced that the demonstration that a board of directors is influenced by the option holder would be highly judgmental, it believes that the existence of control would be excessively difficult to assess in such a case.

The CNC is also convinced that there should be no material difference between the power held by a passive investor and the power obtained by the holder of a « control » option and agrees with the comments provided by the dissenting members of the Board.

The CNC recognises that when assessing the power from holding options or convertible instruments, a reporting entity should consider all the facts and circumstances, however for options currently exercisable, the CNC wonders if this criterion should not be enough by itself. The power is the ability to do something or to impede/restrain someone from doing something that we do not concur with. Furthermore, the power should not depend upon the occurrence or non occurrence of an event that is not under control. On that basis, we are not comfortable with the Board's proposal that options should not be taken into account in assessing control when they allow the holder to influence the decision made by the governing body. We consider that an option that is currently exercisable gives the holder the ability to obtain at any time the voting rights that are necessary to direct the entity's activities.

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 others parties as an agent ? If not, please describe the circumstances in which the proposals would lead to an inappropriate consolidation outcome.

The CNC has concerns about whether paragraphs B3 to B8 which set out guidance on determining when an agency relationship exists are articulate enough in order to be helpful in assessing when a reporting entity controls another entity.

Paragraph B4 indicates that the unconditional right to remove an agent ensures that the principal has the power to direct the activities and that rights to remove a party only in circumstances such as bankruptcy or on breach of contract are protective rights. It should be clearer that removal rights is only one of the indicators along with others to be considered in a control assessment.

The CNC points out that application guidance relating to dual role (in particular, paragraph B11 which provides guidance to assess the power obtained both directly and on behalf of an agent) is included in the guidance relating to agreements with other vote holders rather than the agency relationship guidance.

As suggested by BC 91, which gives the example of a fund manager acting in a fiduciary capacity, having a direct investment in the fund it is managing, a situation of dual role may exist even when the power is not assessed by voting rights.

The CNC's position is that for mutual funds, when by law, contractual agreement or fiduciary responsibility, an agent acts in the best interests of the principal, by the extension of the meaning of the voting rights, the agent's power might be excluded in the assessment of control. Otherwise (if §B11 may not be applied to investment funds), the CNC stresses that a huge number of funds would be consolidated when, it would not be economically relevant.

The CNC considers that paragraph 31 which describes the fact and circumstances to be considered assessing the control of a structured entity should clarify that B11 also has to be taken into account.

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?

As the main objective of the ED is to propose a single consolidation principle that should be applied to all entities, the CNC considers that structured entities need not be specifically defined to be able to assess control and thus the consolidation conclusion.

However, we recognise that such a definition is necessary in order to make clear what types of non consolidated structured entities in which the reporting entity has involvement fall within the scope of particular disclosures.

Besides, the CNC is concerned about whether the current indirect proposed definition would succeed in capturing precisely the structured entities for which enhanced disclosures are required, and recommends that the definition be developed by incorporating some of the guidance provided in BC106.

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?

The CNC considers the guidance for establishing the link between the two criteria of the definition set out in paragraph 4 of the draft standard , i.e. the « power » and « returns » for assessing the control of structured entities, to be subject to discussion and interpretation.

- *Emphasis of the power critera*

The CNC considers, with respect to the assessment of control in structured entities, that the emphasis placed on the need to direct the activities in the definition of control and the guidance set out subsequently in paragraphs 31 to 36 may distort the assessment of control which should be carried out more “in substance” as stated in paragraph 8 of SIC 12: " an SPE shall be consolidated when the SUBSTANCE of the relationship between an entity and the SPE indicates that the SPE is controlled by that entity“.

The CNC considers that once decisions have been identified in the operation of the structured entity that influence returns and that the power to decide is shared amongst different stakeholders, putting emphasis on the criterion of power to direct activities as in the current project may be interpreted as a possible reason for not consolidating an entity and is concerned that the current wording might be used for structuring opportunities. (An example of a situation in which the decisions related to the activities which influence the returns on a vehicle of investment are shared between several banks and illustrating our comments is enclosed in appendix II).

- *Interpretation of paragraph 33*

The CNC considers that paragraph 33 which refers to the correlation between power and variability of returns is drafted in a way that could be interpreted as a presumption according to which the reporting entity which is more exposed than any other third party to the variability of returns which are potentially significant for the structured entity has the power to direct the activities of the structured entity and as a consequence controls that entity, could be in contradiction with certain Basis for Conclusion such as BC 56 which states that *"the right to receive return is not a sufficient condition for control"* and BC 121 which state that " *if a reporting entity has no means of directing or managing the activities or assets and liabilities of an entity, it does not have any ability to affect its returns from its involvement with that entity and would not control the entity even though it might be exposed to risks associated with the structured entity"*

The CNC is of the opinion that if the idea developed in paragraph 33 was interpreted by some as a presumption then its application could lead to inappropriate conclusions for consolidation, in particular in the case of mutual funds where a significant holding is held by a group directed by an irrevocable management company when the group has no possibility of influencing the decisions taken by the management company but, more than any other investor, is exposed to the variability of returns from the fund.

Consequently, the CNC considers that the idea in this paragraph should not be seen as A presumption BUT rather as an indicator amongst others for assessing control of a structured entity and recommends that the drafting of paragraph 33 be revised and clarified.

- *Treatment of silos*

Furthermore the CNC considers that ED10 provides insufficient clarification of the treatment of "silos".

The CNC notes that ED 10 indicates that in the definition of a subsidiary in appendix A, an entity included in a legal structure is sometimes called a "silo" in national accounting standards without giving further details, and wonders about the consequences and implication of this footnote included with the definition of subsidiaries.

The CNC notes that SIC 12 made no mention of the consolidation of silos representing compartments of a legal entity, and that this point has not been resolved by ED10.

The CNC stresses that as a minimum it appears necessary to give guidance in ED10 on the definition of a silo and emphasises the fact that the additional guidance necessary to determine whether to consolidate the assets of a silo separated off for the benefit of specific investors will need to be consistent with the derecognition project.

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.

As indicated in the cover letter the CNC supported the objective to develop one control model that applies to all entities (structured entities and others) ; for this reason the CNC is not in favour of introducing a risk and rewards fallback test when the power criteria is difficult to assess for structured entities as such a test would create the same problems as the application of SIC 12 under the existing IAS 27 / SIC 12 standards.

However the CNC, after reviewing ED10, considers that such a unique control model has not been achieved by the Exposure Draft and may even not be achievable ; it therefore recommends that the IASB reconsider the model. The CNC believes this could be done :

- by requiring the reporting entity, to first identify its "direct rights and obligations" ("direct risks and rewards") resulting from its involvement with other entities as currently proposed in ED 9 and ;
- by introducing a risk and rewards notion as part of the variability of returns in the definition of the control of structured entities.

Question 9

Do the proposed disclosure requirements described in § 23 provide decision-useful information? Please identify any disclosure requirements that you think should be removed from, or added to, the draft IFRS.

The CNC is pleased to note that ED10 indicates the main objectives of the disclosures required and considers that these disclosures represent a significant improvement over the current standard.

The CNC considers that the current project includes two different types of disclosures:

- disclosures directly related to the consolidation project and

- more general disclosures related to the reporting entity's business risk which is not really linked to the consolidation project but to business risks taken by the reporting entity through its involvement in non consolidated entities.

Our detailed comments on both sets of requirements are described thereafter.

Disclosures directly related to the consolidation project

The CNC is broadly in agreement with the main objectives mentioned for the following disclosures directly related to the Consolidation project:

- disclosures allowing users of financial statements to assess the judgements that management has made in assessing the control and the related accounting consequences (paragraph 48a). We consider that these disclosures fall in the scope of IAS1.122 which requires that a entity shall disclose the judgements that management have made and have the most significant effect on the amounts recognised in the financial statements.

- disclosures allowing users of financial statements to assess the nature and financial effect of restrictions that are a consequence of assets and liabilities being held by subsidiaries. (paragraph 48c). We consider that these disclosures address real user needs.

- disclosures carried forward from IAS 27 about the accounting consequences of changes in the reporting's entity ownership interest in a subsidiary that do not result in a loss of control (paragraph 48 e and f).

However, we are not convinced of the decision-usefulness of disclosures proposed regarding the interest that the non–controlling interests have in the group's activities (paragraph 48b). This "Parent entity economic " type of disclosures seems to contradict the Board's previous decision to move to an "economic entity approach" (please refer to paragraph BC 131 and 132).

We consider that this nature of disclosures will unnecessarily significantly increase the volume of consolidated financial statements.

The CNC has also identified inconsistencies and/or inaccuracies in the ED as it is currently drafted.

Whereas B30 indicates that: "*To meet the disclosures objectives in § 48, a reporting entity must disclose the information set out in § B32-B49"*, B31 specifies that it is the reporting entity who "*decides, in the light of its circumstances, how much detail it provides to satisfy the requirement of this draft IFRS"* and paragraphs B33- B34 indicate that: " *a reporting entity shall disclose...such information that might include …"*

The CNC considers that it is not clear whether the disclosures are intended to be mandatory or indicative, and recommends that the term "must" used in B30 be removed and substituted with a less strong word.

Moreover, the CNC thinks that this part of the ED should be redrafted in order to emphasise and make clear that paragraph B31, which the CNC considers is fundamental, covers all of the disclosures required by the standard.

The CNC points out that paragraphs B33 and B34 require disclosures to be provided in aggregate to assist users in evaluating the accounting consequences of the assessment for entities controlled with less than half of the voting rights and for entities not controlled if the reporting entity is the dominant shareholder with voting rights.

The CNC considers that supplying the information required in aggregate is of very little interest to users and therefore the implementation cost of such disclosures is disproportionate.

In accordance with the intent in IAS 1, the CNC recommends that the disclosures required by paragraphs B33 and B34 be given individually for those specific cases when the judgements made by management have the most significant effect on the amounts recognised in the financial statements rather than in aggregate for all the entities which fall within the scope of B32 a) b).

Lastly, the CNC feels that paragraph B36, which requires disclosures when the date to prepare the financial statements of the subsidiary differs from the date to prepare the consolidated financial statements, has nothing to do under the heading: *" Interest that the non-controlling interests have in the group's activities"* and should be moved to another section of the ED.

<u>Disclosures about unconsolidated structured entities that the reporting entity does not control, but in which the reporting entity has involvement.</u>

Even if it is not convinced that such disclosures should be part of a consolidation standard as they relate to the risks of the reporting entity as part of its involvement in non consolidated structured entities, the CNC considers that the recent financial crisis has shown the utility for the users of consolidated financial statements of such disclosures on "off-balance sheet items" and business risks.

However, the CNC considers that paragraph B38 gives a much too broad definition of structured entities for which the reporting entity must give additional disclosures as such definition may encompass all structured entities with which the reporting entity has any type of transactions.

Moreover, paragraph B38b refers to contractual and non contractual commitments ; to the extent that reputational risk has been excluded, it would be useful to have examples of non contractual commitments.

Furthermore, the CNC is extremely concerned about the volume and degree of details of the proposed disclosures and recommends that requirements be rationalised and considerably reduced:

- as already mentioned, clarify that paragraph B31 cover all of the disclosures required by the standard,
- include the "relevant" notion which is only referred to in paragraph B46 in all of the paragraph on structured entities,
- specify clearly that the list of disclosures required should not be understood as an exhaustive list but rather as an indicator of disclosures that could be useful for users to assess the risks to which reporting entities are exposed due to their involvement in non consolidated structured entities.

For the CNC, this approach is justified since some of the disclosures required are already disclosed according to other standards (IAS 28, IAS 31, IFRS 7, IAS 37). This redundancy could impair the quality of published information. Furthermore, some of the disclosures may not be relevant for certain activities.

Disclosures required by paragraphs B44 (a), (b) and (c), B46 (a) and (b) are voluminous, not necessarily very useful for decision making and costly to obtain if they can be obtained at all.

Paragraph B40 requires certain disclosures in relation to unconsolidated structured entities that the reporting entity has set up or sponsored. These two terms are not defined in the exposure draft.

Paragraph B42 requires a reporting entity to disclose the information in B41 for the current reporting period and the preceding two reporting periods. The CNC disagrees with such requirements which are not explained in the basis for conclusions and which are considered irrelevant if no other information is requested for the third year.

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

The CNC is concerned about the fact that:

- the information required might be difficult to obtain from non controlled entities in which the reporting entity is involved,[2]

- significant changes will have to be made to reporting systems,

- providing information under local GAAP when the non controlling entity does not report under IFRS will be of little interest.

Question 11

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.

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

The CNC's position is that reputational risk is not in itself an appropriate basis for consolidation.

The CNC agrees with the disclosures required by paragraph B47 "*If during the reporting period, the reporting entity has, without having a constructive obligation to do so, provided support to structured entities that were not consolidated at the time of providing support*".

However, The CNC considers that §B46e iii) which mentions that: "*in relation to support that has been provided by a reporting entity to structured entities during the reporting period, a reporting entity shall disclose whether there are current intention to provide support or other assistance to structured entities in obtaining any other type of support* " might not be clear enough about whether the information is required only for the entity to which a support has been provided or for all similar structured entities.

[2] In particular disclosures required by paragraphs B44c, B46a), B46b)

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?

The CNC is aware that the accounting procedures for associates might require some reconsideration to address some practical issues identified so far. Apart from those reconsideration, the CNC considers that any potential deliberation on the accounting for such investments should be part of a broader project on the definition of a reporting entity and the objectives of the consolidated financial statements. Such a project should follow the normal due process.

The CNC is not convinced by the arguments proposed by the Board in paragraphs 29 to 31 and strongly believes that there is a clear need to address the situations where an investor/reporting entity has involvement with an entity beyond that of a passive investor but does not control that entity (joint control, significant influence, and potentially other involvement).

At this stage of the IASB's deliberations, the CNC believes that the use of the equity method should be carried forward for such investments that often are made in the perspective to develop the core business and are fully part of the business model of the reporting entity. An investment in an associate is definitely not similar to an investment in a financial asset as the financial and operational objectives are fundamentally different.

APPENDIX II : Example of assessment of control when power has been shared

In order to assess the control of a structured entity, paragraph 31 specifies that *"it is necessary to identify how returns from the entity's activities are shared and how decisions, if any, are made about the activities that affect those returns"*.

For example:

A structured investment vehicle was created in order to purchase long-term investment grade assets (at low risk as for example AAA and BBB- assets according to Standard & Poor's) funded through short-term US commercial paper. The objective of the SIV is to hold the investments until maturity.

The functioning of the structure is organised between the investors, Bank A and Bank B in the following manner:

		Remuneration / Compensation
Investors	Purchase US Commercial Papers to finance the Special Purpose Vehicle	Fixed financing costs
Bank A	Gives its advice concerning assets selection	Variable commission which corresponds to the difference between the yield on the same assets and the global costs - vehicle commission (excess spread). Represents all the excess performance of the vehicle assets compared to global costs
	Commits to lending to the vehicle when the assets are downgraded but still remain investment grade. The loan facility is guaranteed by the downgraded assets along with the setting up of a silo (with the possibility for Bank A to purchase or sell the assets). The aim of this guaranteed loan is to be able to exit any downgraded asset from the vehicle at any time in order to conserve the quality of the vehicle. The loan is renewable on an annual basis (prudentially advantageous for Bank A). Any non-renewable of the loan by Bank A would lead to the liquidation of the vehicle and Bank A would have to compensate Bank B.	Fixed commission
	Grants a liquidity line. The aim of this line is to ensure that the vehicle is refinanced in the event of treasury notes drying up. If the assets are no longer investment graded, the line cannot be used any more.	Fixed fees

Bank B	Structures the deal	Fixed fees
	Makes the decision concerning the purchase of assets chosen by Bank A with the possibility for Bank B to refuse the assets suggested by Bank A	
	Grants a daily CDS (Credit Default Swap) on investment grade assets to hedge the overnight migration risk of financial assets from investment to non-investment grade	Each daily CDS is paid by Bank B at fair value
	Decides on the drawing of the loan from Bank A by the vehicle when the assets are downgraded (while the assets remain investment graded)	

Assessment of control according to paragraphs 30-36

- Purpose and design (§32)

The objective of the vehicle is for Bank A to benefit from returns on long term investment grade assets by minimising their cost of financing thanks to the emission of US Commercial paper and to benefit from a most favourable prudential treatment (off balance sheet assets).

- Returns (§33)

The variability of the return on the vehicle's assets goes essentially to Bank A via its variable commission of advice ("excess spread"). Indeed, all other commissions are either fixed, or at market price as it is the case for the CDS. We could consider that the CDS absorbs the maximum risk attached to the vehicle because it hedges the risk of downgrading of assets beyond the investment grade status. However, the compensation granted to Bank B in return of the insured risk is readjusted permanently on a daily basis, on the appreciation of the risk by the market. Consequently, the deterioration of the quality of assets affects more the variability of Bank A than that of Bank B, the more the quality of the assets of the vehicle degrades, the more the remuneration of CDS paid to Bank B are expensive and less variable are the commissions for Bank A.

- Power to direct the activities (§34)

Only Bank B has the power to decide to buy assets. It follows that a formal analysis of the power to direct the activities criterion could make one conclude that it is Bank B which is in the power to direct the vehicle's activities. In this case, in so much as it is not Bank B which is the most exposed to the variability of the returns on the vehicle, we may conclude on the basis of paragraphs 30 - 36 that neither bank has to consolidate the vehicle.

If the notion of control was assessed more in substance, the power of decision of Bank B would doubtless be considered less determining. Basically, it is Bank A - via its advisory power which influences the returns on the vehicle. Of course, Bank B can refuse an investment but this possibility of refusal is more akin to the decision of an insurer who can decide to refuse to insure certain risks (notion of eligible claim in an insurance contract credit) as a real power of decision.

Conclusion:

The CNC considers that the necessity of integrating the power to direct the activities in the assessment of control can lead to inappropriate conclusions of consolidation compared to an analysis of the control in substance (i.e. without giving a character determining to the analysis of the power to direct the activities).

When the way of making decisions in a structured entity influences returns, the risk of total absence of consolidation necessarily exists from the moment that the decisions will have been shared between the various stakeholders.

The CNC is concerned that, in this type of situation, the direction taken by the Exposure Draft on the notion of power to direct the activities interferes with the assessment of the control which should focus more on the substance of each vehicle, the risk being that entities may be structurally set up with the purpose to by-pass this same criterion which is presented at present as a criterion necessary for consolidation.