Lend Lease
Corporation

The Acting Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West
Melbourne Victoria 8007

23 February 2009

Exposure Draft ED 171 Consolidated Financial Statements

Dear Sir

Thank you for the opportunity to comment on Exposure Draft ED 171 *Consolidated Financial Statements* ("ED") (IASB Exposure Draft 10 *Consolidated Financial Statements*). We welcome the opportunity to contribute to this important project to develop one control methodology for all entities. Lend Lease Corporation ("Lend Lease") has followed the suggested outline in the "Summary of the proposals and invitation to comment" in the ED and has also raised other matters for consideration.

Lend Lease is a global property group which operates across the property value chain. Lend Lease's core businesses are project management and construction, property investment management and property development. Lend Lease is listed on the Australian Securities Exchange.

In summary, we outline our views on the ED below, although full responses to the questions raised in the ED are provided in the Appendix enclosed with this submission.

- The control principle as articulated in the ED is an appropriate basis for consolidation.
- Additional clarity and guidance is required around assessing control with particular emphasis on related arrangements, the power to direct without a majority of voting rights and assessing returns.
- Consolidation would not be appropriate in agency arrangements where all arrangements are at arm's length and the agent acts in a fiduciary capacity.
- The control assessment criteria for structured entities should be integrated into the control assessment outlined in paragraphs 12-29.
- The level of disclosure required is not considered to add meaningful information to allow more informed decisions to be made by users of financial statements. Further, the ability to obtain such information from entities which are not legally controlled would be difficult.
- The definition of significant influence per IAS 28 *Investments in Associates* should be revisited.

If you require further information or clarification please contact our Group Chief Accountant, Mary-Anne Matthews, who prepared our submission.

Yours faithfully

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Lend Lease
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Appendix: Response to questions as listed in IASB Exposure Draft ("ED")

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?

The proposed control definition should be able to be applied to all entities under IAS 27 and SIC 12, with some refinement. We note that there is an inconsistency in the definition of a structured entity in that it is implied that a structured entity is not controlled through a governing body yet such a structure should be assessed for control which is based on the power to direct the activities of another entity. This matter is addressed further in question 6.

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

The overarching principle in the ED appears to be an appropriate basis for consolidation.

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?

The control criteria in the ED certainly addresses many indicators of control that we agree should be taken into account when making the assessment of control. We address specific indicators below.

Related Arrangements

The ED notes that the terms of all related arrangements should be considered when assessing control (paragraph 17), however the ED does not address clearly how the existence of such arrangements fits into an assessment of control. In the absence of such clear guidance we set out the potential implications and interpretation of this section of the ED below.

The nature of Lend Lease's integrated business model (operating across the property value chain) is such that for many of its development projects Lend Lease is able to provide all the services to an entity that holds the property asset throughout its life cycle, including construction, property management and investment management. Any one of these activities could be performed on a stand-alone basis and each service arrangement is not economically dependent on another. However, these arrangements will typically be entered into at the commencement of a long term development program. In our view, the fact that such arrangements entered into simultaneously could be construed to be an indicator of control (as per paragraph 18(a)) is arbitrary. This is on the basis that the simultaneous execution of such arrangements does not result in the reporting entity having the power to direct the activities of the entity holding the asset. We believe that the guidance as drafted could result in an unintended consequence of consolidating an entity due to the mechanics and pure timing of establishing an entity and executing the necessary service contracts.

The drafting of paragraphs 17 and 18 is not clear as to how to deal with such circumstances and related party contracts / arrangements in general. It is difficult to envisage how the existence of related party arrangements can automatically imply that a reporting entity has the power to direct the activities of an entity. Usually contractual arrangements with an entity are at arm's length and the reporting entity purely acts as a service provider, so therefore their existence will not impact on whether a reporting entity has the power to direct the activities of the entity. Further, when the terms and conditions of contractual arrangements will be the same irrespective of whether it is a related party arrangement, this also provides evidence that the fact that arrangements are related is not automatically an indicator of

control. Again, given that the guidance in the ED around related arrangements is general, the ED as drafted could result in unintended outcomes.

We therefore suggest the following:

- A clear definition is provided in paragraph 17 as to what constitutes a related party arrangement. We believe that any definition must be clear and not capture arm's length agreements that do not influence the ability of a reporting entity to direct the activities of another entity;
- Paragraph 18(a) is removed;
- In relation to paragraphs 18 (b) and (c), additional guidance in the body of the ED is provided to assist understand the implications of related party arrangements when making an assessment of control; and
- The guidance in paragraph 18 should include as factor to consider the terms and conditions of similar arrangements in the event that the arrangements are not related.

Power to direct activity without a majority of voting rights

We raise three issues in relation to the guidance around power to direct without a majority of voting rights:

- An assessment that control is obtained based on paragraphs 27 and 28 could result in a reporting entity (X) that only owns, say 30%, of voting rights of an entity (Y) being required to consolidate entity Y. In such a case the entity X only has significant influence over entity Y and therefore it is difficult to envisage how such an outcome could be feasible. Practical challenges would also arise in terms of the ability of the reporting entity to be able to legally access financial records and other information in order to be able to consolidate such an entity.

  In our view, if the ED did not include paragraphs 27 and 28, then the correct accounting treatment of this investment would still eventuate. Continuing the above example, entity X could arguably remove board members of entity Y and then appoint its own directors to the board of entity Y. In this event entity X would be required to consolidate entity Y under paragraphs 4-9, because it has a majority of directors on the board and so has the power to direct the activities of the entity. Therefore we suggest this guidance in paragraphs 27 and 28 is removed.

- Whilst it is considered appropriate to continually assess control, the requirements of paragraphs 26-29 could lead to situations where entities are required to be consolidated and then deconsolidated in subsequent reporting periods (and vice versa). Such a situation may arise due to the existence of substantial shareholders changing frequently. This could be the case for a listed entity that has one major shareholder with a significant interest with the remaining shareholders widely dispersed. This situation could rapidly change in the event that other substantial shareholders emerge over time.

  We believe that this would be an unintended consequence of continuous assessment of control (paragraph 15) when control arises primarily due to circumstances arising in paragraph 28. We suggest that the requirement to continuously assess control (paragraph 15) should have an exception when the key basis for the assessment of control arises from paragraphs 27 and 28.

- We believe that paragraphs 27 and 28 require additional application guidance as interpretation of these paragraphs could result in diversity in practice. For example, to assess whether widely dispersed shareholders could organise to exercise their votes such that they have more voting power than a significant shareholder would presumably require consideration of factors such as voting history, the number of shareholders voting, any precedence for shareholders conglomerating and how this is assessed if a company is newly listed.

Assessing Returns

The definition of 'returns' in paragraphs 19 and 20 is unclear and ambiguous. We believe that the following issues arise:

- There is limited guidance in the ED on how the notion of 'returns' will work in practice. For example, consider an entity that has voting rights in an entity through equity interests and also independently derive fees through other contractual arrangements. The question raised is: how are returns, fixed and variable, received by such reporting entities assessed in the context of determining control?

  Instances can arise when a reporting entity provides a service to an entity, for example a fund advisor, and is remunerated via a base fee and performance related fee. The advisor is therefore only exposed to variability in positive returns, with no downside risk because there is no capital investment at risk. On this basis, we do not foresee that such an arrangement needs to be considered in assessing returns in the assessment of control criteria outlined in paragraph 12 because there is not variability in both positive and negative returns. However, the ED is not clear that this would in fact be the conclusion.

  Further, we agree that a quantitative assessment of returns is not appropriate in assessing control but more guidance is required as to the practical implications. Consistent with this view, it would also be useful for paragraph B6(b), (c) to be removed as it implies a quantitative analysis is necessary in relation to the remuneration of agents. This is explained in question 5 below.

- The Board's assumption in BC53 that the entity that receives the greatest returns is likely to have the greatest power does not necessarily follow in all situations; we suggest this reference is removed.

- It would be useful for the Illustrative Examples to be expanded to provide a comprehensive worked example of how to assess 'returns'. Also non-financial services sector examples would be welcomed.

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 activities of the entity.

We agree that options and convertible instruments can give an option holder the power to direct activities of the entity if they are presently exercisable. We note that in contrast to B13(a),(c) of the Application Guidance, we believe that holding options and convertible instruments that have not been exercised, and cannot be exercised until a specified date in the future, should not be included in the assessment of whether the holder has sufficient rights to determine the entity's strategic, operating and financing policies. If control does not exist without the exercise of the options, then the inability to exercise these options would by definition preclude a conclusion of control being reached.

Based on the current drafting of the ED, instances could arise where the holder of the instruments has not been involved in the direction of activities of the entity and then when conversion is possible, does not convert the instruments or exercise the options. This could lead to the counterintuitive outcome whereby the holder had consolidated the entity yet has never had the power to direct its activities. This point would be particularly relevant and important for venture capitalists which may have options exercisable in the future that, if exercised, would result in sufficient voting rights to have the power to control the strategic operation and financial policies. However, if not exercised the venture capitalist may never have had control but would have been required to consolidate the entity.

BC87 indicates that currently exercisable is not a mandatory criteria for control. Further, the Board indicates that the reporting entity must have the current power to direct the activities of the entity, before contemplating any options or convertible instrument held. This rationale makes sense however the drafting in B13 appears contradictory to the Board's conclusion because B13 (a), (c) could imply that a reporting entity is deemed to 'control' an entity by virtue of being a holder of these options and convertible instruments, even if it does not currently have any power to direct the activities of that entity.

We suggest that the ED is reworded to accurately reflect the Board's conclusion in BC87.

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.

We agree that it is appropriate for consideration of both direct equity interests and agent responsibilities when assessing control. However, we have specific concerns in relation to the proposals in the ED.

B4 of the Application Guidance raises the issue of the ability to remove agents from their role. We set out an example of a typical structure in the property industry and outline our view of the potential outcome under the ED.

- As part of the reporting entity's business, it acts as an investment advisor to an investor (a "Fund") and the advisor can only be removed under the contract 'with cause'. As the ED is currently drafted, this could indicate that the advisor controls the Fund due to the limited ability of unitholders in the Fund to kick out the advisor.
- Further, typical remuneration structures of advisors provide for performance fees that may vary according to a performance measure related to the Fund's returns.
- The advisor also has a 25% direct equity interest, with equivalent voting rights and board representation in the Fund.
- The advisor has a fiduciary duty to act in the best interests of all unitholders in the Fund and only can make recommendations to the independent board of directors of the Fund. All such arrangements are on an arm's length terms.

There are contrary indicators of control under the ED and a clear conclusion cannot be reached as to whether the reporting entity would control the Fund. Our view is that consolidation would not be an appropriate outcome where all arrangements are at arm's length, the advisor can only make recommendations to a majority independent board of directors, and the advisor must act in a fiduciary capacity.

It is worthwhile noting the rationale for certain structures and agency relationships in the property industry in Australia and abroad. During the development phase of a property development, it would be impracticable should development managers and fund advisors be able to be removed 'without cause'. Where the local jurisdiction legislation permits, it is common for such contractual arrangements to only allow shareholders to remove the manager or advisor 'with cause', i.e., on breach of a contract that remains unremedied. We do not believe that the lack of ability to remove the manager/advisor should result in a reporting entity being considered to control an entity as long as the managers/advisors are still bound by a fiduciary duty to act in the best interest of all shareholders and are subject to approvals from independent Board of Directors.

We suggest the following to improve this guidance:

- Clarity is provided on how assessment of control is performed when contradictory indicators exist. Illustrative Examples may assist with this objective.
- B8 is expanded to clarify that, irrespective of the answer to B6, if a reporting entity is only exposed to upside returns, and there is no downside risk due to lack of capital exposure then these returns should not be included when assessing whether an agent has power to direct the activities of an entity.
- B6(b), (c) of the Application Guidance are removed as they indicate a quantitative assessment of variability of returns is appropriate to assess whether fees are commensurate with services performed.

We also believe that these improvements would prevent the outcome whereby in the property industry whereby a reporting entity that has only a small equity interest in another entity and has exposure to positive returns by contractual arrangements ends up consolidating the entity. There is no clarity in the ED around the outcome of such a situation.

Our overarching concern with the agency relationships, and assessment of returns, is that the ED may inadvertently result in consolidation of entities, as portrayed in the examples above. The outcome of this is that financial statements would be misleading to users particularly in the case of any consolidation of entities with small equity interests, primarily due to the following:

- Significant allocation of profit and retained earnings to minority interests. This would artificially expand the 'size' of the reporting entity – revenues, assets, liabilities.
- In the property industry, the entities that hold the properties often will have borrowings that are non-recourse to shareholders and so in any case the consolidation of 100% of debt would not provide any meaningful information and could well be deemed to be misleading because the reporting entity does not have the requirement to repay the debt in the event of default by the underlying entity.

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?

We acknowledge and understand the rationale for the increased focus by the Board on structured entities given the current economic environment.

We do not believe that the definition in paragraph 30 provides clear guidance around what constitutes a structured entity. This has the potential to lead to different interpretations of whether an entity is a structured entity.

There is diversity in practice in relation to the assessment of whether a reporting entity is a special purpose entity (SPE) as defined in SIC 12. Clear guidance is required in relation to what type of entity should be captured by the structured entity definition.

We believe that the comment in BC99, that the Board envisages that a structured entity is unlikely to differ significantly from an SPE under SIC 12, is an undesirable objective and outcome. In our view, an important objective of this project is to create consistency in the definition of a structured entity and eliminate all linkage to SIC 12. Our observation of existing practice is that there is diversity in practice of what constitutes and SPE under SIC 12. We therefore suggest additional guidance be added to assist in application of this definition.

For example, Lend Lease has entities that are established to develop specific property sites. The entity often may have a limited life, have a governing body and be wound up at the end of the project for legal and warranty purposes. Typically these entities do not run on auto-pilot as there would be decisions required to be made by the governing body throughout the life of the development and during operation. It is our view that these would not be intended to meet the definition of a structured entity however the guidance in relation to activities and the 'purpose and design' (paragraph 32) could be interpreted differently and an alternative conclusion formed.

We note that the draft Illustrative Examples 2-4 focus on the transactions and activities of financial institutions. To provide practical examples, we suggest that other transactions and companies in the non-financial services sector are provided so there is clarity around the Board's view of what type of entities should be captured. We believe that this may be a more efficient and meaningful way in which to ensure consistent application of a definition of a structured entity.

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 Board makes it clear that the main objective of this project is to develop a control model that can be applied to all entities. It is therefore counter-intuitive that the ED splits the guidance for the assessment of control of entities between structured (paragraphs 30-38) and effectively 'non-structured' entities (paragraphs 12-29).

We suggest that the Board should, to the extent possible, integrate the control assessment criteria for structured entities into the control assessment outlined in paragraphs 12-29. For example related arrangements (paragraph 37) could be incorporated into paragraph 18. Furthermore, as discussed in question 3, we disagree with the notion in paragraph 33 that generally the more a reporting entity is exposed to variability in returns, the more power it is likely to have over that entity.

8. Should the IFRS on consolidated financial statements include a risk 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.

The ED does not include a definitive statement on the absolute measure of returns. As the focus is on the basis of control we consider it inappropriate to include a risk and rewards fall back test. In situations of high volatility in forecast and returns, this could lead to instances of entities falling in and out of consolidation requirements over a number of reporting periods. The application of the risks and rewards test in SIC 12 is unclear and our view is that there is diversity in practice in terms of the application of the current SIC 12 risks and rewards test.

Lend Lease
Corporation

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.

Overall we do not consider that the level of disclosure proposed adds meaningful information to allow more informed decisions to be made by users of financial statements. The cost of providing and collating such disclosures proposed will outweigh the benefits. The main reasons are:

- For entities with a large number of local (and overseas) subsidiaries, the level of disclosure is likely to become onerous and less meaningful (particularly if it is aggregated into one table).

- The basis of control may differ significantly for numerous subsidiaries. How should this information be presented? We consider that to provide the basis of control for each subsidiary, or even by aggregation of subsidiaries, to be onerous and will add value only in specific circumstances. It is suggested that this disclosure is only required where there is significant judgement involved in determining whether a subsidiary is controlled.

- Any requirement to provide disclosure of the assets, liabilities and results of controlled and non-controlled entities can lead to further voluminous disclosure for what is limited added value.

- Disclosure of involvement with non-controlled structured entities may be an onerous reporting requirement as these could vary widely across each structured entity. The nature of risks may be different for each non-controlled entity and again can overwhelm the user of financial statements.

- The requirement to include information required in paragraphs B43 to B47 of the Application Guidance for unconsolidated structured entities suggests that narrative is being used as a substitute for consolidation. It is well embedded in IAS 28 that for entities that significantly influence another that equity accounting is the most appropriate accounting. The requirement to provide information on a proportionate consolidation basis undermines some of the fundamental principles of IFRS. We believe that this is excessive and a more meaningful approach would be for the reporting entity to disclose the maximum amount at risk from exposure to non-consolidated structured entities.

10. Do you think that reporting entities will, or should, have available the information to meet the disclosure requirements? Please identify those requirements which you will believe it will be difficult for reporting entities to comply, or that are likely to impose significant costs on reporting entities.

A reporting entity should be expected to have enough information to understand the nature and risk of the investments entered into. However for the purposes of the proposed disclosure, it is likely that there would be difficulty in obtaining the most up to date and accurate information, particularly if the investments are held in non-public entities. Further, the underlying entities may object to this information being disclosed when it is not otherwise readily available to the market.

An exchange listed entity such as Lend Lease with a reporting deadline of two months post year end (and the same for half year), may not have easy access to the latest information for non-controlled entities other than an update from management of that entity. This also stems from legal restrictions on investors obtaining information when a reporting entity does not legally control an entity.

Publication of assets, liabilities, results and other information may be misleading if the non-controlled entity is unaudited, not required to have the same year end reporting date and not being subject to an interim reporting requirement.

This issue also adds to the issue outlined in question 9 and we suggest these disclosures are significantly curtailed. Also any disclosures should be limited to current year with narrative on changes from disclosure in the prior years.

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.

No, reputation risk is not an appropriate basis for consolidation. Consolidation of entities by association would seem contrary to providing information on the results of the reporting entity and all other entities over which the reporting entity has the power to direct activities and obtain returns.

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

The disclosures in B47 seem reasonable.

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?

We agree that the definition of significant influence per IAS 28 should be revisited. Given the potential changes in assessment of control that will arise from application of this new draft IFRS, and the current proposal to require disclosure of non-controlled entities similar to that currently for associates, the understanding of the distinction between associates, consolidated entities and indeed financial assets is blurred.

Other Observations

Effective Date and Transition

The Board has proposed that transition be prospective due to the difficulties in applying consolidation or deconsolidation retrospectively. We are concerned about the impact this may have on profits and minority interests arising from the fair value adjustments arising from adoption of a revised IFRS at the point of transition or subsequently.

Any fair value adjustments required on transition to this, a new IFRS, on both consolidation and de-consolidation of entities, has the potential to have a significant impact on the earnings profile of a reporting entity. Further this could also create inadvertent implications or issues on issues such as debt covenants, other banking arrangements and corporate guarantees.

In the event that the adoption of a new standard result in changes to assessment of control compared to IAS 27 and SIC 12, it would be costly for entities to perform a fair value allocation for all entities. We encourage the Board to reconsider the adoption and whether retrospective application is more appropriate when the fair value allocation process has already been performed under IFRS either on first time adoption of IFRS or in subsequent reporting periods.