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Mr Bruce Porter  
Acting Chairman  
Australian Accounting Standards Board  
PO Box 204  
Collins St West  
MELBOURNE Vic 8007

Dear Mr Porter



**ED 171 CONSOLIDATED FINANCIAL STATEMENTS**

The Heads of Treasuries Accounting and Reporting Advisory Committee is responding to the Australian Accounting Standards Board's request for comment on the International Accounting Standards Board's *Exposure Draft 10 - Consolidated Financial Statements*. HoTARAC appreciates that the comment period closed on 22 February 2009. However, workload issues have caused delays in framing the response.

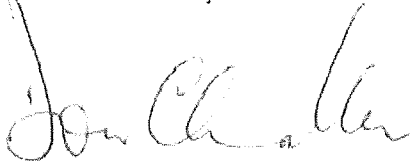
HoTARAC notes that the IASB has issued this Exposure Draft on a very significant topic without previously providing a Discussion Paper on the issue. Further, this IASB Project is not currently a joint project with the Financial Accounting Standards Board although both Boards continually monitor each other's work. According to the IASB, a joint Project may be conducted at a later stage.

HoTARAC has some concerns that, while the Exposure Draft appears to be suitable for application in the for-profit sector, it is not suitable in its current form for use by the public sector.

Although HoTARAC recognises that the IASB does not specifically cater to the public sector, additional guidance should be provided to aid for-profit sector entities in determining whether control is present.

HoTARAC will continue to monitor and provide comment on the work being undertaken by the IASB as the Project progresses.

Yours sincerely

A handwritten signature in black ink, appearing to read 'D W Challen', written in a cursive style.

D W Challen

**CHAIR**

**HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE**

4/ March 2009

Encl

Contact: David Tadd  
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**AASB Exposure Draft**  
**ED 171 Consolidated Financial Statements**  
**HoTARAC response**

**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?**

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

HoTARAC believes that, although the proposed control definition is an appropriate basis for consolidation, it is not suitable for the public sector in its current form. The main issue with the definition is primarily related to the term “returns” and to a lesser degree “power” and “risks and rewards”.

*Returns*

It is the preference of HoTARAC to use the term “benefits” rather than “returns”. Returns has a connotation of return on investment or distributions to owners; ie positive returns. Returns also has a for-profit connotation. However, the term benefits provides a better link:

- with the idea of service potential in the public sector, as well as achieving objectives; and
- to the risks and benefits concept in SIC 12 which is not referred to in the Exposure Draft.

*Power*

The term “power” raises the following questions:

- (a) is it sufficient that the power exists or must it be exercised?
- (b) what is the difference between “power” and the “right to power”?

To solve the above issues, an alternative approach could be use of “capacity to dominate decision making, directly or indirectly”. The term capacity has the advantage of providing more guidance than the word power. Capacity means the ability to dominate decision making, it may or may not actually have been exercised. The words directly or indirectly strengthen the idea that you don’t have to actually dominate the decision making, but merely have the ability to dominate, directly or indirectly.

*Risks and rewards*

The proposed definition could be applied to entities within the scope of IAS 27, although HoTARAC would prefer the use of alternate wording such as “capacity to dominate decision making, directly or indirectly”.

HoTARAC agrees with the concern raised in Alternative View 9 that, by eliminating the risks and rewards test, “an entity that clearly and obviously has the majority of risks and rewards of a structured entity can easily avoid consolidation by circumventing the power criterion”.

**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?**

HoTARAC does not believe that the guidance regarding the assessment of control is sufficient to enable the consistent application of the control definition. In particular, having certain paragraphs (paragraphs 23-29) relating to normal control (related to voting rights) and different paragraphs (paragraphs 30-38) relating to control of structured entities is confusing. There should be one set of requirements and guidance without differentiating between types of entities.

As currently drafted, the Exposure Draft gives too much importance to voting rights; ie control is either demonstrated by voting rights or else the entity is a structured entity (paragraph 21). This will potentially capture a wider scope of entities than is currently the case with SIC 12 as it has a limited focus on special purpose entities created to accomplish a narrow and well-defined objective.

**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.**

HoTARAC considers that the power to direct the activities does not arise from the ability to exercise or convert the instruments and thus obtain voting rights in the future. Further, HoTARAC does not believe that a reporting entity controls another entity by merely holding an option that would give it control through voting rights.

In addition, two paragraphs in the Basis for Conclusions seem inconsistent, namely paragraphs BC85 and BC86.

In BC85, a reporting entity required to transfer little, or no, consideration to exercise an option is likely to have control of those shares and is in the same position as a passive majority voting shareholder. However, if the option is exercisable at a price that equals the fair value of the shares as in BC86, the option holder does not obtain a return from those shares until the option is exercised. It is only once the option holder has obtained the shares that it has access to the returns and control.

In such circumstances, the IASB concluded that the option fails the second part of the control definition (the returns criterion). This raises the following questions, would the entity:

- required to transfer little, or no, consideration to exercise an option in paragraph BC85 be entitled to obtain a return?; and
- not be failing the second part of the control definition as well?

**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.**

HoTARAC believes that the proposal set out in the Exposure Draft needs to be more clearly articulated as various HoTARAC members have interpreted the proposal differently.

As currently written, some HoTARAC members are concerned that the agency guidance may be interpreted as preventing an intermediate parent from preparing consolidated financial statements as described in paragraph BC96, although the Board says it has no intention to do so.

HoTARAC is of the view that a reporting entity which holds voting rights only on behalf of others is not considered to have control and should not consolidate the other entity. HoTARAC considers that where acting as an agent, the reporting entity will not exercise the voting rights to generate returns for itself and therefore does not satisfy the control test based solely on its agent relationship.

**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?**

Individual HoTARAC members hold different views on the suitability of the definition of a structured entity. However, all HoTARAC members agree that the definition needs to be improved as it is currently somewhat vague and difficult to interpret. One possible approach to improve the definition is through the IASB describing the content of paragraphs 23-29 rather than referring to another section. As many public sector entities are not directed through the exercise of voting rights or other arrangements (as stipulated in paragraphs 23-29), they therefore would fall under the definition of structured entities.

The Exposure Draft's consequences are that, if the entity's activities are not directed as described in specific paragraphs relating to control, which focus on voting rights, then it is a structured entity. This raises the question that, if the entity doesn't fit in with those earlier paragraphs, is it going to meet the Exposure Draft definition of a structured entity, which potentially widens the scope of a structured entity. However, just because voting rights may not be relevant does not necessarily mean the "activities are restricted" as per the definition of a structured entity.

**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?**

HoTARAC recognises that there will be no single simple test in identifying whether an entity is controlled, rather it relies on the particular facts and circumstances of that entity. Further, it is not clear how different the concept

of “exposure to variability of returns” for assessing control in the Exposure Draft is to the current risks and rewards approach from SIC 12.

**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.***

HoTARAC does not believe it is appropriate to have an exception to the principle that consolidation is on the basis of control. This would be inconsistent with the overall purpose of the Project, which is to have one model for consolidation.

HoTARAC is also of the opinion that the methods for assessing control are similar to the guidance provided in SIC 12 on risks and rewards. Given this, the HoTARAC questions how the fall back test will differ from control and how the IASB might structure the fall back test. HoTARAC also questions if differences do in fact exist between the two models, whether using a risks and rewards test would lead to inconsistencies in consolidation of structured entities.

**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.***

**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.***

HoTARAC agrees with the disclosures in paragraph 48 with the exception of 48(d). HoTARAC is of the opinion that the term involvement in paragraph 48(d) needs to be defined. This term could have a very broad meaning in the public sector for example, grant recipients. For similar reasons, HoTARAC is also of the opinion that the IASB needs to clarify the meaning of support of unconsolidated structured entities as referred to in paragraph B47.

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

HoTARAC does not consider that “reputational risk” would be an appropriate basis for consolidation and is sceptical that it would meet the definition of control. HoTARAC also considers the disclosures in paragraph B47 relate more to issues that are business risks that are more appropriate for a directors' report or annual report and therefore should not be disclosed in the financial statements.

**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?***

HoTARAC supports such a Project.