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Sir David Tweedie
International Accounting Standards Board
30 Cannon Street, London, EC4M 6XH
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By Electronic Submission at: www.iasb.org

CC:
Mr Bruce Porter
Acting Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West
Melbourne, VIC, 8007

20 March 2009

ED 10 *Consolidated Financial Statements*

Dear David,

We are responding to the Exposure Draft, ED 10 *Consolidated Financial Statements* ('ED 10').

We are supportive of the IASB's objective to develop a single approach for consolidation of entities on the basis of control. However, we disagree with finalising ED 10 in its current form. We are concerned that the due process for this project has been negatively affected by a perceived need to address the topic quickly. We recognise that the IASB is facing pressure to respond to financial reporting issues more quickly than usual as a result of the global financial crisis, however we believe that the IASB should balance this with the need to develop high quality standards. We urge the Board to separate this project into two projects and progress them on different timelines -- the concept of control should be reviewed more thoroughly through a Discussion Paper, and the disclosure aspects could be considered in a shorter timeframe using an Exposure Draft. We recommend this approach because:

- the topic of control is so central to the basic elements reported in the financial statements that it is important for the new standard to result in consistent application, not just for consolidation to be said to be based on one consistent model

- ED 10 fails to provide any meaningful illustrations that demonstrate the practical application of assessing control for structured entities. We consider the Board has underestimated the challenge of assessing control for structured entities on bases different from SIC-12 by not recognising their unique complexity, and we therefore believe ED 10 will result in greater diversity in practice and in some cases produce lower quality outcomes

- we believe the current consolidation guidance (IAS 27 and SIC-12) is standing up in the current economic climate to produce high quality outcomes. Therefore we are not convinced there is an urgency to bring these two approaches into one model. We believe advances could be made quickly for consolidation of non-structured entities by clarifying IAS 27 with some points in ED 10 in respect of the following: (a) dominant minorities can control; (b) control can be passive; (c) distinguishing protective from participative rights; (d) identifying agent relationships.

Our other main concerns with ED 10 are:

- guidance has been included covering various thresholds of returns to indicate when a party controls another entity (all entities: para 13; structured entities: para 33; remuneration of agents: para B6(b), (c)). These thresholds of returns imply an underlying risks and rewards analysis that serves to confuse the principle of control which we believe will lead to diversity of interpretation. It is by having 'an' exposure to 'a' variable return, not a particular threshold of variable return, along with having the power to direct the activities that should determine whether an entity controls another. Retaining this guidance will not improve financial reporting

- the proposed treatment of options (other than those with a fair value strike price) is non-operational and is inconsistent with the assessment of either a passive controlling shareholder, or a shareholder having power to appoint/remove members to the governing body

- certain disclosures related to unconsolidated structured entities (para B44(a)-(c), B46(a), (b)(i), (b)(ii)) suggest the judgement exercised in determining control may not have been correct. The look-through nature of these disclosures ignores the importance and purpose of consolidated financial statements and suggests to us that the Board is not confident it has developed a cohesive consolidation model that will lead to consistent interpretation

- if the IASB anticipates a future convergence project with the US FASB in the near to medium term, then the IASB should cease its project and begin a co-ordinated joint project with the US FASB. If the IASB finalises a standard based on ED 10 and then in a few years were to begin a joint IASB/ FASB project, we would consider the IASB to be unduly burdening all involved in financial reporting by requiring two reassessments of their judgement of control.

Our detailed responses to the specific questions set out in ED 10 are provided in the attached Appendix.

If you have any questions in relation to this submission or would like our assistance, please do not hesitate to contact myself (+61 2 8232 8670) or Frank Palmer (+61 2 8232 5193).

Yours sincerely,

Stuart Dyson
Group Financial Controller
Macquarie Group

About Macquarie Group

Macquarie Group ('Macquarie') is a global provider of banking, financial, advisory, investment and funds management services. Macquarie's main business focus is making returns by providing a diversified range of services to clients. Macquarie acts on behalf of institutional, corporate and retail clients and counterparties around the world.

Macquarie Group Limited is listed in Australia (ASX: MQG) and is regulated by APRA, the Australian banking regulator, as it is the parent of Macquarie Bank Limited, an authorised deposit taker. Macquarie also owns a bank in the UK, Macquarie Bank International, which is regulated by the FSA. In addition, Macquarie's activities are subject to scrutiny by other regulatory agencies around the world.

As an owner and manager of significant community assets, Macquarie works closely with governments around the world to deliver important services including transport, roads, airports and utilities.

Founded in 1969, Macquarie operates in more than 60 office locations in 27 countries. Macquarie employed approximately 12,800 people at 31 January 2009 and had assets under management of AUD 242 billion at 31 December 2008.

Appendix

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?

We agree with the proposal for a single model of consolidation for all entities, however we do not believe that ED 10 achieves this objective. ED 10 separates the guidance for structured entities (para 30 to 38) from the guidance for non-structured (i.e. governing body) entities (para 23 to 29), which implies two discrete assessments should be applied in determining whether control exists. Further, for structured entities, much of the risks and rewards guidance from SIC-12 has been repeated in ED 10 (e.g. para 31(a)-(c) seem to replicate SIC-12 para 10(a)-(d)). Consequently, ED 10 seems to simply result in geographically relocating the SIC-12 guidance into the proposed consolidation standard. We find this confuses the intended new control approach and practically will result in little change in the way control is currently assessed for structured entities. We consider it important that an integrated approach to control for all entities not distinguish between types of entities.

The proposed definition of control encompasses two key elements: (1) power to direct the entity's activities; and (2) an ability to generate returns (para 4). We agree that both of these elements are needed, and we agree with the improvement to use 'returns' rather than 'benefits', although in practice 'benefits' is already interpreted widely to include losses or reduced benefits. We acknowledge that the use of 'benefits' would better assist those national standard setters which incorporate IFRS into their literature for use by public sector entities.

Question 2

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

We agree that the control principle is the appropriate basis for consolidation. Consistent with having a single model of consolidation for all entities, we recommend the separate guidance for structured and non-structured entities be integrated together (see our response to Question 1). We consider illustrative examples are necessary to address the unique complexity often found in practice with structured entities, and provide consistent application for structured entities (see our responses to Questions 7 and 8).

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?

ED 10 assumes that underlying the control definition is a correlation between returns and power (para 13 and 33). The Board concludes there need not be a direct correlation (par BC56). In practice, there are many and frequent circumstances where there is no correlation. For example, economic exposure (i.e. variability of returns) is not correlated with power in cases where there are side agreements between certain shareholders, or some shareholders bring non-financial aspects (e.g. expertise, network and reputation) to the arrangement.

We also note a number of circumstances where ED 10 provides guidance covering various thresholds of returns to indicate when a party controls another entity – all entities "greatest returns" (para 13 and BC53); structured entities: "significant" and "more than that of any other party" (para 33); and remuneration of agents (para B6(b), (c)).

The threshold guidance is inconsistent with the Board's decision to not specify a threshold of returns needed for control to exist (para BC 57). We consider the inclusion of these assumptions and guidance indicates that the Board has not done enough work to determine a clear control principle, and this guidance implies an inherent *risks and rewards analysis* that confuses the assessment of control. If a party has 'an' exposure to 'a' variable return (not a particular threshold of variable return) and has the power to direct, then consistent with para 28 relating to a dominant minority shareholder, that party has control. Consequently, retaining this guidance in a final standard will cause diversity of treatment in practice, because (as is already the case) some will err on the side of assessing risks and rewards and others will err on the side of assessing the power to direct. We encourage the Board to remove this guidance, so as to remain clear to its principle that control rests on the analysis of power to direct the activities so as to generate returns (regardless of the threshold of those returns).

The Board concludes in para BC57 to not specify proportions and to allow for circumstances where alternative proportions could give control. We do not consider it appropriate to then presume that having a majority of the voting rights gives the reporting entity the power to determine the strategic operating and financing policies of an entity (para 23 to 24). It is very common for governing constitutions or agreements factually to require other levels of ownership/voting rights (e.g. 75%) to direct the strategic operating and financing policies. Further, we consider the judgment should be determined by reference to the facts and circumstances, and that a majority presumption will cause diversity in treatment because some will consider there to be an automatic floor on either the level triggering consolidation or an increased onus of proof when judging non-consolidation. We recommend redrafting para 23 to 24 to refer to the level of voting rights required under the governing constitution/agreement to determine the entity's strategic operating and financing policies (i.e. to use wording similar to that in para 27(b)).

ED 10 also presumes that where there is a dominant shareholder with less than the majority of voting rights and the other shareholders <u>are</u> 'organised to cooperate', then the dominant shareholder does not control (para 28). We disagree with the need for other shareholders to be organised and cooperating for the dominant shareholder to not be in a position of control. We consider it conceptually consistent with a defacto approach to control for the other shareholders only to be *likely to cast their vote* (using e.g. past attendance records or degree of sophistication of investors as supporting information) in order to negate the dominant shareholder from being in a position of control. Whether those other shareholders agree with each other or not, and as long as they have exercised their votes free from influence by the dominant shareholder, should have no bearing on the assessment of control. We recommend the example in para 28 be amended to reflect that a reporting entity can control if it holds less than a majority of the voting rights, where a sufficient number of the other shareholders are considered unlikely to exercise their vote in respect of policy decisions, such that the reporting entity dominates the voting rights expected to be cast.

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.

ED 10 considers that an option with a *fair value* strike price does not provide the option holder with control until the option is exercised and the voting rights are obtained, because the option holder is not exposed to returns yet (para BC86). We agree, because it is consistent with the control definition that requires an entity to have access to returns. Prior to exercise, such options do not provide a return for the entity, hence failing the second element of the control principle.

For options with a *fixed* strike price, ED 10 requires the consideration of relevant facts and circumstances other than the option holding itself. In other words, ED 10 effectively provides that an option holder does not necessarily have control just from holding an option which, if exercised, gives him majority voting rights (para BC 81 and 83). It is whether the existence of an option (currently exercisable or not) has influenced others to abide by the wishes of the option holder. We disagree, because:

- it is inconsistent with the treatment that a shareholder does not need to demonstrate exercise of his right to vote to be in control (para 8 and 24). Practically, there is no difference between a present shareholder who is able to force his will at a shareholders' meeting and an option holder who can presently exercise the option and attend that same meeting (as a shareholder and force his will). This is because a shareholder cannot exercise his vote before the meeting, and an option holder needs next to no time to exercise and attend the *same meeting* to vote. Consequently, a passive shareholder (e.g. 40% voting rights) has the same power as an investor with a 20% voting rights and a 20% presently exercisable call option

- it is inconsistent with a shareholder controlling where it has the right to remove its agent (para B4) or members of the governing body (para 23). The fact that a shareholder needs to take action to appoint/remove either members of the governing body, or an agent, does not alter the shareholder's current control position

- the 'power', no matter how that is attained (whether via exercising an option to gain more voting rights, exercising voting rights or voting to remove an agent), should reflect a present ability. A "currently exercisable" option provides an option holder with the right to immediately acquire additional voting power (by removing voting rights from the current shareholders) even if the option holder chooses to not exercise that right.

In respect of options with a *nominal* strike price, the Board has included an implied presumption that such an option holder likely has control of those shares due to other factors (para BC85). If this is to be judged based on the facts and circumstances, then we consider it inappropriate to include implied presumptions as these suggest that the control principle is not robust. We consider presumptions and the use of the term 'likely' to bring a rule mindset to the standard. We recommend that the Board remove presumptions, and focus instead on providing clear guiding principles so entities can make their own professional judgement based on the relevant facts and circumstances. Specifically, we disagree with this presumption, because:

- it is inconsistent with the conclusion for fixed price options where the Board considers exercise is necessary before having the same effect as owning a share. If the message behind the presumption is the need to consider all other facts and circumstances then this is already addressed in para B13

- this new guidance on options will also be used in the context of assessing whether significant influence exists under IAS 28 (due to consequential amendments). There are circumstances where nominal strike priced options do not give significant influence (after considering all facts and circumstances), and therefore there may very well be situations where, after considering the facts and circumstances, a nominal strike priced option does not give control.

Overall, we recommend that the Board revert from ED 10 and retain the existing guidance for "currently exercisable" options in IAS 27 (IG1 to IG8) for all options, other than those with a fair value exercise price (which we agree fails the returns element of the control definition prior to exercise).

We believe the principle of "currently exercisable" is important because when an option is not currently exercisable, consideration is required of whether other shareholders are influenced in their decision making by the existence of the option. In other words, ED 10 requires an option holder to read the minds of other shareholders to determine whether they are influenced by the option holder's potential to exercise at a future date, which we consider to be non-operational. There would be no objective evidence available to make this assessment which would lead to diversity in practice. Non-currently exercisable options are fairly common in practice – some examples are those which are exercisable at a specified future point in time and those which are exercisable on meeting a specified earnings target.

Application of the existing IAS 27 in respect of options currently provides consistency of interpretation and application, and the approach is more consistent with defacto control. In our view, the approach in ED 10 will result in less consistency of treatment than under the existing IAS 27, and allow for various interpretations.

We also consider it important for the Board to maintain a clear objective with respect to control, by supporting it with consistent guidance. The proposals for options and convertible instruments are inconsistent with other guidance. As new arrangements and fact patterns develop in complexity, more consistent control assessments will be made if there is a clear control principle articulated in supporting guidance.

Question 5

Do you agree with the Board's proposal 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 with the principle that an entity can have power by having an agent act on its behalf and that conversely, an entity does not have power when it is acting solely as an agent (para 9). We consider the principle and guidance to be consistent with the current approach to determining that a director who can be appointed/removed by a shareholder to a governing body is acting as agent for that shareholder when exercising the voting power at directors' meetings. We also agree with the very helpful guidance on agency relationships provided in Appendix B, except for para B6(b), (c).

As noted in our responses to Questions 3 and 7, we disagree with providing guidance on the thresholds of returns (para B6) as it moves away from the control principle by implying a risks and rewards analysis, and is also subject to interpretation difficulty. For example, it is unclear when fees are "large" (para B6(b)) relative to total expected returns; and the term "expected variability" (para B6(c)) is not defined. Further, is the guidance in para B6 to take precedence over guidance in para B7 or vice versa?

In respect of the guidance covering removal rights (para B4), we recommend that the Board clarify that the principal's power should be a presently exercisable power (i.e. the agent can be removed either immediately or within a reasonably short period customary in the marketplace concerned to identify and appoint a replacement agent), so as to remain consistent with the definition of control. Otherwise, it may be considered that where a one year notice period has to be provided, then there could still be an agency relationship.

We agree with the conclusion that a performance-related fee is not indicative of an agency relationship where the agent must act in the best interests of the principal (para B7). However, we disagree with the Board's approach to performance-related fees subject to clawback (due to a subsequent decrease in the value of the fund) in para B8 because this is inconsistent with a performance fee for a specified period. For example:

- if a performance fee is paid at the end of three years based on the fund's three-year cumulative performance, then this indicates an agent relationship (using para B8 which says a fee for a specified period indicates an agent relationship)
- whereas, if a fee is paid as an instalment each year during the three years (with refunds where necessary to align to the revised cumulative fund performance) such that the total cumulative net fees are the same as the previous example, then para B8 suggests there is no agent relationship.

These two arrangements are economically identical (except for time value of the prepayment) and we do not understand why the timing of payment affects whether an agent relationship is established. Further, as suggested by the Board (para BC89) some fee arrangements incentivise the agent to act *more* in the best interests of the principal. We believe this to be exactly the case (represent a closer agent relationship) in our example of fees subject to clawback (where the objective is to base fees on a period of the fund's return) and therefore recommend para B8 be removed.

Overall, we consider the focus on identifying an agency relationship should rest on: the responsibility to act in the best interests of the principal (para B3 and B7); having independent decision making processes (para BC95); and commercially agreed fee arrangements (para B5 and B6(a)) as supported by the Board in para BC90 and BC95. Consequently, we consider the guidance in para B8 (fee refundable based on future performance of the fund) and guidance in para B6(b), (c) to be inconsistent with this general principle, since the fee is commercially agreed.

We consider the objective of para B12 to be unclear. If its purpose is to simply identify which entities to look out for as possible agents, then we do not consider this guidance to be of assistance and recommend its removal. Anyone could potentially be an agent for a reporting entity – lawyers, service providers, etc, and in principle there should be no limitation on the parties to consider. Two indicators that concern us are:

- all of a reporting entity's related parties under IAS 24 could be an agent (sub para (a)). Some could interpret this to mean that all associates of the reporting entity are agents for the reporting entity without assessing the facts and circumstances. Then despite only having significant influence over various associates that each holds an investment in the same underlying entity, some might simply aggregate the ownership in the underlying entity held by all associates and if that exceeds a simple majority then default to assume a control of the underlying entity. There is a very important difference between a reporting entity having limited voting power in multiple entities that gives it no ability whatsoever to direct the activities of the underlying entity, and having control 'as if' the reporting entity could fictitiously aggregate all its votes so as to direct the activities of the underlying entity

- a party that cannot finance its operations without financial support from the reporting entity (sub para (d)). Some could interpret this to mean that all financing companies should consolidate the entities for which loans are provided. Some form of financial support is needed in most corporates to assist them in their business operations. Loans are provided by financiers on arms length terms and covenants provide adequate security protection. The most basic equity support is provided by a company's shareholders. However, this does not mean the company is an agent for the debt or equity provider.

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?

Consistent with our response to Question 1, we consider that there should be an integrated approach to assessing control for all entities, rather than distinguishing between and defining two different types of entities (structured entities and those with governing bodies).

We consider the change in term from "special purpose entity" to "structured entity" to be unhelpful, because it does not improve the description of the entities making up this group and those included are unlikely to differ significantly from those considered special purpose entities under SIC-12 (para BC99). In addition, the Board's reason for changing the term (due to connotations with a risks and rewards approach – para BC100) does little to change the focus to an integrated control assessment, because having separate terminology for this type of entities practically implies a different approach to the assessment is needed.

If the Board decides to retain the definitions under ED 10, we consider that the definition of a structured entity should incorporate the key point of differentiation from other entities, that is, structured entities do not have a governing body (para BC 98). We find it unhelpful to define a structured entity in the context of what it "is not" (i.e. one "whose activities are restricted to the extent that those activities are not directed as described...") (para 30 and Appendix A) rather than what it "is".

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?

Consistent with our response to Question 1, we believe that the Board should provide an integrated approach to the control assessment for all entities without distinguishing between the types of entities. We consider that having separate guidance for structured and non-structured entities will not result in a consistent application of the control definition. However, making this change will be insufficient in itself to ensure consistent application.

Consistent with our response to Question 3, ED 10 has included thresholds of returns as guidance when determining whether an entity has control over a structured entity – an entity is considered to control a structured entity if it is exposed to "potentially significant" variability of returns and its exposure is "more than that of any other party" (para 33). The inclusion of such thresholds implies an inherent risks and rewards analysis consistent with SIC-12, however, we consider this guidance to be inconsistent with ED 10's control principle and the Board's decision to not provide a threshold of returns needed for control to exist (para BC57). It is 'an' exposure to 'a' variable return and not a particular threshold of variable return (together with the power to direct the activities) that determines whether an entity controls another. As the Board's objective with ED 10 is to provide a new control approach for structured entities, the retention of risks and rewards guidance is inconsistent with this objective and will cause diversity of treatment.

The control assessment for structured entities is practically difficult and therefore a high degree of professional judgement is needed. SIC-12 provided a practical approach to addressing some of this difficulty. We consider it extremely important for illustrative examples to be provided so as to have consistent treatment, not just for consolidation to be said to be based on one consistent model. We recommend not underestimating the challenge to be had in applying the new approach in practice.

We continue to support an integrated approach to control assessment for all entities but, in order for there to be consistent interpretation we need illustrative examples that address the complex fact patterns relating to structured entities. We strongly encourage the Board to focus its efforts in this area.

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.

We agree that the control principle should be the basis for consolidation, and disagree in principle with the inclusion of a risks and rewards 'fall back' test for structured entities. We consider that a robust control principle supported by illustrative examples should be sufficient for making consistent interpretations. We recommend that the Board continue to focus on providing a clear control principle with consistent supporting guidance, and illustrative examples to address the unique complexity often found in practice for determining control of structured entities.

We disagree with a risks and rewards 'fall back' test, which assesses control based on returns, irrespective of the "power" element (para BC112). However, as mentioned in our response to Question 7, ED 10 already includes guidance that implies a risks and rewards analysis is needed for determining control of structured entities. We recommend that this risks and rewards guidance be removed to avoid inconsistent interpretations.

However, consistent with our response to Question 7, we consider it imperative that the Board provide illustrative examples for assessing control of structured entities. If the Board finalises a draft IFRS based on ED 10 in its current form without illustrative examples that provide meaningful assistance, then we would support a risks and rewards 'fall back' test for structured entities. If a 'fall back' test were to exist, then we recommend using a qualitative rather than a quantitative computational approach to assessing risks and rewards, since we consider it is often readily apparent in practice to determine whether an entity is exposed to the majority of risks and rewards.

We also acknowledge the recent efforts undertaken by the US FASB. While a risks and rewards 'fall back' test in a final IFRS standard is consistent with the current requirements of FASB Interpretation No. 46(R) *Consolidation of Variable Interest Entities,* such a 'fall back' test would be inconsistent with the direction being proposed by the FASB (its exposure draft issued in September 2008) to move away from an assessment on returns alone and towards an assessment based on both power and returns.

As mentioned in our cover letter, we recommend that the Board separate the consolidation project into two projects and address the control assessment together with the FASB in a coordinated joint project.

Question 9

Do the proposed disclosure requirements described in paragraph 23[1] provide decision-useful information? Please identify any disclosure requirements that you think should be removed from, or added to, the draft IFRS.

We consider that some of the proposed disclosures replicate disclosures currently required, where material, by other standards. For example, income and the assets/instruments that generate the income (para B33, B41(a), 46(c)) are already disclosed in the consolidated financial statements by virtue of IFRS 7, IAS 18, IAS 39 and IAS 1. We recommend removing this duplication.

Of particular concern to us are those proposed disclosures that suggest the judgement exercised in determining control of an entity may not have been correct, because of the nature of the disclosures (para B34, B44(a)-(c), B46(a), (b)(i), (b)(ii)) relating to unconsolidated structured entities). We consider the look-through nature of these disclosures ignores the importance and purpose of consolidated financial statements, and suggests to us that the Board is not confident it has developed a cohesive consolidation model that will lead to consistent interpretation. These disclosures also lessen the importance for making appropriate control judgements and reasonable estimates based on the facts and circumstances. If the Board believes it has achieved its objective of providing a high quality standard based on control, then it should support this with appropriate disclosures that acknowledge the boundaries of the reporting entity. Providing the proposed disclosures, assuming information is available, will also serve to overload financial statements for users.

We recommend that the Board focus on those disclosures important for:

- the basis of determining control where a high degree of professional judgement was needed (para B32). We consider IAS 1 would already capture this disclosure if it is a critical judgement
- understanding the associated risks from involvement with unconsolidated structured entities – what the risks are, how the entity manages those risks, how the risks are measured, and what the range of possible economic outcomes might be (para B44(d), B45, B46(b)(iii)-(v), B46(d), B46(e), B47).

We are concerned with the growing amount of disclosure in financial statements that do not seem to provide a corresponding increase in the value for users (including para B36, B41(b)). We acknowledge para B39 provides relief from the disclosures if it is impracticable, however this is a higher threshold than simply being too costly or exhausting and consequently we consider this relief to be practically of no assistance.

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 disclosures proposed under ED 10 will be significantly burdensome to prepare and the underlying information difficult to obtain, particularly in relation to entities that are unconsolidated (para 48(d)). The difficulties arise from:

- legal restrictions preventing access to the information, since the entities are not controlled
- the difference in reporting dates between the reporting entity and the unconsolidated entity, which means information will not be as at the same date

[1] We consider this reference should have been to para 48 of the draft standard.

- unconsolidated entities operating in a jurisdiction where either they comply with an accounting framework other than IFRS, or their financial statements are not subject to an independent audit, and therefore the information will either be unavailable or not be sufficiently reliable
- the lack of existing systems needed to capture the appropriate information.

Further, we disagree with requiring two years of comparative information in relation to structured entities that are set up or sponsored (para B42). We consider one year of comparative information to be sufficient to meet the disclosure objective, and would also be consistent with the general approach to comparative information in IAS 1 for requiring only one year.

Notwithstanding the difficulties above, we believe that the proposed disclosures (para 48(d) and B34) will be costly for us to prepare in terms of gathering information from a significant number of unconsolidated entities. We challenge the Board to have a robust discussion about whether the weight of the benefits will exceed the costs, because we consider the costs outweigh the benefits (including relevance for users).

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.

We do not believe that reputational risk is an appropriate basis for consolidation. Rather, we agree with the Board (para BC39) that a commitment to provide support to unconsolidated structured entities is likely to be accounted for in accordance with IAS 37.

Question 11 (b)

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

We agree with the proposed disclosures in paragraph B47.

We interpret the term "support" as used in para B46(e)(ii) and B47 to be wide (e.g. free services, forgoing a cash receipt in place of additional equity) and to include those provided on an arm's length basis (e.g. provision of funding). We believe it would be beneficial for the Board to clarify with examples whether our interpretation is consistent with the intention of ED 10.

We also recommend that the Board extend its disclosure of *voluntary* support in para B47 to cover *contractual* support provided to unconsolidated structured entities.

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?

Yes, we believe that the Board should revisit the assessment of significant influence with the objective of reconciling the indicators with those of assessing control. The indicators for determining significant influence has historically related to those used in assessing control. Accordingly, it is important to understand whether the Board intends a change in the control *guidance* (via a consequential amendment to the definition of significant influence) is to consequently affect the assessment of significant influence. For example, could an investment in a structured entity that is not consolidated be subject to an assessment of whether it is an associate? Could the guidance distinguishing protective from participative rights be used in the context of assessing significant influence? If the Board progresses its changes to the control model in a different timeframe to a reconsideration of significant influence, then diversity of practice may likely develop as some may reconsider their assessments of significant influence and others may not.

If such a project to reconsider IAS 28 were to be undertaken, then a candidate for reconsideration would be whether the equity method of accounting remains appropriate. Another approach might be that if an entity is not controlled (but is otherwise significantly influenced), then it might change to fall within the scope of IAS 39 rather than IAS 28. Importantly, if the Board is to take this approach, it should remain true to the boundaries of consolidated financial statements when it considers disclosures (i.e. not replicate the precedent it has set in ED 10 by requiring look-through disclosures).

As part of a review of IAS 28, we urge the Board to also revisit the many various treatments to the recognition and reversals of impairment losses for assets (associates, intangible, physical, financial). The current different approaches provide different outcomes depending on the nature of the asset, which suggests the Board does not have a clear principle that is easily understood by users.

Other observations and editorial comments

We agree with the need for a continuous assessment of control (para 15). However, without additional guidance there may be interpretation difficulties. For example, ED 10 considers there to not be control when an entity "ceases to receive returns" (para 16) from its involvement with another. So, if losses in a structured entity exceed the equity, some would consider this to mean that the next highest ranking security holder (e.g. subordinated debt providers) may now be in control. However, others may consider there still to be potential for future profits and so there is no change in control.

We are also supportive of and agree with the guidance distinguishing participative from protective rights (para B1 to B2), because this provides useful guidance that is largely already used by many in practice. We also note that the guidance is consistent with US FASB guidance, EITF 96-16 *Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*.

We list below editorial comments for consideration:

- "returns from involvement with an entity" is defined in para 10 and also Appendix A. However this term is not used elsewhere, when we would have expected so. For example, para 19 states that "returns generated for a reporting entity are returns an entity receives from its involvement with another entity...", instead of making use of this defined term

- we propose insertion of the words in italics into para 38: "A reporting entity can have the power to direct the activities of a structured entity if the reporting entity has the *unilateral or unfettered* ability to change the restrictions or predetermined strategic operating and financing policies...", because the power to direct needs to be held absolutely and not be subject to approval by others

- para 48(d) requires disclosure of "the nature of, and risks associated with, the reporting entity's involvement with structured entities that the reporting entity does not control". The very wide nature of 'involvement' with a structured entity can potentially capture a wide range of commercial arrangements (e.g. interest rate swaps). We recommend that the Board clarify the term 'involvement'

- we propose insertion of the words in italics into para B3: "...The agent must use any decision-making ability delegated to it to generate returns primarily for the principal *or principals as a whole*." In many cases, an agent may not necessarily act for a single principal (e.g. individual investor) but may act for many principals as a whole. We believe this would be consistent with the current situation where many shareholders individually vote on the appointment/removal of a director to the governing body, and that director would be considered an agent acting on behalf of the shareholders as a whole

- some guidance provided in para BC89 and BC95 is helpful in assessing whether an agent has control. We recommend that those useful comments be relocated to para B3 of Appendix B as they are integral to the agency discussion

- we propose insertion of the words in italics into para B13(b): "...any party with voting rights that is the counterparty to an option agreement *and is assessed to be acting* [delete "acts"] as an agent for the reporting entity...". It should not be implied that option holders are automatically considered agents, because the factors for assessing an agency relationship should be considered (for example, removal rights and remuneration)

- para B32(b) and B34 require disclosures in respect of unconsolidated non-structured entities (i.e. entities which are not controlled "even though the reporting entity is the dominant shareholder with voting rights"). This may be interpreted to cover investments in associates and joint ventures or available for sale investments. We recommend that the Board clarify the scope of this disclosure since the existing standards (IAS 28, IAS 31 and IAS 39) already provide disclosure requirements in respect of such investments

- para B41(b) requires disclosure of "the value of assets transferred to those structured entities, at the date the transfers were made". It is not clear whether this value refers to the carrying value of the seller; the fair value; or the transaction price

- para B44(c) requires disclosure of "the reported amount of assets held by structured entities with which the entity has involvement...". It is not clear whether the reported amount refers to carrying amount as recognised by the structured entity under its local GAAP; the carrying amount it would have recognised under IFRS had IFRS been its basis of preparation; or the fair value where that is different to the carrying amount.