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Shane Buggle  
Group General Manager Finance

18 March 2009

Sir David Tweedie  
Chairman  
International Accounting Standards Board  
First Floor, 30 Canon Street  
London EC4M 6XH  
UNITED KINGDOM

Dear David

**Exposure Draft 10: Consolidated Financial Statements**

Thank you for the opportunity to comment on this Exposure Draft.

We support the development of a revised standard on the definition and assessment of control which provides a common principle for all entities. However, we have fundamental concerns regarding certain proposed disclosures as outlined in the proposal. Furthermore, we consider that additional guidance and examples are necessary to ensure consistency of application, particularly around structured entities.

Detailed comments on all matters raised in the Exposure Draft are attached to this letter.

Should you have any queries on our comments, please contact Rob Goss, Head of Accounting Policy, Governance and Compliance at [Rob.Goss@anz.com](mailto:Rob.Goss@anz.com).

Yours sincerely

SHANE BUGGLE  
Group General Manager Finance

cc: Bruce Porter, Acting Chairman AASB

**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 support a consistent approach to defining control and believe that the proposed definition can be applied to all entities previously captured under IAS 27 and SIC-12. However, we consider that consistent application will not be achieved without additional guidance and clarification.

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

Yes, the principle utilises a broadly consistent approach to what has been applied in practice for special purposes entities under SIC-12 (a variability analysis) but with a power to direct overlay. We therefore consider the principle, in theory, an appropriate basis for consolidation. However, we believe that the relationship and significance of and between the power to direct returns and the variability of returns may give rise to difficulties and inconsistencies in application without additional guidance and practical examples (refer also question 3).

**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?

The requirements and guidance regarding the assessment of control are considered insufficient to ensure the consistent application of the control definition for a number of reasons. First and foremost, more guidance and practical examples on applying the proposed principles is necessary, particularly around situations whereby returns (variability) and ability to direct may not be directly correlated, for example in structured entity scenarios. Following on from our previous response, application of the principles in this instance would be very difficult with only the limited guidance provided in the proposed ED. An example of the difficulty has been provided in our response to question 7.

In addition, it is our position that there is a lack of clarity in relation to "related arrangements" and what to take into account when assessing an entity for returns. If one was to apply the requirement to take into account related arrangements very broadly, the result may be to capture additional standard commercial transactions within the scope of the control assessment and potentially change previous consolidation decisions without strong justification.

Lastly, the guidance/example as outlined in par 34 and 35 of the exposure draft, particularly in relation to securitisation vehicles, needs to be clearer. The guidance states that if a structured entity holds only receivables, and another entity manages those receivables, the managing entity is considered to have the power to direct the activities of the vehicle (presuming it can affect its own returns). This would appear to be the wrong outcome if say for instance another party (perhaps a residual unitholder) had the ability to appoint or change the manager and ultimately wore more variability. The manager is therefore only an agent of the residual unitholder. While this point may be implied in the guidance, the example could be clearer in this regard.

**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.

It appears from the proposal that the options and convertible instruments are not required to be presently exercisable in order to indicate a power to direct. If this is the intention of the proposal it poses a difficulty in that we are assuming a power to direct when in fact one may never exist or does not currently exist. We note that the proposed standard also suggests that the control assessment is continuous. It is therefore our position that options and convertible instruments should only be considered a power to direct if they are presently exercisable. If they become so when previously they were not, the consolidation assessment will have to be revisited with potentially a change in conclusion.

**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.

Yes, we agree with the proposals.

**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?

The proposed definition of a structured entity appears to be a "catch-all" for any entity which does not have a traditional governing structure. As a result, it is a much broader concept than the previous "Special Purpose Entity". We do not disagree with this definition, as it should ensure that all entities are captured under the requirements of the proposed standard. However, we note that by widening the scope of the definition, the structured entity concept becomes so far reaching and broad that disclosure of information in relation to this category becomes somewhat meaningless. This point is discussed further in question 9.

**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?

Refer also to comments under question 3. We recommend additional guidance and examples whereby the return and power to direct are not necessarily correlated. As an example, let's take a situation whereby an investment fund has a fund manager who also owns 1% of the units. The fund also has a significant unitholder (say 40%) who wears the most significant portion of the variability of returns. The remaining 59% of units is widely held and each holding carries an equivalent portion of the variability. The 40% unitholder cannot, in this situation, direct the activities of the entity because they are unable to, in isolation, appoint or remove the manager. The manager is however acting only in the interest of the unitholders with a small variable return and a management fee. In this situation would the manager consolidate or would the 40% unitholder? Or would this fund not be consolidated by either entity? Our reading of the guidance is that the manager would consolidate in this instance but question if this is the correct result. Would the answer be the same if the manager did not own the 1% of units and if it is, should it be?

Another point is that the assessment of control and variability of returns in many instances results in an analysis of cash flows related to the entity. In practice, the consideration of what constitutes a negative return and what constitutes an opportunity cost has been an ongoing debate. It is our position that clarification and guidance around the return assessment would be very beneficial.

We also consider that paragraphs 34 and 35 should be further clarified and consider that examples and guidance regarding joint control scenarios is warranted.

**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.

No, we do not believe that there should be a risks and rewards 'fall back' test. The principles proposed in the standard should be sufficient in their own right, with appropriate guidance.

**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.

The proposed disclosures appear particularly onerous and may not provide decision-useful information. For instance, we do not support the requirements of paragraph B41 which necessitate summary income and asset information from structured entities set-up or sponsored. Structured entities 'set-up or sponsored' is a very broad category and not clearly defined in the proposed standard, creating a high probability that consistent application will not be achieved. Furthermore, all income (and the assets/instruments that generate this income) are subject to normal disclosure requirements for the consolidated group via other standards (IFRS 7, IAS 18, IAS 1). We therefore question the relevance of additional disclosures based on a specific counterparty or source entity type. For example, in the context of a bank, we do not believe that there are necessarily any differences in the *types* (not the measurement/assessment of) of risks associated with an interest rate swap entered into with a corporate customer compared to a structured entity.

The above point is particularly relevant given that the proposed standard is drafted so that the structured entity definition is a 'catch-all' for all entities which are not governed in a traditional manner. This means that the structured entity category is exceedingly broad and we stress that disclosures defined by this sub-set of counterparty will add little value to the reader. In addition it will result in significant burden to financial statement preparers and auditors. It is also important to consider that such information may be particularly difficult to capture, as most organisation's financial systems are not constructed in a way to isolate income from this very wide and unclear category of counterparty/source.

Another example of disclosure which should be reconsidered or removed are those required under paragraph B38(b) in fulfilling the requirements of paragraph 48(d), which suggests that the nature and extent of, and changes in, market, credit and liquidity risk from the reporting entity's involvement with structured entities that it 'has an involvement with' but does not control should be disclosed. The guidance (paragraph B44) goes on to require tabular format of financial information including assets held by these structured entities. As a first point, information about significant risks are already disclosed as part of IFRS 7 requirements, so we question the need for an additional detailed disclosure requirement for one particular subset of counterparty (as discussed above). We are also extremely concerned by the very broad nature of the entities which would fall under this non-specific category – what constitutes an 'involvement'? Furthermore, accurate/auditable and timely information about the assets held by structured entities which are not controlled would be extremely difficult to obtain (potentially unobtainable in instances) and it is therefore an unreasonable burden for reporting entities to be required to collect this data. We also question how an entity would ever satisfy audit requirements in relation to this data.

**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.

No we do not believe that some of the information is obtainable (or auditable and potentially not reliable), refer to comments in question 9 above.

**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?

No, we do not believe that reputational risk is an appropriate basis for consolidation. We also question the appropriateness of the disclosures in B47 as how does an organisation capture such information adequately and accurately? We suggest that it would be difficult to provide appropriate guidelines to capture transactions which represent "support" provided to ensure reputational risk is covered, compared to a standard commercial transaction. Is the disclosure of such information suggesting that normal processes/due care is not performed prior to entering into these transactions and that this should be identified to readers of 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?

We consider that it is imperative that the Board address the definition of significant influence prior to the release of a revised consolidation standard. If the definition and assessment of control is revised, this must have follow-on consequences for the definition and assessment of significant influence. As such they should be considered together and reissued using common terminology with clarity around the distinction between the two.