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Sir David Tweedie
International Accounting Standards Board
30 Cannon Street
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UNITED KINGDOM

Dear David

IASB Exposure Draft ED 10: *Consolidated Financial Statements*

The Australian Accounting Standards Board (AASB) is pleased to provide comments on Exposure Draft ED 10 *Consolidated Financial Statements*. In formulating its views, the AASB sought the views of Australian constituents.

We are supportive of the IASB's objective to develop a single basis for consolidation and, in particular, support using the control principle as the basis of consolidation.

However, the AASB is concerned that the perceived need to respond quickly to the outcomes of the Financial Stability Forum meetings has resulted in this project being progressed without sufficient due process. If the current key concern is a lack of disclosure surrounding the association of a reporting entity with off-balance sheet structured entities, then the objective of the IASB in the near term should be to develop disclosure requirements regarding these relationships. Further consideration needs to be given to the consolidation issues themselves, particularly since the Exposure Draft incorporates the requirements from IAS 27 and SIC-12 into one Standard without developing a cohesive and comprehensive concept of control. In their current form the proposals would fail to improve financial reporting. We consider these proposals could result in more inconsistency in interpretation than the current IAS 27 and SIC-12 requirements and could be difficult to operationalise.

The AASB is also concerned about the shortened due process (that is, the three-month comment period) for a number of reasons. The IASB had earlier indicated that the Consolidations Project would commence with a Discussion Paper. The AASB, has in past letters to the IASB, commented on the need for proper due process, including sufficient comment periods, to help ensure the development of high quality financial reporting standards. Therefore, in the absence of a Discussion Paper, the AASB considers that a longer comment period should have been provided for such a fundamental project, to allow constituents to give proper consideration to the proposals and to provide time for field testing.

Furthermore, the AASB believes that it is preferable for the IASB to coordinate its efforts with the FASB since the topic will presumably need to be reassessed in the near future as part of a convergence exercise. Such a reassessment in the near future could be burdensome for all involved in financial reporting.

Consequently, we recommend separating the project into two projects – addressing the need for disclosures regarding special purpose entities that has arisen as a result of the global financial crisis in the shorter term, and addressing the development of a conceptually robust consolidations model in the longer-term in conjunction with the FASB.

The AASB is concerned about the current proposals in ED 10 to disclose the relationships with non-controlled structured entities. This is discussed further in the response to Questions 6 and 9 in the attachment to this letter. In addition, the AASB has a number of concerns with the proposals that are further explained in the attachment to this letter, including:

- the need for further work to develop a conceptually robust definition of control that can be applied to all types of entities;
- difficulties will be encountered in distinguishing between structured entities and non-structured entities;
- the lack of illustrative examples to assist in understanding how the proposals should be applied. The AASB notes the extent of disclosure examples in the Illustrative Examples, and believes that it is necessary for the amended consolidation requirements to be illustrated with examples of typical complex structured entities; and
- the extent of useful guidance that is located in the Basis for Conclusions. Some of this guidance should be transferred either to the body of the pronouncement or to an appendix that is integral to the pronouncement.

If you have any queries regarding any matters in this submission, please contact Natalie Batsakis (nbatsakis@asb.gov.au) or me.

The AASB is interested in participating in an IASB Roundtable meeting on this topic.

Yours sincerely



Bruce Porter
Acting Chairman

Consolidated Financial Statements

Specific comments

The AASB provides the following responses to the IASB's ED 10 *Consolidated Financial Statements*.

Issue 1. Control

Q1. 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?

No. The AASB supports the IASB's efforts in pursuing a single basis of consolidation that can be applied to all entities, and also supports the IASB's decision to use the control model as the basis for consolidation. However, the AASB believes that more extensive consideration needs to be given to the development of the concept of control and a robust definition. The AASB does not believe that the proposed definition of control can be applied to all entities within the scope of IAS 27 and SIC-12.

The proposed definition of control has two elements – (i) the power to direct activities; and (ii) returns. The AASB has identified issues with the current drafting that may be particularly problematic in its application.

The amendments made in ED 10 to the definition of control (as compared to the current definition in IAS 27) appear to be mainly editorial in nature, with the expectation that this will now incorporate the risks and rewards concept from SIC-12. If this were the case, the requirements would outline one set of procedures for assessing the control of all entities. However, the current drafting presents guidance on assessing the existence of control of non-structured entities in paragraphs 12 to 29 separately from the assessment for structured entities in paragraphs 30 to 38. Accordingly, the AASB does not believe that the IASB has achieved its goal of having a single basis of consolidation that can be applied to all circumstances.

For example, a reporting entity has been involved in setting up an entity, the contractual terms of which entitle it to 80% of the returns, but only 50% of the voting rights. Under the current risks and rewards model of SIC-12, the entity would be consolidated, and the AASB believes that this is the appropriate accounting outcome. However, the AASB does not believe that the proposals as currently drafted would result in the same outcome. Whilst the reporting entity is exposed to variability in returns, it does not have the power to direct the activities of the entity because it has an equal number of voting rights as the other party involved. The first element of the proposed definition of control would not be met and therefore would not result in the same accounting treatment as under SIC-12. While the AASB is not advocating the status quo in terms of the entities that are controlled, we consider this example highlights the need for a longer and more robust consultation period. Refer to the section below titled 'Correlation between power and returns' for further discussion.

Correlation between power and returns

The IASB has assumed and articulated in its proposals that the reporting entity that receives the greatest level of returns from another entity is ‘likely’ to have the greatest power over that entity. The AASB does not agree with this conclusion. Use of the word ‘likely’ may be misused as a rule rather than as an explanation as to a possible situation based on the facts and circumstances to be judged. If judgment is to be exercised, then presumptions should be removed. As shown in the example directly above, it is not uncommon for structures to be consolidated into the financial statements of a reporting entity, in accordance with the requirements of SIC-12, where the power of the reporting entity is not correlated with the returns it receives. The AASB believes that the current accounting treatment to consolidate such structures is appropriate.

Situations can also arise where there is a number of reporting entities that have been involved in setting up a structured entity, and some of the entities receive fixed returns and others residual returns. The AASB is uncertain whether the reporting entity that controls the structured entity would be the entity that receives the largest fixed level of returns and is not exposed to variability of returns or another entity that receives a residual amount of returns and that is therefore exposed to variability in returns.

Given the existence of such structures, the AASB believes that the IASB should reconsider the interaction between ‘power to direct the activities’ and ‘returns’ and be clear about which element takes precedence in such circumstances.

Use of the term ‘returns’

The AASB disagrees with replacing ‘benefits’ with ‘returns’. The second element is articulated as the ability “...to generate returns for the reporting entity”. The AASB notes that normal language usage of ‘returns’ may still result in the confusion the IASB indicates it is trying to avoid regarding ‘benefits’. Given the importance of the guidance to explain that it covers both positive and negative elements, we do not consider it imperative to change the term. An additional reason to support ‘benefits’ is that, ‘returns’ are often considered in the economic context of ‘returns on investment’, indicating an entity’s exposure to financial returns, whereas ‘benefits’ has broadly been interpreted to capture both financial and non-financial exposures (for example, service potential). Although not central to the IASB’s current thinking, benefits remains a more appropriate term in a transaction neutral context applicable to both for-profit and not-for-profit entities.

Q2. Is the control principle as articulated in the draft IFRS an appropriate basis for consolidation?

Yes. Of the three bases for consolidation – controlling entity model, common control model and risks and rewards model – the AASB considers the control principle (under the controlling entity model) to be the most appropriate basis for consolidation.

However, as discussed in the response to Question 1 above, we believe that further work is required to enhance the definition of control.

Issue 2. Assessing control

Q3. 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?

No. Whilst the AASB considers that the ED provides a number of factors that should be considered in assessing control, the AASB has a number of concerns with the requirements and guidance provided.

Split between structured and non-structured entities

ED 10 appears to be a compilation of the requirements from IAS 27 and SIC-12, and therefore, depending on whether or not an entity meets the definition of a structured entity will determine which assessment of control is undertaken. In order to enable the consistent application of the control definition, the guidance regarding the assessment of control should be the same for all entities covered by the resulting Standard. For example, in addition to requiring the assessment of control to be continuous (paragraphs 15 and 16), the criteria outlined in paragraph 30(a) – (f) could be applied to all types of entities in assessing control and the requirements in paragraphs 17 to 29 could be incorporated as follows:

- (i) paragraphs 17 and 18 into the paragraphs that expand on paragraph 31(d) – that is, paragraph 37 ;
- (ii) paragraphs 19 and 20 into the paragraph that expands on paragraph 30(b) – that is, paragraph 33; and
- (iii) paragraphs 21 to 29 into the paragraph that expands on paragraph 30(e) – that is, paragraph 38.

Regardless of whether the IASB retains the current format and splits the requirements, the AASB believes that the IASB should consider the following comments.

Inconsistent application of the control definition – power to direct the activities with a majority of the voting rights

The AASB does not consider it appropriate to assume that having more than half of the voting rights (that is, a simple majority) will necessarily give the reporting entity the power to determine the strategic operating and financing policies of the entity. The level of voting rights sufficient to give the reporting entity power over another entity is determined by the governing constitution of the entity, and it is not uncommon for other levels of ownership/voting rights (for example, 75%) to be required for a reporting entity to have the power to direct the strategic operating and financing policies. The AASB would prefer to use wording similar to that drafted in proposed paragraph 27(b) and reword paragraph 23 as follows:

23. A reporting entity can have the power to direct the activities of another entity by having voting rights that are sufficient to give it the power to appoint or remove members of that entity's governing body, that thereby give it ability to determine the strategic operating and financing policies, unless paragraph 25 applies.

The AASB believes that paragraph 24 is repetitive and superfluous to the commentary in paragraph 23, and can therefore be deleted.

Inconsistent application of the control definition – power to direct the activities without a majority of the voting rights

The AASB considers that the guidance in relation to assessing control where the reporting entity has less than half the voting rights could be improved. Proposed paragraph 27 suggests that a reporting entity has the power to direct the activities with less than half of the voting rights if (a) it has more voting rights than any other party; and (b) its voting rights are sufficient to give it the ability to determine the strategic operating and financial policies of the entity. Proposed paragraph 28 goes on further to state that a reporting entity will have control if it is the dominant shareholder and the other shareholders with votes are widely dispersed and not organised in such a way that they can actively co-operate to have more voting power than the reporting entity.

Some AASB members have strong opposing views to that in ED 10, and do not consider 'de facto' control to be an appropriate basis for consolidation, and instead prefer control to be an absolute right independent of action (or inaction) by others. The IASB concluded that control need not be absolute, but as long as the reporting entity has the power to direct the activities of another entity to generate returns, it controls that entity. The AASB believes the IASB should clearly articulate how 'de facto' controls fits into the controlling entity model as a basis for consolidation.

Other AASB members that accept that control need not be absolute consider the guidance to be subjective and inconsistent with the definition of control given the uncertainty that can arise from one shareholder meeting to another, as to whether a reporting entity that has less than a majority of the voting rights, has the power to direct the activities of an entity simply because the other shareholders are not organised. Therefore, they consider that under a de facto control approach, the other shareholders need not be 'organised to cooperate' for the dominant shareholder to be in a position where it does not control. It should be sufficient for the other shareholders to demonstrate past participation in decision making at meetings, in order for the dominant shareholder that does not hold more than half of the voting rights at the meeting to not be in a controlling position. Therefore, it is the past actions of other shareholders (and therefore their likelihood of voting at future meetings) that should be considered in assessing control where an entity holds less than half of the voting rights. If the proposals outlined in paragraphs 27(a) and 28 are not required to be demonstrated in some way to assist with the assessment, then the significant shareholding entity would need to speculate as to the intentions of other shareholders and without further guidance this may result in diversity in the application of these requirements. This concern is highlighted by examples where some minority shareholders, that have previously not participated in general meetings, have been galvanised by a particular event to act to out-vote the 'dominant' shareholder. These cases demonstrate a capacity or power among the dispersed shareholders which is akin to control. Therefore, the example at paragraph 28 should be amended to reflect that a reporting entity can have control if it holds less than a majority of the voting rights, where other shareholders with votes are widely dispersed and a sufficient number of them are not likely to vote at meetings where policy decisions are made such that the reporting entity is able to dominate the votes cast.

Q4. 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.

No. The AASB does not agree with the proposals regarding options and convertible instruments on the basis that the requirements would be difficult to make operational and lead to diversity of interpretation. The fact that the guidance is widely dispersed in various locations has added to the difficulties of determining how a reporting entity would assess control when it holds options or convertible instruments.

As documented in paragraph BC 87 of the Basis for Conclusions, the AASB acknowledges that, instead of making presumptions as to whether control exists based on whether the options or convertible instruments held by the reporting entity are 'currently exercisable', the IASB's objective is to ensure that both elements of the control definition are met when considering whether, in conjunction with all relevant facts and circumstances relating to the option, a reporting entity that holds options or convertible instruments has the power to direct the activities irrespective of whether the options are (subsequently) exercised.

The AASB has two concerns with this decision. Firstly, the Board's objective is not clearly articulated throughout the ED because options and convertible instruments are discussed under the section 'power to direct the activities' in the body of the proposed Standard and in paragraph B13 of Appendix B. The only consideration of the returns element is in paragraph BC86 of the Basis for Conclusions which concludes that the holder of an option to acquire shares at fair value will fail the returns element of the control definition because it is not until the reporting entity owns the shares that it will obtain returns. Given this is the only discussion regarding consideration of returns, there is a tendency to focus on only meeting one element of the control definition in assessing control.

Secondly, the AASB believes that whether an option or convertible instrument is currently exercisable is a separate notion from whether the option or convertible instrument is actually exercised – somewhat similar to an entity that has the right to vote and direct the activities of an entity (due to a majority shareholding), but does not exercise that right (that is, a dominant yet passive shareholder).

The AASB notes that paragraphs BC85 to BC87 outline the IASB's deliberations on the topic of options and convertible instruments. The AASB does not agree with some of the explanations and conclusions drawn and these are discussed below.

The AASB is also concerned about the view expressed in paragraph BC85 that it would be unlikely that a situation would arise where the reporting entity would be required to transfer little, or no, consideration to exercise an option, if it did not already control the other entity when it acquired those options. As a result of this, the IASB does not conclude as to whether having such an option would need to be assessed using judgment based on the facts and circumstances, or whether there could be situations in which such an option exists and there is no control. Consequently, the current drafting may be interpreted by some to mean that, where a reporting entity holds an option and is required to transfer little or no consideration to exercise that option in exchange for the shares of another entity, then the reporting entity automatically has control over the other entity without a further assessment being needed. The AASB is of the view that nominal strike

price options are not uncommon and in some situations are held by entities that do not already have control, and therefore, if such instruments are held by the reporting entity, this should not automatically give rise to control. The AASB believes that the wording should be amended to avoid the potential for this conclusion to be drawn without further requiring an assessment of all facts and circumstances. The way in which the IASB view is expressed further suggests this document is more in the nature of a Discussion Paper than a proposed standard.

Therefore, the AASB believes that consideration as to whether an option or convertible instrument is currently exercisable (as under current IAS 27), and the financial ability of management to exercise, is relevant in assessing whether the instrument gives the reporting entity power over the other entity, and most importantly, consideration should be given to all relevant facts and circumstances in assessing control. Therefore, the guidance should not preclude the decision that a reporting entity with options or convertible instruments can control an entity if those instruments are not currently exercisable. The AASB believes that the guidance in paragraph B13(a)-(c) of Appendix B could be rephrased along the lines of:

- (i) currently commercially exercisable – in assessing control, consideration should be given to whether the reporting entity has the financial ability to exercise the options or convertible instruments, if doing so would result in sufficient voting rights immediately to provide the reporting entity with the power to direct the strategic operating and financing policies of the entity so as to generate returns for itself;
- (ii) not currently exercisable and/or subject to restrictions – consideration of all relevant facts and circumstances relating to the option or convertible instruments to determine whether there are rights or other features attached that would mean the reporting entity has the power to direct the strategic operating and financing policies so as to generate returns for itself.

The AASB considers that the current guidance in paragraphs B13(a) – (c) illustrates options that are not currently exercisable, but whose features lead to an assessment that the reporting entity has control and should therefore be retained. Many view that such rights or features would not be attached to options. Whilst the AASB considers it unlikely, we believe there is merit in retaining the examples because they illustrate the need to consider all relevant facts and circumstances.

Q5. 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.

The AASB supports the IASB's proposals for having indicators to help identify situations in which a party acts as an agent. However, the AASB disagrees with having a rebuttable presumption that is likely to be interpreted by some as always being rebuttable and by others as never rebuttable, particularly in situations where managers/trustees with fiduciary responsibilities also have direct economic interests in the funds/trusts. The AASB considers the indicators work effectively only where a manager/trustee has no direct economic interest in the fund and only receives a performance fee. For example, a responsible entity (manager) of a managed fund in Australia must act in the best interests of the investors and may itself be one of those investors. It is not clear whether these managed funds are structured entities or not, as whilst it could be argued that the reporting entity is itself a 'governing body', the reporting entity is not controlled by

voting rights of the investors of the fund. However, if any one investor has more than 75% of direct interests they can remove the reporting entity, so it could be argued that the fund is not a structured entity.

If the structured entity guidance is applied a reporting entity could argue that any voting interest held directly has no impact because of their fiduciary responsibilities, however the guidance indicates that an entity that receives more returns than any other investor is likely to have the power to direct the activities and therefore control. Accordingly, it is not clear whether applying the proposals in a situation where the manager has an investment greater than any other of a dispersed group of investors should consolidate the fund.

The AASB disagrees with providing a potential list of agents, as anyone could be an agent and the principles should focus on what makes an agent, not the circle of potential agents. However, the AASB believes that there is a need for guidance on when the entity is the 'principal', given no two entities can be in control.

In addition, the AASB notes that there is potentially useful guidance located in paragraphs BC88 to BC95 of the Basis for Conclusions, about assessing whether an agent has control, that should be more prominently located. For example, the AASB considers that paragraph B3 of Appendix B could be usefully expanded to incorporate the guidance in paragraph BC95 regarding how to assess whether a reporting entity that is acting in a dual role (that is, acting as agent and holding an investment in an entity that carries voting rights) has sufficient power to direct the entity's activities.

Issue 3. Structured entities

Q6. Do you agree with the definition of a structured entity? If not, how would you describe or define such an entity?

No. As discussed in the covering letter, the AASB is concerned that insufficient thought has gone into the project due to there being a need to respond to the outcomes of meetings held by the Financial Stability Forum. The AASB acknowledges that the global financial crisis has raised concerns regarding accounting and disclosure for off-balance sheet vehicles, but perhaps this concern is more for those using a basis of accounting other than IFRSs. In comparison to the requirements proposed in the Exposure Draft, we consider the SIC-12 requirements to be superior. The SIC-12 requirements help prevent structuring opportunities that avoid the consolidation of entities. If the IASB's concern is the lack of disclosure about off-balance sheet vehicles, then the AASB encourages the IASB to reconsider its objective of 're-thinking' the consolidations model in the immediate-term. The IASB should instead focus on providing disclosure requirements regarding non-controlled structured entities in the short-term, and give further longer-term consideration to the consolidations model.

Although the AASB believes that there is a need for disclosures regarding special purpose entities in the shorter term, the AASB does not support the proposals in ED 10 to disclose the relationships with non-controlled structured entities. This is because reporting entities are likely to find the disclosure requirements to be particularly onerous and may experience difficulty in obtaining the necessary information, and also because it is unclear what type of relationships are expected to be captured.

More work is needed to clarify the scope of the relationships that are to be disclosed. For example, there is uncertainty about whether simple incorporated joint ventures, and possibly also associates, would be captured by the disclosure requirements for non-controlled structured entities, because of the risks that reporting entities are exposed to from their relationships with them. Clearly these would not be controlled under paragraphs 23 to 29, nor would they meet the requirements for controlled structured entities. There is no exclusion clause that scopes out joint ventures or associates and the disclosures in IAS 31 and IAS 28, respectively, are limited in this regard. The AASB believes that new disclosure requirements could either be included in a standalone document or separately included in the respective applicable standards.

Consideration would need to be given to the types of relationships that the IASB intends to capture. For example, there should be consideration of the relationships resulting from sponsoring and co-sponsoring activities, managing activities, trusteeship, economic dependency or where there are contingencies that could alter the relationship between the reporting entity and another entity such that it could become part of the economic entity.

If the IASB pursues its objective of developing a single basis for consolidation, as mentioned in the response to Question 1, a more conceptually robust definition of control should be developed, with associated requirements and guidance for assessing control that can be applied to all entities, and the definition of and separate requirements and guidance for structured entities should be eliminated.

The AASB would strongly support eliminating the term ‘structured entity’ and its definition and associated guidance. The distinction between what is, and what is not, a structured entity (special purpose entity) is difficult to make currently under SIC-12 and the proposed guidance would not eliminate this problem. For example, there are many managed investment schemes (both listed and unlisted) established by Australian financial institutions and it is not clear if some or all of these would be structured entities. The AASB had hoped that this distinction would be removed in creating a revised consolidations Standard, and replaced with a conceptually robust definition of control that can be applied to all types of entities. The IASB appears to have made little progress on this issue, and paragraph BC99 of the Basis for Conclusions articulates the IASB’s view that structured entities would not be too dissimilar from the types of entities described as ‘special purpose entities’ under SIC-12.

If the IASB decides to retain the term ‘structured entity’ as proposed in the Exposure Draft, the AASB believes that the following should be addressed:

- (i) the references, in the definition of ‘structured entity’, to other paragraphs within the body of the proposed revised Standard may be confusing for users. In addition, the AASB would interpret the definition to mean that an entity whose activities are not restricted or directed by way of voting rights (paragraphs 23 to 29) will automatically be a structured entity. We do not believe this is appropriate and consider that the wording unintentionally broadens the definition in comparison to the definition of a special purpose entity under SIC-12; and
- (ii) the meaning of ‘restricted’ – the AASB is uncertain whether this applies to those entities with a narrow and well defined purpose, or those that are restricted to the extent that they are on ‘autopilot’, or both. It would be appropriate for the IASB to clarify its intended meaning.

Q7. 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?

No. We urge the board to provide examples illustrating how the control assessment should be made for complex structured entities that recognises the unique difficulties encountered. Without this much needed guidance, we consider the guidance in ED 10 to be insufficient for a consistent analysis and have a concern that it will lead to more diversity in practice than the current guidance (IAS 27 and SIC-12).

As noted in previous responses, the AASB does not believe that it is appropriate to distinguish between structured and non-structured entities and have separate guidance for each class of entity (paragraphs 12 to 29 versus paragraphs 30 to 38).

However if the proposals are progressed, the AASB believes that the guidance could be combined and used in assessing control for all types of entities. The notion of ‘variability of returns’ should be revisited, because as mentioned in our response to Question 1, it may pose practical difficulties in determining which reporting entity has control.

Q8. 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.

There are mixed views among AASB members about the need for a risks and rewards ‘fall back’ test. Some members believe that risks and rewards are inherent in the concept of control, and should a conceptually robust definition of control be developed, the concept of risks and rewards would be automatically incorporated into it. Other members consider a ‘fall back’ test necessary where a definition of control cannot be developed that appropriately addresses structured entities (by including illustrative examples that address their complex and unique difficulties) and do not consider risks and rewards to be inherent in a control model.

Issue 4. Disclosure

Q9. 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, the AASB is concerned with the growing level of disclosure in financial reports. The AASB acknowledges that some disclosures may be warranted in light of the global financial crisis to enhance transparency in accounting for transactions – such as the proposal to disclose the judgement used in the basis for consolidation. However, the AASB does not support the supplemental disclosures under paragraphs B32(c) and B34 in Appendix B, and the disclosures proposed under paragraph 48(d). The proposed requirements are particularly onerous and duplicate disclosures required by IFRS 7. The AASB believes that such disclosures should not be needed if a conceptually robust Standard that sets out requirements for consolidated financial statements were issued by the IASB.

The objective of disclosure requirements is to supplement reported numbers in the financial report. This notion is supported by paragraph 82 of the *Framework* which states that disclosures should not be a substitute for recognition. The information sought by these paragraphs of the ED is information that we are concerned is a substitute for what may be perceived as an unsatisfactory consolidation framework. The AASB is also concerned that management may seek to exercise judgment on the side of consolidating structured entities that are not controlled in order to avoid making the onerous disclosures. The AASB is concerned about this potential outcome and believes the Board needs to undertake a review of the appropriateness of the proposed disclosures about non-controlled structured entities to determine the relevance of these additional disclosures. In its review, the IASB should also consider which types of structured entities such disclosures would apply to. For example, do the disclosure requirements apply only to structured entities that the reporting entity has been involved in setting up or do they also apply to structured entities that the reporting entity has bought investments in and subsequently has the same exposures?

The AASB believes that in respect of disclosures regarding non-controlled structured entities, it would be useful to know if the reporting entity provided financial support to the structured entity during the year, and:

- (i) whether the support remains outstanding at the reporting date;
- (ii) when the support is expected to be repaid; and
- (iii) the financial risk, if any, to which the reporting entity is exposed by providing the financial support.

Q10. 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. The AASB believes that there will be a number of impediments in obtaining information to meet the requirement in paragraph 48(d) to disclose the nature of, and risks associated with, entities that are not controlled:

- (i) it will be difficult, and sometimes impossible to obtain information from an organisation due to legal restrictions on investors obtaining financial information from entities that are not controlled;
- (ii) the unconsolidated entity may be operating in a different jurisdiction that does not use IFRSs, may have a different reporting period or the relevant information may not be audited. There may be little benefit achieved in comparison to the costs incurred of validating and incorporating such data into the financial statements of a reporting entity;
- (iii) many entities will not have the reporting systems to provide the reporting entity with such detailed disclosures; and
- (iv) the unconsolidated entity may be able to legally prevent the disclosure of its financial information in the financial report of the reporting entity, where that information is not otherwise readily available to the market.

The AASB acknowledges that paragraph B39 relieves the reporting entity from making the disclosures if it is impracticable to do so, however impracticability is a high threshold

and the reporting entity is then required to explain why it is impracticable to do so and how it manages its exposure to risk from its involvement with unconsolidated structured entities. Given the existing disclosure requirements in IFRS 7 and the difficulty that many entities will face in obtaining the information for ED 10, the AASB believes the disclosures proposed are unwarranted.

Issue 5. Other matters – reputational risk

Q11(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. The AASB does not believe that reputational risk is an appropriate basis for consolidation in respect of for-profit entities. As noted in paragraph BC39 of the Basis for Conclusions, the AASB believes that an entity's commitment to support another entity is likely to be best accounted for in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and it would not be appropriate to consolidate based on an occurrence which may not eventuate.

Q11(b). Do you think that the proposed disclosures in paragraph B47 are sufficient? If not, how should they be enhanced?

As discussed in the response to Questions 6 and 9 above, the AASB does not support the disclosures required by paragraph 48(d) and considers them to be excessive and unnecessary in a consolidations Standard.

Issue 6. Other matters – accounting for associates and the equity method

Q12. Do you think 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. The definition of 'significant influence' is based on the definition of control. Given the amended definition of control, the new guidance in the ED with respect to having the power to direct the activities without a majority of the voting rights, and the interaction between IAS 27 and IAS 28 *Investments in Associates*, the AASB believes that the IASB should reconsider the definition of significant influence and the use of the equity method prior to finalising a revised consolidations Standard.

Other AASB concerns

Illustrative Examples

The illustrative examples focus on the disclosures required for off-balance sheet vehicles and on the financial sector. The AASB believes that if the Standard is progressed, illustrations should be developed to broadly address all industries and we urge the board to provide examples that assist in (i) determining which entities constitute structured entities; and (ii) assessing control of structured entities.