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Organización Internacional de Comisiones de Valores
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April 9, 2009

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

RE: Exposure Draft 10, *Consolidated Financial Statements*

Dear IASB Members:

The International Organization of Securities Commissions (IOSCO) Standing Committee No. 1 on Multinational Disclosure and Accounting (Standing Committee No. 1) thanks you for the opportunity to provide our comments regarding the International Accounting Standards Board (IASB or the Board) Exposure Draft 10, *Consolidated Financial Statements* (ED 10 or draft IFRS).

IOSCO is committed to promoting the integrity of international markets through promotion of high quality accounting standards, including rigorous application and enforcement. Members of Standing Committee No. 1 seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect a general consensus among the members of Standing Committee No. 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

We have organized our letter in two sections. The first lays out some general observations regarding ED 10. The second specifically answers the questions asked in the ED's invitation to comment.

General Observations

In the past decade, accounting scandals and the global financial crisis have revealed significant off-balance sheet exposure and potential weaknesses in accounting and disclosure for off-balance sheet entities. Recently, the Financial Stability Forum and Group of Twenty (G-20) asked accounting standard setters to accelerate their work to

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improve accounting and disclosure for off-balance sheet entities.¹ In response, the Board published ED 10 in December 2008 to strengthen and improve the principles that determine when a reporting entity should consolidate another entity. While we are aware that the FASB must first complete certain short-term amendments to its off-balance sheet accounting standards, we strongly encourage the IASB and FASB to work together in determining the core principle of consolidation and definition of control using consistent terminology and in developing sufficient application guidance with a longer term goal of issuing a converged standard on consolidation.

Regarding the core principle of consolidation noted in ED 10 (and largely carried forward from IAS 27), we agree that a reporting entity that has the power to direct the activities of an entity and to generate its returns (both positive and negative) should consolidate that entity. We also agree that all facts and circumstances must be considered when applying this core principle as it can be difficult to identify the controlling shareholder or interest holder. However, in describing this core principle and providing guidance for its application, we have identified several concerns with ED 10 that can be categorized as follows:

- Structure of the standard and consistency of the principles
- Correlation of power and returns (both risks and rewards)
- Agency relationships
- Removal rights
- De facto control
- Options and convertible instruments
- Related parties
- Definition of entity and silo
- Field testing

Structure of the standard and consistency of the principles

We believe that the structure of the standard requires improvement. While the core principle and definition of control are provided in the body of the standard, other significant principles are explained only in the appendix that provides application guidance. We believe the standard should be reorganized such that all key principles are contained entirely within the body of the standard. The application guidance should be limited to expanding and clarifying the principles found in the body of the standard, rather than introducing and explaining new principles outside the body of the standard.

We are concerned that there appears to be inconsistent use of the consolidation principles within ED 10. First, it is unclear whether structured entities follow the same core principle of consolidation and definition of control as other entities. Paragraphs 30-38 provide specific guidance for evaluating structured entities. While these paragraphs are helpful and necessary, we believe ED 10 should clarify that these paragraphs are application guidance that is consistent with the core principle of consolidation and definition of control.

¹ Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience (April 7, 2008) and G-20 Declaration, Summit on Financial Markets and the World Economy (November 15, 2008)

We are also concerned that the proposed principles lack clarity as to whether the basis for consolidation is current control or having the ability to control at some point in the future (e.g., after the resolution of a contingent event). This concern was also expressed by three IASB board members that voted against the publication of ED 10. This issue is of particular concern when considering the impact options and convertible instruments may have on the consolidation analysis. We believe the core principle of consolidation should be based on current control. We also believe that some options and convertible instruments may result in current control by virtue of an agency relationship as noted in paragraph B13(b), while others may only grant to the holder the ability to control at some point in the future. The distinction between these two can be difficult to identify and therefore we believe additional examples may be necessary in order to clarify how to apply the core principle to options, convertible instruments, and agency relationships.

Correlation of power and returns (both risks and rewards)

We are concerned with how the analysis of risks and rewards might impact the consolidation principle in ED 10, in particular for structured entities. We understand a primary objective of the project is to issue a single IFRS on consolidation to replace the consolidation requirements in IAS 27 and SIC-12. Paragraph 10 of SIC-12, along with its Appendix, provides indicators of a relationship in which a reporting entity might in substance have control over an SPE. The four indicators include an analysis of benefits and risks along with decision making and the activities of the SPE. In practice, many have found these indicators of control to be appropriate. We compared these four indicators of control to the six criteria noted in paragraph 31 of ED 10 that must be considered when evaluating power over a structured entity. While consideration of benefits and risks represented two of the four indicators of control in SIC-12, the consideration of returns (both positive and negative) is only one of the six criteria in ED 10. We are concerned that these differences may in practice result in substantial, unanticipated changes in the consolidation conclusion. We believe the four indicators of control in the Appendix to SIC-12 should largely be carried over to ED 10 and supplemented with additional indicators as appropriate. We also believe field tests are necessary prior to issuing a final standard to ensure this analysis results in the right entities being consolidated.

We are aware that ED 10 contemplates the correlation between power and returns when assessing control. While all relevant facts and circumstances must be considered, paragraph 13 states the following regarding this correlation:

A reporting entity's power to direct the activities of another entity is generally correlated with its exposure to the variability of returns from that other entity.

This concept of correlation is further supported in paragraph 33 which provides application guidance for structured entities as noted below:

Generally, the more a reporting entity is exposed to the variability of returns from its involvement with an entity, the more power the reporting entity is likely to have to direct the activities of that entity that cause the returns to vary. A reporting entity is likely to have power to direct the activities of a structured entity if it is

exposed to the variability of returns that are potentially significant to the structured entity and the reporting entity's exposure is more than that of any other party.

While we agree with these two statements about the correlation between power and returns, we believe greater emphasis should be placed on the expectation of correlation in situations where power is difficult to assess, although as noted in the appendix to this letter we do not believe that the emphasis should be extended so far as to result in a "fall back test" such that all factors are disregarded in favor of a computational analysis. Rather, we believe there should be an increased focus on the analysis of risks and rewards in such situations. We believe this approach is consistent with ED 10's core principle of consolidation with control as its basis. We also believe this approach would address the concerns of several IASB board members who voted against the publication of ED 10, in part because of a concern that ED 10 would result in more structuring opportunities because power is more easily disguised than exposure to variability of returns.

De facto control

We agree that a reporting entity can have power to direct the activities of an entity even though it holds less than half of the voting rights of the entity. This could happen in situations in which a reporting entity has voting rights (less than a majority), other contractual arrangements with the entity (e.g., supplier arrangements), or there are other relevant facts and circumstances (e.g., the ability to appoint or remove the majority of the members of the board) that give it power to direct the activities of the entity. One must have regard for all relevant facts and circumstances when performing this analysis including the relative holdings of the shareholders, how diversely the remaining votes are held, and past history of voting if such history is indicative of the future. In summary, we believe power to direct activities should be assessed in terms of all relevant facts and circumstances.

We do have concerns with the example provided in paragraph 28 in which one reporting entity is the dominant (not majority) shareholder while all other shareholders with voting rights are widely dispersed and are not organized. First, applying the term 'dominant' in practice may prove difficult without further guidance. Second, while this example may result in current control in certain situations, we are not convinced that this example would result in current control in all circumstances. We are also concerned that this principle may not be operational. The other shareholders may not have organized for a variety of reasons, including apathy or contentment. If the other shareholders are satisfied with the decisions of the dominant shareholder, it may be difficult to support a view that the dominant (but not majority) shareholder has current control over the entity. Also, a view that ignores shareholders that hold a majority of the voting rights of an entity simply because such shareholders have not exercised their voting rights is contrary to the last sentence in paragraph 8 which states that "a reporting entity need not have exercised its power to direct the activities of an entity to control that entity."

Options and convertible instruments

Paragraph 8 notes that a reporting entity can possess the power to direct the activities of another entity by having options or convertible instruments to obtain voting rights. We

believe the principle in this section should provide guidance for all potential voting rights (e.g., including forward contracts), and should not limit its scope to only options and convertible instruments. Paragraph B13, which provides application guidance for evaluating this concept, does not provide a sufficiently clear principle that can be applied to all potential voting rights. For example, such potential voting instruments may (a) be currently or contingently exercisable, (b) be in or out of the money, or (c) contain fixed or fair value conversion rates. The specific terms of such instruments can have important consequences on an analysis of whether or not such instruments grant the holder power to direct the activities of another entity. As previously noted, we agree that holding options and convertible instruments may indicate the holder of such instruments has current control similar to an agency relationship, discussed further below. However, this principle is not clearly stated in paragraph B13. We believe this principle should be clarified and expanded upon such that it can be applied to all options and convertible instruments in a consistent fashion. We also believe that some of the discussion contained in the basis for conclusions (BC85 to BC86) should be brought forward into the standard.

Paragraph BC81 provides an example where an “option holder could have power indirectly if the shareholder that is the counterparty to the option agreement uses its voting power to act on behalf of the option holder.” Some may view this concept to be in conflict with the notion of control discussed in paragraph BC47 which states that “a controlling entity needs to have the power or ability to direct the activities—exercise of that power is not necessary.” On one hand, the counterparty to the option agreement may be viewed as having control while others may view the counterparty as simply an operator acting on behalf of the option holder. The confusion in this area also arises when de facto control is being assessed as discussed above. This issue must be clarified before finalizing the standard.

Finally, we believe the discussion regarding options and convertible instruments should explicitly refer to both parties to the agreement (i.e., the holder of the instrument and the counterparty to the instrument).

Agency relationships

Paragraph B3 defines an agent as “a party engaged to act on behalf of another party or parties (the principal(s)).” The Board provided in its basis for conclusions additional discussion regarding agency relationships noting that “an agent is a party that is required under an agreement or law to act in the best interests of a principal or principals. An agent will receive remuneration for its services that is commensurate with the services provided.” While the Board has acknowledged that the line between principal and agent can be blurred, ED 10 provides limited guidance to assist in this evaluation. We believe that appropriate and consistent identification of principals and agents is currently and will continue to be a critical aspect of the overall control/power determination. Considering the significant amount of judgment required to identify which party is the principal and which party is the agent, we believe additional guidance should be provided. For example, we believe that some of the discussion contained in the basis for conclusions (BC88 to BC95) should be brought forward into the standard (e.g., dual roles).

Removal rights

Paragraph B4 states that “removal rights can indicate an agency relationship.” However, the draft IFRS does not differentiate between substantive and non-substantive removal rights. For example, if there are significant barriers to exercising the removal rights (e.g., financial penalties, operational barriers, an absence of qualified replacements, etc.), such removal rights may not be substantive. Clarifying the importance of substantive removal rights is essential to prevent reporting entities from granting non-substantive removal rights in order to avoid consolidating another entity.

Related parties

ED 10 does not clearly address the impact related parties might have on the consolidation analysis. While paragraph B12 includes related parties (as defined in IAS 24, *Related Party Disclosures*) as an example of parties that often act for a reporting entity, we do not believe the ED provides sufficient guidance to apply this concept. For example, a reporting entity may not have the power to direct the activities of another entity alone, but does have such power when combined with its related parties. We believe ED 10 will be significantly improved if the effect related parties have on the overall consideration of power and control is addressed. This principle must be clarified in order to prevent structuring opportunities whereby reporting entities may disperse their voting interests and other influence over another entity among several related parties in order to avoid consolidation. Addressing this would also clarify that control cannot be shared by the related parties and therefore prevent more than one reporting entity from consolidating another entity. If a group of related parties have control over an entity, only one of the reporting entities in the related party group should consolidate the entity.

Definition of entity and silo

The scope of ED 10 applies to all entities, including silos. However, we note that neither of the terms ‘entity’ or ‘silo’ are defined. Appendix A, *Defined Terms*, includes a footnote to the definition of subsidiary that states “an entity within a legal structure referred to in the definition of subsidiary is sometimes referred to in national GAAP as a silo.” We believe both of these terms should be explicitly defined in Appendix A and be consistent with any definitions used in the Conceptual Framework as the scope of ED 10 depends on accurate definitions of these terms.

Field testing

Our final general observation is that this draft IFRS must be evaluated through field testing prior to issuance of a final standard. The goal of field testing should be to evaluate whether or not the draft IFRS has accomplished the objectives of the IASB to (a) improve the accounting and disclosures for consolidated and off-balance sheet entities, (b) to issue a single IFRS on consolidation that appropriately replaces IAS 27 and SIC-12, and (c) to clarify the definition of control and address application issues.

Responses to the Board's Questions

DEFINING CONTROL and ASSESSING CONTROL

Question #1: *Do you think that the proposed control definition could be applied to all entities within the scope of IAS 27 as well as those within the scope of SIC 12? If not, what are the application difficulties?*

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

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?*

Question #4: *Do you agree with the Board's proposal 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?*

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.*

Please reference our general observations for a discussion regarding the control definition, control principle, and control assessment.

STRUCTURED ENTITIES

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?*

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?*

The Board has defined a structured entity as “an entity whose activities are restricted to the extent that those activities are not directed as described in paragraphs 23-29.” We believe this definition lacks substance and clarity. We also believe this term and its definition should be removed from the section related to *Assessing power to direct activities* (see discussion below) and only utilized in the disclosures section of the draft IFRS.

We believe the guidance regarding assessing control of structured entities should remain in the body of the draft IFRS (rather than being moved to Appendix B, *Application Guidance*). However, we believe it should be included as guidance for all entities when evaluating the power to direct activities, not only for structured entities.

We also believe that greater emphasis should be placed on the correlation between exposure to variability of returns and power to direct activities in situations where power is difficult to identify as noted in paragraph 13. While all relevant facts and circumstances must be considered when assessing control, the greater a reporting entity is exposed to variability of returns of an entity, the more likely that reporting entity has the power to direct the activities of that entity. We believe there is a rebuttable presumption that if a reporting entity is exposed to a majority of the variability of returns from an entity, then it also has power to direct the activities of that entity. This presumption could only be overcome by clear evidence that another party has the power to direct the activities of that entity.

FALL BACK TEST

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 the draft IFRS should include a risks and rewards 'fall back' test. There should be no exceptions to the core principle of consolidation that has control as its basis.

Please refer to our discussion regarding the relevance of risks and rewards in the consolidation determination noted above in the section titled *Correlation of power and returns (both risks and rewards)*.

DISCLOSURES

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, or added to, the draft IFRS.*

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

In general, we are supportive of the disclosure requirements for 'off-balance sheet activities' noted in paragraph 23 of the Board's ED. However, we are concerned that some of the disclosures required are not focused on the key risks to the reporting entity, may be too extensive and may not be operational. For example, paragraph B44(c) requires disclosure of the assets held by structured entities, measured at the date of the reporting entity's financial statements. Some entities may not be able to comply with this requirement.

We also believe that some of the disclosure requirements for structured entities (e.g., paragraph B38) duplicate disclosures already required by IFRS 7 *Financial Instruments: Disclosures* which requires disclosures regarding the nature and extent of risks arising from financial instruments. This duplication should be eliminated.

REPUTATIONAL RISK

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 basis of consolidation might work in practice.*

Question #11(b): *Do you think the proposed disclosures in paragraph B47 are sufficient? If not, how should they be enhanced?*

The Board included in paragraph BC37 of its basis for conclusion that “the consolidation of structured entities on the basis of reputational risk is inconsistent with the controlling entity model.” While being exposed to reputational risk in and of itself does not seem to result in control (and thus consolidation) of a structured entity, reputational risk might impact a reporting entity’s exposure to the variability of returns of an entity and thus may impact the analysis under paragraph 33 of the draft IFRS. We do not believe there should be a scope out provided for reputational risk or any implicit, non-contractual obligations. All relevant facts and circumstances should be evaluated when determining a reporting entity’s exposure to the variability of returns of an entity.

SIGNIFICANT INFLUENCE

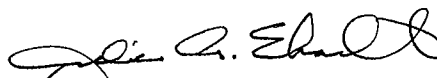
Question #12: *Do you think that the Board should consider the definition of significant influence and the use of the equity method with a view to developing proposals as part of a separate project that might address the concerns relating to IAS 28?*

No. We are not aware of any major issues arising from the use of the equity method or the notion of significant influence.

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We appreciate your thoughtful consideration of the comments raised in this letter. If you have any questions or need additional information on the recommendations and comments that we have provided, please do not hesitate to contact me at 202-551-5300.

Sincerely,



Julie A. Erhardt
Chair

IOSCO Standing Committee No. 1