

Roundtable on Consolidation

IASB discussion notes can be downloaded here:

<http://www.iasb.org/NR/rdonlyres/7F52132F-1E5D-45EE-86D8-5001F12CBE8F/0/ConsolidationRoundtablediscussionpoints.pdf>

Staff draft of an exposure draft can be downloaded here:

<http://www.iasb.org/NR/rdonlyres/6E43180A-6733-4936-BDA2-1D289A28BF31/0/ED10ConsolidatedFinancialStatementsVersion3.pdf>

QUESTIONS FROM THE IASB DISCUSSION NOTES:

1. Do you think that the revised control definition could be applied to traditional control arrangements and those entities set up with a narrow and well-defined purpose? If not, where do you think the definition falls down?
2. Is the general control principle likely to lead to the right entities being consolidated?
3. Do you agree that the continuous assessment of control should not lead to entities 'flipping in and out' of consolidation?
4. Do you agree with the presumption that the greater the variability of returns that a party exposes themselves to the greater the *expected* ability of that party to affect the performance of the assets of that entity? If not, why not?
5. We envisage that there will be some circumstances when an entity is not controlled by any party. Do you agree? If not, why not?
6. Do you agree that a party can have control over an entity even if they hold less than half the voting rights? If not, why not?
7. Are the indicators provided in the draft ED sufficient to capture the entities that should be consolidated and to ensure consistent application?
8. Do you agree that the existence of an option on its own is not enough to give a party control over an entity? If not, why not?
9. Do you agree that the definition of significant involvement will capture the right entities about which you want further information or do you think it is casting too wide a net? What entities are being captured that you believe should not be, and vice versa?
10. Do you support a requirement to disclose additional information in those circumstances in which the consolidation decision was not straight-forward?
11. Do you support the proposal to require the disclosure of more information about the claims of non-controlling interests?
12. Do you support the suggested disclosures in relation to significant involvement?
13. Would you, as a preparer of financial statements, be able to produce the additional information required to be disclosed under the draft ED?

14. Do you agree that where a fund manager has dual role - it acts in a fiduciary capacity and hold a direct investment in the investee- the fund manager should consider the two positions collectively when determining whether it has control? If not, why not?

Please provide examples for which you believe that in spite of the dual role performed by the fund manager you believe it is appropriate for the fund manager not to consolidate the entity.

15. Do you agree that investment companies should be required to consolidate any entities it controls? If not, why no

Session 1

Questions 1 to 5

Many participants supported the approach of the IASB to merge IAS 27 and SIC-12 into one standard and welcomed that the IASB has involved constituents in a very early phase. One constituent highlighted that the direction is right, but the current draft has too many words circumscribing the principle, which itself has not been properly described. Another constituents wanted even more guidance in the document and expressed concerns about how to operationalise certain aspects of the draft. It was noted that the words used are not consistent and not properly defined.

Others were concerned that the words would not provide sufficient guidance. The concept of a continuous assessment of control was considered as creating entities to be consolidated in one period, not in another, but then again, by many.

It was also questioned whether the presumptions are rebuttable and if so, the draft should be clear about this.

Some were concerned about the continuing divergence to the US guidance.

Questions 6 and 7

One constituent highlighted that they saw the words as drafted as providing more flexibility on the consolidation decision on the issue of so-called 'de facto' control. Another participant noted that the guidance is unclear when power and benefits are not pro rata, i.e. the percentage of benefits does not equal the percentage of power.

Others were confused about the indicators provided in the Appendix.

Question 8

One constituent highlighted that in situations which options are intended to be deeply in the money and are not driven into the money by market forces were critical. If the standard would be absolute about this this would create opportunities.

Question 9

Most of the roundtable participants were concerned over the concept of significant involvement as it could be too wide a net. It was noted that without further narrowing down many relationships would be captured by the definition. It was also asked how this related to the existing Standards on significant influence and joint control. The staff responded that this would be a question in the ED.

Some constituents were concerned about the practical challenges that would arise from a wide interpretation of the notion of significant involvement. They believed it would be difficult to gather the necessary data.

Questions 10-13

n/a

Question 14

It was questioned that the guidance on agency relationships would be difficult to be applied in practice. It was asked by one constituent if an intermediate parent entity would be considered an agent as it acts on behalf and for the benefit of the ultimate parent.

Question 15

There seemed to be agreement around the table that investment companies should not be excluded from consolidation and fair value their investments. One constituents saw some possible merits in this treatment.

Session 2

Questions 1 to 4

Several constituents expressed concern about how the revised control definition was to applied to "autopilot" entities. If all decision are predetermined then what does "power" really refer to? There was a concern over moving away from the concept of looking at what has been predetermined and whether this would be applied in the appropriate way to provide the sought for outcome with regards to SPEs. The fear was that on SPEs the current draft of the ED could be read to allow entities that are currently consolidated not to be consolidated. Other constituents still expressed concern over whether the concept in the Exposure Draft adequately makes the connection between control through active governance and control over an entity with very narrowly predetermined activities and little decision making left.

One constituent questioned how the new notion of control was to be applied to situations where you have control over a segregated portfolio (silo) and how that interacts with the question of control over the whole legal entity within which the silo sits.

Another constituent whether there were several adjectives in the draft of the Exposure Draft that were superfluous or could be modified such as:

- A) given that wording of "has control" is used whether further descriptor of "currently" is needed
- B) use of the word "manage" might be more usefully replaced with word such as "direct" that more usefully conveys power ("manage" implying perhaps directing for someone else's benefit, or not taking key strategic decisions)
- C) modifier of "economic" not needed in "economic activities" in the context of an entity as all activities are economic

The project manager and FASB representatives both expressed the view that although the efforts of the FASB and IASB were at the moment not being run as a joint project (FASB having issued exposure draft of FIN 46R revision and IASB to issue separate exposure draft) there was considerable overlap between the direction in which the proposed changes were going on both GAAPs. In particular mention was made of the fact that when 9 common securitisation/SPE models were measured up against both the IASB draft ED and the ED of changes to FIN 46R they produced the

same results on all of the 9 structures. The hope was that the efforts could be combined into a joint project and result eventually in a converged standard (although it was acknowledged that this might mean the need to re-expose changes again on either the FASB or IASB side).

Several constituents said that in their view the notion of continuous assessment could result in entities flipping in and out of consolidation.

One constituent presented the scenario of a sponsoring bank contributing assets into an SPE and then entering into an option that would give it the right but not the obligation to buy back those assets and questioned how the approach in the Exposure Draft would deal with such a scenario as he believed it might indicate that consolidation is necessary as the the sponsoring bank has the power to effectively "buy back losses" that it is likely to exercise for reputational reasons/reputational benefit. A similar question arises as to whether a sponsoring bank should consolidate on the basis of its option to (again right but not obligation) to provide liquidity support. One Board member questioned whether this in itself was enough to result in consolidation before such support was given.

Questions 6 and 7

Some constituents still struggled with the notion of de facto control given that it was contrary to the idea of being able to maintain and protect control. Others said that there had been instances where they had applied a notion of de facto control but this was in circumstances where there other strong indicators ie just having 49% of votes and the other shareholders not being active would not be enough. The point was also made that any judgement on de facto control should be very specific to particular market and legal environment. Representative of an audit firm noted that in advising clients on the appropriateness of using a notion of de-facto control they were also highlighting the need to think through the implications in terms of a future position where control is lost (as the claim of de-facto control can no longer credibly be made) and how this is explained to shareholders.

Question 8

In discussing the material dealing with options the question emerged over what was the concept of control that the IASB was trying to arrive at, ie was it a notion of:

- A) perpetuating control (ie protective notion)
- B) currently exercising control
- C) having the ability to acquire control

One board member thought this was the fundamental philosophical question that needed to be addressed. The suggestion was made that in the absence of more compelling reasons for choice between the alternatives it might be useful to examine which approach would prevent the most objectionable structuring opportunities.

A constituent suggested that material might also deal with forward over voting shares and put and call combinations that amounted to synthetic forwards over such shares.

Some constituents questioned whether you really had power if it could be taken away from you (whether by one entity or a combination of entities acting together). It was noted that whatever notion of control was chosen in the end it should be applied consistently to options, de facto control scenarios and SPEs.

Question 9 to 13

One constituent questioned how the concept of significant involvement would interact with significant influence and joint control. The project manager noted that significant involvement could be through means other than an investment or any financial instrument so that associated disclosure would tackle areas not covered by IAS 28, IAS 31 or IFRS 7. One constituent expressed the view that if there was a possibility of entity stepping in as sponsor to provide liquidity (even though it has no obligation to do so) then it has significant involvement and should be providing additional disclosures from the beginning. The project manager did concede that it might be worth stepping away from a more general notion of significant involvement (that would include JVs and associates) to target more specifically disclosures on SPEs that were really of concern.

One constituent questioned whether the notion of significant involvement should not be more of a through the eyes management concept. A representative of one of the investment banks noted that the disclosure proposed at the moment would be hugely onerous to prepare in terms of the information that needed to be assembled.

Question 14

A constituent raised the question over whether the draft could be interpreted to say an intermediate parent was an agent on behalf of an ultimate parent and whether this was the intention. One constituent suggested that the present draft might result in less entities being consolidated in the fund management industry. The presumption that if an entity acts as agent on behalf of others but is also partly exposed as principal then it exercised its power as agent on behalf of itself was criticised as overly harsh or at least lacking a clear idea of how it could be rebutted. It was questioned whether there was need for more guidance over thresholds for economic interest of an agent also acting as principal and strength of kick out rights vis a vis agents to help make consolidation decisions in this area.