

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

18 March 2009

Grant Thornton International
Regent's Place
7th Floor
338 Euston Road
London NW1 3BG

Submitted electronically through the IASB Internet site (www.iasb.org)

Exposure Draft 10 Consolidated Financial Statements

Grant Thornton International is pleased to comment on the International Accounting Standards Board's (the Board) Exposure Draft 10 *Consolidated Financial Statements* (ED10). We have considered ED10 along with the accompanying draft Basis for Conclusions.

We welcome the Board's efforts to unify IAS 27 and SIC-12 based on a clear principle. This should eliminate tension between the two models and uncertainty as to which model applies to some entities. We also support ED10's broad approach - in particular its clear focus on control as the basis for consolidation of another entity. However, we do have some significant concerns which are explained in the following paragraphs.

Additional comments and suggestions are set out in Appendix 1 as part of our responses to the invitation to comment questions. A number of other suggestions (mainly of a drafting nature) are set out in Appendix 2.

Major concerns

Control definition, 'power' and 'ability'

We agree at a general level that 'control' is the appropriate basis for consolidation. The outcome of a control-based approach in specific circumstances will of course depend on how that term is defined and the application guidance supporting the definition.

We agree in substance with ED10's definition of control as 'the power to direct the activities of another entity to generate returns for the reporting entity' (Appendix A), although we have some drafting suggestions in Appendix 2 to this letter. However, we are concerned that this definition and ED10's underlying principle are obscured by the proposed guidance using the words 'can' and 'ability' as if they are synonymous with 'power'. For example:

- paragraph 22 states that a reporting entity has power to direct the activities of another entity if it can determine that other entity's strategic operating and financial policies;
- BC47 explains that to have control an entity must have 'power or ability to direct ...';
- paragraph 27 addresses power to direct without a majority of voting rights and part (b) of that paragraph refers to 'ability to determine strategic operating and financial policies'.

These terms could be interpreted differently and should not in our view be used interchangeably. 'Power' has connotations of access to rights or force such that decisions can be imposed to the exclusion of others' wishes. Paragraph 5 of ED10 seems consistent with that view of power. 'Ability' is perhaps a broader term that encompasses influence and persuasiveness.

Taking ED10's proposed definition of control together with the supporting guidance, the proposed basis for consolidation could be expressed approximately as a reporting entity's expectation that another entity will (for the time being) behave in accordance with the reporting entity's wishes. We do not believe that is a robust basis for consolidation or one that is capable of being applied consistently. To have control we believe the reporting entity's current rights or powers must be sufficient to enable it to compel another entity to act in a certain way.

Agency relationships

We welcome the inclusion in ED10 of guidance on assessing control in the context of agency and fiduciary arrangements. However, we are concerned that ED10's guidance as drafted may lead to inappropriate conclusions when assessing agency rights and involvement with structured entities. Our primary concern is that, even in a controlling relationship, the controlling entity is likely (as a matter of law) to have fiduciary responsibility to other investors and other parties involved with the entity. We believe that the guidance in paragraphs B7 and B11 of ED10 could provide a straightforward means of avoiding consolidation of some entities through assertion of fiduciary responsibility.

We explain our concerns in more detail in our response to Question 5.

Structured entities - definition

In our view ED10 should not attempt to define 'structured entities' (or, if it does so, the use of the definition should be limited to specifying the population of entities for which disclosures are required). Defining a sub-category of entities to which specific guidance applies is likely to have unintended consequences. Possible problems are that entities that do not have the characteristics stated in the definition will be excluded and also that the perceived scope uncertainties between IAS 27 and SIC-12 (referred to in BC11-12) will be perpetuated in another guise.

We believe that, rather than defining a sub-category of entities, it is preferable to focus instead on the different ways in which control can be achieved over any entity. Accordingly, instead of referring to structured entities in paragraphs 30-38, we recommend introducing that material with a statement along the lines:

The power to direct an entity's activities in order to generate returns might be achieved in ways other than those described in paras []. This might arise because the activities are so restricted that the entity either has no need for a governing body or any party with wide decision-making powers or such a body exists but the decisions entrusted to it are not those that most affect the returns. A reporting entity with involvement in such an entity shall assess control on the basis of the power to take decisions that affect the returns. In making this assessment...

Structured entities - assessing control

We are concerned that ED10 takes a narrower view of the role of 'predetermination' in assessing control compared to SIC-12's concept of an 'autopilot' - at least in terms of how we believe that latter term is currently applied. Paragraph 36 takes a restricted view of predetermination which can be summarised as the reservation of specified decision-making. Paragraph 36 is also unclear as to whether the assessment is based on the right to

take decisions on future actions, or the predetermination of future actions. In our view these are different concepts. We believe that both should be relevant to the control assessment.

Moreover, ED10 refers to restricted activities in the definition of a structured entity, but not in the guidance on assessing control. In our view restricting another entity's activities is an aspect of decision-making that may affect the returns from involvement with that entity. We therefore suggest that a reporting entity that has caused the activities of another entity to be restricted in accordance with its wishes (or has otherwise determined the activities that the other entity will undertake) is likely to have control if no other party (or parties) has (have) powers amounting to control. We believe that the guidance in paragraph 34 on 'activities' should be expanded to capture this broader view of predetermination.

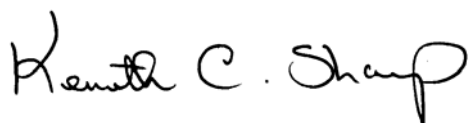
We share to some extent the concern in the Alternative Views that some entities in relation to which the reporting entity has the majority of exposure to variability of return will not be consolidated if decision-making powers have been 'disguised'. However, we believe that including a risks and rewards fall-back test would not be consistent with the control-based model the Board is seeking to develop. We do not believe that a reporting entity has control if it has exposure to 'risks and rewards' but has no decision-making role. However, consistent with our comments in the preceding paragraphs, we believe that predetermination of activities, predetermination of policies and reservation of decision-making are all relevant 'powers' that may contribute to overall control. One way of linking this broader view of predetermination with the concerns expressed in the Alternative Views might be to include a rebuttable presumption that the reporting entity controls another entity if it:

- has caused that entity to be established or has otherwise determined the activities that the entity undertakes (ie it is the sponsor); and
- is exposed to variability of returns from that entity's activities that is large relative to the total variability of returns from that entity's activities or has the right to returns from that entity's activities that are large relative to the total expected returns of the entity.

Such a presumption could be rebutted if the reporting entity can demonstrate that another party or parties has assumed control over the other entity.

If you have any questions on our response, or wish us to amplify our comments, please contact our Executive Director of International Financial Reporting, Andrew Watchman (andrew.watchman@gtuk.com or telephone + 44 207 391 9510).

Yours sincerely,



Kenneth C Sharp
Global Leader - Assurance Services
Grant Thornton International

Invitation to comment questions

Question 1 - proposed control definition

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 are unsure of the intention of this question. However, we believe that a control-based concept is the appropriate basis for consolidation. We also believe that this concept can be applied to all entities that would currently be assessed in accordance with IAS 27, SIC-12 or both.

We have some suggestions on the wording of the definition to make it more operational. These are set out in Appendix 2.

Question 2 - control principle

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

As noted in our response to Question 1 and in the main body of this letter, we agree that consolidation should be based on control. The main letter also explains our concerns with ED10's use of 'power' in the definition of control and 'ability' (and also 'can') in the subsequent guidance.

Question 3 - assessment of control

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?

We believe the guidance in paragraphs 12 to 25, along with the related guidance in Appendix B, covers the appropriate issues and is generally sufficient. We do however have the following concerns over the guidance on assessing control achieved through a large minority of voting rights (paragraphs 26-29):

- consistent with our comments on power and ability in the main body of the letter, we question whether the guidance in paragraph 27 is consistent with a power-based definition of control. In our view a reporting entity with a large minority of voting rights is not ordinarily in a position to preclude others from exercising control (with reference to paragraph 5);
- given that ED10 seems to treat power and ability as synonymous, the logic of paragraph 27(b) (which refers to 'ability to determine the strategic operating and financial policies' as determinative of power for the largest shareholder) is circular; and
- we believe that this guidance will be difficult to put into practice and will lead to inconsistent application.

Accordingly, we recommend deleting paragraphs 27 and 28. Consequential amendments to paragraphs B9 to B16 in the Application Guidance would also be required.

Question 4 - options and convertible instruments

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.

We believe ED10's approach to potential voting rights is an improvement on IAS 27's rule-based approach. Application of the guidance in IAS 27 can lead to the inappropriate conclusion that two different entities have control over a third entity. ED10 recognises that: (i) an option normally encompasses a right to obtain voting rights in exchange for the exercise price; and (ii) that this is not economically equivalent to present ownership of those rights.

Although we support the general approach of ED10 in this area, we are concerned that the draft IFRS does not explain how options and convertible instruments might confer or contribute to control. In our view, any decision-making rights included in the terms of an instrument are clearly relevant to a control assessment. We therefore agree with the guidance in Appendix B13(b) and (c).

However, we do not believe that control is conferred as a result of the option issuer's management (or current owners) choosing to act in accordance with the wishes of the option holder. In our view a reporting entity has 'power to direct' only if it can compel another entity to act in a certain way. A plain vanilla option does not ordinarily confer rights or powers that enable compulsion. With this in mind, we believe the guidance in B13(a) is ambiguous in that it does not state whether the entity under review is obliged to act in accordance with the wishes of the reporting entity or simply chooses to do so in its current circumstance (because its interests are aligned with the option holder's).

Thus the guidance in ED10 may perpetuate the problem in IAS 27, namely that two different parties may believe that their current holdings (of options and shares) result in the entity's management making decisions in accordance with the option holder's wishes. The desired clarity over who controls the entity will therefore not be achieved.

Question 5 - voting rights held as an agent

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.

We agree that it is important to identify agency and fiduciary arrangements that should not result in consolidation. We also believe the guidance in B3 to B6 on agency relationships is useful and appropriate, and largely consistent with existing practice in accordance with IAS 27.

We do however have concerns over the guidance in paragraphs B7 and B11. Taken together, those paragraphs have the broad effect that a reporting entity's decision-making rights are excluded from the control assessment if those rights are accompanied by an obligation to act in the best interests of other parties. The difficulty with this is that, even in a controlling relationship, the controlling entity is likely as a matter of law to have fiduciary responsibility to other investors and parties involved with the entity. Likewise, almost all agency relationships require an agent to act in the best interests of the principal.

Accordingly, the 'tests' in B7 and B11 as to whether decision-making rights are limited by responsibilities to others appear to set a low hurdle and may not reflect the substance of many arrangements. This guidance therefore seems overly definitive in its effect on the control assessment, and insufficiently linked to other factors that should be considered as part of that assessment. For these reasons we believe that B7 and B11 may create fairly straightforward structuring opportunities for reporting entities seeking to avoid consolidation.

More specifically, we question the appropriateness of the final sentence of B7 which states: 'However, if this ability is limited by the agent's responsibility to act in the best interests of the principal, the performance-related fee **does not** indicate involvement with the entity beyond that of agent' [emphasis added]. We suggest that 'does not' should be amended to 'may not' or something similar.

Turning to paragraph B11, the second sentence in paragraph B11 sets out that that the reporting entity '**excludes** the voting rights it holds as agent only if [it] can demonstrate that it is obliged to act in the best interests of those other parties' [emphasis added]. This guidance seems to introduce an element of choice into the control assessment, and again appears overly definitive and isolated from other factors. As explained above, we believe that demonstrating such an obligation will usually be a straightforward matter. Moreover, we are unsure as to whether the obligation to act in the best interests of others is substantive when those others' best interests are aligned with the reporting entity's interests or are served by being part of a control group (which will be often). B11 contains an implied presumption that a reporting entity uses the voting rights of other parties for *either* its own benefit *or* the benefit of the other parties but not for the benefit of *both* itself and the other parties. It would also seem that a majority of decision-making rights accompanied by any significant exposure to variable returns meets the basic definition of control in ED10.

Accordingly, it can be argued that the effect of the agency guidance is to establish a de facto exemption from consolidation for legal-form agency arrangements. For these reasons, we suggest that B7 and B11 could permit non-consolidation in some inappropriate circumstances.

However, we also believe that the decision-usefulness of consolidation in circumstances such as 'dual role' involvement in an investee by a fund manager is questionable (even if applying the control principle leads to the conclusion that the fund manager has control). Applying a broad-based consolidation model to the funds management industry raises particular issues - in relation both to the consistent application of the underlying principles and to the decision-usefulness of the information that results from consolidation. We suggest that further work (including field-testing) is necessary to address those issues.

However, if the Board wishes to finalise an IFRS on an accelerated timetable, our preference would be to amend the drafting of B7 and B11 to address the concerns indicated above. We also suggest that the requirement of paragraph 14 (that a reporting entity shall consider all relevant facts and circumstances when assessing control) should be clearly restated in this section as the principal foundation of determining whether an agent has control. In addition, the Board should consider the need to amplify the generic guidance after further analysis and study and provide examples of application of the principles to common scenarios (with particular emphasis on the funds management industry).

Question 6 - definition of a structured entity

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?

See our comments in the main body of this letter. We do not believe that the term structured entity should be defined for the purpose of assessing control.

Question 7 - assessment of control of a structured entity

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?

See our comments in the main body of this letter.

Question 8 - risks and rewards

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.

In our view a risks and rewards fall-back test should not be included but a discussion of risks and rewards is relevant to identifying powers to direct activities. We recommend that this discussion is included in the Application Guidance.

See also our comments in the main body of this letter and in response to question 5 on agency relationships.

Question 9 - disclosures

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.

This is primarily a question for users of financial statements. With that in mind, our reaction is that the overall disclosure package appears burdensome. We believe that compliance is likely to be costly for preparers and may result in excessive volume from a user perspective. We suggest that the Board and Staff should ascertain how the proposed information would be used in practice, and consider whether user needs could be better and more clearly addressed by disclosures on financial instruments, commitments and contingencies.

We also note that extensive disclosure requirements for unconsolidated 'structured entities' will put considerable stress on the definition of that term. For example, paragraph 48(d) would seem to require disclosures for any investment, associate or joint venture deemed to be a structured entity, even if the 'structuring' has no effect on the reporting entity's interest.

We question the need for extensive disclosures about unconsolidated structured entities by all reporting entities with any involvement that exposes the reporting entity to variability of returns of such entities, regardless of the significance of that involvement. Paragraph B39 provides an exception if it is impracticable to obtain information for required disclosures. However, any passive investor in an entity would be required to determine whether the entity in which it has invested meets the definition of a structured entity just to determine whether disclosures are required. Such investors might lack the ability to obtain information necessary to make such a determination.

Question 10 - disclosures

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.

This is primarily a question for preparers of financial statements. However, consistent with our response to Question 9 we believe that the overall disclosure package could impose significant costs on preparers.

We also have the following specific comments:

- the definition of involvement with a structured entity includes both contractual and non-contractual involvement, which seems broad. We suggest that disclosures regarding involvement might be limited to contractual, constructive and statutory involvement;
- Appendix B42 requires disclosure of transaction-based information regarding unconsolidated structured entities covering three years. We believe that two years is sufficient (but suggest leaving in place the last sentence of B42 which requires additional information if necessary to meet the applicable disclosure objective).

Question 11 - reputational risk

(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, we do not believe that reputational risk alone is an appropriate basis for consolidation.

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

We believe the proposed disclosures are sufficient.

Drafting suggestions

We have the following suggestions on possible improvements to the drafting of ED10:

Definition of control and returns (paragraphs 4, 10 and Appendix A)

We believe the definition articulated in paragraph 4 is an improvement on IAS 27's definition. However, we also have the following suggestions on improving the definition further:

- we agree that 'returns' is a better term than 'benefits' (for the reasons stated in BC52) but have a concern that some constituents might read 'returns' as a narrower phrase that captures only monetary returns rather than wider benefits. We note that paragraph 11 expands on the meaning of returns and we support that guidance. However, it might also be helpful to expand ED10's definition of returns at paragraph 10 and Appendix A to state that such returns can be both financial and non-financial.
- for consistency we suggest that the definition of control is expanded by adding: 'variable' before 'returns'. Accompanying this, in paragraph 10 and Appendix A we suggest defining 'variable returns' rather than 'returns from involvement with an entity' (or improving the link between the definitions of control and of returns in some other way).

Paragraph 7

We suggest deletion of the word 'those' in the final line.

Paragraph 8

The final sentence might read better expressed as follows:

'A reporting entity can control an entity without having exercised its power to direct the activities of the entity.'

Paragraph 9

We suggest replacing 'have' in the first line with 'exercise'.

Paragraph 16

We believe the final sentence should be rephrased along the lines of:

'However, if the reporting entity ceases to have exposure to returns from its involvement with an entity, it does not control that entity.'

Paragraph 22

This paragraph states that a reporting entity has the power to direct the activities of another entity if it can determine that other entity's strategic operating and financial policies. The main body of this letter outlines our concerns with ED10's interchanging use of 'power', 'can' and 'ability'. We also have a concern that paragraph 22 as drafted could be read as a definition of 'power to direct' (which calls into question the relationship between paragraphs 4 and 22). We therefore suggest redrafting paragraph 22 along the lines:

'A reporting entity that has the power to determine another entity's strategic operating and financial policies has the power to direct the activities of that entity.'

Paragraphs 23-25

In paragraphs 23 to 25 we believe it should be clarified that, in the absence of other control mechanisms, a simple majority voting interest confers control only if decisions are made by a simple majority vote. We note that some entities require supermajority votes for strategic operating and financing decisions.

Paragraph 30

As noted in the main body of this letter, we believe that ED10 should not attempt to define 'structured entities'. Accordingly, we recommend deleting paragraph 30.

Paragraphs 31-38

This guidance is a mixture of:

- ways in which structured entities are controlled (for example paragraph 34 discusses direction of the limited activities and paragraph 36 discusses predetermination of policies as mechanisms through which power can be achieved); and
- circumstances that indicate that control might exist (for example paragraph 32 discusses how purpose and design can indicate when a structured entity's activities are 'part of the reporting entity's ongoing activities' and paragraph 33 states that an exposure to significant variability in a structured entity's returns is likely to be accompanied by powers).

We recommend that the final IFRS distinguishes more clearly between means of having power or control and circumstances that indicate that such power might exist. We also suggest that the guidance in paragraphs 31-38 should be moved to the Application Guidance (Appendix B, following paragraph B16).

Paragraph 32

As a practical matter, we agree with the statement at the beginning of paragraph 32 to the effect that understanding the purpose and design of a structured entity is helpful in assessing control. However, we find the statement in the second sentence that: 'a reporting entity is likely to control a structured entity that has been created to undertake part of the reporting entity's ongoing activities...' somewhat circular. This is because the boundaries of the group (ie the consolidated reporting entity) are determined by the outcome of the control assessment. The ongoing activities of the reporting entity are identifiable only by first identifying the composition of the group.

Moreover, the second sentence as drafted appears to suggest that it is unlikely that an entity might 'genuinely' outsource certain functions that were previously undertaken by that entity.

We suggest it would be more accurate to say that:

'if a reporting entity creates a [structured] entity to undertake activities that have previously been undertaken by existing group entities, and are integral to the group's other ongoing activities, the reporting entity is more likely to retain powers to direct the activities of the structured entity.'

We also note that the broader view of predetermination that we propose in the main body of this letter may have the beneficial effect that this part of the guidance on structured entities becomes unnecessary.

Paragraph 33

We question whether the assertion in the final sentence of paragraph 33 is true and suggest that it should be deleted or amended. Many large passive investments in a securitization entity could expose the holder to variability considered significant to the entity and to more variability than any other investor in that entity is exposed to; the holders of such passive investments often do not have the power to direct the activities of that entity. In order to generalise this paragraph we suggest that either 'likely' is replaced by 'more likely', or the sentence is redrafted to read:

'An indicator that a reporting entity may have power to direct...'

Paragraph 35

We believe that offering only a single example is inadvisable. We also suggest that this and other examples of means of achieving control through the power to direct specified activities are included in the Application Guidance.

Appendix A - definition of 'involvement with a structured entity'

In the fourth line we suggest that the second 'of' should be 'from'.

Appendix B18

The last sentence assumes that depreciable assets of a consolidated subsidiary will always be measured at fair value on the date the subsidiary is acquired. However, the acquisition of an entity that is not a business is accounted for at cost (with the cost of the acquisition allocated to the assets acquired based on relative fair values).

Appendix B32(b)

A non-controlling dominant shareholder has not been defined. It is not clear when this disclosure would be required or how it relates to disclosures that may be required for equity method investments.

Appendix B36

We agree with the proposed disclosure on non-contemporaneous reporting dates, but suggest that a new heading should be inserted above this paragraph (which seems misplaced at present, under the heading "The interest that the non-controlling interests have in the group's activities").