

The Hundred Group
of Finance Directors

Financial Reporting Committee

Patrina Buchanan
Project Manager
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

31 March 2009

Dear Patrina,

ED 10: Consolidated Financial Statements

We are pleased to submit our comments on the above proposals.

Who we are

The Hundred Group represents the views of the finance directors of the UK's largest companies drawn largely, but not entirely, from the constituents of the FTSE100 Index. Our members are the finance directors of companies whose market capitalisation collectively represents over 80% of that of companies listed on the London Stock Exchange. While this letter expresses the views of The Hundred Group of Finance Directors as a whole, they are not necessarily those of individual members or their respective employers.

Summary

Is the current model broken?

We are aware that the Board accelerated its project on consolidation under pressure from the G20 and the Financial Stability Forum, which both contended that one of the causes of the financial crisis was weak accounting standards that enabled a proliferation of off-balance sheet special purpose entities.

While this is a well documented issue under US GAAP, we do not believe that the approach to consolidation under IFRS as set out in IAS27 "Consolidated and Separate Financial Statements" and SIC-12 "Consolidation - Special Purpose Entities" has been found to be seriously lacking during the course of the financial crisis. We therefore believe that the Board should have been more robust in defending its standards and conducted a limited review to remove any apparent inconsistencies between IAS27 and SIC-12, rather than undertake radical reform. On the other hand, we believe that radical reform is needed of US GAAP and are therefore puzzled as to why the consolidation project has not been conducted jointly by the IASB and the FASB as a convergence project (converging in this instance to accounting based on existing IFRSs).

Do the proposals meet the Board's objectives?

We support the objective of developing a single consolidation model that can be applied to all entities. Unfortunately, we do not believe that the current proposals achieve this objective. We are concerned that the proposals focus on the power to direct activities and that the importance of the substance of relationships between entities characterised by the balance of risks and rewards has been diluted. We are supportive of a substance over form approach because it is helpful in communicating to shareholders the underlying economics of transactions.

We share the concern expressed in the Alternative Views that the current proposals would lead to fewer entities being consolidated because power is more easily disguised and that fact will provide more structuring opportunities than are permitted at present.

At a fundamental level, we do not see how the Board can claim that the proposed model can be applied to all entities when it perpetuates the notion of a separate group of "structured entities" to which special rules apply. In our view, this is incompatible with there being a single consolidation model.

What model do we suggest?

We suggest that IAS27 and SIC-12 should be combined, but that the notion of the special purpose entity or the structured entity should be jettisoned (not least because even in the current proposals it is still not adequately defined). We suggest that there should be a single consolidation model applied to all entities that is based on a two-stage approach. First, control should be assessed using basically the IAS27 approach. Second, if control is not evident under the IAS27 approach, the substance of the arrangement should be assessed using basically the SIC-12 approach.

We believe that, in this way, consolidated financial statements would reflect all arrangements in which the parent is exposed to the majority of the risks and rewards, which is what we understand was intended by the Financial Stability Forum.

Precision of disclosure requirements

We view financial reporting as primarily an exercise in communication. We are therefore concerned that the Board seems increasingly to mandate voluminous disclosure requirements. Disclosure does not always assist communication. Excessive disclosure can actually hinder communication because users "cannot see the wood for the trees". We believe that the proposed disclosures are likely to fall into this category.

We do not believe that in a single consolidation model there should be different accounting for structured entities (indeed, there should be no notion of a structured entity). Consistent with this view, we do not believe that there should be special disclosures for structured entities.

We believe that users are interested in the risks to which the reporting entity is exposed and the disclosure requirements should be consistent with this need. We would therefore strongly encourage the IASB to rethink the whole premise of the proposed disclosures. Instead of adopting an approach which seeks to provide information about all entities (whether consolidated or not), the disclosures should be more precise and provide information only on significant risks and rewards that are not consolidated in the financial statements and are not captured within the definition of an associate or a joint arrangements. In this way, the disclosures, if any, would provide additional information that is of interest to users.

We believe that improved disclosures surrounding risks and rewards that are not otherwise reflected in financial statements should have been developed in the context of IFRS7 “Financial Instruments: Disclosures”. Indeed, we would have preferred that, in its urgent response to the demands of the G20 and the Financial Stability Forum, the Board had focussed on improving disclosures and, thereby, allowed itself more time to revisit its consolidation and derecognition rules.

Other matters

Options and convertible instruments

We support the existing approach in IAS27, i.e. that options and convertible instruments should be taken into account in assessing control only if they are currently exercisable. We believe that this is consistent with the notion that consolidation should be based on the *ability* to exercise the power to control. In the absence of any other arrangements, the holders of options and convertible instruments that are not currently exercisable do not have the ability to exercise the power to control.

Significant minority shareholders

We do not believe that a reporting entity should consolidate another entity if it has a significant minority shareholding and the majority shareholders are widely dispersed and are not organised in such a way that they actively co-operate when they exercise their votes so as to have more voting power than the reporting entity.

In our view, in the absence of other arrangements, consolidation in this scenario would be inappropriate because a significant minority shareholder simply does not have the ability to exercise control over the entity on his own.

Agency relationships

We suggest that the guidance on agency arrangements is enhanced to address the specific issues faced by a fund manager who may hold an investment in an entity as both an agent and as a principal and who will generally have the same interests in both capacities.

Structure of the proposals

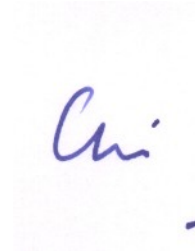
We would ask that the Board revisits the structure of the proposals as we believe that much of the content of the Application Guidance should be covered in the body of the accounting standard itself. It is inconvenient to have to constantly cross refer from one section to another when attempting to understand and interpret an accounting standard. We believe that the body of an accounting standard should cover the relevant accounting principles and where necessary guidance on the specific application of those principles), the disclosure requirements and any transitional arrangements. We believe that it should be necessary to cross refer only to illustrative examples (when provided by the Board) and the basis for the Board’s conclusions.

Derecognition

We believe that it is not possible properly to consider consolidation and derecognition in isolation. It is therefore a pity that the Board chose to issue its proposals on derecognition after the deadline for comments on its proposals on consolidation. We may therefore have additional comments on the consolidation proposals when we have considered the proposals on derecognition.

Please feel free to contact me if you wish to discuss our comments on the proposals.

Yours sincerely,

A handwritten signature in blue ink that reads "Chris Lucas". The signature is written in a cursive style. Below the name "Lucas", there is a short horizontal line.

Chris Lucas

Chairman

The Hundred Group - Financial Reporting Committee

E: chris.lucas@barclays.com

Responses to Specific Questions

Question 1

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

We acknowledge that there are theoretical inconsistencies between IAS27 and SIC-12, but we do not believe that the existing consolidation model under IFRSs has been found seriously lacking during the current economic crisis and, therefore, do not believe that the existing approach is in need of radical reform.

IAS27 requires an entity to consolidate another entity if it controls that entity. Control is defined as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities, regardless of whether or not that power is actually exercised. SIC-12 requires an entity to consolidate a “special purpose entity” (which it does not define) when the substance of the relationship between it and the special purpose entity indicates that it is controlled by that entity. SIC-12 identifies indicators of control over that entity which are based on whether in substance (rather than by legal form) the entity is exposed to the majority of the risks and rewards arising from the special purpose entity.

We are concerned that the current proposals focus on the power to direct activities and that the importance of the substance of relationships between entities characterised by the balance of risks and rewards has been diluted.

We are supportive of a substance over form approach because it is helpful in communicating to shareholders the underlying economics of transactions. Indeed, in our comment letter on the Discussion Paper on Phase A of the Conceptual Framework, we expressed concern that the Board proposes to subsume substance over form within the qualitative characteristic of faithful representation.

We share the concern expressed in the Alternative Views that the current proposals would lead to fewer entities being consolidated because power is more easily disguised and that fact will provide more structuring opportunities than are permitted at present. Our answer to Question 1 is, therefore, no.

Question 2

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

For the reasons set out in our response to Question 1, we do not believe that consolidation can be based solely on control and that consideration must be given to the substance of relationships between entities characterised by the balance of risks and rewards. Our answer to Question 2, is therefore also, no.

We suggest that IAS27 and SIC-12 should be combined, but that the notion of the special purpose entity or the structured entity should be jettisoned (not least because even in the current proposals it is still not adequately defined). We suggest that there should be a single consolidation model applied to all entities that is based on a two-stage approach. First, control should be assessed using basically the IAS27 approach. Second, if control is not evident under the IAS27 approach, the substance of the arrangement should be assessed using basically the SIC-12 approach.

We believe that, in this way, consolidated financial statements would reflect all arrangements in which the parent is exposed to the majority of the risks and rewards, which is what we understand was intended by the G20 and the Financial Stability Forum when they requested the acceleration of the Board's project on 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?

As explained in our answer to Question 1, we are concerned that the proposals are based on the power to direct activities. We share the concerns expressed in the Alternative Views that the guidance in relation to structured entities is insufficient because it relies primarily on the supposition that power will be retained in situations in which the reporting entity has significant exposure to the variability of returns of a structured entity or has been involved in setting up the structured entity for its benefit. We therefore propose the alternative two-stage approach set out in our answer to Question 2.

We are concerned about the view expressed in paragraph 28 that "a reporting entity can have the power to direct the activities of another entity if the reporting entity is the dominant shareholder that holds voting rights and all other shareholders with voting rights are widely dispersed and are not organised in such a way that they actively co-operate when they exercise their votes so as to have more voting power than the reporting entity". We do not believe that this is an appropriate basis for consolidation. In our view, it is not necessary for other shareholders to co-operate in such situations. If they were faced with a resolution to which they were all opposed, they could act completely independently and yet vote the resolution down. Accordingly, in the absence of other arrangements, consolidation in this scenario would be inappropriate because the dominant shareholder simply does not have the ability to exercise control over the entity on his own.

We do not believe that it is appropriate to require that control should be assessed "continuously". Rather, we suggest that control should be reassessed as and when there are changes in the facts and circumstances that are relevant to the determination of control, i.e. consistent with the approach under IFRSs to reviewing assets for impairment and the reassessment of embedded derivatives.

Question 4

Do you agree with the Board's proposals regarding options and convertible instruments when assessing control of an entity? If not, please describe in what situations, if any, you think that options or convertible instruments would give the option holder the power to direct the activities of an entity.

We support the existing approach in IAS27, i.e. that options and convertible instruments should be taken into account in assessing control only if they are currently exercisable. We believe that this is consistent with the notion that consolidation should be based on the *ability* to exercise the power to control. In the absence of any other arrangements, the holders of options and convertible instruments that are not currently exercisable do not have the ability to exercise the power to control.

If the Board retains its current proposals, we would encourage it to review the guidance provided in paragraph B13. As currently worded, the guidance is unclear and may be difficult to apply in practice.

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.

While the guidance in paragraph B3 adequately describes the legal position of an agent and will in most cases lead to an appropriate consolidation outcome, it does address the difficulties surrounding the position of a fund manager who may hold an investment in an entity as both an agent and as a principal. We understand that investment management agreements often require the manager to hold a stake in the investments they manage as principal. We recommend that the guidance is enhanced to address the issues arising from certain investment management agreements.

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?

We recognise the problems faced by the IASB in defining a structured entity – it is fair to say, that most of us know what one is, but defining it in writing is difficult. However, we do not believe that paragraph 30 can be considered a definition (which one would normally expect to be a succinct description of what a term is, not a reference back to a number of paragraphs which describe what it isn't. While SIC-12, doesn't really define a special purpose entity either, we prefer its attempt at a definition compared with that contained in the current proposals.

Notwithstanding the above, if the objective of the proposals is to arrive at a single model under which the need for consolidation of all entities is assessed in the same way it should not be necessary to define a structured entity or special purpose vehicle. We propose such an alternative approach to consolidation in our answer to Question 2.

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?

We do not think that the guidance provided in paragraphs 30-38 represents an improvement on that provided in paragraph 10 of SIC-12.

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.

We believe that risks and rewards should be taken into account in assessing consolidation. However, we would incorporate risks and rewards in a two-stage assessment of consolidation as outlined in our answer to Question 2, not merely as a "fall back test" in situations in which it is not possible to determine the power to direct the activities of a structured entity as is proposed in the Alternative Views. Furthermore, we believe that it is

the level of risks and rewards to which the reporting entity is exposed that is relevant in the assessment of consolidation, not the exposure to a particular level of *variability* of returns as is suggested in the Alternative Views.

Question 9

Do the proposed disclosure requirements described in paragraph 23 provide decision-useful information? Please identify any disclosure requirements that you think should be removed from, or added to, the draft IFRS.

We do not believe that in a single consolidation model there should be different accounting for structured entities (indeed, there should be no notion of a structured entity). Consistent with this view, we do not believe that there should be special disclosures for structured entities.

We believe that users are interested in the risks to which the reporting entity is exposed and the disclosure requirements should be consistent with this need. We would therefore strongly encourage the IASB to rethink the whole premise of the proposed disclosures. Instead of seeking to provide information about all entities (whether consolidated or not), the emphasis should be on the disclosure of significant risks and rewards that are not consolidated in the financial statements and are not captured within the definition of an associate or a joint arrangements. In this way, the disclosures, if any, would provide additional information that is of interest to users.

We believe that improved disclosures surrounding risks and rewards that are not otherwise reflected in financial statements should have been developed in the context of IFRS7 "Financial Instruments: Disclosures". Indeed, we would have preferred that, in its urgent response to the demands of the G20 and the Financial Stability Forum, the Board had focussed on improving disclosures and, thereby, allowed itself more time to revisit its consolidation and derecognition rules.

We consider that the disclosure requirements should be included in the body of the accounting standard, not in the application guidance.

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.

As the consolidation of each entity must be considered, we do not think that reporting entities should be lacking the information required to compile the disclosures.

Our difficulty is with the proposed disclosures themselves as outlined in our answer to Question 9.

Question 11

(a) Do you think that reputational risk is an appropriate basis for consolidation? If so, please describe how it meets the definition of control and how such a basis of consolidation might work in practice.

We agree with the Board that reputational risk is not an appropriate basis for consolidation. Consolidation may, however, become appropriate as a result of actions actually taken by the

reporting entity to mitigate reputational risk at a point in time, e.g. by providing support to an unconsolidated entity to prevent it defaulting on its obligations.

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

We have no particular concerns regarding the proposed disclosures in paragraph B47. However, the disclosures should be restricted to discussion of support that has actually been provided and should not therefore encompass current intentions (which, in our view, are irrelevant to consolidation until they materialise).

Question 12

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

We believe that consolidation and the accounting for associates and joint ventures should ideally have been dealt with concurrently because it is very difficult to consider changes to these interrelated standards on a piecemeal basis.

We do not believe that accounting in these areas under IFRSs is seriously deficient and therefore consider that there are actually more important projects to which the Board should be devoting its attention. However, the reality of the situation is that the Board was forced to accelerate its project on consolidation and had already issued proposals on accounting for joint arrangements. We therefore believe that it would be appropriate to bring forward the Board's reconsideration of IAS28 so that it can be conducted concurrently with the projects on consolidation and joint arrangements.