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

Comments on the Exposure Draft of *ED 10 Consolidated Financial Statements*

To the Board Members:

The Japanese Institute of Certified Public Accountants appreciates the continued efforts of the International Accounting Standard Board (IASB) on the consolidation project and welcomes the opportunity to comment on the exposure draft of *ED 10 Consolidated Financial Statements.*

The ED 10 states that the current *IAS 27 Consolidated and Separate Financial Statements* and *SIC 12 Consolidation – Special Purpose Entities* should be merged and the same definition of control applied. However, we believe that the proposed definition in ED 10 does not achieve this objective in establishing an appropriate unified definition of control. Rather, we are concerned that it will lead to confusion in practice. If the Board is concerned that there are immediate issues that needs to be addressed in respect of accounting for structured entities, rather than rushing the implementation of ED 10, we believe it would be much effective for the Board to simply tighten the definitions around SIC 12 and improve the disclosure requirements under IAS 27 in relation to unconsolidated structured entities - this should allow the Board to meet the current needs of constituents and at the same time, to take a step back and re-deliberate the new definition of control.

In addition, we believe that sufficient time should be given to prior to the effective date, in order to allow preparers to implement the new standard properly.

The following is our response to the items in 'invitation to comment' with which we disagree or have questions or concerns.

Question 1 and Question 2

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?

Comment:

We do not agree.

If the definition of control can be established more clearly than the current IAS 27, we do not believe it necessary to define the structured entity separately. However, as the definition of control proposed by the exposure draft still assumes the power and returns in the same way as the current definition in the IAS 27, the application is difficult for entities that do not have a decision making function, such as structured entities. Therefore, if the definition of control is not established more clearly than the current definition, we believe it necessary to develop a different consolidation model for the structured entities based on the returns.

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?

Comment:

Not sufficient.

According to paragraph 27 of the exposure draft, if a reporting entity has more voting rights than any other party and the reporting entity's voting rights are sufficient to provide the reporting entity the ability to determine the another entity's strategic operating and financing policies, the reporting entity has the power to direct the activities of another entity.

However, there will be the cases where it is difficult to assess the control only by the explanation of paragraph 27, because "more voting rights than any other party" can be interpreted differently depending on the laws and regulations of countries and regions. Therefore, we propose to provide the additional conditions for the assessment of control in that situation, such as holding of the principal voting right by looking at the laws or regulations of the country or region of the domicile of the relevant entity with agreement between the reporting entity and other vote holders (paragraph B10 of the exposure draft), dispatching people to be members of the board of directors, having a contract stipulating about the holding of ability to control the entity's financial and management or business policies, fund procurement, etc.

In relation to this question, we noted that paragraph 18 of the exposure draft states three criteria for the assessment of control of multiple arrangements. These are the same as three of the four criteria stated in IAS 27, paragraph 33. However, IAS 27 paragraph 33(c), "The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement." is deleted in the exposure draft. Therefore, if the current requirement is revised, the reason for the deletion should be stated in the section for the basis for conclusions.

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.

Comment:

We do not agree.

We believe that holding a potential voting right through options and convertible instruments is not necessarily linked directly with control. In addition to holding a potential voting right, we propose to provide the additional conditions for the assessment of control in that situation, such as an agreement on the principal voting right between the reporting entity and other vote holders (paragraph B10 of the exposure draft), dispatching people to be members of the board of directors, having a contract stipulating about the holding of ability to control the entity's financial and management or business policies, fund procurement, etc.

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?

Comment:

We do not agree.

Considering that the objective of this project is to develop a clearer single definition of control that can be applied to all types of entities, structured entities should not need to be defined separately: they should simply be treated the same as other types of entities. On the contrary, any criteria that should be applied in assessing control of structured entities should equally apply to all types of entities. Therefore, a separate definition for structured entities is necessary only to determine which entities would require additional disclosure where there is no control. In this respect, we believe the current definition to be too broad in determining the scope of structured entities which would require additional disclosure.

From a technical aspect, paragraph 30 of the exposure draft indirectly defines structured entities by referring back to paragraphs 23-29. This not only lacks clarity, but makes it too broad, because as long as an entity's activities are not directed in a way as described in paragraphs 23–29, it will be captured by this definition. We believe the definition of structured entities that would require additional disclosure should be a more direct one and paragraphs 23-29 should be moved into the appendix section.

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?

Comment:

We do not agree.

The guidance in the exposure draft is useful in terms of illustrating the various factors that should be required to be taken into account when assessing control. However, where there is more than one source of power, there is almost an effect of these factors cancelling each other out and making the judgment a difficult one. The hierarchy of these factors that require consideration when assessing control is not clear and we believe this is because the principle under the current definition of control is not clear enough.

Potential significance of returns is mentioned in paragraph 33, but there is no mention of this in any of the preceding paragraphs. We assume that this means to make a judgment based on the proportion of returns that the entity is exposed to in relation to overall returns (or may be understood as a high relative variability of returns). Consequently, when assessing control of structured entities, it reads as if we must go beyond the general definition of control. However, this concept may be a useful one from a practical perspective and if the Board can clearly articulate the role of significance of returns in determining the existence of control, it should consider making it a component of the definition of control in general.

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.

Comment:

We do not believe that it is preferable to have a risks and rewards 'fall back' test, but if the current definition of control is to be implemented as it is, our view is that there is no choice but to bring this in.

It should be noted that this is not very different from maintaining the current IAS 27 and SIC 12, so from a practical point of view, we believe that there is greater merit in improving and retaining SIC 12 as a short term solution.

Question 9 and Question 10

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. **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.

Comment:

The disclosure rules proposed in the exposure draft are far too detailed and extensive as to provide decision-useful information, but would rather obscure the more important disclosures. For instance, with regard to continuing involvement in structured entities, since the definition of entities that require disclosure is so broad, it is possible that all SPEs that have transacted with the reporting entity may become subject to this. This is not practical for financial institutions, etc., that have created numerous SPEs during the course of their normal business. Examples of entities that clearly do not require additional disclosure should be given in order to create some sort of boundary. Also, it is difficult to understand the necessity for the information required in paragraph B41 of the exposure draft to be disclosed for three periods; namely, the current reporting period and the preceding two reporting periods as stated in paragraph B42. We believe that the Board should at least explain the reason for this. Finally we believe that paragraphs B44(c) and B46 should be deleted because it is practically impossible for entities to gather such information.

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?

Comment:

We do not agree.

We do agree that the definition of significant influence should eventually be discussed sometime in the future. However, as we have stated above, the Board should first re-examine the definition of control and only after this, based on the conclusion reached, should the Board start to carefully re-look at the definition of significant influence.

Yours faithfully,

Kiyoshi Ichimura
Executive Board Member－Accounting Standards
The Japanese Institute of Certified Public Accountants