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November 5, 2010

Mr. Trevor Farber Practice Fellow Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

## Re: International Accounting Standards Board Staff Draft, Consolidated Financial Statements

Dear Mr. Farber:

General Electric appreciates the opportunity to provide comments for the FASB Public Roundtable on the International Accounting Standards Board Staff Draft, Consolidated Financial Statements ("Staff Draft").

While we generally support the overall direction of the proposed amendments, we do not believe that the IASB should issue a final standard at this time for the following reasons: (1) the way the Staff Draft defines the effective control concept and treatment of potential voting rights is not workable; (2) the IASB has not made corresponding changes to its derecognition standard, which is integrally linked to consolidation; and (3) we believe that the FASB and the IASB should jointly issue a one converged standard on consolidation in order to facilitate full consideration and acceptance in the U.S. of the principles in the future standard. In so doing, the ISAB and the FASB will also have the opportunity to benefit from learnings from application of SFAS 167 in the U.S. and what they portend for a broader standard that would be based on those concepts.

## **Overall Comments**

The model in the Staff Draft is based on an effective control concept, elements of which already exist in current IFRS guidance. We favor an approach based on legal or contractual rights. Specifically, we believe that a party has power to direct only when it has an unassailable legal or contractual right to do so. If a party has control it should not be possible for them to lose it based on the actions of other parties (e.g., a change in the behavior of other shareowners from fragmented ambivalence to

coordinated activism). We believe that the more expansive notion of effective control in the Staff Draft will not be operational or capable of consistent application. The Staff Draft also provides little guidance regarding power that is shared. Therefore it is difficult for us to evaluate when two or more parties may be considered to share power.

With the issuance of SFAS 167, the FASB has already addressed diversity in practice for variable interest entities. While we continue to have concerns with the treatment of substantive majority kick-out rights and the identification of agency relationships, we generally believe that SFAS 167 has been effective in determining who, if anyone, has control. However, many preparers have yet to prepare annual financial statements in accordance with SFAS 167 and divergence in practice may develop. We believe that it is an important part of due process to allow all parties a full reporting cycle to understand the nuances and practice issues associated with SFAS 167, prior to asking them to comment on a broader standard that would apply those same concepts to voting interest entities.

We observe that the FASB has already identified certain issues with paragraph B22 of SFAS 167 and deferred application to affected entities pending further work with the IASB on convergence. We also are concerned about the broadened definition of returns that goes beyond ownership benefits and which may be difficult to evaluate; the proposals include no guidance on what weight should be attributed to the broader factors that go beyond traditional ownership benefits, or how different types of returns should be aggregated in order to assess their significance. We also note that the control model described in the Staff Draft has substantive changes from ED10. While these changes were made in response to the significant concerns of commentators, we believe it would be beneficial for the IASB to have exposed the Staff Draft to its constituents.

We have provided our responses to the specific questions posed to Roundtable participants in the attachment to this letter. I look forward to the discussion at the upcoming roundtable.

Sincerely,

Christopher Gill Global Controller

Technical Accounting Center of Excellence

In response to your questions:

1. The Staff Draft provides a single concept of control that is used to evaluate control on a consistent basis for all types of entities (both voting interest entities and variable interest entities). Do you agree that a single-model approach to assess control will provide more consistent financial reporting for all types of entities rather than providing separate models for voting interest entities and variable interest entities? If not, why not?

We agree that a single-model approach should, in concept, provide for more consistent consolidation decisions for all types of entities by eliminating differences between the voting interest model and variable interest model. We observe that this will also eliminate the need for preparers to have to perform the complex and judgmental evaluation of whether an entity is a variable interest entity or not. It also will eliminate the potential for arbitrage between the two models on kick-out rights.

As discussed in our cover letter, we believe that there is sufficient work to be done with the principles in the Staff Draft, along with technical amendments the FASB plans to pursue with SFAS 167, such that there is no reason that the IASB should issue a final standard at this time.

2. The Staff Draft does not incorporate the U.S. GAAP concept of a variable interest entity or a structured entity. Rather, the Staff Draft provides that the way in which control is assessed will vary depending on how the activities that significantly affect the entities' returns are directed. For example, how control is assessed will depend on whether the decisions that significantly affect the returns of an entity are made through voting rights. Without an explicit definition of a variable interest entity, do you believe that (ignoring the differences when analyzing decision making relationships and the effect related party arrangements have on the analysis) the Staff Draft will produce the same consolidation conclusions as the recently issued U.S. GAAP guidance for consolidating variable interest entities (FASB Accounting Standards Codification™ Subtopic 810-10, Consolidation1)? If not, what are the situations that produce a different conclusion and why? Do you think it is sufficiently clear how to assess power and control for all types of entities in the Staff Draft?

We believe that in certain circumstances, the principles in the Staff Draft may produce a different consolidation conclusion as compared to the variable interest model in SFAS 167. For example:

 Under the variable interest entity model, participating rights and removal rights are deemed substantive only when they can be exercised unilaterally by a single party. The facts and circumstances evaluation provided for in the Staff draft will allow a reporting entity to consider the intentions of the parties to the legal documents that created the entity. Since few transactions have unilateral removal rights, such an evaluation may well conclude that the current primary beneficiary would not be the party with control under the Staff Draft. Conversely voting interest entities subject to EITF Issue 04-5 that have considered majority removal rights to be substantive, may reach a differing conclusion once such rights are one of a range of factors requiring consideration.

- As noted in our cover letter, the Staff Draft provides comparatively little guidance on shared power over relevant activities. Reporting entities that have concluded that they share power over relevant activities under SFAS 167 may reach a different conclusion under the Staff Draft.
- Under SFAS 167, reporting entities are required to explicitly consider low probability/high outcome events in determining whether their exposure from variable interests they hold is significant. Since the Staff Draft does not require variable returns to be significant, reporting entities that have concluded that their variable interest is not significant under SFAS 167 would automatically reach a different conclusion under the Staff Draft.

We believe that the above differences are of sufficient moment to warrant that the Boards take the necessary time to work through these issues and arrive at converged principles that would form the basis for a single consolidation model.

3. The Staff Draft proposes that in order to control an entity, the reporting entity must have the power to direct the activities of that entity. Power is defined as having existing rights that give the reporting entity the current ability to direct the activities that significantly affect the entity's returns. Do you agree with the control principle as articulated in the Staff Draft? Do you agree that there are situations when a reporting entity can have control of an entity controlled through voting rights with less than a majority of voting rights? Why or why not?

As discussed in our cover letter, we believe that control should reflect the current rights a reporting entity has to control the relevant activities of the entity itself and not rights that depend on future economic outlays or the inactions of others. We believe that the indicators in B15 of Staff Draft can assist in determining whether the reporting entity has power.

The broadened definition of returns in paragraph B52 to include consideration of returns that are not available to other investors is not conducive to producing consistent consolidation decisions. It is not clear why such returns should be considered when evaluating consolidation of an entity if those synergistic returns have already been appropriately recorded in the financial statements of the reporting entity. The relevant returns are those provided directly by the entity itself. It also is unclear whether such returns are expected returns contemplated by the design of the entity that may never actually be realized or whether they reflect current experience. In many cases, power over those synergistic returns may reside with the reporting entity and not the entity that is being evaluated. It also is unclear whether the failure of a reporting entity to achieve expected

returns from its involvement with an entity would require reconsideration of the consolidation evaluation. Overall, there is a lack of guidance in the Staff Draft as to how a reporting entity evaluates synergistic returns and weighs those when evaluating the entity's relevant activities. We believe that benefits that inure from direct ownership are easier to verify and therefore provide a more consistent basis for consolidation decisions.

We agree that effective control may exist where a reporting entity has less than the majority voting rights over another entity, but only if the reporting entity has other contractual or other legal rights to unilaterally direct the relevant activities of that entity. Said differently, there are other sources of control that give the reporting entity power beyond that provided by its voting rights but those sources must be presently available. Equally, this would apply in a situation where there is a majority shareholder, but the reporting entity has other rights that overcome the presumption that the holder of the majority equity position would consolidate.

4. The Staff Draft states that if the activities that significantly affect an entity's returns are directed through voting rights, a reporting entity holding less than a majority of the voting rights (assuming no potential voting rights or other contractual rights exist) has power when it can unilaterally direct the activities of the entity that significantly affect the entity's returns. This assessment requires judgment. The Staff Draft provides application guidance to determine when a reporting entity holding less than a majority of the voting rights in an entity controlled through voting rights has power. Specifically, the Staff Draft provides that, in some cases, a determination can be made about whether a reporting entity has power by just considering the absolute size of the reporting entity's holding of voting rights, the size of its voting rights relative to the size and dispersion of holdings of the other vote holders, the voting patterns at previous shareholders' meetings, and other arrangements. Do you believe that there are circumstances when, considering only these factors, an assessment could be made about whether a reporting entity has power? Why or why not?

We do not believe that simply owning a large percentage of the outstanding shares of an entity is sufficient to convey control over the reporting entity. The fact that other shareholders are dispersed and lack organization to operate as a group does not translate into the owner of the large percentage of the outstanding shares having control. We believe control should be defined as the current power to direct the relevant activities of an entity, whether by means of voting rights or other arrangements where a party has an unassailable legal or contractual right to do so. The power to direct should not be so tenuous that it relies on the actions or inactions of others. There is nothing in the rights of this minority owner that would prevent the other shareholders from overturning or blocking a decision other than ambivalence and disorganization. Voting patterns at prior shareholder meetings may not be indicative of effective control, simply because existing facts and circumstances have not required the other shareholders to act together. SFAS 167 was in part designed to address practice

issues arising from the use of a probability-based expected loss model to identify which reporting entity was the primary beneficiary of a variable interest entity. Based on that experience, we do not believe it will be productive to introduce probability into this new consolidation model.

5. In other circumstances the Staff Draft provides that additional evidence may be needed in order to conclude that a reporting entity holding less than a majority of the voting rights in an entity controlled through voting rights has power. The Staff Draft includes indicators that may provide additional evidence in these circumstances to assist in determining whether the reporting entity has power. Do you believe that these indicators provide sufficient guidance to conclude that a reporting entity has power in situations where it is unclear as to whether a reporting entity has power solely based on the absolute size of the reporting entity's holding of voting rights, the size of its voting rights relative to the size and dispersion of holdings of the other vote holders, the voting patterns at previous shareholders' meetings, and other arrangements? If not, what additional indicators should be included or which of these indicators should be removed

As we noted in our response to Question 4, we do not generally believe that a reporting entity with less than a majority of the voting rights controls an entity in the absence of other contractual or legal rights that provide it with the ability to unilaterally direct the relevant activities of that entity.

The factors listed in the Staff Draft do not provide sufficient guidance about the relative significance of each indicator and how preparers should weigh each factor. In particular, how preparers should weigh past inaction or action on relatively benign decisions that have required consent against potential significant decisions that may be required in times of economic stress, when organization among dissident shareholders is more likely to occur.

6. The Staff Draft requires a reporting entity to consider its rights to obtain additional voting rights of another entity, as well as such potential voting rights (options or convertibles, for example) held by other parties, to determine whether the reporting entity has power. Do you believe the guidance in the Staff Draft is appropriate and operational? Specifically, do you believe that the guidance for determining when potential voting rights are considered substantive is operational? If not, what additional guidance would you suggest?

We do not believe the guidance in the Staff Draft is appropriate or operational with respect to potential voting rights. Nor do we believe that the guidance for determining when potential voting rights are substantive is operational.

We do not believe in general that potential voting rights should be considered in assessing whether the reporting entity has a controlling financial interest because the reporting entity does not currently have an unassailable legal or contractual right to use such voting or similar rights. Such rights are only obtained when the

instrument (convertible securities, forward contracts, etc.) that gives rise to the potential voting rights is exercised.

In addition, we do not believe that a reporting entity will necessarily have knowledge of agreements between other holders of interests in the entity, which may give rise to potential voting rights.

There is an underlying presumption that a reporting entity holds an instrument that would provide it with potential voting rights also has the requisite liquidity available to exercise. We believe that the financial outlay required of the holder to exercise the instrument giving rise to the potential voting rights should be a determining factor, regardless of whether the instrument is in the money or not.

We find the guidance in paragraph B83 particularly confusing. It states:

The proportion [of earning] allocated to the parent and non-controlling interests in preparing consolidated financial statements, and the proportion allocated to an investor that accounts for its investment using the equity method in accordance with IAS 28, are determined on the basis of present ownership interests. The proportion allocated is determined taking into account the eventual exercise of potential voting rights and other derivatives that, in substance, give access at present to the economic benefits associated with an ownership interest

We interpret this to mean that when allocating earnings between the controlling interest and the non-controlling interest, a reporting entity would have to make a probability-based determination as to the likelihood and timing of exercise of potential voting rights and allocate earnings to potential voting interests that currently have no legal rights to earnings.

- 7. When determining whether a reporting entity acts as an agent, the reporting entity must consider the overall relationship between it and other parties involved with the entity, considering the following factors:
  - a. The scope of its decision-making authority over the entity
  - b. The rights held by other parties
  - c. The remuneration the reporting entity is entitled to in the arrangement
  - d. The reporting entity's exposure to variability in returns as a result of other interests that it holds in the entity.

Do you believe the guidance related to assessing decision-making arrangements in the Staff Draft is appropriate and operational? Do you believe the Staff Draft would lead to appropriate consolidation conclusions?

We believe that a facts and circumstances analysis incorporating the factors listed in the Staff Draft is superior to the current guidance for identifying when a decision maker or service provider has a variable interest in an entity.

Many agents are provided with incentivized fee structures to align their interests more closely with those of the principals. Under the guidance contained in SFAS 167, such incentive fee structures would often have resulted in an evaluation in the identification of a variable interest. The absence of unilateral removal rights in most contracts between entities and decision-makers/service providers coupled with the financial incentive structure, results in many agents being incorrectly identified as principals.

We believe that an agent (and its related parties):

- Is exposed only to the loss of its remuneration
- Does not have any other direct or beneficial variable interests in the entity
- Can be removed by principals with or without cause
- Acts within specific delegated powers subject to change by principals

In many respects, we believe it may be preferable to define when an entity or person involved with an entity is a principal rather than an agent. Any party that is not a principal position could not have a combination of powers and rights that would give it control.

We believe that the scope of its decision-making authority should be placed more closely in the context of the overall design of the entity and whether the entity has a substantive Board of Directors.

As noted below in our response to Question 8, we believe that the recognition that removal rights can be substantive when held by more than one party is helpful.

The Staff Draft does not include guidance to illustrate how preparers should weigh the listed factors to arrive at consistent outcomes.

8. When evaluating a decision-maker's role, rights held by other parties are considered when determining whether a decision-maker is an agent. Specifically, situations in which a single party holds substantive removal rights and can remove the decision-maker without cause, in isolation, would be sufficient to conclude that the decision-maker is an agent. However, if numerous parties hold such rights, those rights would not, in isolation, be conclusive in determining whether a decision-maker is an agent. In such a situation, those rights would be considered together with the other factors included in question 7 above, to determine whether the decision-maker is an agent. Do you believe that removal rights held by numerous parties should be a factor when evaluating whether a decision-maker is an agent? If so, do you agree that it should be one factor but not in and of itself determinative, when evaluating whether a decision-maker is an agent?

We agree that a reporting entity must consider the overall relationship between it and other parties involved with the entity in determining if it or other parties involvements are those of an agent or a principal.

We believe that removal rights held by numerous parties should be determinative when evaluating whether a decision-maker is an agent. Removal rights held by one party or numerous parties are indicative that an agency relationship exists, if they result in the reporting entity being able to direct the relevant activities of an entity.

If the guidance in the Staff Draft is retained, we would favor the provision of additional guidance illustrating how the paragraphs on rights held by other parties (B60-B62) should be applied.

9. The Staff Draft requires a reporting entity to reassess whether it controls another entity if facts and circumstances indicate that there are changes to one or more of the three elements of control. Do you believe this principle, and the related guidance in the Staff Draft, is sufficiently clear and operational?

We generally agree with the requirement in paragraphs B76-B80 that requires a reporting entity to continuously reassess whether it controls another entity as a result of changes in facts and circumstances.

We would favor an approach similar to that required by SFAS 167 requiring reconsideration on the occurrence on specified verifiable events indicative of changes to design, voting rights, contracts and relevant activities.

We do not believe the paragraphs B76-B80 are operational as written when considered in conjunction with the effective control model. A reassessment of whether a reporting entity controls an entity may be required when there has been no change in the reporting entity's rights or involvement with that entity, only a change in economic circumstances and consequential effects on the action or inaction on the part of other shareholders.

We believe the requirement to perform a continuous assessment of control should be moved to the base text and that more specific guidance should be provided to help preparers better understand how these requirements should be interpreted and applied.