Financial Accounting Standards Board  
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3 November 2010

International Accounting Standards Board Staff Draft – IFRS X Consolidated 
Financial Statements

Dear FASB Board Members

Ernst & Young is pleased to submit responses to the Financial Accounting Standards Board's (FASB) 
questions regarding the International Accounting Standards Board Staff Draft of IFRS X – 
Consolidated Financial Statements (Staff Draft).

We continue to support the objective of developing a single consolidation principle, based on control, 
applicable to all entities. For successful implementation of the principle, we agree there should be a 
clear definition of control which incorporates the related concept of power. Specifically, we agree with 
and support a control principle as articulated in the Staff Draft that:

- Requires a controlling investor to have exposure, or rights, to variable returns from its involvement 
  with an investee and the ability to use its power to affect the amount of the investor’s returns

- Requires a controlling investor to have existing rights that give it the current ability to direct the 
  activities that significantly affect the investee’s returns, when those decisions need to be made 
  (the “relevant activities”)

- Contemplates that an investor may control an entity even if its existing rights to direct the relevant 
  activities have yet to be exercised (e.g., a substantive removal right held by a single party may 
  indicate that control is held by that single party)

Inherent in this principle is the notion that the controlling investor must have the current ability to 
unilaterally direct the investee’s relevant activities when such decisions need to made regardless of 
the action or inaction of other investors.

However, while we agree with the control principle articulated in the Staff Draft, we believe that the 
application guidance in the Staff Draft is internally inconsistent with this control principle. In particular, 
we believe the application guidance for potential voting rights and de facto control is inappropriate. 
For example, absent an incremental right, we do not believe a potential voting right, in and of itself, 
provides an investor with a current ability to unilaterally direct the investee’s relevant activities. In this 
circumstance, a potential voting right provides only a current economic benefit and an opportunity to
obtain that ability at a future date. Likewise, we believe that a control principle that relies on both historical investor behavior and an assumption of continuous inaction by relatively smaller investors is fundamentally incompatible with a principle that is based on unilateral control.

**Potential voting rights:** We do not believe that the existence of potential voting rights alone results in control. While potential voting rights should be considered in the evaluation of control, an arrangement providing an investor with a potential voting right does not, in and of itself, give that investor the current ability to direct the relevant activities, when decisions about those activities need to be made. Rather, such a right provides the holder with an economic benefit that includes an opportunity to obtain that ability to control at a future date. Consequently, potential voting rights provide the holder with control only when other contractual and legal rights ("contractual rights") give the holder power.

When an entity’s activities are directed solely by shareholder vote, the application guidance (paragraph B44) indicates that any substantive potential voting right alone can give an investor the current ability to direct the relevant activities. This guidance appears to create a bright-line that potentially is inconsistent with the key principle. To remain consistent with the control principle, the application guidance for determining when a potential voting right provides its holder with the current ability to direct the relevant activities when those decisions need to be made, requires incremental consideration above and beyond the guidance provided in paragraphs B18 through B21. The following examples may help to articulate the incremental guidance that is necessary for the application of potential voting rights to remain consistent with the control principle.

Investor D holds 100% of Investee X’s voting shares. Investor A holds a currently exercisable option to purchase 51% of the voting shares of Investee X. Investor A may have the current ability to make decisions if the option contract includes a nominal exercise price (assuming there were no other barriers to exercise). In this circumstance, the incremental contractual right (i.e., the nominal exercise price) substantively eliminates any distinction, economic or otherwise, between current voting rights and potential voting rights.

Investor B holds 0% of Investee Y’s voting shares and holds a currently exercisable option to purchase 51% of the voting shares. Investor B may have the current ability to make decisions if the option contract, prior to exercise, provides Investor B with the right to a majority of Investee Y’s Board seats. In this circumstance, the contractual right to the Board seats may be the power indicator.

Investor C holds 0% of Investee Z’s voting shares and holds a currently exercisable option to purchase 51% of the voting shares. The option is currently exercisable at a more than nominal exercise price. In this circumstance, we do not believe that the incremental right (the more than nominal exercise price), in and of itself, is sufficient to conclude that Investor C has the current ability to direct the activities of Investee Z. The potential voting rights do not provide Investor C with the current ability to make decisions when those decisions need to be made. Rather, the potential voting rights represent only an economic right providing Investor C with the opportunity to obtain the ability to control at a future date.
**De facto control**: We believe that an investor can have power with less than a majority of voting rights when combined with other contractual arrangements (with the entity or among other shareholders) in certain circumstances. However, we do not agree that an investor holding less than 50% of the voting shares, without other incremental rights, can have the current power to direct the relevant activities of an entity.

The application guidance in the Staff Draft (paragraphs B37 through B41) conflicts with the control principle because the guidance inherently relies on historical investor behavior and the continued inaction of other investors. We do not believe that a control principle can rely on an appearance of power that is based solely on behavior, including investors' past choices to not act. The appearance of deference by the other investors, or of domination by the larger investor, may exist solely due to the investors' approval of management's execution of the strategy in the past, and it should not be assumed that such deference and domination currently is present, or will continue in the future. Thus, even if it may appear that the larger investor is able to direct activities, we do not believe that such actions or inactions could ever be indicative of power, because the larger investor does not have a unilateral right to such power.

For similar reasons, we do not believe analogies of de facto control to removal rights (paragraph BCB1) are appropriate. When an investor holds a removal right, that investor has explicitly agreed to contractually (and conditionally) permit another party to direct the investee's relevant activities, as those decisions need to be made. Conversely, in de facto control circumstances, the other shareholders have not entered into an implicit or explicit agreement, but rather may have determined that exercising their rights is currently not necessary to enhance their returns. Generally, we agree that substantive removal rights could indicate the holder has the current ability to exercise power. However, unlike holding a contractual removal right, we do not agree that the control principle should result in consolidation (or deconsolidation) of an investee due solely to the inaction or deference of other investors.

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Our responses to the FASB's questions also include a discussion of certain application issues that may make the Staff Draft difficult to apply in practice and result in greater diversity in practice. Therefore, to improve the control principle's clarity and overall operationality, the Staff Draft requires further clarification regarding the:

- Concept of purpose and design, which should be incorporated throughout the Staff Draft
- Guidance on how "de facto agents" and related parties may affect control conclusions
- Identification of principals and agents in an arrangement

Each concern is addressed more fully in our responses to Questions 2 through 9 within Appendix A below.
We would be pleased to discuss any of these specific concerns with the Board or its staff, at your convenience.

Very truly yours,

Ernst & Young LLP

cc: International Accounting Standards Board
Appendix A

Appendix A – responses to specific questions

Question 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?

As discussed in our cover letter, we support the objective of developing a single consolidation principle, based on control, applicable to all entities. The existence of two primary models in US GAAP, one for voting interest entities and another for variable interest entities (VIE), does cause tension and could result in different accounting conclusions regarding whether a party has a controlling interest, depending on whether an entity is a voting interest entity or a VIE. For example, these differences can arise as a result of the existing inconsistent evaluation of how to consider removal or liquidation rights and interests held by other parties (including related parties and de facto agents).

Question 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, Consolidation)? 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?

The control principle articulated in the Staff Draft focuses on rights or exposure to variable returns and power to affect the returns, which is generally consistent with the principles in the variable interest model in ASC 810-10 and will often result in similar accounting conclusions. However, the application of certain aspects of the Staff Draft’s consideration of “current ability” will result in different conclusions compared to the application of the variable interest model in US GAAP. These differences arise, in part, as a result of the Staff Draft’s application of the control principle to potential voting rights and whether an investor could have power with less than a majority of the voting rights

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1 Originally issued as FASB Statement No. 167, Amendment to FASB Interpretation No. 46(R)
2 Generally, ASC 810-10 includes guidance with respect to the consolidation considerations for voting interest entities and variable interest entities for each of ASC 810-10’s sections. In each of ASC 810-10’s sections there is a general subsection with respect to the consolidation model. This guidance applies to voting interest entities and also may apply to variable interest entities in certain circumstances. The Variable Interest Entities subsection within each of ASC 810-10’s sections contains considerations with respect to variable interest entities. In referring to the variable interest model in ASC 810-10, we are referring to the guidance applicable to variable interest entities in each of ASC 810-10’s sections.
(de facto control), we believe the Staff Draft could mitigate the risk of increased diversity in practice if the application guidance incorporated the following suggestions:

**Power and current ability:** The Staff Draft defines power as "[t]he current ability to direct the relevant activities." However the term "current ability" is not defined and at times appears to extend to potential or future abilities. As noted in our cover letter, we recommend revising the definition of power to clarify that the existence of an option or convertible instrument or significant minority voting rights may provide an indication of power, but, without other contractual rights, is not conclusive when determining if one investor controls another entity. Without such changes or clarifications, we would expect significant diversity in practice upon the application of the Staff Draft.

**ASC 810-10 and potential voting rights:** The Staff Draft's inclusion of potential voting rights would produce different accounting conclusions than evaluations under the variable interest model guidance in ASC 810-10. Under ASC 810-10's variable interest model, an enterprise must identify which activities most significantly affect the entity's economic performance and determine whether it has the power to direct those activities. Unlike the Staff Draft, we do not believe the variable interest model in ASC 810-10 contemplates that potential voting rights could provide the holder with such power. Rather, potential voting rights provide the holder with an economic benefit and not current power. The exercise or conversion of potential voting rights would be an event that would require reconsideration of the primary beneficiary of a VIE.

**De facto control:** As indicated in our cover letter, we do not believe that a reporting entity holding less than a majority of the voting rights (assuming no other contractual rights exist) can have the current power to unilaterally direct the activities of the entity that significantly affect the entity's returns. Because the variable interest model in ASC 810-10 does not contemplate that a reporting entity could have power solely due to the magnitude of its voting shares relative to other investors, we believe the Staff Draft could result in different control conclusions than ASC 810-10's variable interest model. We also discuss our conceptual and operational concerns with this concept in our response to Question 4.

**Purpose and design:** While we believe the Staff Draft requires consideration of the purpose and design of an entity, we observe that the Staff Draft could be improved to clarify the consideration of purpose and design in determining which party has power. We observe this concept is discussed in various contexts but the principle should be emphasized as an important element throughout the standard. As an example, the Staff Draft indicates on paragraph B48 that a party should consider its involvement in the design of an entity when evaluating the overall decision making authority. The Staff Draft goes on to indicate that such involvement is not, in itself, determinative that the party in question has power. We would agree with both of those statements. However, the Staff Draft could create application differences from ASC 810-10's variable interest model because it does not clearly articulate how to evaluate the involvement of other parties in the purpose and design evaluation.

**De facto agents and related parties:** While Question 2 does not focus on the effect of decision making relationships and related parties, we believe it is important to emphasize that the Staff Draft omits a clear principle for evaluating how to consider power and rights held by related parties, including in principal and agent relationships, when evaluating whether an investor has a controlling interest. We acknowledge that paragraph BC113 indicates that the IASB believes that an investor would consider the interests and involvement of related parties, together with its own, when the nature of the
relationship with a related party is such that the related party is acting on behalf of the investor. However, the Staff Draft does not adequately incorporate that theme throughout the guidance. It is unclear what effect, if any, a related party and de facto agent relationship may have on:

- The application guidance for assessing whether an investor’s right is substantive. In considering whether rights are substantive, it is not clear how rights held by related parties should be incorporated into the analysis.

The evaluation of removal rights. The discussion of removal rights (paragraphs B60 through B62) does not appear to contemplate the rights held by related parties. Conversely, the application guidance (paragraphs B66 through B68) does consider an investor’s related parties in the overall evaluation of the same decision maker’s exposure to variability.

Assessing power when two or more investors have the ability to direct certain relevant activities and determining whether an entity is jointly controlled. Paragraph 13 provides guidance to determine which party has power when “two or more unrelated investors” (emphasis added) have the ability to direct certain relevant activities. However, paragraph 9 is silent on how to evaluate circumstances when an investor, inclusive of the interests of its related parties, has such power and rights to returns.

We believe that paragraphs B69 through B71 provide a reasonable definition of what constitutes a de facto agent. However, those paragraphs provide little insight on how to incorporate the concept into the application of the model. For example, guidance may be needed to clarify how the rights held by funds operated for the benefit of employees would be considered. It is also unclear whether the term “unrelated” refers to parties that are not related parties, as defined in IAS 24, or are not related because one is not a de facto agent for the other reasons, as described in paragraphs B69 through B71. In this context, we believe guidance similar to ASC 810-10-55-37A would improve the Staff Draft and absent inclusion of that guidance there will be inconsistency in application of the Staff Draft and inconsistency with US GAAP.

Finally, we appreciate that the Staff Draft and the variable interest model in ASC 810-10 both contemplate the potential for an investor to consolidate (or deconsolidate) a portion of an entity, known as silos. The definition and application to such silos appears to be consistent between the two as well. However, under the variable interest model in ASC 810-10 consolidation of silos only applies if the host entity is a VIE. We believe the application of the silo concept may become operationally difficult. For example, we anticipate it may be difficult for a reporting entity to gather sufficient information to identify or determine whether a financial asset, on the books and records of historical voting interest entity because it failed to meet the sale requirements in ASC 860 Transfers and Servicing, qualifies as a silo. We believe further evaluation of how that concept may apply in practice (e.g., field testing) to financial institutions, insurance companies (e.g., protected cell companies) and more generally under the newly proposed lease accounting guidance, may be necessary.
Question 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 \(^1\). 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?

We agree with a control principle based on current power and returns.

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 a reporting entity could have control with less than a majority of voting rights only in combination with other substantive contractual rights. For example, when an entity is controlled through voting rights, we believe that an investor that has less than a majority of the voting shares could control the entity only if that investor also has other substantive contractual rights that provide the investor power over an entity’s relevant activities. Consistent with the overall principle, a controlling investor must have the current ability to unilaterally direct the investee’s relevant activities when such decisions need to be made regardless of the action or inaction of other investors.

Question 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 exits) 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 a reporting entity could conclude it can control another entity based on any of the factors listed above. Generally speaking, and consistent with ASC 810-10, it is our belief that relying on other investors’ inactivity does not represent control. Rather, we believe control requires an investor to have the ability to ‘force’ decisions and actions regardless of the action or inaction of other investors. Said another way, it is not clear how an investor with less than a majority of the voting rights and no other substantive contractual rights that provide it with additional power can be in a position to “unilaterally” direct the activities of another entity. Further, we believe the application of

\(^1\) A reporting entity controls another entity when the reporting entity has (1) power over the other entity, (2) exposure, or rights to variable returns from their involvement with the other entity, and (3) the ability to use its power over the other entity to affect the amount of the reporting entity’s returns.
this aspect of the guidance in the Staff Draft on control will introduce significant diversity in the application of the control principle. Please refer to page 3 of our cover letter for additional discussion.

**Question 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 noted above, we do not agree that a reporting entity can control another based solely on the factors indicated in Question 4. Notwithstanding that view, we also have operational concerns with the guidance in paragraph B14 and believe the additional indicators included in paragraph B15 may create additional diversity in practice.

Paragraph B14 emphasizes past events such as previous shareholder meetings and evidence of power exerted by the reporting entity in the past. Such an approach has the potential to result in more consistent consolidation decisions. While that may be a more objective approach than an approach that does not consider past events, it still depends on the inactivity of the other parties that may have had power but chose not to exercise it in the past. Therefore, consistent with paragraph 12 of the Staff Draft, we believe that past behavior is not in of itself conclusive in the determination of control. Any past decisions by shareholders, for example - choosing not to attend a shareholders' meeting or not challenging the reporting entity's decisions - do not necessarily indicate that the reporting entity has control. Rather, such inactivity should only be considered an indicator that the shareholders are satisfied with the reporting entity's decisions to date. Relying solely on past behavior cannot meet the definition of power, which requires the "current" ability to direct the relevant activities.

We believe these factors also would present significant practical and operational problems, particularly in determining when a reporting entity has gained control over another entity (i.e., when a business combination has occurred). We believe that preparers could discover, long after it obtained a significant minority interest that the reporting entity has (de facto) control using the principles provided and, thus, would be required to account for a significant business combination subsequent to the actual change in power.
Question 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 Staff Draft's guidance and the related examples for determining when potential voting rights are considered substantive are appropriate or sufficient to make the potential voting rights guidance operational. Specifically, we note that the examples in paragraph B44 do not clearly indicate whether the potential voting rights would definitely result in the holder obtaining power. To be useful, we believe the guidance should provide examples indicating when control exists.

In paragraph B20, the Staff Draft provides examples of circumstances when potential voting rights could be indicative of power. However, even if such potential rights will become substantively exercisable at the next shareholder meeting, often decisions over relevant activities are made prior to the next shareholding meeting. The holder of such rights remains powerless to “remove” management or exercise any other indicator of power until that shareholder meeting.

Ultimately, we do not believe the Staff Draft's examples in paragraphs B20 or B44 effectively articulate how the ability to direct the relevant activities is in fact “current power.” Consequently, the use of the term “current” in the definition of “power” would introduce inconsistencies and new diversity compared with US GAAP. This diversity would arise because ASC 810-10 does not contemplate that power to direct the activities that most significantly impact economic performance includes unexercised options or conversion features. In ASC 810-10, unexercised options or conversion features (absent other contractual rights) do not provide an investor with the current ability to direct the relevant activities.

Although the Staff Draft provides an analogy between unexercised options and removal rights, we believe that removal rights are substantively different. The existence of substantive removal rights provides a holder the current ability to exercise a substantive current right — at any time, for any reason. Consequently, the holder of removal rights has the current ability to control one or more relevant activities. Conversely, a potential voting right requires an economic exchange (e.g., cash paid to exercise an option) for the investor to exercise its rights. While an option may have economic value (i.e., it provides the holder a current benefit) it does not provide power. Other than potential rights with nominal exercise prices, the exercise of potential voting rights also relies on external factors, including favorable economic conditions and the passage of time. The Staff Draft does not appear to contemplate the substance of the economic exchange (the payment of the exercise price by the investor to acquire the interest) and describes these external factors as part of the facts and circumstances to consider. However, we do not believe the ability to obtain certain rights that, if exercised, (whether that ability is substantive or not) necessarily provides the holder with the current ability to exercise its power (i.e., direct the relevant activities) when the decisions need to be made until such time as the options are exercised and the rights are held.
An additional operational concern relates to the potential for the controlling party to change from one investor to another simply due to changes in economics, rather than any substantive change in the purpose and design of the entity and its operations. For example, consider a scenario in which an "out-of-the-money" option suddenly becomes in-the-money and then falls out-of-the-money over the course of a few weeks. Pursuant to the Staff Draft it is possible that an investor holding such option would consolidate and deconsolidate the entity within a matter of weeks simply as a result of changes in market forces rather than any substantive change in the power over an entity. As noted above, we do not believe a potential voting right, absent other contractual rights, should be included in the control analysis. However, if changes in the value of an option (in vs. out-of-the-money) were to be included in the control analysis, we believe that additional guidance on differentiating between in or out-of-the-money and "deeply" in or out-of-the-money will be necessary. There also would be practical difficulties in determining what is sufficiently in and out-of-the-money on an ongoing basis, particularly for potential voting rights over unlisted entities.

Finally, another operational difficulty would arise in applying business combination accounting when control is evidenced solely through potential voting rights. For example, consider an investor with no investment in an investee other than a right to acquire a majority of its voting shares. It is unclear how that investor would apply ASC 805 Business Combinations (or IFRS 3R) when it has no current rights to the equity of the investee.

Question 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?*

One of the most important aspects of any project to improve consolidation accounting under current US GAAP would be to clarify when a party is acting as a principal and when it is acting as an agent. As such, we support the Boards’ attempt to provide guidance that will result in decision useful financial reporting. As such, we believe that the Staff Draft has identified several important factors that should be considered when evaluating whether an entity is acting as a principal or as an agent. However, it does not provide adequate guidance on how to evaluate remuneration for services, rights held by other parties and variability in returns from other interests.
Scope of decision making authority: Refer to our discussion in Question 2 regarding broadly including the role of purpose and design in the guidance. Incorporating the concept of purpose and design of an entity and its related guidance, particularly in the context of entities with limited decision making, would improve the Staff Draft.

Rights held by other parties: Both broadly and in the specific context of principal and agent evaluations, our concerns on how to consider the involvement of related parties is discussed in our response to Question 2.

Remuneration/variability in returns from other interests: The variable interest model requires a decision maker to evaluate whether its fees represent a variable interest. That is, the decision-maker is required to evaluate whether it is acting as a principal or an agent. The variable interest model, while not prescriptive, does provide some basis to measure the relative significance of the fees and other interests held by the decision-maker (e.g., significance in relation to the investee’s anticipated economic performance) when making the principal/agent conclusion. If the decision-maker’s fees and other interests do not meet the significance and other tests, the decision-maker does not have a variable interest (i.e., the decision-maker is an agent). The concept of significance included in the Staff Draft is similar to the concept in the variable interest model when evaluating whether a party is a principal or agent.

However, as we learned in the adoption of ASC 810, determining when an interest is or is not significant (or more than insignificant) is inherently subjective. In many circumstances, practice attempted to define some non-determinative common rules of thumb (e.g., 10% of expected variability or returns). This process had a significant cost to preparers and still did not eliminate diversity in practice upon adoption.

Based upon our observation of the Boards’ deliberations and review of the Staff Draft, there seems to be an intentional increase in the tolerance of the magnitude of a decision maker’s remuneration and the variability that the remuneration or other interests held may absorb before that party would no longer be considered an agent. As a result, general rules of thumb in assessing what is significant would seemingly increase as well. While we agree with the directional move implied, the Staff Draft does not provide representative examples that could serve as guideposts for preparers and accountants to make those necessary evaluations and mitigate future diversity in practice. There were, however, useful illustrative examples provided in paragraph 21 of Agenda paper 8C for the week of 15 and 22 March 2010 joint meetings of the Boards.

We believe the Staff Draft would be significantly improved by including additional guidance and examples of common structures (such as those previously discussed at the joint Board meetings) and how the Boards expect those examples would be evaluated. Including those or similar examples with conclusions in the final guidance would significantly enhance the concept’s operational effectiveness and improve application consistency.
Question 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 believe substantive removal rights held by numerous parties should be a factor when evaluating whether a decision-maker is acting as an agent. However, the Staff Draft appears to have contradictory guidance in paragraphs B61 and B64. In paragraph B61, the guidance indicates that substantive removal rights held by a single party would be sufficient to conclude that a decision maker is an agent. However, paragraph B64 states that a decision maker cannot be an agent unless the remuneration criteria in paragraphs B63(a) and B63(b) are present. Consequently, it is unclear whether the test in paragraph B61 is truly determinative.

The Staff Draft’s guidance for evaluating potential removal and liquidation rights would represent a significant change from the guidance currently included in ASC 810 for both VIEs and voting interest entities, which rely on both a qualitative (e.g., the existence of barriers to exercise) and a quantitative test (e.g., whether a single investor or a simple majority of multiple investors can exercise such rights). As a result of these differences, we would expect an incremental change in practice for both historical variable interest and voting interest entities. However, as a result of the lack of clarity and examples, as previously described, we would expect significant diversity in interpretations and consequently a reduction in the comparability of financial statements, prepared using the Staff Draft, on the whole.

Question 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 that an investor should reassess whether it controls another entity if facts and circumstances change, indicating an investor has gained or lost power to direct the relevant activities of an entity. Those facts and circumstances typically follow changes in the purpose and design of an entity, including changes in the governing contractual rights or changes in ownership interests. The issues that we have described in our cover letter and in response to Questions 2-6 regarding the evaluation of de facto control and potential voting rights potentially could render the continuous reassessment non-operational. Additionally, we believe the guidance on determining when a party is acting as an agent requires additional guidance in the context of reassessment. The Staff Draft does not sufficiently clarify the IASB’s view on what types of changes would be necessary to alter a conclusion that a party is acting as principal or agent and whether such changes necessarily need to
be tied to changes in the purpose and design of the entity. For example, would changes in market conditions affecting the variability of fees be sufficient to conclude an agent's relationship with the entity has changed?