October 26, 2010

Ms. Leslie F. Seidman
Acting Chairman
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 Ms. Seidman,

The Financial Reporting Committee (FRC) of the Institute of Management Accountants (IMA) is writing to share its views on the International Accounting Standards Board’s (IASB) Staff Draft, Consolidated Financial Statements, and to provide input requested in the FASB Roundtable Meeting Agenda on Consolidations now scheduled for November 22.

FRC is the financial reporting technical committee of the IMA. The committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations.

As indicated in our letter dated October 13, 2010, our committee has significant concerns that the Boards are moving too fast and in a way that increases the risk of issuing standards that are not fully converged. We believe the pace of standard setting is still too fast for constituents to thoughtfully review, evaluate and comment on proposals. The FASB request for input, by October 12, on the IASB Staff Draft issued on September 29 for a Roundtable originally scheduled for October 25 is a poster child for these concerns. We appreciate the Board's response to constituent requests for additional time but remain concerned given the IASB's announcement that it remains committed to issuing the final standard on consolidation in 2010.

Specific to the Staff Draft of IFRS X, Consolidated Financial Statements, we find certain aspects troubling. Overall, we prefer existing US GAAP to the proposal in the Staff Draft because it is clearer, more operational and produces more understandable results. This letter outlines our
concerns, many of which were included in our letter dated March 20, 2009 to Sir David Tweedie and Robert Herz on IASB Exposure Draft 10 Consolidated Financial Statements (ED 10). We are also providing our input on the FASB Roundtable Meeting Agenda Questions on Consolidations in the attachment as we will not have representation at the upcoming Roundtable.

Definition of Control
As noted in our letter on ED 10, we support a two-pronged definition of control that incorporates the elements of power and economic returns. We are not sure why the IASB expanded the definition of control to include three elements, particularly when the element in paragraph 7(c) appears to be a consequence of having the elements of power in paragraph 7(a) and rights to variable returns in paragraph 7(b). We would like to understand what 7(c) is intended to convey.

Effective Control
We agree that an investor without a majority of the voting rights could have control through other related agreements. However, we are concerned about the conclusion that an investor with a large block, but less than 50% of the outstanding voting rights, controls the investee when the remainder of voting rights are dispersed and are not subject to collaborative or collective decisions. Such an investor may exercise effective control over the investee because other shareholders choose not to vote or may not vote in a collaborative or collective manner. However, we do not believe that the absence of an agreement or past collaborative or collective voting patterns is necessarily an indicator that shareholders with a majority of the voting shares will always allow the significant minority shareholder to control. As we noted in our previous letter, this is particularly the case in times of economic stress when the needs of the shareholders with a majority of the voting shares diverge from those of the significant minority shareholder. In those situations, the inability of the less-than-majority holder to control is too obvious to ignore. Therefore, we find the conclusions in the Application Examples troubling. In those examples, the investor with the largest single stake may have the opportunity to control but not the unilateral right. We believe the consolidation model should be based on factors that demonstrate unilateral control.

Options and Convertible Debt
We strongly disagree with the presumption of the exercise of options and forwards and conversion of convertible securities in evaluating control and in the application of consolidation accounting. Consolidation should not be triggered by transactions that are not yet executed. The option or convertible security holder does not currently have voting rights. As noted in our comment letter on ED 10, we believe that just holding options or convertible debt, which if exercised could result in control, should not, by default, result in consolidation by the holder, absent the instrument being in substance common stock (e.g., a nominal exercise price) and currently exercisable. Instruments can move in and out of the money over time. We believe that an investor should evaluate the rights and benefits of securities it currently holds, including options and convertible securities without assumption of exercise, to assess control. As a result, we disagree that the actual consolidation accounting entries should presume exercise or conversion (paragraphs B83 and B84).

Further, we believe including options and convertible securities in the analysis of control raises
the risk that an investor may consolidate an investee in one period when the options or convertible securities are "deep in-the-money" but deconsolidate in a subsequent period if the investee stock price declines. We are also not sure how "deep in-the-money" an option or a convertible security should be before the investor includes those securities in its analysis of control over the investee.

Disclosures
We understand the related footnote disclosures are being finalized as part of a separate project. We find it difficult to evaluate the impact of the guidance in the Staff Draft without knowing what the disclosure requirements will be and believe that better feedback could be provided in the Roundtable if the discussion included the footnote disclosures. In addition, as we have commented previously, we believe the Boards need to address disclosures on individual proposals based on a comprehensive framework.

Kick Out Rights
We believe the Staff Draft is not clear or operational when numerous parties hold kick out rights. We believe that kick-out rights, if substantive, should be determinative that the current decision maker does not control, whether those kick-out rights are held by one party or by a simple majority of interested parties. Therefore, we suggest that the current US GAAP guidance from EITF 96-16 and EITF 04-5 (ASC 810-10-25 and 810-20-25) be incorporated as guidance. (We would support amending the US VIE accounting model to conform.)

Investment Company Accounting
Although the consolidation of investment companies is being dealt with in a separate project, as noted in our letter on ED 10, we support the specialized accounting for investment companies and strongly believe that the specialized accounting must be retained at the parent level. If the specialized accounting is appropriate for the subsidiary to reflect the underlying economics and provide useful information, it should also be appropriate at the consolidated/parent level. We do not understand any other conclusion and support the FASB's decision of October 13 to change its previous tentative decision.

Power Over Specified Assets (Silos)
We are uncertain of the application of this guidance to situations other than those involving investees that are "Special Purpose Entities" generally with more passive financial assets and liabilities. Since the guidance is intended for other situations, it needs to be clear and operational. For example, assume that a biotech company has licensed a molecule from another entity with multiple development programs and has engaged the entity to develop the molecule to commercialization. The biotech company has no voting rights in the other entity. The molecule represents 40% of the fair value of the entity. Is the biotech company required to evaluate whether it has power over the molecule? If so, would an evaluation of control by the licensee always be required when rights to an asset have been granted under a license or such other arrangement?

Transition
We agree that retrospective application of this proposal will provide consistency among entities
and should be a permitted transition approach. However, we believe that it may be very difficult to apply this guidance retrospectively. With the benefit of hindsight, it may be impossible to objectively conclude which factors may have had what sort of relative importance at the time an investor made the initial investment or gained or lost control. Therefore, we believe that the guidance should acknowledge the difficulty and explicitly permit application as of the earliest period practical through a cumulative catch up adjustment, deeming the date of application as the date of acquisition or loss of control.

Field Testing
We are concerned about the broad application of the Staff Draft Guidance to all entities without robust field testing. Today, many businesses participate in partnering arrangements. It is not uncommon to find products developed jointly, manufactured by an unrelated entity and marketed through a local partner. An entity participating in these arrangements may have no voting rights. Such arrangements must comply with local jurisdictional regulations and laws, and often involve complex agreements. Given the frequency and complexity of these arrangements, the pervasive impact of consolidation accounting and the proposed requirements to consider all agreements, we believe that there will be many ambiguous situations that arise that have not been contemplated in the Staff Draft. There may be unintended consequences in applying the guidance in the Staff Draft. It is our experience that questions always arise in the details. Because the model proposed by the IASB will represent a substantial shift in current practice, we believe a thorough due process must involve field testing the guidance for investments involving many different facts and circumstances in many different industries and countries. We find the Application Examples weak. In many, the indicators of control appear obvious. There needs to be numerous and varied examples of factors in contractual arrangements that give control. We believe that field testing would provide valuable input for Application Examples where the control indicators are not obvious.

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Based on these concerns, we prefer current US GAAP to the proposals in Staff Draft. Current US GAAP is based on unilateral control which we believe is more useful and more understandable. It is based on "no conditions", that is, it is not dependent on the actions or inactions of others. In addition, we do not find the Staff Draft clear or operational, e.g., implementing effective control, dealing with potential voting rights, dealing with kick out rights, etc. We would be pleased to discuss these comments with the IASB Staff at their convenience. I can be reached at (212) 484-8112.

Sincerely,

Allan Cohen
Chair, Financial Reporting Committee
Institute of Management Accountants

cc: Sir David Tweedie, Chairman
International Accounting Standards Board
ATTACHMENT

FASB ROUNDTABLE MEETING AGENDA
Consolidations
November 22, 2010

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 support a single approach using a two-pronged definition of control that incorporates the elements of power and economic returns. We are not sure why the IASB expanded the definition of control to include three elements, particularly when the element in paragraph 7(c) appears to be a consequence of having the elements of power in paragraph 7(a) and rights to variable returns in paragraph 7(b). We would like to understand what 7(c) is intended to convey.

Nonetheless, we are concerned about the broad application of the Staff Draft guidance to all entities without robust field testing. Today, many businesses participate in partnering arrangements. It is not uncommon to find products developed jointly, manufactured by an unrelated entity and marketed through a local partner. An entity participating in these arrangements may have no voting rights. Such arrangements must comply with local jurisdictional regulations and laws, and often involve complex agreements. Given the frequency and complexity of these arrangements, the pervasive impact of consolidation accounting and the proposed requirements to consider all agreements, we believe that there will be many ambiguous situations that arise that have not been contemplated in the Staff Draft. There may be unintended consequences in applying the guidance in the Staff Draft. It is our experience that questions always arise in the details. Because the model proposed by the IASB will represent a substantial shift in current practice, we believe a thorough due process must involve field testing the guidance for investments involving many different facts and circumstances in many different industries and countries. We find the Application Examples weak. In many, the indicators of control appear obvious. There needs to be numerous and varied examples of factors in contractual arrangements that give control. We believe that field testing would provide valuable input for Application Examples where the control indicators are not obvious.

In addition, while we support a single-model approach, additional guidance is needed for limited purpose, brain-dead entities.
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?

First, we note that when comparing the Staff Draft with US GAAP, the principles and guidance are different (e.g., removal rights and the definition of silos). Second, the robust field testing suggested in our response to Question 1 is a way to answer the question. Without field testing involving a wide array of investments in entities in many different industries and countries, we are not certain that Staff Draft guidance is sufficiently clear on how to assess power and control for all types of entities. For example, we do not believe that there is sufficient guidance for entities where an investor may have no voting rights but has significant exposure to variable returns of the investee and the power to affect those returns through contractual agreements, such as licensing agreements.

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?

We agree that an investor has control over an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. As noted in our response to Question 1, we are not sure why the IASB has added the third element in paragraph 7(c) of the Staff Draft.

We believe that control with less than a majority of voting rights can be obtained through other agreements that give the investor unilateral control.

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1 Originally issued as FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R).
2 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.
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 there are any circumstances where an investor should assess control considering only those factors. We do not believe those factors represent an appropriate basis for determining control. As noted in our cover letter and in our comment letter on ED 10, the fact that minority shareholders have permitted another minority shareholder with a significantly greater interest to direct the investee’s activities does not mean they will permit that situation to continue especially if conditions change. In that regard, the possibility that minority shareholders who own a majority of the investee’s voting securities in the aggregate may assert their rights is similar to shareholders having the right to remove a decision maker.

We believe the consolidation model should be based on the right to unilateral control which we believe is more useful and more understandable. It is based on "no conditions", that is, it is not dependent on the actions or inactions of others. In addition, we do not find the Staff Draft clear or operational, e.g., implementing effective control, dealing with potential voting rights, dealing with kick out rights, etc.

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?

We believe that control with less than a majority of voting rights can be obtained through contractual agreements with other shareholders and other agreements that give the investor unilateral control. There needs to be numerous and varied examples of such factors in contractual arrangements in the guidance. We believe that the factors regarding the size of its voting rights relative to the size and dispersion of holdings of the other vote holders and the
factors related to potential voting shares should be removed.

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. We strongly disagree with the presumption of the exercise of options and forwards and conversion of convertible securities in evaluating control and in the application of consolidation accounting. Consolidation should not be triggered by transactions that are not yet executed. The investor does not currently hold voting rights. As noted in our comment letter on ED 10, we believe that just holding options or convertible debt, which if exercised could result in control, should not, by default, result in consolidation by the holder, absent the instrument being in substance common stock (e.g., a nominal exercise price) and currently exercisable. Instruments can move in and out of the money over time. We believe that an investor should evaluate the rights and benefits of securities it currently holds, including options and convertible securities without assumption of exercise, to assess control. As a result, we disagree that the actual consolidation accounting entries should presume exercise or conversion (paragraphs B83 and B84).

Further, we believe including options and convertible securities in the analysis of control raises the risk that an investor may consolidate an investee in one period when the options or convertible securities are “deep in-the-money” but deconsolidate in a subsequent period if the investee stock price declines. We are also not sure how “deep in-the-money” an option or a convertible security should be before the investor includes those securities in its analysis of control over the investee.

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?

The guidance seems appropriate. We believe that the operationality and the appropriateness of the resulting consolidation conclusions can only be determined through the robust field testing recommended in our response to Question 1.
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 the Staff Draft is not clear or operational when numerous parties hold kick out rights. We believe that kick-out rights, if substantive, should be determinative that the current decision maker does not control, whether those kick-out rights are held by one party or by a simple majority of interested parties. Therefore, we suggest that the current US GAAP guidance from EITF 96-16 and EITF 04-5 (ASC 810-10-25 and 810-20-25) be incorporated as guidance. (We would support amending the US VIE accounting model to conform.)

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 agree that when changes occur and an investor gains or no longer has unilateral control, there is a need to reassess.