



12 January 2009

To: **Members of the Hong Kong Institute of CPAs**  
**All other interested parties**

**INVITATION TO COMMENT ON IASB EXPOSURE DRAFT ED 10  
CONSOLIDATED FINANCIAL STATEMENTS**

***Comments to be received by 27 February 2009***

The Hong Kong Institute of Certified Public Accountants' (Institute) Financial Reporting Standards Committee (FRSC) is seeking comments on the IASB Exposure Draft which has been posted on the Institute's website at:

[www.hkicpa.org.hk/professionaltechnical/accounting/exposedraft/content.php](http://www.hkicpa.org.hk/professionaltechnical/accounting/exposedraft/content.php).

The Exposure Draft forms part of the IASB's comprehensive review of off balance sheet activities and respond to the concerns cited by the G20 leaders at their 15 November meeting and recommendations contained in a report published in April 2008 by the Financial Stability Forum, the international body tasked with co-ordinating the global regulatory response to the credit crisis. It aims to strengthen and improve the requirements for identifying which entities a company controls with the objective of publishing a single standard to replace the consolidation requirements in IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation—Special Purpose Entities*.

The IASB seeks comment on whether the control definition proposed in this Exposure Draft and the accompanying guidance on how to apply that definition, provides clearer guidance for determining when one entity controls another. The IASB is also seeking comment on whether the enhanced disclosure requirements for consolidated and unconsolidated entities will give capital providers and other users of financial statements information that is useful for their decision-making.

In addition, the Exposure Draft also invites comments on other matters such as whether reputation risk is an appropriate basis for consolidation and should the IASB consider the definition of significant influence and the use of the equity method in IAS 28 *Investments in Associates* with a view to develop a cohesive set of requirements for all investments in entities.

--- A summary of the main proposals in the Exposure Draft is set out in the Appendix.

In accordance with the Institute's Convergence Due Process, comments are invited from any interested party. The FRSC would like to hear from both those who do agree and those who do not agree with the proposals contained in the IASB Exposure Draft.

Comments should be supported by specific reasoning and should be submitted in written form.

To allow your comments on the IASB Exposure Draft to be considered, they are requested to be received by the Institute on or before **27 February 2009**.



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

Comments may be sent by mail, fax or e-mail to:

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Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

### **Summary of the main proposals in the Exposure Draft**

#### **(1) Definition of control**

The Exposure Draft proposes to replace the definition of control in IAS 27 *Consolidated and Separate Financial Statements* and the indicators of control in SIC-12 *Consolidation—Special Purpose Entities* with a single definition of control that would apply to all entities and be more difficult to evade by special structuring.

The IASB proposes the following definition of control of an entity as:

*“A reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity to generate returns for the reporting entity.”*

Consequences of the definition are that only one party can control an entity and there could be circumstances in which an entity is not controlled by any party.

'Power to direct the activities' is broader than 'power to govern the financial and operating policies' and, therefore, would broaden the scope of consolidation. The Exposure Draft also clarifies that a reporting entity can have power even if it has not exercised its voting rights or options to acquire voting rights, or is not actively directing the activities of another entity.

Moreover, the proposed definition retains the concept in IAS 27 that control conveys the right to obtain benefits from another entity. The Exposure Draft uses the term “returns” rather than “benefits”, as used in IAS 27, because many interpret “benefits” to imply only positive returns. The IASB believes that “returns” makes more explicit that a reporting entity may obtain positive or negative returns.

#### **(2) Assessing control**

The Exposure Draft retains the presumption in IAS 27 that a reporting entity that can exercise more than half of the voting rights in another entity has power to direct the activities in the absence of circumstances that indicate otherwise. The Exposure Draft provides guidance on how to assess power and returns when:

- (a) a reporting entity has less than a majority of the voting rights.
- (b) assessing control of a structured entity (special purpose entities referred to in SIC-12 have characteristics similar to structured entities).

When assessing control of structured entities, the Exposure Draft proposes that a reporting entity should assess the particular circumstances of its relationship with a structured entity, and consider factors such as the purpose and design of the structured entity and how decisions are made about the activities that cause the returns of the entity to vary.

#### **(3) Disclosure**

The Exposure Draft proposes enhanced disclosure requirements for consolidated entities, particularly relating to the effect of non-controlling interests.

In addition, it requires disclosure about the nature of, and risks associated with, a reporting entity's involvement with structured entities that the reporting entity does not



control (i.e. “off balance sheet” activities). The Exposure Draft proposes requiring a reporting entity to disclose:

- (a) information about the basis of control and the related accounting consequences.
- (b) information about the interest that the non-controlling interests have in the group’s activities.
- (c) information about restrictions on assets and liabilities held in subsidiaries, including the claims of non-controlling interests.
- (d) information about unconsolidated structured entities that the reporting entity does not control, but with which the reporting entity has involvement.

#### **(4) Other matters**

In the context of the Exposure Draft, reputation risk refers to a reporting entity’s implicit commitment to provide support to unconsolidated structured entities without having a contractual or constructive obligation to do so.

Despite the conclusion reached by the IASB that reputation risk is not an appropriate basis for consolidation, the Exposure Draft proposes that a reporting entity should disclose the support it has provided to unconsolidated structured entities regardless of whether having a contractual or constructive obligation to do so.

The IASB has not deliberated the concept of significant influence. However, it noted the overlap and even possible conflict between the proposals in this Exposure Draft and the requirements in IAS 28 *Investments in Associates*. The IASB would consider developing a separate project to address this issue.