The Corporate Reporting Users' Forum

Mr. Michael Buschhueter
Project Manager
International Accounting Standards Board
First Floor, 30 Cannon Street,
London
EC4M 6XH

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Ref.: ED10 Consolidated Financial Statements

Dear Michael

The Corporate Reporting Users' Forum (CRUF) welcomes the opportunity to comment on the Exposure Draft Consolidated Financial Statements. We would also like to thank you for taking the time to present the issues to us at our recent meeting.

In this letter, we provide input on some of the most relevant issues we see as users of the accounts.

Due Process

As we have stated in previous letters, in order to maintain confidence in the reporting of corporates, the IASB needs to adhere to a process of standard setting that allows sufficient time for the investment community and others to analyse and comment upon any proposed changes. Whilst we appreciate that the IASB was explicitly asked to review the accounting for consolidations by the Financial Stability Forum, we believe that, by going straight to an accelerated exposure draft on such a significant project, the time period for comprehensive development of the proposals including an evaluation of their consequences and public comment, has been too short.

Given this, we have not had time to consider fully many of the technical aspects of the proposed changes, and the likely resulting outcome for consolidation. This does not signify indifference towards the accounting for consolidations; simply a lack of time, particularly given the number of critical projects that the Board currently has out for public comment. We would welcome a continued dialogue on the consequences for financial statement reporting.

Evidence of a need for change

We understand that the proposed changes seek to address certain difficulties faced by companies and their auditors in evaluating the current requirements under IAS 27 and SIC 12 and the potential for inconsistencies resulting from this evaluation, and to improve the disclosure of risks related to what in the ED are termed 'structured entities'. We have certainly observed cases where banks have stepped in to provide support to structured entities, often in the absence of a legal obligation to do so. In some cases, the relationships with these structured entities would have been known to certain market participants, but little if any information was previously disclosed in the financial statements, presumably due to the lack of any obligation to provide such support, or what was previously judged to be a remote likelihood of suffering an outflow of resources.

While it is difficult for us to evaluate the extent of the need to address difficulties in decision making with respect to consolidation or the resulting level of inconsistency, we observe that the outcome is binary in that an entity is consolidated or not, and if not, considerably less information is currently made available to users. Additionally, relationships between a parent and investees or structured entities cover a wide spectrum through which the Board is attempting to draw a new line to distinguish those that are consolidated versus those that are not, with in some cases, little in the characteristics between them to distinguish, but a large difference in accounting and disclosure. We support the project and encourage the Board to consider more widely the level of information available on both consolidated and unconsolidated investees and structured entities, and characteristics of the relationships between a parent and investee or structured entity that are key to the consolidation decision made.

We also encourage the Board to consider the implications of change to consolidation together with those relating to de-recognition, as these requirements need to work closely together as a package to ensure meaningful financial statement reporting.

The proposal on consolidation

We agree that a single model with guidance is a logical approach, if it can be achieved, but it is essential that enough guidance is given for structured entities (including the definition of structured entities) to enable consistent decision making and reporting, and such guidance may be viewed as a second model by some. We understand that the practical consequences of which entities would be consolidated and unconsolidated under the changed requirements are not yet clear, and we look forward to seeing the input to the IASB from companies and auditors that may shed further light on this. We understand that some at the IASB expect about the same number of structured entities to be consolidated, but that some would shift off balance sheet and some on. It is unclear which types of entities or relationships would fall into the categories that would experience change, or that we would want structured entities now consolidated to become unconsolidated.

Investment funds are a separate case where we believe that there is sufficient regulation to safeguard clients such that the risks associated with all economic returns are passed from the investment manager to the client. We see little reason for such funds to be consolidated.

As part of our response on the Financial Statements Presentation project, we will outline a framework for disclosing information on entities which are not consolidated fully. Our aim is to ensure that we have enough information to form a clear view on the performance of such entities and the risks associated with their business and balance sheet structure.

We comment below on certain disclosure that we believe should complement the decision to consolidate or not. Regarding consolidation, we emphasize disclosure of significant subsidiaries, segment information, restricted assets and related nonrecourse obligations (at least legally), and risks relating to consolidated structured entities that could lead to needs for support. Whether a structured entity is consolidated or not, similar information is needed by users. Regarding non-consolidation, we emphasize disclosure needs relating to associates and JVs, and structured entities and involvement/support required or the potential for such support.

Significant subsidiaries
While disclosure of subsidiaries and key information such as % of voting rights held is not required by IFRS, we note that many companies do include such information in their financial statements. However, while consolidated structured entities are also subsidiaries under IFRS, they are not always included. This disclosure is useful to help analysts better understand the scope of consolidation, as is information stating why more judgemental investments or structured entities were either included or excluded from consolidation.

Segment information
An enlarged scope of consolidation is not always the best answer, and particularly, it increases the pressure on disclosure on the face of the financial statements of widely different activities, in the notes on the adequacy of segmental disclosure, and disclosure of investments and minority interests. Common cases that pose analytical challenges are:

- Banks with consolidated insurance subsidiaries and insurers with consolidated bank subsidiaries.
- Financial institutions with consolidated private equity investments.
- Manufacturing companies with consolidated financial services entities.

We are also concerned that as IFRS 8 is now being implemented, we have seen a number of companies reduce the number of segments they disclose. The information provided for each segment is also too limited to support much analysis of individually very different business lines. In some cases, a full set of statements, prepared under Group IFRS accounting policies is needed to understand the respective contribution of a segment. We believe that segment reporting needs to keep pace with the already expanded scope of consolidation. We plan to comment further on this in our response to the Financial Statement Presentation Discussion Paper.

Restricted assets, related debt and support obligations
Consolidation of structured entities typically results in a grossing up of the balance sheet for assets that have been secured within the structure and are therefore not available to other creditors, and related debt obligations. It is essential that such restrictions on such assets are disclosed, as are the related debt obligations, committed support arrangements, and potential risks beyond the committed support. If such information is not disclosed, consolidation could result in a misleading picture of assets, and even a loss of information on commitments to support a structured entity as they become internal commitments within the consolidated group (and the need to fund them is external, but not a commitment), rather than an external support commitment that would be addressed under IAS 37 or the new requirements for structured entities addressed in the consolidation ED. We consider that whether a structured entity is consolidated or not, similar information is needed.

Associates and JVs
Associates and joint ventures are of course not consolidated, resulting in limited information, generally. Single line equity method accounting in particular provides little insight. Analysts frequently consider issues such as the potential need to support the debt of an associate or JV, or even what the result would be if a significant associate or JV were to be consolidated. We believe that more information on these entities' key financial statement amounts, including: cash, debt, operating income, operating cash flows, working capital changes, and capex, should be provided.

Unconsolidated structured entities
We welcome improved disclosure of involvement with unconsolidated structured entities, including disclosure of where support has been provided without having a contractual or constructive obligation.

About the Corporate Reporting Users' Forum

The CRUF was formed in 2005 as a discussion forum with the aim of helping its participants in their approach to the debate on current and future corporate reporting requirements. In particular, participants are keen to have a fuller input into the deliberations of the International Accounting Standards Board and the Financial Accounting Standards Board.

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The CRUF is a discussion forum. Its participants take part in CRUF discussions and joint representations as individuals, not as representatives of their employer organisations. It does not seek to achieve consensus views, though at times some or all of its participants will agree to make joint representations to standard setters or to the media.

CRUF

The Corporate Reporting Users' Forum

CRUF participants include individuals from both buy and sell-side institutions, and from both equity and fixed income markets. The forum includes individuals with global or regional responsibilities and from around the world. The CRUF meets on a regular basis in London, Frankfurt, Sydney and NY with facilities for remote participation.

Yours sincerely,

Peter Elwin
Head of Accounting & Valuation Research
Cazenove Equities

Ralf Frank
Managing Director
DVFA

Susannah Haan

Roger Hirst
Head of London Research
Main First Bank AG

The Corporate Reporting Users' Forum

Christian Krause

Elmer Huh, CFA, FRM
Director
Portfolio Valuation and Corporate Finance
Duff & Phelps, LLC

Bernd Laux
Analyst
Head of Research
Cheuvreux Germany

Paul Lee
Director
Hermes Investment Management Ltd

Jochen Mathee
Senior Portfolio Manager
Fortis Investments

Richard Mathieson
Senior Analyst
Barclays Global Investors

Gunnar Miller
Head of European Research
Co-Head of Global Research
RCM-Allianz Global Investors AG

Peter Reilly
Head of Capital Goods
European Equity Research
Deutsche Bank

Crispin Southgate
Institutional Investment Advisors Limited

Deborah Taylor
Research Analyst
Accounting and Valuation
Citigroup Investment Research

The Corporate Reporting Users' Forum

Dr Lothar Weniger
Head of Equity Research
DZ Bank

Jed Wrigley
Portfolio Manager
Director – Accounting and Valuations
Fidelity Investments