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12 March 2012

Re: Draft endorsement advice on the IFRS 10 Consolidation

Dear Francoise,

OIC is pleased to have the opportunity to provide our comments on your draft endorsement advice on the *IFRS 10 Consolidation*.

IFRS 10 was intended to overcome at the same time the following issues:

- Diversity in practice, related to the perceived inconsistencies between the consolidation guidance in IAS 27 and SIC-12;
- Disclosures and the financial crisis. This was a request from the G-20 to enhance the disclosures related to unconsolidated vehicles;
- US GAAP convergence. IFRS 10 is a project inserted in the MoU between the IASB and FASB.

Considering for a moment IFRS 10 and IFRS 12, the IASB successfully met two of the above-mentioned objectives. IFRS 10 is based on a single consolidation principle based on the concept of control, and has therefore eliminated the "risk and rewards test" of SIC 12. IFRS 12 has introduced disclosures on the exposures to risks over unconsolidated vehicles.

The convergence objective was reached only partially as the FASB decided not to proceed with proposing changes to its consolidation requirements for voting interest entities (i.e. de facto control), whilst, it decided to expose changes that would substantially align its consolidation requirements for special purpose entities with IFRS 10.

The main concern we have on this approach is related to effects of the elimination of "risk and rewards" model for consolidation. This concern has been reiterated several times in the past when OIC responded to EFRAG and IASB consultations. Whilst the request from the G-20 of an improvement of disclosures over non-consolidated vehicles is appreciated, it cannot

be meant as a compensative measure for the reduction of vehicles consolidated. We do not believe was the intention of the G-20 to compensate the reduction of information in the balance sheet with an increase of disclosures.

OIC has consulted its constituencies (mainly preparers) with the aim to verify whether the new requirement may in practice determine a reduction of entities being consolidated. As a result of this consultation no significant impacts are expected. However it is fair to say that this must be considered only an initial assessment that might give very different results if replicated when the requirements of the standards have to be applied and are better understood. For this reason OIC believes that there is a need to better investigate the issue with an additional field test to be conducted in Europe to ensure that the principle of IFRS 10 not only has no significant impacts on current structures, but also it is unlikely that in the future the principle can be easily circumvented to avoid consolidation of SPEs.

In its draft endorsement advice EFRAG concludes that although *“the application of a single control model may result in some true ‘autopilots’ remaining unconsolidated [...], a uniform principles-based approach to consolidation will over time help entities assess which investees they control, and reduce inappropriate deconsolidation decisions or off-balance sheet treatment [...] and would reduce inappropriate consolidation decisions when an entity is exposed to the majority of risks and rewards but has no control over an investee”*.

OIC is not convinced that consolidation of vehicles in accordance with SIC 12 is considered by investors, especially potential investors, “inappropriate” only because it does not rely on the control principle. We believe that users acknowledge that the full exposure to risks and rewards generated by a vehicle acting as an “autopilot” (no substantive economic decisions taken, as it happens in operating entities) can be considered as the proof that the control of the investor has been exercised – at the origination and once for ever – in designing the statute of the vehicle.

For all these reasons, a conclusion that the IFRS 10 satisfies the endorsement criteria can be reached only after having ensured that no significant impacts on the current scope of consolidation are expected from the application of the new standard. Therefore OIC strongly suggests to EFRAG not to conclude its assessment on the endorsement advice before an additional and more detailed field test on this issue – as also requested by the Accounting Regulatory Committee – is carried out. To this objective, OIC, as well as in all the similar activities, is keen to give its contribute to EFRAG staff to contact Italian interested parties.

In relation to the other areas of the standard, it seems that particular concerns arise from the application of the requirements over consolidation when control is reached through potential voting rights. In its draft endorsement advice EFRAG TEG acknowledges that *“operational difficulties may arise to assess whether the rights are substantive or not, which may affect the relevance of information”*, and notes that *“the assessment should be supported by an analysis of the purpose and design of the instrument giving rise to potential voting rights”*. In EFRAG TEG view *“this includes an assessment of the terms and conditions of such rights as well as the apparent expectations, motives and reasons for agreeing them, which should assist in appropriate assessment of the rights conveyed by the underlying instruments”*.

In our view IFRS 10 does not give sufficient explanations in relation to importance of the “intention of the holder” element in determining whether the potential voting rights are substantive. In the absence of this clarification, differences in the application of the standard are likely to arise. Some constituents note that it is not clear how this “intent”

should be “shown” or “proven”, as no indication is provided by the standard and, consequently, this concept appears to be too subjective.

OIC strongly support IASB or EFRAG with European NSS to provide specific guidance on how this assessment should be applied in practice.

Finally, OIC welcomes the initiative of EFRAG TEG to ask for a delay of one year on the application of the IFRS 10, since the short period between the endorsement and the mandatory application was also an issue perceived by constituents when the field test was conducted. We understand that another additional reason for requesting the delay is the announced amendments to the IFRS 10 in relation to the consolidation exemption envisaged for investment entities. In this respect, OIC recommend the EFRAG, once the IFRS 10 will be amended, to conduct a careful and comprehensive review of how that amendment will interact with that part of the standard related to the relationship principal/agent (i.e. guidance on the assessment of who of them is the decision maker).

Should you need any further information, please do not hesitate to contact us.

Yours sincerely,

Angelo Casò
(Chairman)