

# Rådet för finansiell rapportering

The Swedish Financial Reporting Board

RFR-rs 2011:02

International Accounting Standards Board  
30 Cannon Street  
London EC4M 6 XH  
United Kingdom

Dear Sirs,

## Staff draft IFRS X Consolidated Financial Statements

We have analysed the staff draft "IFRS X Consolidated Financial Statements".

In our comment letter as of April 6, 2009 on the Exposure Draft we were in most aspects positive but suggested "that the requirement for consolidation based on "de facto" control is restricted to situations, where it is beyond reasonable doubt that control really exists". The principles in the main text of the staff draft are, in our view, in line with our suggestion but a number of paragraphs in the application guidance (AG) are not. We enclose a document with copies from the AG with bold marking of the questionable paragraphs.

Our concern is that for example companies offering both products and services (P&S) most certainly will be negatively impacted. The reason for this is that these companies sometimes are involved in creating entities where one or more companies transfer property, plant and equipment to a new company, NewCo. The P&S company sometimes becomes an owner with only a small proportion of ownership, with the former asset owner(s) as co owners, sometimes together with a financial investor.

More specifically, our concern is that in a significant number of paragraphs reference is made to the existence of a service agreement between an investor and an investee and that the key management personnel of the NewCo are former employees of the investor. The number of references to these factors results in overemphasizing them. There is also a paragraph (B 51) stating that "fixed performance fees for managing investee's assets are variable returns" (bold marking by us). This statement is not correct – a fixed fee means that the price is fixed (as the name demonstrates). Another paragraph that is too far reaching is B52 (C) which points to economy of scale as an example of returns. Any supplier might get synergies due to economy of scale.

The consequence of the above focus could be that the new consolidation standard will prohibit the development of sound business models that lead to more efficient use of assets.



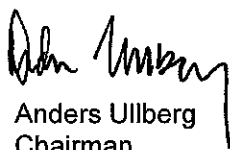
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We therefore strongly recommend the Board to amend the draft AG in the areas mentioned. If the Board would find it valuable for the project, we would be very glad to offer our support, for example by providing examples from our network of persons with experience of these industrial business models.

If you have any questions concerning our comments please address our Executive member Carl-Eric Bohlin by e-mail to: [carl-eric.bohlin@radetforfinansiellrapportering.se](mailto:carl-eric.bohlin@radetforfinansiellrapportering.se)

Stockholm, 31 January 2011

Yours sincerely



Anders Ullberg  
Chairman

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Enclosure

## Impact on a service-/equipment provider in relation to consolidation, based on Consolidation staff draft X, paragraphs from the AG

*Copies from the staff draft where paragraphs relevant to the letter have been bold marked.*

### Assessing control

B1

An investor must always assess whether it has all of the following elements to determine whether it controls an investee:

- (a) power over the investee;
- (b) exposure, or rights, to variable returns from its involvement with the investee; and
- (c) the ability to use its power over the investee to affect the amount of the investor's returns.

B4

.....**For more complex cases, it may be necessary to consider many or all of the following factors to determine whether an investor controls an investee:**

**(a) what the relevant activities are and how decisions about these activities are made (see paragraphs B7–B10);**

(b) whether the rights of the investor give it the current ability to direct those activities (see paragraphs B11–B49);

(c) whether the investor is exposed, or has rights, to variable returns from its involvement with the investee (see paragraphs B50–B52); and

(d) whether the investor has the ability to use its power over the investee to affect the amount of the investor's returns (see paragraphs B53–B68).

### Relevant activities and direction of relevant activities

B7

Understanding the purpose and design of an investee may help identify the relevant activities, how decisions about the relevant activities are made, who has the ability to direct those activities and who receives returns from that direction.

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B8

For many investees, a range of operating and financing activities significantly affect their returns. Examples of activities that, depending on the circumstances, **can be relevant activities include, but are not limited to:**

- (a) sales and purchases of goods or services;
- (b) managing financial assets during their life (including upon default);
- (c) selecting, acquiring or disposing of assets;
- (d) researching and developing new products or processes; or
- (e) determining a funding structure or obtaining funding.

B9

**Examples of decisions about an investee's activities** that, depending on the circumstances, can significantly affect the returns of the investee include but are not limited to:

- (a) establishing operating and capital decisions of the investee, including budgets; or
- (b) appointing and remunerating an investee's **service providers or key management personnel** and terminating their services or employment.

B10

In some situations, activities both before and after a particular set of circumstances arise or event occurs may be relevant activities. When two or more unrelated investor have the current ability to direct activities that significantly affect the investee's returns and those activities occur at different times, they must still determine which investor is able to direct the activities that most significantly affect those returns, consistently with the treatment of concurrent decision-making rights (see paragraph 13). It will be necessary to reconsider this assessment over time if relevant facts or circumstances change.

B11

Power arises from rights. To have power over an investee an investor must have rights that enable it to direct the relevant activities. Therefore, the rights that may give an investor this ability and that need to be considered in assessing power can differ between investees. Examples of rights that, either individually or in combination, can give an investor power include but are not limited to :

- (a) rights in the form of voting rights (or potential voting rights) of an investee (see paragraphs B30–B44);
- (b) **rights to appoint, reassign or remove members of an investee's key management personnel** who have the ability to significantly affect the investee's return;
- (c) rights to appoint or remove another entity that participates in decisions about the relevant activities;
- (d) **rights to direct the investee to enter into**, or veto any changes to, transactions that affect the investor's returns;

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(e) **other rights (such as decision-making rights within a management contract)** that significantly affect the investee's returns.

## B 12

Generally, when investees have a range of operating and financing activities that significantly affect the returns of the investee and when substantive decision-making in respect to these activities is required on an ongoing basis, it will be voting or similar rights that give an investor power, either individually or in combination with other arrangements.

## B 13

When voting rights cannot have a significant effect on an investee's returns, such as when they relate solely to administrative tasks and it is contractual arrangements that determine the direction of most of the activities that significantly affect the return of the investee, an investor needs to assess those contractual arrangements in order to determine whether it has rights sufficient to give it power over the investee. Considering the purpose and design of an investee together with the indicators in paragraphs B15 and B16 may help to determine whether the investor has rights sufficient to give it power.

## B 14

In some circumstances it may be difficult to determine whether an investor's rights are sufficient to give it power over an investee. In these cases, to enable the assessment of power to be made the investor should consider evidence of whether it has the ability to direct the relevant activities. **Consideration is given, but is not limited,** to the following, which, when considered together with the indicators in paragraphs B15 and B16, may provide evidence that the investor has rights sufficient to give it power over the investee.

(a) **The investor can appoint or approve the investee's key management personnel who direct the relevant activities.**

(b) **The investor can direct the investee to enter into, or can veto any changes to, significant transactions that affect the investor's returns.**

(c) The investor can dominate either the nominations process of electing members of the investee's governing body or the obtaining of proxies from other holders of voting rights.

(d) Its key management personnel or the majority of the members of the investee's governing body are related parties of the investor.

## B15

Often, there will be indications that the investor has a special relationship with the investee, suggesting that the investor has more than a passive interest in the investee. **The existence of any individual indicator, or a particular combination of indicators, does not necessarily mean that the power criterion is met. However, having more than a passive interest in the investee could indicate that the investor has other, related, rights or provide evidence of existing power over an investee.** For example, the following would suggest that the investor has more than a passive interest in the investee:

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(a) The investee's key management personnel who direct the activities that significantly affect the investee's returns are current or previous employees of the investor or of the investor's subsidiaries.

(b) The investee's operations are dependent on the investor, such as in the following situations:

(i) The investee depends on the investor to fund its operations.

(ii) The investor guarantees a significant portion of the investee's obligations.

(iii) The investee depends on the investor for critical services, technology, supplies or raw materials.

(iv) The investee depends on the investor for key management personnel, such as when the investor's personnel have specialised knowledge of the investee's operations.

(v) The investor controls assets that are critical to the investee's operations.

(c) A significant portion of the investee's activities either involve or are conducted on behalf of the investor.

(d) The investor's exposure, or rights, to the returns from its involvement with the investee is disproportionately greater than its voting rights. For example, there may be a situation in which an investor is entitled, or exposed, to more than half of the returns of the investee but holds less than half of the voting rights of the investee.

## Substantive rights

### B18

An investor, in assessing whether it has power, considers only substantive rights relating to an investee (held by the investor and others). **For a right to be substantive, the holder must have the practical ability to exercise the right.** To be substantive, rights also need to give the holder the current ability to direct the relevant activities when decisions about those activities need to be made.

### B19

Determining whether rights are substantive requires judgment, taking into account all available facts and circumstances. Factors to consider in making that determination include:

(a) whether the party or parties that hold the rights would benefit from the exercise of those rights. For example, the holder of potential voting rights in the investee (see paragraphs B42–B44) shall consider the exercise or conversion price of the instrument. The terms and conditions of potential voting rights are more likely to be substantive when the potential voting rights are in the money or the investor would benefit for other reasons (eg by realising synergies between the investor and the investee) from the exercise or conversion of the potential voting rights.



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(b) whether there are any barriers (economic or otherwise) that prevent the holder (or holders) from exercising the rights. Examples of such barriers include:

- (i) financial penalties and incentives that would prevent the holder from exercising its rights.
- (ii) terms and conditions that make it unlikely that the rights will be exercised, for example, conditions that narrowly limit the timing of their exercise.
- (iii) the absence of an explicit, reasonable mechanism in the founding documents of an investee or in applicable laws or regulations that allows the holder to exercise its rights.
- (iv) the inability of the holders of the rights to obtain the information necessary to exercise their rights.
- (v) **operational barriers or incentives that would prevent (or deter) the holder from exercising its rights (eg the absence of other managers willing or able to provide the specialised services or provide the services or financial support provided by the incumbent manager).**

## **Power without a majority of the voting rights**

B34

An investor can have power even if it holds less than a majority of the voting rights of an investee. **An investor can have power with less than a majority of the voting rights of an investee, for example, through:**

- (a) **a contractual arrangement between the investor and other vote holders (see paragraph B35);**
- (b) **rights arising from other contractual arrangements (see paragraph B36);**
- (c) the investor's voting rights (see paragraphs B37–B41)
- (d) potential voting rights (see paragraphs B42–B44); or
- (e) a combination of (a)–(d).

## **Contractual arrangement with other vote holders**

B35

A contractual arrangement between an investor and other vote holders can give the investor the right to exercise voting rights sufficient to give the investor power, even if the investor itself does not have sufficient voting rights to give it power. Alternatively, a contractual arrangement might ensure that the investor can direct enough other vote holders on how to vote to enable the investor to make decisions about the relevant activities.

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## Rights from other contractual arrangements

B36

Other decision-making rights, in combination with voting rights, can give an investor the current ability to direct the relevant activities. For example, the rights within a contractual arrangement in combination with voting rights may be sufficient to give an investor the current **ability to direct some of the manufacturing processes of an investee or to direct other operating or financing activities of an investee that significantly affect the investee's returns**. However, economic dependence of an investee on the investor (such as relations of a supplier with its main customer) does not, alone, lead to the investor having power over the investee.

## The investor's voting rights

B37

An investor with less than a majority of the voting rights (considered together with all outstanding substantive potential voting rights, if any) has rights that are sufficient to give it power when the investor can unilaterally direct the relevant activities.

B38

When assessing whether an investor's voting rights are sufficient to give it power, an investor considers all available facts and circumstances, including:

(a) the size of the investor's holding of voting rights relative to the size and dispersion of holdings of the other vote holders, noting that:

- (i) the more voting rights an investor holds, the more likely it is to have existing rights to give it the current ability to direct the relevant;
- (ii) the more voting rights an investor holds relative to other vote holders, the more likely it is to have existing rights that give it the current ability to direct the relevant activities;
- (iii) the more parties that would need to act together to outvote the investor, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;

(b) potential voting rights held by the investor, other vote holders or other parties (see paragraphs B42–B44);

(c) **rights arising from other contractual arrangements; and**

(d) **any additional facts and circumstances that indicate that the investor has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.**



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## The purpose and design of an investee

### B45

In cases where voting rights or similar rights do not have a significant effect on an investee's return such as when contractual arrangements determine the direction of the relevant activities, the assessment of its purpose and design includes the consideration of the risks that the investee was designed to create, the risks it was designed to pass on to the parties involved in the transaction and whether the investor is exposed to some or all of those risks. Consideration of the risks includes not only the downside risk but also the potential for upside.

### B46

Furthermore, in determining **the purpose and design of the investee**, the investor should consider the decisions made at the investee's inception as part of its design. In addition, **contractual arrangements such as call rights**, put rights or liquidation rights established at the investee's inception need to be considered. When these contractual arrangements involve activities that are closely related to the investee, then these activities are, in substance, an integral part of the investee's overall activities, even though they may occur outside the legal boundaries of the investee. Therefore, explicit or implicit decision-making rights embedded in contractual arrangements that are closely related to the investee need to be considered as relevant activities when determining power over the investee.

### B47

For some investees, relevant activities occur only when particular circumstances arise or events occur. The investee may be designed so that the direction of its activities and its returns are predetermined unless and until those particular circumstances arise or events occur. In this case, only the decisions about the investee's activities when those circumstances or events occur can significantly affect its returns and thus be relevant activities. The circumstances or events need not have occurred for an investor with the ability to make those decisions to have power. The fact that the right to make decisions is contingent on circumstances or an event arising does not in itself make those rights protective.

### *Application examples*

- *An investee's only business activity, as specified in its founding documents, is to purchase receivables and to service them on a day-to-day basis. Upon default of a receivable the investee automatically puts the receivable to the investor as agreed separately in a put agreement between the investor and the investee. The only activity that significantly affects the returns of the investee is managing the receivables upon default. Therefore, the investor's right to manage the assets upon default should be considered when assessing the overall activities of the investee that significantly affect the returns. In this example, the design of the investee ensures that the investor has decision-making authority over the activities that significantly affect the returns at the only time that such decision-making authority is required. The terms of the put agreement are integral to the overall transaction and the establishment of the investee. Therefore, the terms of the put agreement would be considered together with the founding documents of the investee to conclude that the*

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*investor has power over the investee even though the investor takes ownership of the receivables upon default and manages the defaulted receivables outside the legal boundaries of the investee.*

- *The only assets of an investee are receivables and the only relevant activity is managing the receivables on default. The party that has the ability to manage the defaulting receivables has power over the investee, irrespective of whether any of the borrowers have defaulted.*

B48

**Being involved in the design of an investee, alone, is not sufficient to give an investor control. However, involvement in the design may indicate that the investor had the opportunity to obtain rights that are sufficient to give it power over the investee.**

B49

An investor may have an explicit or implicit commitment to ensure that an investee continues to operate as designed. Such a commitment may increase the investor's exposure to the variability of returns and, thus, the likelihood that it has power. However, a commitment to ensure that an investee operates as designed does not, alone, give an investor power, nor does it prevent another party from having power.

## **Exposure, or rights, to variable returns from an investee**

B50

**When assessing whether an investor has control of an investee, the investor determines whether it is exposed, or has rights, to variable returns from its involvement with the investee.**

B51

Returns have the potential to vary as a result of the performance of an investee and can be positive, negative or both (see paragraph 15). An investor assesses whether returns from an investee are variable and how variable those returns are on the basis of the substance of the arrangement and regardless of the legal form of the returns. For example, an investor can hold a bond with fixed interest payments. The fixed interest payments are variable returns for the purpose of this IFRS because they expose the investor to the credit risk of the issuer of the bond and the amount of variability (i.e. how variable those returns are) will depend on the credit risk of the bond. **Similarly, fixed performance fees for managing an investee's assets are variable returns because they expose the investor to the performance risk of the investee. The amount of variability will depend on the investee's ability to generate sufficient income.**

B52

Examples of returns include:

(a) dividends, other distributions of economic benefits from an investee (eg interest from debt securities issued by the investee), and changes in the value of the investor's investment in that investee.

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(b) **remuneration for servicing an investee's assets** or liabilities, fees and exposure to loss from providing credit or liquidity support, residual interests in the investee's assets and liabilities on liquidation of that investee, tax benefits, and access to liquidity that an investor has from its involvement with an investee.

(c) **returns that are not available to other interest holders.** For example, an investor might use its assets in combination with the assets of the investee, such as combining operating functions to achieve economies of scale, cost savings, sourcing scarce products, gaining access to proprietary knowledge or limiting some operations or assets, to enhance the value of the investor's other assets.

## **The scope of the decision-making authority**

B58

**The scope of an entity's decision-making authority is evaluated by considering:**

(a) **the range of activities that it is permitted to direct according to the decision-making agreement(s)**, including those specified by law, and

(b) the discretion that it has when making decisions about those activities.

B59

**Consideration shall be given to the level of influence the decision-maker had in determining the restrictions on its decision-making authority.**

For example, if the decision-maker (either individually or together with other parties) determined the founding documents of the investee or other documents that determine decision-making rights, the activities that are embedded in those documents that the decision-maker may perform shall be considered part of the decision-maker's authority.

## **Rights held by other parties**

B60

Even if a decision-maker has the ability to direct the relevant activities, substantive removal rights held by other parties (or similar rights such as some liquidation or redemption rights) may indicate that the decision-maker is an agent.

B61

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. This is the only factor that, in isolation, can result in a conclusion that a decision-maker is an agent. If numerous parties hold such rights (and no individual party can remove the decision-maker without the agreement of other unrelated parties) those rights would not, in isolation, be conclusive in determining whether a decision-maker is an agent.

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B62

Restrictions on a decision-maker's discretion, as a result of rights held by others, shall be considered when evaluating whether the decision-maker is an agent. An investor that is required to obtain approval from other parties for its actions is generally an agent. (See paragraphs B18–B21 for additional guidance on rights and whether they are substantive.)

## Remuneration

B63

The remuneration of the decision-maker shall be considered in determining whether it is an agent. Accordingly, the following should be considered:

- (a) whether the remuneration of the decision-maker, for providing its services, is commensurate with the level of skills needed to provide the services.
- (b) whether the remuneration agreement includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated on an arm's length basis.**
- (c) the magnitude of, and variability associated with, the decision-maker's remuneration agreement relative to the investee's returns that are expected of the investee.

