20 March 2009

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

Submitted via www.iasb.org "open for comment"

Dear Sir/Madam

Exposure Draft 10 Consolidated Financial Statements

We are pleased to submit this comment letter on the International Accounting Standards Board's (the Board) Exposure Draft 10 Consolidated Financial Statements (Exposure Draft).

We are submitting these comments on behalf of the Real Estate Equities Securitisation Alliance (the Alliance), which includes the following real estate organisations:

- Asian Public Real Estate Association (APREA)
- British Property Federation (BPF)
- European Public Real Estate Association (EPRA)
- National Association of Real Estate Investment Trusts (NAREIT)® (U.S.)
- Property Council of Australia (PCA)
- Real Property Association of Canada (REALpac)

The Alliance represents publicly traded real estate companies and Real Estate Investment Trusts (REITs) in the United Kingdom, Europe, Australia, Asia, and North America. Our members are real estate companies and other businesses that develop, own, operate and finance investment property, as well as those firms and individuals who advise, study and service those businesses.

One of the major goals of the Alliance is to enhance the comparability of financial information between real estate companies worldwide.

In Summary, the Alliance believes that:

- The control principle would be an appropriate basis for consolidation if the control assessment criteria for structured entities were integrated into the control assessment outlined in paragraphs 12-29.

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- Additional clarity and guidance is required around assessing control, with particular emphasis on related arrangements, the power to direct without a majority of voting rights, and the assessment of returns.

- Clarity is required on how the assessment of control is performed when contradictory indicators exist. Relevant Illustrative Examples (in particular, ones from outside the financial services sector) would assist with this objective.

- Consolidation would not be appropriate in agency arrangements where all arrangements are at arm's length and the agent acts in a fiduciary capacity in the best interests of investors.

- The disclosure requirements in relation to non consolidated structured entities are onerous and may not assist users' understanding of the financial statements. It is doubtful whether such information could be obtained by the reporting entity.

We attach our submission which sets out our detailed comments on the Exposure Draft.

Members of the organisations identified above would be pleased to meet with the Board or its staff to discuss any questions regarding our comments.

We thank the Board for this opportunity to comment on the proposal.

Please contact Genevieve Hutcheson, Chair of the Property Council of Australia Accounting Roundtable at genevieve.hutcheson@gpt.com.au if you would like to discuss our comments.

Roberto Fitzgerald
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Property Council of Australia

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Comment Letter Submitted by the Property Council of Australia

On behalf of the Real Estate Equities Securitisation Alliance (REESA) which includes the following organisations:

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In response to the

Exposure Draft 10 Consolidated Financial Statements

Issued by the International Accounting Standards Board

December 2008

Most member companies of the organisations submitting comments in this letter have been consolidating entities under IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities*. United States and Canada consolidate under requirements similar to IAS 27, and have additional standards that address variable interest entities.

The application of these standards has not been entirely satisfactory, with certain common factual scenarios being dealt with in inconsistent ways.

One common arrangement is where a reporting entity acts as an investment advisor to a fund in which the reporting entity also has an investment.

The existing standards are interpreted and applied in widely differing ways to such cases.

We understand that the aim of the Exposure Draft is to propose an IFRS that improves financial reporting by clarifying the principles that determine when a reporting entity should consolidate another entity.

In particular the Board aims to issue a single IFRS on consolidation, clarify the definition of control of an entity, address application issues and require enhanced disclosures about consolidated and unconsolidated entities.

This is an important project and we fully support the objectives of issuing a single standard for consolidation and improving the disclosure requirements about consolidated and unconsolidated entities.

Furthermore, we believe that applying a single definition of 'control' to all entities is the right basis for the consolidation model.

However, as more fully discussed below, we are concerned that the Exposure Draft proposed by the IASB may still result in a divergence of interpretations on when an entity should be consolidated.

Our major concern is that the guidance in the Exposure Draft is ambiguous and inconsistent in a number of fundamental areas.

We consider that all standards should be clear and workable to be of maximum value to preparers and users of accounts.

Without a clear definition of 'control', the resulting standard may be difficult to interpret and apply on a consistent basis, and financial statements of groups will become less, and not more, comparable and understandable.

We are also concerned that the proposals of the Exposure Draft are not clear on how related party transactions should be considered when looking at "other arrangements" to determine whether control exists.

We welcome the opportunity to contribute to this important project to develop one control model for all entities.

Definition of Control

Under the proposed definition of control "a reporting entity controls another entity when the reporting entity has the power to direct the activities of that entity to generate returns for the reporting entity".

When assessing control, a reporting entity must consider power and returns together, and how the reporting entity can use its power to affect the returns.

Assessment is continuous and must take into account related party arrangements and the total returns that the reporting entity receives from that entity.

When assessing power, the Exposure Draft assumes that there are "voting rights and other arrangements", where as in the case of structured entities, it assumes that there are no voting rights and it is instead necessary to look at how the returns are shared and how decisions are made about the activities that affect those returns.

<u>Assessment of control</u>

The requirement to assess separately the power between an entity with voting rights and a structured entity when assessing the purpose and design, returns and activities, has resulted in a hierarchy under which one considers power and voting rights first, before considering returns from the involvement of the entity. We note that the Board envisages that a structured entity is unlikely to differ significantly from a special purpose entity (SPE) under SIC 12; however, the existence of voting rights does not currently prevent SIC-12 from applying.

The structure of the Exposure Draft seems to create a two layered assessment of control based on entities with voting rights and those without (structured entities). We do not support a control model based on creating two categories of entity and assessing control differently for each category. We believe much of the guidance for structured entities is useful in the assessment of control of all entities and prefer a single definition and assessment process to drive decisions on consolidation.

- We believe there is a natural layering within the Exposure Draft which makes it unnecessary to distinguish between an entity having voting rights (paragraphs 23-29) and structured entities having no voting rights (paragraphs 30-38). In addition, in the light of the Board's main objective of developing a control model that can be applied to all entities, it is surprising that the Exposure Draft should then identify two types of entity (structured entities and other entities) and that, having done so, it then adopts a different approach to 'control' for each type of entity.

- We suggest that the Board should, to the extent possible, integrate the control assessment criteria for structured entities into the control assessment outlined in paragraphs 12-29. For example related arrangements (paragraph 37) could be incorporated into paragraph 18.

Definition of structured entities

If however the Exposure Draft is to retain the distinction between entities with voting rights and structured entities then we do not believe that the definition in paragraph 30 provides clear guidance around what constitutes a structured entity.

- We note that there is an inconsistency in the definition of a structured entity in that it is implied that a structured entity is not controlled through a governing body, yet control should presumably be assessed in the normal way (based on the power to direct the activities of the structured entity to generate returns).

- For example, an entity may have been established, for legal and warranty reasons, for the development of a specific property. The entity, which would typically have a governing body, may have a limited life and be wound up at the end of the project. The entity would normally have a governing body because there are specific decisions required to be made throughout the life of the development; it cannot be run on autopilot. It is our view that this type of entity is not intended to meet the definition of a structured entity, but the guidance in relation to activities and the 'purpose and design' (paragraph 32) could be interpreted differently and an alternative conclusion reached. The actions that the reporting entity has taken in the past may also be relevant to assessing control when considering the extent to which the scope of activities or an entity are predetermined or not.

- Clear guidance is required in relation to what type of entity should be captured by the structured entity definition. We note that the draft Illustrative Examples 2-4 focus on the transactions and activities of financial institutions. To provide practical examples, we suggest that other transactions and companies in the non-financial services sector are provided so there is clarity around the Board's view of what type of entities should be captured. We believe that a broader range of examples could be very helpful in ensuring consistent interpretation and application of the 'structured entity' definition.

Disclosure Requirements

The disclosure requirements proposed in the Exposure Draft appear voluminous particularly in relation to involvement with unconsolidated structured entities.

We believe this may present a number of issues:

- Requiring substantial disclosures for structured entities may create a pressure to avoid this categorisation.

- While Paragraph B31 implies judgement should be used to assess the level of disclosure paragraphs B32-B49 appear to require a lengthy list of disclosures. In some cases this information may not be readily available to the reporting entity, especially where its influence over the structured entity is limited.

- Providing this additional information may distract users from the relevant information, and may invite users of the financial statements to form an alternate view as to the appropriateness of management's decision to not consolidate.

A more principles based approach to disclosure would be more appropriate with reporting entities providing sufficient, relevant information targeted to assist users to understand the impact on profit or loss, liquidity and capital resources of a reporting entity's off balance sheet arrangements.

Fund Management

Many of our members manage funds and provide development management, construction, property management and investment management services to these funds. The structure of each arrangement varies enormously from country to country based on the local legal and tax requirements and from company to company and case to case, based on the services being provided and investor requirements.

At a fairly general, indicative level, in a typical structure:

- Related party arrangements may:

  (i) allow for performance fees which vary according to a performance measure related to the fund's returns,

  (ii) have clauses which state that the related party can only be removed under the contract "with cause".

- Funds may be managed by a board *or "governing body"* which is:

  (i) independent, or

  (ii) not independent, but where investors can vote to replace the board *or "governing body"* and a majority shareholder vote is required on significant decisions.

- Members may co-invest in these funds to show alignment of economic interests with investors and the co-investment may carry voting rights and board *or "governing body"* representation.

A typical fact set which we believe emphasises the difficulty in interpreting the Exposure Draft is that described below.

Entity A provides development, construction and property management services to Trust B, for which it receives arm's length fees. The Trustee of Trust B is a related entity of Entity A but has a majority of independent directors on its board. Entity A can be removed from its contractual arrangements by the Trustee only with cause. Entity A has no equity interest in Trust B.

It is not clear if, for the purposes of assessing control, the focus should be on the following:

- Does the absence of any equity interest in Trust B mean that, by definition, Entity A does not have control? Would this conclusion differ if Entity A had a 2%, 10%, 20%, or 40% equity interest and, if so, what is the "tipping point"? Does this "tipping point" change depending upon the degree to which the remaining equity holdings are widely spread? Is the control decision influence based on historic voting patterns of, or inaction by, other co-investors?

- Does the existence of a performance fee component to the management fees, and the variability in returns this introduces, in itself alter the control decision? Or should the focus be on the overall quantum of returns – fixed and/or variable?

- Does the assessment alter depending on whether the variable fee arrangement provides upside returns to Entity A while exposing the unitholders to downside risks, rather than an equal sharing of risks and returns between the parties?

- Is the existence of removal rights, of itself, sufficient to demonstrate that Entity A does not control Trust B? Is this conclusion the same if it can only be removed "with cause"? Would the decision change if there was the existence of pre-emptive rights in the event of removal?

We agree that it is appropriate to consider both direct equity interests and agent responsibilities when assessing control, but we believe that many cases would arise in practice in which the indicators of control are contradictory, necessitating judgments and making it very difficult to achieve consistent application of the Exposure Draft. We would therefore recommend the inclusion of examples on the 'control' borderline, to clarify whether a reporting entity should be regarded as controlling a fund in such cases.

Our view is that consolidation would not be an appropriate outcome where all arrangements are at arm's length, and the reporting entity is an advisor which can only make recommendations to a majority independent board of directors *or "governing body"*, and is required to act in a fiduciary capacity in the best interests of investors. On this basis the reporting entity cannot control entity for its own benefits.

We now provide further detail on our views on certain of the control indicators outlined in the Exposure Draft.

<u>Agency relationship concept</u>

We believe that a reporting entity should only consolidate assets over which it bears the risks. Hence we fully support the inclusion of the agency relationship concept in the exposure draft. The concept underlies the reason why a reporting entity can have power over another entity without that power being used to generate returns for the reporting entity itself.

In circumstance where the investment manager of a fund (who is both an investor and is operating the fund as an agent of the investors collectively) does not have the power to direct activities in order to generate a return in its capacity as an agent, we believe that the control by the reporting entity in its capacity as an investor should be assessed separately from this agency relationship in determining whether the reporting entity has control over the fund.

We would strongly encourage the Board to ensure that the principles of the agency relationship (B3-B8) and paragraph B11 remain in the final standard. In order to clarify the interpretation in the final standard we believe that paragraph 31 should specify that, when assessing control of a structured entity, B11 should also be considered.

<u>Related Party Arrangements</u>

The Exposure Draft notes that the terms of all related arrangements should be considered when assessing control (paragraph 17), however the Exposure Draft does not clearly address how the existence of such arrangements fits into an assessment of control or how to deal with related party arrangements in general. The contractual position will not always be determinative of whether a reporting entity has the power to direct the activities of the entity and hence is not automatically an indicator of control.

In the property industry, related party agreements such as development management, construction, property management and investment management contractual agreements are usually entered into at the commencement of a Fund on an arm's length basis where the reporting entity acts purely as a service provider. We believe that the existence of related party arrangements at the commencement of the fund does not automatically imply that a reporting entity has the power to direct the activities of the entity.

<u>Removal rights</u>

Where the local jurisdiction's legislation permits, it is common for contractual arrangements to allow shareholders to remove the manager or advisor only 'with cause', i.e., if there is a contractual breach that remains unremedied.

We do not believe that the lack of ability to remove the manager/advisor should result in that manager/adviser, as a reporting entity, being considered to control an entity provided the manager/adviser is still bound by a fiduciary duty to act in the best interests of all shareholders and is subject to approvals from an independent board of directors *or "governing body".*

Assessing Returns

The definition of 'returns' in paragraphs 19 and 20 is unclear and ambiguous. There is limited guidance in the Exposure Draft on how the notion of "returns" will work in practice.

For example:

- A reporting entity may have voting rights in an entity through a co-investment or other equity interests and also independently derive fees through other contractual arrangements. It is unclear how the returns, fixed and variable, received by such reporting entities are to be assessed in the context of determining control.

- A reporting entity which is a fund manager/adviser may be remunerated via a base fee and performance related fee. The adviser is therefore only exposed to variability in positive returns, with no downside risk because there is no capital investment at risk. On this basis, we would not expect the arrangement to need to be considered in assessing returns for the purposes of the control criteria outlined in paragraph 12, because there is not variability in both positive and negative returns. However, the Exposure Draft is not clear that this would in fact be the conclusion.

Further, we agree that a quantitative assessment of returns is not appropriate in assessing control but more guidance is required as to the practical implications. Directly introducing the assessment of return among the criteria of power described in paragraph 31b and discussing returns further in paragraph 33 could lead to confusion that, for structured entities, the significance of returns is sufficient evidence of power. This could result in conclusions that are not in accordance with the underlying control model and would lead to inconsistencies in the application of this model between normal and structured entities. Consistent with this view, it would be helpful for paragraphs B6(b)and (c) to be removed, as they imply that a quantitative analysis is, in fact, necessary in relation to the remuneration of agents.

It would also be helpful for the Illustrative Examples to be expanded to provide a comprehensive worked example of how to assess 'returns'. We would particularly welcome the inclusion of non-financial services sector examples.

We also believe that these improvements would prevent the outcome in the property industry whereby a reporting entity that has only a small equity interest in another entity and has exposure to positive returns by contractual arrangements is required to consolidate the entity.

We believe that references in the exposure draft to the concept of variability of returns and particular paragraph 33 are potentially confusing and open to mis-interpretation. If the returns generated are not significant we do not believe that it should be concluded that control exists. However paragraph 4 could suggest that whatever the level of returns, even if they are not significant, a reporting entity controls another entity if it has the power to direct its activities. In order to avoid any unintended consolidation, we believe that paragraph 4 should add that the returns must be significant. We believe it would be helpful to provide additional guidance on assessing 'significance.'

Our overarching concern with the assessment of returns in the context of agency relationships is that the Exposure Draft may result in the consolidation of entities, for example in some of the cases outlined above, which we believe is not the intent of the Exposure Draft. The outcome of this is that financial statements would be misleading to users, particularly in the case of any consolidation of entities with small equity interests, primarily due to the following:

- Significant allocation of profit and retained earnings to minority interests. This would artificially expand the 'size' of the reporting entity – revenues, assets, liabilities.

- In the property industry, the entities that hold the properties often will have borrowings that are non-recourse to shareholders and so in any case the consolidation of 100% of debt would not provide any meaningful information and could well be misleading because the reporting entity does not have the obligation to repay the debt in the event of default by the underlying entity.

Summary of Alliance Views

In Summary, the Alliance believes that:

- The control principle is an appropriate basis if the control assessment criteria for structured entities were integrated into the control assessment outlined in paragraphs 12-29.

- Additional clarity and guidance is required around assessing control with particular emphasis on related arrangements, the power to direct without a majority of voting rights and the assessment of returns.

- Clarity is required on how the assessment of control is performed when contradictory indicators exist. Relevant Illustrative Examples (in particular, ones from outside the financial services sector) would assist with this objective.

- Consolidation would not be appropriate in agency arrangements where all arrangements are at arm's length and the agent acts in a fiduciary capacity in the best interests of investors.

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