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March 19, 2009

International Accounting Standards Boards
30 Cannon Street
London EC4M 6XH
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Dear Sir or Madame,

Comments on the Exposure Draft ED10
"CONSOLIDATED FINANCIAL STATEMENTS"

We appreciate the efforts of the International Accounting Standards Board (IASB) on the consolidated financial statements project and welcome the opportunity to comment on the Exposure Draft ED10 "Consolidated Financial Statements" (the draft IFRS). The views described below are those expressed by the Technical Committee for Special Purpose Entities (SPEs) in the Accounting Standards Board of Japan (ASBJ). In the Technical Committee, we have deliberated issues mainly on the scope of consolidation, including SPEs, under Japanese accounting standards and also discussed the ED10 to provide comments to the IASB.

Summary

(1) We are of the view that the proposed control definition will be an appropriate basis for consolidation to all entities. However, the draft IFRS could lead to the application difficulties because it is not always clear how the components of control, that are power and returns, are considered in the draft IFRS. Hence, it would be necessary to improve the draft IFRS in some aspects (See paragraphs 1 and 2 of this letter).

(2) In particular, we are of the view that requirements and guidance regarding power without a majority of the voting rights (paragraphs 27, 29 and B9 to B16 of the draft IFRS) need to be amended appropriately in order to clarify that whether a reporting entity has the power to direct the activities of entities other than structured entities are assessed based on the voting rights (See paragraphs 3 to 7 of this letter).

(3) We recommend defining the structured entity as an entity whose activities could not be directed through the voting rights (See paragraphs 13 to 15 of this letter). As the requirements and

guidance regarding the assessment of control of a structured entity may not be sufficient to enable consistent application of the control definition, we recommend that, in addition to the improvement of the proposed requirements and guidance, development of practical illustrative examples will be added to facilitate the understanding of those in application (See paragraphs 16 to 18 of this letter).

Comments on Question 1 to Question 12

Our comments on the questions which are set out in the draft IFRS are provided below. We hope that these help the IASB in its forthcoming deliberations in this project.

I. Control

Question 1: Do you think the proposed control definition could be applied to all entities within the scope of IAS 27 as well as those within the scope of SIC-12? If not, what are the application difficulties?

Question 2: Is the control principle as articulated in the draft IFRS an appropriate basis for consolidation?

Response to Question 1 and 2:

1. We are of the view that the proposed control definition will be an appropriate basis for consolidation to all entities because it includes both power and returns together as its components and could be applied to entities that do not necessarily require a governing body.
2. However, the draft IFRS could lead to the application difficulties because it is not always clear how the components of control, that are power and returns, are considered in the draft IFRS. Our comments are stated in detail below.
   (1) Comments on entities other than structured entities without a majority of the voting rights: Paragraphs 3-7 of this letter (in relation to Q3)
   (2) Comments on entities other than structured entities with a majority of the voting rights: Paragraph 10 of this letter (in relation to Q4)
   (3) Comments on structured entities: Paragraphs 16-18 of this letter (in relation to Q7)

II. Assessing control

Power without a majority of the voting rights

Question 3: Are the requirements and guidance regarding the assessment of control sufficient to enable the consistent application of the control definition? If not, why not? What additional guidance is needed or what guidance should be removed?

Response to Question 3:

3. We don't necessarily think that guidance of the draft IFRS regarding power without a majority of the voting rights (paragraphs 26 to 29 and paragraphs B9 to B16 of the draft IFRS) is sufficient to enable the consistent application of the control definition.
4. First of all, we propose that description of paragraph 27(a) of the draft IFRS be changed to "the reporting entity has high percentage and more voting rights than any other party" and that a case that "the reporting entity has a majority of the voting rights, in the aggregate, together with other vote holders who agree to exercise voting rights for the reporting entity and who act for a reporting entity " is added in paragraph 27(a) of the draft IFRS so that the proposed requirements will be effectively implemented in practice (See paragraph 5 of this letter). Secondly, we propose that paragraph 27(b) of the draft IFRS is to be amended as "the reporting entity's voting rights in conjunction with other involvements", and that its guidance is tuned up in a practical manner for the reporting entity to sufficiently have the ability to determine the other entity's strategic operating and financing policies (See paragraphs 6 and 7 and Appendix 1of this letter).
5. Paragraph 27 of the draft IFRS provides that a reporting entity with less than half of the voting rights has the power to direct the activities of another entity if:

   (a) the reporting entity has more voting rights than any other party; and

   (b) the reporting entity's voting rights are sufficient to give the reporting entity the ability to determine the entity's strategic operating and financing policies.

   As an example, paragraph 28 of the draft IFRS provides that a reporting entity is the dominant shareholder that holds voting rights and all the other shareholders with voting rights are widely dispersed and are not organized in such a way that they actively co-operate. However, it is not clear in practice how many voting rights of the other shareholders will be exercised in such a way. We are particularly concerned that such guidance in paragraph 27 of the draft IFRS might be applied only when holding of the voting rights are very close to the majority (i.e., 49.9%) or might not be applied at all in practice, judging from the past experience about the application of existing IAS 27[1],. Accordingly, we are of the view that additional description that "the reporting entity has high percentage of the voting rights[2]" in paragraph 27 (a) of the draft IFRS would rather enhance a feasibility. In addition, the requirement would be more applicable if a case that the reporting entity has a majority of the voting rights, in the aggregate, together with other vote holders who agree to exercise voting rights for a reporting entity (like paragraph B10) and who act for a reporting entity (like paragraph B12) is added in paragraph 27 (a) as well. (See Appendix 1)

6. Moreover, in case of power without a majority of the voting rights, the guidance provided in paragraphs B9 to B16 of the draft IFRS needs to be tuned up so that the criterion whether the reporting entity could sufficiently determine the other entity's strategic operating and financing policies, as described in paragraph 27 (b) of the draft IFRS, can be applied practically. Among these guidance, we consider that paragraph B13 (holding option and convertible instruments) and paragraph B16 (economic dependence) are appropriate in addition to paragraph B10 (an agreement between a reporting entity and other vote holders to exercise the voting rights for a reporting entity) and paragraph B12 (parties that act for a reporting entity) because they explain how a reporting entity has the power to direct the activities of another entity in relation to the case that the entity has a majority of the voting rights.
7. On the other hand, indicators articulated in paragraph B9 and other arrangements articulated in paragraphs B14 and B15 are not clear in relation to the possession of a majority of the voting rights to give the reporting entity the ability to determine the entity's strategic operating and financing policies. As articulated in paragraph B16 (economic dependence), indicators as a result of involvements and arrangements could give power when used in combination with the voting rights. However, if they have no conjunction with the voting rights, it is not necessarily provide power to the reporting entity. Hence, we propose that paragraph 27(b) of the draft IFRS be amended as "the reporting entity's voting rights in conjunction with other involvements" so as

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1 Although the existing IAS 27 paragraph 13 contemplates that a party can control another entity without owning more than half of voting right, it is said that there are diversity and difficulties of such application in practice (Paragraph BC15(a) and BC70 and paragraph 150 of Discussion paper "Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity.")

2 The accounting standard for consolidation in Japan that was issued in 1999 provides guideline that an entity with less than half of the voting rights has the power to direct the activities of another entity and then controls a subsidiary. Subsequent to such issuance, it has been widely implemented as well as a case that an entity with majority of the voting rights since last decade. This description is included in that standard has actually materialized a notion of control with holding less than the majority of the voting right in another entity. (See Appendix 3)

to sufficiently give the reporting entity with less than half of the voting rights the ability to determine the other entity's strategic operating and financing policies, and propose following improvements:

(1) In order to clarify that entities other than structured entities are assessed based on the voting rights, the first sentence of paragraph 29 of the draft IFRS (a reporting entity can also have the power to direct the activities of another entity by means of other arrangements.) be eliminated or be amended as an application guidance of paragraph 27(b) to add a phrase of "using it in combination with the voting rights."

(2) Make the second sentence of paragraph 29 (paragraphs B9 to B16 provide application guidance) as a separate paragraph so that paragraphs B9 to B16 could provide application guidance for paragraph 27 (b) of the draft IFRS to assess whether a reporting entity sufficiently has the ability to determine the other entity's strategic operating and financing policies.

(3) As paragraphs B9, B14 and B15 of the draft IFRS should be dealt with in relation to the voting rights, make amendments to these paragraphs as application guidance for paragraph 27 of the draft IFRS.

Options and convertible instruments

Question 4: Do you agree with the Board's proposals regarding options and convertible instruments when assessing control of an entity? If not, please describe in what situations, if any, you think that options or convertible instruments would give the option holder the power to direct the activities of an entity.

Response to Question 4:

8. We agree with the Board's proposals regarding options and convertible instruments when assessing control of an entity. This is because the guidance described in paragraph B13 of the draft IFRS would be appropriate as an application of paragraph 27 of the draft IFRS which indicates a reporting entity with less than half of the voting rights can have the power to direct the activities of another entity if something are used in combination with the voting rights.

9. We acknowledge that there is an alternative view regarding this question (that is a view as described in paragraphs AV4-8, that holding exercisable options of other rights that if exercised would represent power to control should always be considered as being in control). This alternative view is based on the conclusion, in accordance with latter half of paragraph 8 of the

draft IFRS, that an entity with a majority of the votes necessary to elect the governing body is always in control even if it never exercises its rights to vote (paragraphs BC48(a) and AV3).

10. We are of the view that the entity with a majority of the voting rights but never exercises its rights to vote should be within the scope of paragraph 25 of the draft IFRS, and add the disclosure requirements to paragraph B32. By doing so, we believe that the Board is able to deal with the alternative view.
11. Furthermore, we are of the view that it is not necessary for the draft IFRS to indicate "by having options or convertible instruments to obtain the voting rights" (paragraph 8) as a means of giving the power to direct the activities of another entity. In light of the description of paragraph B13 of the draft IFRS, possession of exercisable option is to be dealt with in the context of the voting rights, and thus such description of' by having options separately as a means of giving the power to direct the activities of another entity will lead to misunderstanding.

Dual role

Question 5: Do you agree with the Board's proposals for situations in which a party holds voting rights both directly and on behalf of other parties as an agent? If not, please describe the circumstances in which the proposals would lead to an inappropriate consolidation outcome.

Response to Question 5:

12. We agree with the guidance for situations of a dual role described in paragraph B11 of the draft IFRS. This is because paragraph B11, which do not always conclude all cases in the same light but indicates that the reporting entity excludes the voting rights it holds as an agent only if the reporting entity can demonstrate that it is obliged to act in the best interests of those other parties, would be appropriate although the line between principal and agent when a party has a dual role is blurred as considered in paragraphs BC91 to BC95.

Structured entities

Question 6: Do you agree with the definition of a structured entity in paragraph 30 of the draft IFRS? If not, how would you describe or define such an entity?

Response to Question 6:

13. We advocate the use of consistent control criteria in the draft IFRS in contrast with IAS 27 and SIC-12, and observe that the term structured entity is for identifying the disclosure requirements related to that entities and for providing guidance to identify the controlling party of that entities (paragraph BC98). We also observe that, in the draft IFRS, whether an entity is a structured entity should not affect the control assessment (paragraph BC109)[3].
14. Although it is merely such usage as terminology, we do not support the definition of a structured entity in paragraph 30 of the draft IFRS, which is an entity whose activities are restricted to the extent that those activities are not directed as described in paragraphs 23 to 29. This is because, in paragraph 29 of the draft IFRS, a reporting entity can also have the power to direct the activities of another entity that is other than structured entities by means of other arrangements, and therefore, if it is the case, the line between structured entities and entities other than structured entity is blurred (See [Illustration 1] of Appendix 2 of this letter). Hence, we consider that the definition of a structured entity in paragraph 30 of the draft IFRS is not robust enough unlike the description in paragraph BC140 of the draft IFRS.
15. In order to make the definition more robust, we recommend defining the structured entity as an entity whose activities could not be directed through voting rights[4]. This is consistent with the Board's conclusion that it should define a structured entity as one for which control could not be assessed in a typical manner such as by assessing voting rights or control of the entity's governing body (paragraph BC106). In addition, because structured entities often do not have typical governance structures (paragraph BC98), and there is no single, simple test for assessing control of a structured entity (paragraph BC116), the definition we have recommended is consistent with the objective of the draft IFRS which is to provide additional guidance for assessment of control. (See [Illustration 2] of Appendix 2 of this letter) Further, it would be helpful to capture structured entities by indicating a character such as a narrow well-defined purpose, a limited range of activities in which they are permitted to engage and predetermined strategic policies.

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[3] The accounting standard for consolidation in Japan that was issued in 1999 has applied common control criteria for both normal operating entities and special purpose entities. (See Appendix 3) However, it does include a rebuttable presumption that certain SPEs are not under control even if they satisfy "de fact control/ effective control" criteria. This issue is currently being revisited.

[4] In this connection, the draft IFRS describes entity other than structured entities as "an entity whose activities are directed through voting rights" (paragraph B32(a) and (b)). Also the proposed amendment to FIN 46 (R) often uses a term of "voting interest entity."

Question 7: Are the requirements and guidance regarding the assessment of control of a structured entity in paragraphs 30-38 of the draft IFRS sufficient to enable consistent application of the control definition? If not, why not? What additional guidance is needed?

Response to Question 7:

16. We have negative response to this question that the requirements and guidance regarding the assessment of control of a structured entity are sufficient to enable consistent application of the control definition.
17. The reasons why we do not advocate are that there might be inconsistencies and ambiguity such as the following points.

(1) As mentioned, the guidance regarding power without a majority of the voting rights (paragraphs 29 and B9 to B16 of the draft IFRS) may not be enough to apply consistent control criteria (See paragraphs 3 to 7 of this letter). Given whether an entity is a structured entity should not affect the control assessment, the guidance regarding the assessment of power of a structured entity in paragraph 34 of the draft IFRS needs to be consistent with the improved guidance regarding power without a majority of the voting rights. (See [Illustration 2] of Appendix 2 of this letter)

(2) Paragraph 21 of the draft IFRS describes that a reporting entity shall assess whether it has power to direct the activities (a) of an entity by having the voting rights or other arrangements and (b) of a structured entity. However, paragraphs 30 to 38 referred in (b) above (in case of structured entities) provides the requirements and guidance for assessing control which includes not only power but also return, which seem not to be systematized.

(With regard to paragraph 21 of the draft IFRS, it will be revised based upon our proposal commented in paragraphs 14 and 15 and Appendix 2 of this letter: A reporting entity shall assess whether it has power to direct the activities (a) of an entity through voting rights, or (b) of the structured entity.)

(3) Paragraph 22 of the draft IFRS does not distinguish (a) and (b) of paragraph 21 stated above (1), and describes a reporting entity has the power to direct the activities of another entity if it can determine that other entity's strategic operating and financing policies[5]. However, this differs from the understanding that having power to direct the strategic operating and financing policies

[5] Paragraph BC105 of the draft IFRS describes that decisions in a structured entity as strategic because this is more consistent with how predetermined policies are described in SIC-12.

is one means of having power to direct the activities of another entity[6], as stated in paragraph 12 of introduction section and paragraphs BC44 to BC46 of the draft IFRS. (See [Illustration 2] of Appendix 2 of this letter)

(4) The first half of the paragraph 31 of the draft IFRS describes that, when assessing control of a structured entity, it is necessary to identify how returns from the entity's activities are shared and how decisions, if any, are made about the activities that affect those returns. This is likely to correspond to the assessment of particular facts and circumstances stated in paragraph BC116. On the other hand, the second half of the paragraph 31 also describes that a reporting entity shall consider all relevant factors and circumstances. The relationship between first and second half of the paragraph 31 of the draft IFRS is not clear.

(5) Although paragraph BC102 of the draft IFRS describes that it makes a distinction between two concepts in the SPE that are limiting the activities and predetermining the action, guidance for activities of a structured entity and power to direct activities of those entities described in paragraphs 34 to 36 show a mixture of these two concepts and make it more difficult to understand.

18. The requirements and guidance regarding the assessment of control of a structured entity by considering items pointed out in the preceding paragraph need to be improved. Subject to such improvement, practical illustrative examples are to be additionally developed to facilitate the understanding of those in application.

Question 8: Should the IFRS on consolidated financial statements include a risks and rewards "fall back" test? If so, what level of variability of returns should be the basis for the test and why? Please state how you would calculate the variability of returns and why you believe it is appropriate to have an exception to the principle that consolidation is on the basis of control.

Response to Question 8:

19. We are of the view that the IFRS on consolidated financial statements should not include a risks and rewards "fall back test." Reasons are as follows:

(1) removing quantitative analysis provides a more principles-based approach,

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[6] Similar argument can be seen in paragraph AV7, that is, "determining strategic operating and financing policies and directing activities are not the same thing. This document uses these two terms as though they were synonymous."

(2) removing quantitative analysis enables more feasible ongoing assessments in practice, and

(3) because quantitative analysis is a bright line approach, preparers or auditors may rely on quantitative analysis even if such analysis is not primarily required under IFRS.

20. With respect to assessing returns in the draft IFRS, it would be suitable based upon our following understandings:

(1) Position of assessing returns

Control entails an entity using power for its own benefit or return and is not used as a synonym of power to exclude act only as a trustee or agent (Paragraphs BC52 and BC55). Although power to direct the activities of another entity is generally correlated with its exposure to the variability of returns from that other entity (Paragraphs 13), fluctuations in the reporting entity's returns without a change in the reporting entity's power do not cause that reporting entity to obtain or lose control of that other entity. Accordingly, assessing returns would be secondary position.

(2) Criteria for assessing returns

According to descriptions of paragraphs 11, 13 and 33 of the draft IFRS, assessing returns from a reporting entity's involvement with an entity considers its exposure to the variability, not its volume.

(3) Application for criteria of assessing returns

Paragraphs 13 of the draft IFRS describes that a reporting entity's power to direct the activities of another entity is generally correlated with its exposure to the variability of returns from that other entity, and then the draft IFRS indicates the following guidance:

- Generally, the more a reporting entity is exposed to the variability of returns, the more power the reporting entity is likely to have to direct the activities of that entity (paragraph 33).
- A reporting entity is likely to have power to direct the activities of a structured entity if it is exposed to the variability of returns that are potentially significant to the structured entity and the reporting entity's exposure is more than that of any other party (paragraph 33).
- A reporting entity discloses the basis for its assessment and any significant assumptions or judgments when the reporting entity has concluded that it does not control a structured entity from which the reporting entity receives returns that are potentially significant to the structured entity (paragraphs B32 and BC127).
- If a reporting entity has no means of directing or managing the activities of an entity, it does not have any ability to affect its returns from its involvement with that entity, and thus the reporting entity does not have the power to direct the activities and would not control the entity, even

though it might be exposed to risks associated with the structured entity. It is more appropriate for the reporting entity to account for and disclose its exposure to those risks, rather than a consolidation (paragraph BC121).

III. Disclosure

Question 9: Do the proposed disclosure requirements described in paragraph 23 provide decision-useful information? Please identify those requirements with which you believe it will be difficult for reporting entities to comply, or that are likely to impose significant costs on reporting entities.

Response to Question 9:

21. Among those proposed disclosure requirements about off balance sheet activities described in the draft IFRS, we are of the view that paragraph B32(a) and (b) as disclosure requirements for basis of control are not appropriate.
  (a) When the reporting entity has concluded that it controls an entity whose activities are directed through the voting rights even though the reporting entity has less than half of that entity's voting rights (paragraph B32(a)).
  This disclosure requirement is inconsistent with the view of the Board described in paragraph BC70 that a term referred to as "de facto control" is not supported because it implies, incorrectly, that obtaining control in such a manner is in some way weaker than other means of obtaining control.
  (b) When the reporting entity has concluded that it does not control an entity whose activities are directed through voting rights even though the reporting entity is the dominant shareholder with the voting rights(paragraph B32(b)).
  In this disclosure requirement, the definition of dominant shareholder is not clear and, if a reporting entity does not satisfy paragraph 27 of the draft IFRS, as a matter of course, the reporting entity merely does not have control over another entity. Therefore, the proposed disclosure would be meaningless.
22. On the other hand, in case of disclosure requirements for basis of control in paragraph B32, we are of the view that the entity with a majority of the voting rights but never exercises its rights to vote will be within the scope of paragraph 25 of the draft IFRS, and then basis for its assessment should be added to the disclosure requirements in B32 (See paragraph 9 of this letter)

23. Paragraphs B41 and B42 of the draft IFRS describe that a reporting entity shall disclose nature and extent of involvement for unconsolidated structured entities that the reporting entity has set up or sponsored. While we speculate that no definition of sponsor could avoid structuring, it is not certain why set up is separately described and it would differ from the treatment proposed by the FASB. In addition, it seems that paragraphs B41 of the draft IFRS requires the disclosure even if the reporting entity that has set up or sponsored has no further involvement. If so, paragraph B41 should be amended because it would be a over-disclosure requirement and be different from the Board decision that its disclosure requirements is limited to involvements with structured entities that expose the reporting entity to variability of returns of the structured entities (paragraph BC137 of the draft IFRS).

Question 10: Do you think that reporting entities will, or should, have available the information to meet the disclosure requirements? Please identify those requirements with which you believe it will be difficult for reporting entities to comply, or that are likely to impose significant costs on reporting entities.

Response to Question 10:

24. Paragraph B46 of draft IFRs illustrates a list of risk disclosures when a reporting entity shall disclose other information that is relevant to an assessment of the risks to which the reporting entity is exposed. Although paragraph BC143 of the draft IFRS describes that a reporting entity should provide such disclosure only if it is relevant to an assessment of the risk to which the reporting entity is exposed, concerns expressed in paragraph B139 would not solved because it is not clear enough how to determine examples in the list are relevant to an assessment of the risk. Hence, we are of the view that these examples illustrated in paragraph B46 of draft IFRS should be reviewed.

Reputational risk

Question 11:

(a) Do you think that reputational risk is an appropriate basis for consolidation? If so, please describe how it meets the definition of control and how such basis of consolidation might work in practice.

(b)Do you think that the proposed disclosures in paragraph B47 are sufficient? If not, how should they be enhanced?

Response to Question 11:

25. We agree with the view of draft IFRS that reputational risk is not an appropriate basis for consolidation (paragraphs BC37 and BC38).
26. We also agree with the view of draft IFRS not to require disclosures of a reporting entity's intention to provide future support to an unconsolidated structured entity without having a contractual or constructive obligation to do so because of its feasibility (paragraphs BC144 and BC145). Consequently, it would be appropriate that the description of paragraph B47 which requires certain disclosures to a reporting entity only when it has, without having a contractual or constructive obligation to do so, provided support to structured entities that were not consolidated at the time of providing the support.

Accounting for associates and the equity method

Question 12: Do you think that the Board should consider the definition of significant influence and the use of the equity method with a view to developing proposals as part of a separate project that might address the concerns raised relating to IAS 28?

Response to Question 12:

27. We are of the view that the Board should not reconsider the use of the equity method at this stage.
28. The concern may arise from the unclearness of the reason why the equity method requires consolidating procedures such as elimination of profits and losses to investment in associates that are outside the group because the draft IFRS reaffirms that a group is a parent and all its subsidiaries. If that is the case, however, the concern could be solved simply by amending the draft IFRS to include associates and joint ventures as a part of the group. We do not believe that the use of the equity method that does not cause problems in practice needs reconsideration only to deal with the unclearness of the wording.
29. As the consolidation model in the draft IFRSs has developed well beyond a simple voting rights model and the proposed disclosures are intended to assist investors and other users in assessing the risks to which the reporting entity is exposed as a consequence of its involvement with entities

that the reporting entity does not control (paragraph30 of the introduction in the draft IFRS), the Board noted the overlap, and possible conflict, between the proposals in the draft IFRS and the requirements in IAS 28 (paragraph 31 of the introduction in the draft IFRS). However, as mentioned below, those overlaps and conflicts are only limited to structured entities. Therefore, for the entities other than structured entities, which will be dealt with the significant influence model through the voting rights as in the past, we believe there will be no overlaps or conflicts.

(1) Structured entities should be defined as an entity whose activities could not be directed through voting rights (See paragraph 15 of this letter). Entity other than structured entities should be defined as an entity for whose activities are directed through voting rights (See footnote 4 and [Illustration 2] of Appendix 2 of this letter)

(2) Enhancement of disclosures about entities that are not controlled is mainly relates to structured entities. Disclosure requirements for entities other than structured entities are not enhanced compared to those for structured entities.

30. Significant influence to the structured entities could be defined as follows in light of the possible definition of control: A reporting entity has a significant influence to another entity when the reporting entity has the power to participate in the activities of that other entity to generate returns for the reporting entity other than control or joint control. As a consequence, it could address the circumstances in which a reporting entity has involvement with an entity beyond that of a passive investor.

31. Some strategic investments in other entities that are not controlled have similar characteristic to investments in subsidiary. This is because a reporting entity as a positive investor aims to obtain a business return earned in the investee, including enhancement of value of the reporting entity through the relationship with the investee. In such case, because the nature of the investment is similar to investments in subsidiaries, it is better to reflect the reporting entity's share of the investee earnings rather than to reflect only receipt of dividend (cost method) or fluctuation of market value (market value method). Based on this understanding, for example, IAS 28 treats the loss of significant influence as economically similar event of the loss of control because both of them are changes of the nature of the investments. Accordingly, we are of the view that the Board should not reconsider the use of the equity method with a view to remove the method.

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We expect that our comments contribute to the forthcoming deliberations in the project.

Yours sincerely,

Take Arai

Takehiro Arai
Chairman of the Technical Committee for SPEs
Board member of the Accounting Standards Boards of Japan

Appendix 1

Existing paragraph 27 of the draft IFRS

27 A reporting entity with less than half of the voting rights has the power to direct the activities of another entity if:

(a) the reporting entity has more voting rights than any other party; and

(b) the reporting entity's voting rights are sufficient to give the reporting entity the ability to determine the entity's strategic operating and financing policies.

Proposed paragraph 27 of the draft IFRS

27 A reporting entity with less than half of the voting rights has the power to direct the activities of another entity if:

(a) the reporting entity has (i) high percentage and more voting rights than any other party, or (ii) a majority of the voting rights in the aggregate, together with other vote holders who agree to exercise voting rights for the reporting entity and who act for a reporting entity; and

(b) the reporting entity's voting rights in conjunction with other involvements are sufficient to give the reporting entity the ability to determine the entity's strategic operating and financing policies.

Appendix 2

[Illustration 1] Our understanding of the draft IFRS

An entity other than structured entity	A structured entity
Paragraph 21(a)(assessing power): Paragraphs 23-29 By having voting right: (With majority of the voting right) / (Without majority of the voting right) By means of arrangements Paragraphs 23-25 Paragraphs 26-29 Paragraphs B9-B16	An entity whose activities are restricted to the extent that those activities are not directed as described in paragraphs 23 to 29 (para 30) Para 21(b)(assessing power): Paragraphs 31-38

A reporting entity has the power to direct the activities of another entity if it can determine that other entity's strategic operating and financing policies (paragraph 22).

[Illustration 2] Our proposal to the draft IFRS

An entity other than structured entity	A structured entity
An entity whose activities are directed through voting rights (With majority of the voting right) / (Without majority of the voting right)	An entity whose activities could not be directed through voting rights

Assessing power :

By holding voting rights

By holding voting rights in conjunction with other involvements

Whether a reporting entity has the power to direct the activities of another entity other than structured entity are assessed based on the voting rights:

► A reporting entity assesses whether it can determine that other entity's strategic operating and financing policies by holding voting rights in conjunction with other involvements.

Whether a reporting entity has the power to direct the activities of a structured entity could not be assessed based upon the voting rights:

► A reporting entity assesses whether it has the power to direct the activities of a structured entity through any involvements other than by holding voting rights.

Control: the reporting entity has the power to direct the activities of that other entity to generate returns for the reporting entity (paragraph 4).

Appendix 3

Relevant requirements in the accounting standard for consolidation in Japan

An entity that controls the decision-making body of other entity is one met in either condition a, b or c below. However, if it is evident that the entity does not control the decision-making body of the other entity from the perspective of financial or operating or business relationship, such entity may not be defined as controlling entity:

a. The entity that owns the majority of the voting shares of the other entity (except for reorganized, liquidated, bankrupt or other similar entities over which no effective control exists; this exception is also applied to following b. and c.) in their own account.

b. The entity that owns high percentage of the voting rights[7] in their own account and that meets either of the following conditions:

  i. Combination of the voting shares held by the entity' own account and the voting shares held by the closely related party (party or parties who are expected to exercise the voting rights in a way similar to the company based on the closely tied relationship with the company through investment, personnel, finance, technology, trading or other relationship) and the agreed party (party or parties who have agreed to exercise the voting rights in a way similar to the company) exceed the majority of the voting shares of the other entity.

  ii. Current or former executives or employees of the entity whose decisions on financial and operating or business policies of the other entity would be influenced by the entity occupy the majority of the board of directors or other similar bodies of the other entity.

  iii. There are contracts or other arrangements that the entity controls important financial or operating or business policies of the other entity.

  iv. The company (and together those who are closely related to the company through investment, personnel, funding, technology, trading or other relationships) provides loans (including providing financial guarantees and collateral) the majority of the total debt of the other entity.

  v. There are other facts that indicate control of the entity over the decision-making body of the other entity.

c. Combination of the voting shares held by the entity's own account (including the case of no voting shares are held by the entity) and the voting shares held by a closely related party[8] and an agreed party[9] exceed the majority of the voting shares of the other entity, and either additional condition (i.e., one or more conditions from b.ii. through v. described above) is met.

[7] This is dealt with 40 percent or more but no more than 50 percent.
[8] That is a party who is expected to act in same way for close relationship.
[9] That is a party who is agreed to act in same way.