
**STATUTORY BOARD FINANCIAL
REPORTING STANDARD**

ED 10 IE

Draft Illustrative Examples

**CONSOLIDATED FINANCIAL
STATEMENTS**

Comments to be received by 6 February 2009

Contents

	<i>page</i>
ED 10 CONSOLIDATED FINANCIAL STATEMENTS [DRAFT] ILLUSTRATIVE EXAMPLES	
INTRODUCTION	4
EXAMPLE 1 – Basis of control and related accounting consequences	4
EXAMPLE 2 – Nature and extent of involvement in unconsolidated structured entities	6
EXAMPLE 3 – Risk disclosures relating to unconsolidated structured entities	11
EXAMPLE 4 – Risk disclosures relating to non-contractual support provided to structured entities	18

[Draft] Illustrative examples

SB-FRS X Consolidated Financial Statements

These [draft] illustrative examples accompany, but are not part of, [draft] SB-FRS X.

[Draft] SB-FRS X
paragraph
reference

Introduction

Examples 1–4 illustrate some of the disclosure requirements of the [draft] SB-FRS. A reporting entity is required to provide some of the disclosures in a tabular format, unless another format is more appropriate. However, the formats used in the illustrations are not mandatory.

Example 1 relates to a reporting entity, Company X, and illustrates the disclosure requirements relating to the basis of control and related accounting consequences. Examples 2–4 relate to a reporting entity, XYZ Bank, and illustrate some of the risk disclosures associated with XYZ Bank's involvement with structured entities.

Example 1—Basis of control and related accounting consequences

Illustrating the application of paragraphs 48(a) and B32–B34 of the [draft] SB-FRS.

This example illustrates the disclosure requirements relating to the basis of control and related accounting consequences.

B32(a) Example 1A—control with less than half of the voting rights

Company X, a venture capital entity, holds 35 per cent of the voting rights of Company Z, a tyre manufacturer. Company X also arranged for third party investors to purchase 30 per cent of the voting rights of Company Z. At the time of investing, the third party investors entered into an agreement with Company X, giving Company X the power to vote on their behalf at meetings of Company Z. Because of the power given to Company X by the investors, Company X can cast the majority of votes when appointing the Board of Directors of Company Z, who in turn determine the strategic operating and financing policies of Company Z.

B33 Therefore, Company X has the ability to direct the activities of Company Z to generate returns for itself. Company X controls Company Z and consolidates it. Of the group's consolidated assets and liabilities, Company Z has consolidated assets of CU250 million and consolidated liabilities of CU195 million at 31 December 20X8. Company Z generated revenue of CU450 million and profit of CU22 million for the year ended 31 December 20X8.

B32(c) Example 1B—involvement with structured entities that are not controlled

Company X provides credit enhancement for a market fee, in the form of guarantees, to some structured entities set up to hold lease receivables. The receivables are sold to those entities by third party leasing entities. Company X provides either first or second loss protection for other investors, up to a maximum of 10 per cent of the value of the lease receivables. The guarantees expose Company X to losses that are potentially significant to the entities holding the lease receivables. Company X, however, has no means of exerting power over the activities of those entities and, therefore, does not control the entities. Note A *Risk disclosures relating to unconsolidated structured entities* provides further information about Company X's exposure to risk from the provision of the credit enhancement.

Example 2—Nature and extent of involvement in unconsolidated structured entities

Illustrating the application of paragraphs 48(d) and B38–B42 of the [draft] SB-FRS.

This example illustrates some of the disclosure requirements of the [draft] SB-FRS relating to the nature and extent of involvement of a reporting entity in unconsolidated structured entities that it has set up or sponsored, or with which it has involvement at the date of the consolidated financial statements. The example is not intended to be all-inclusive. It may, however, include information that is not required explicitly by the [draft] SB-FRS but which is provided to meet the disclosure objectives.

Structured entities

B40 XYZ Bank enters into securitisation arrangements for a variety of business purposes, mainly relating to the securitisation of mortgages and credit card receivables, and providing investors with investment opportunities. Securitisation entities are entities in which interests in consumer and commercial receivables are sold to investors. The securitisation entities acquire assets originated by XYZ Bank itself or other third parties. The securitisation entities issue commercial paper, debt securities or equity interests to investors to fund the purchase of receivables. Cash received from the collection of receivables is used to service the finance provided by the investors.

XYZ Bank consolidates the majority of securitisation entities that hold receivables originated by itself because it controls those entities. XYZ Bank has the power to direct the activities of the entities to generate returns for its benefit both as a result of the extent of its involvement in setting up the entities and because of the powers that it has in managing the assets when payments are in default. XYZ Bank does not consolidate securitisation entities that hold receivables originated by itself if it has no involvement with those entities after selling the receivables to the entities.

XYZ Bank also facilitates the establishment of structured entities on behalf of third parties. These entities are established to securitise third party receivables, to hold assets leased by third parties and for investing purposes (for example, collateralised debt obligations are used to provide investment opportunities for investors). XYZ Bank generally does not control entities that it sets up or sponsors on behalf of third parties. It sometimes provides asset management services to those entities, or has involvement with the entities as described below.

Structured entities set up or sponsored

B41 The following tables summarise XYZ Bank's involvement with securitisation and other investing entities that XYZ Bank set up or sponsored, by asset type. The tables present XYZ Bank's income recognised in each reporting period (which consists of fees for setting up the structured entities and providing asset management services) and the fair value of the assets securitised at the date the securitisation transactions were completed. In some cases, XYZ Bank retained some involvement with the structured entities, in the form of investments in the structured entities, credit guarantees or liquidity commitments. Further information is provided about those involvements in [Note A *Risk disclosures relating to unconsolidated structured entities*].

		Total fee income for the year ended		
		20X8	20X7	20X6
B41(a)	Type of asset in unconsolidated entity	CU	CU	CU
		million	million	million
	Collateralised debt obligations	1,025	820	697
	Residential mortgage-backed securities	6,055	4,844	4,117
B42	Commercial mortgage-backed securities	878	703	597
	Assets under lease	332	265	226
	Credit card receivables	189	151	128
	Total	8,479	6,783	5,765

		Assets securitised during the year		
		20X8	20X7	20X6
B41(b)	Type of asset in unconsolidated entity	CU	CU	CU
		million	million	million
	Collateralised debt obligations	14,650	11,720	9,962
	Residential mortgage-backed securities	86,500	69,200	58,820
B42	Commercial mortgage-backed securities	2,546	10,037	8,532
	Assets under lease	4,739	3,791	3,223
	Credit card receivables	2,695	2,156	1,833
	Total	121,130	96,904	82,370

The tables below provide a split between those transactions in which XYZ Bank retains some involvement at 31 December 20X8 and those in which it does not, by asset type.

Involvement at 31 December 20X8

		Total fee income for the year ended		
		20X8	20X7	20X6
Type of asset in unconsolidated entity		CU million	CU million	CU million
B41(a)	Collateralised debt obligations	410	328	279
	Residential mortgage-backed securities	2,422	1,938	1,647
B42	Commercial mortgage-backed securities	351	281	239
	Assets under lease	332	265	226
	Credit card receivables	189	151	128
Total		3,704	2,963	2,519

No involvement at 31 December 20X8

		Total fee income for the year ended		
		20X8	20X7	20X6
Type of asset in unconsolidated entity		CU million	CU million	CU million
B41(a)	Collateralised debt obligations	615	492	418
	Residential mortgage-backed securities	3,633	2,906	2,470
B42	Commercial mortgage-backed securities	527	422	358
Total		4,775	3,820	3,246

Involvement at 31 December 20X8

		Assets securitised during the year		
		20X8	20X7	20X6
Type of asset in unconsolidated entity		CU	CU	CU
		million	million	million
B41(b)	Collateralised debt obligations	5,860	4,688	3,985
	Residential mortgage-backed securities	34,600	27,680	23,528
B42	Commercial mortgage-backed securities	5,018	4,015	3,413
	Assets under lease	4,739	3,791	3,223
	Credit card receivables	2,695	2,156	1,833
	Total	52,912	42,330	35,982

No involvement at 31 December 20X8

		Assets securitised during the year		
		20X8	20X7	20X6
Type of asset in unconsolidated entity		CU	CU	CU
		million	million	million
B41(b)	Collateralised debt obligations	8,790	7,032	5,977
B42	Residential mortgage-backed securities	51,900	41,520	35,292
	Commercial mortgage-backed securities	7,528	6,022	5,119
	Total	68,218	54,574	46,388

Example 3—Risk disclosures relating to unconsolidated structured entities

Illustrating the application of paragraphs 48(d) and B43–B46 of the [draft] SB-FRS.

This example illustrates some of the disclosure requirements about the risks associated with a reporting entity's involvement with unconsolidated structured entities. This example is not intended to be all-inclusive. It may, however, include information that is not required explicitly by the [draft] SB-FRS but which is provided to meet the disclosure objectives.

Risk associated with unconsolidated structured entities

The following table summaries XYZ Bank's involvement at 31 December 20X8 with structured entities, by asset type.

XYZ Bank's involvement with structured entities takes the form of investments in the structured entities, credit guarantees and liquidity commitments.

B44 At 31 December 20x8

Maximum exposure to loss in unconsolidated structured entities

B45 CU million

B44(a)

B44(c)

B44(d)

Type of asset in unconsolidated entity	Current carrying amounts of assets held by structured entities	Maximum exposure to loss				Carrying amount in statement of financial position	
		Total	Investments	Credit guarantees	Liquidity commitments	Assets	Liabilities
Originated by XYZ Bank						Assets	Liabilities
Collateralised debt obligations	13,080	196	196			196	
Subtotal	13,080	196	196			196	
Originated by other entities						Assets	Liabilities
Collateralised debt obligations	92,780	6,031	1,856		4,175	1,856	(167)
Real estate, credit-related and other investing	167,400	6,944		248	6,696		(258)
Assets under lease	8,520	512	43		469	43	(2)
Credit card receivables	42,000	1,260	1,260			1,260	
Subtotal	310,700	14,747	3,159	248	11,340	3,159	(427)
Total	323,780	14,943	3,355	248	11,340	3,355	(427)

Carrying amount of assets and liabilities in unconsolidated structured entities recognised in XYZ Bank's statement of financial position

B44(b)

Class of financial asset or liability	Investments	Credit guarantees	Liquidity commitments	Total	
				Assets	Liabilities
Debt securities (fair value through profit or loss)	2,052			2,052	
Loans and Investments (at amortised cost)	1,303			1,303	
Financial guarantee contracts		(7)			(7)
Provisions			(420)		(420)
Total	3,555	(7)	(420)	3,355	(427)

Maximum exposure to loss

B44(d) The maximum exposure to loss presented in the table above is contingent in nature and may arise as a result of the provision of liquidity facilities, and any other funding commitments, such as financial guarantees provided by XYZ Bank to structured entities. XYZ Bank's investments in structured entities also create exposure to loss from impairment.

The maximum exposure to loss is calculated as the notional amounts of credit lines, guarantees, other credit support and liquidity facilities, less any related liabilities recognised. The maximum exposure to loss relating to XYZ Bank's investments is their carrying amount. The maximum exposure to loss does not take into account the effects of any hedging activities of XYZ Bank designed to reduce that exposure to loss.

Liquidity commitments

B46(d) XYZ Bank provides liquidity support to structured entities containing collateralised debt obligations (CDOs), real estate, credit-related and other investing receivables, and entities that hold assets under lease. The liquidity support takes the form of a commitment to purchase securities issued by these entities if they experience problems in attracting investment on refinancing.

B44(d) XYZ Bank's maximum exposure is limited to the amortised cost of assets held by the structured entities, which reflects the risk that XYZ Bank may be required to fund the vehicle if debt is redeemed without reinvestment from third parties.

B46(b)(iv) At 31 December 20X8 XYZ Bank recognised a liability of CU420 million relating to the provision of liquidity support. The provision reflects XYZ Bank's best estimate of amounts that will be drawn and not repaid under its liquidity facilities. XYZ Bank expects that in the light of current market conditions some CDO entities, real estate, credit-related and other investing entities will not be able to roll over their financing without drawing on liquidity facilities with XYZ Bank. The deterioration of these entities' credit standing has made some of the liquidity commitments onerous.

Credit guarantees

B43 XYZ Bank provides credit enhancement to some investing vehicles in the form of financial guarantee contracts. XYZ Bank is required to reimburse investors for some losses incurred when a debtor defaults on payment.

Investments in structured entities

B44(d) XYZ Bank invests in some structured entities, acquiring debt or equity securities of those entities. The maximum exposure to loss represents the carrying amount of these investments at 31 December 20X8. The table below presents XYZ Bank's investments in structured entities by nature of the investment (ie subordinated, mezzanine and senior) and provides information on losses incurred for the year ended 31 December 20X8.

Maximum exposure to loss from investments in unconsolidated structured entities

B46(b)(v)	Maximum exposure to loss at 31 December 20X8	<i>Total</i>	<i>Subordinated interest</i>	<i>Mezzanine interest</i>	<i>Senior interest</i>
	Type of asset in unconsolidated entity	CU million	CU million	CU million	CU million
	Collateralised debt obligations	2,052	2	1,954	96
	Assets under lease	43	—	—	43
	Credit card receivables	1,260	7	50	1,203
	Total	3,355	9	2,004	1,342

B46(b)(iii)	Losses incurred for the year ended 31 December 20X8	<i>Total losses</i>	<i>Losses subordinated interest</i>	<i>Losses Mezzanine interest</i>	<i>Losses Senior interest</i>
	Type of asset in unconsolidated entity	CU million	CU million	CU million	CU million
	Collateralised debt obligations	1,190	9	1,146	35
	Assets under lease	—	—	—	—
	Credit card receivables	33	12	19	2
	Total	1,223	21	1,165	37

Collateralised debt obligations (CDOs)

B40 XYZ Bank arranges a number of CDO transactions, in which it administers the activities of the CDO entities on behalf of investors. The CDO entities are established to facilitate the rating of the securities issued to investors. The structured entities are not consolidated by XYZ Bank because it acts as an agent on behalf of investors, administering the activities of the entities according to policies approved by the investors.

B46(b)(iii) XYZ Bank re-securitises subprime mortgage backed securities rated AA or lower in CDO securitisations, which create senior to junior securities of CDOs. The holders of the most junior (subordinated) securities are exposed to losses before the holders of mezzanine and senior securities. In some transactions, XYZ Bank purchased an insignificant amount of senior securities in CDO entities. In the second half of 20X8, the credit ratings of some senior CDO securities, many with exposures to US subprime mortgages, were downgraded. This resulted in a loss of CU35 million for XYZ Bank.

B46(b)(iii) XYZ Bank acquired investments in mezzanine and subordinated securities of CDO entities, the assets of which were originated by third parties. XYZ Bank incurred losses of CU9 million in 20X8 relating to the subordinated securities that it holds in CDO entities. Owing to the severe deterioration in the value of assets held by these CDO entities, XYZ Bank incurred further losses of CU1,146 million on its investments in mezzanine securities. The losses incurred by XYZ Bank represent losses incurred by the CDO entities in excess of the amounts absorbed by the holders of subordinated securities.

B46(b)(v) XYZ Bank's mezzanine interest in CDO entities of CU1,954 million at 31 December 20X8 exposes the bank to loss when first loss protection provided by other third parties is fully drawn. Assets held in CDO entities with which XYZ Bank has involvement at 31 December 20X8 total CU105,860 million, and third party investors provide first loss protection to XYZ Bank of CU10,000 million. The total carrying amount of XYZ Bank's investment in CDO entities of CU2,052 million at 31 December 20X8 is measured at fair value [description of how fair value was measured not included in this example].

Assets under lease

B40 XYZ Bank provides leasing facilities and arranges finance for aircraft and other physical assets, customarily placed in structured entities.

At 31 December 20X8, XYZ Bank holds senior securities in such structured entities of CU43 million, measured at fair value [description of how fair value was measured not included in this example].

Credit card receivables

B40 XYZ Bank acquired investments in senior, mezzanine and subordinated securities of securitisation entities that hold credit card receivables originated by third parties. Credit card securitisations are revolving securitisations, ie as customers pay their credit card balances, the cash proceeds are used to purchase new receivables and replenish the receivables in the securitisation entities.

B46(b)(iii) Owing to an unprecedented increase in defaults on credit card payments during the year ended 31 December 20X8, XYZ Bank suffered a total loss of CU33 million. Impairment losses of CU12 million resulted from XYZ Bank's exposure to first losses as the most subordinated investor. In addition, the value of XYZ Bank's investments in mezzanine and senior securities suffered an impairment loss of CU21 million due to the subordinated securities not being sufficient to absorb the losses incurred by some credit card securitisation entities.

B46(b)(v) XYZ Bank's senior interest in credit card securitisation entities of CU1,203 million at 31 December 20X8 exposes the bank to loss when loss protection provided by third parties holding more junior securities is fully drawn. Assets held by those securitisation entities with which XYZ Bank has involvement at 31 December 20X8 total CU42,000 million. First loss protection, provided by third party investors, absorbs credit losses of CU5,000 million. In addition, investors holding mezzanine interests in those entities absorb a further CU14,600 million of losses before XYZ Bank is exposed to loss. The total carrying amount of XYZ Bank's investment in credit card securitisation entities of CU1,260 million at 31 December 20X8 is measured at fair value [description of how fair value was measured not included in this example].

Example 4—Risk disclosures relating to non-contractual support provided to structured entities

Illustrating the application of paragraphs 48(d) and B47 of the [draft] SB-FRS.

This example illustrates the disclosure requirements of the [draft] SB-FRS in situations in which a reporting entity has no investment in or other contractual involvement with structured entities, but has provided non-contractual liquidity support.

Non-contractual support provided to structured entities

The provision of non-contractual support results in consolidation

B46(b)(ii)
B47(a)
B47(b)
B47(c)

In February 20X8, because of disruption in the supply of commercial paper (CP) funding, XYZ Bank provided CU17,500 million of funding in the form of CP purchases to Company S (founded in 20X7). The amount of CP purchased represented 90 per cent of the asset value of Company S. As a consequence, XYZ Bank obtained the power to change the restrictions according to which Company S operates, and concluded that it controlled Company S. XYZ Bank consolidated Company S from February, resulting in CU20,000 million of BBB-rated mortgage receivables being recognised in the statement of financial position. The CP was acquired as an act of good faith to the clients who had invested in the fund on the basis of XYZ Bank's advice.

The provision of non-contractual support does not result in consolidation

B46(b)(ii)
B47(a)
B47(b)

In May 20X8 XYZ Bank was approached by the administrators of the fund, Company Y (founded in 20X4), which was having difficulties obtaining short-term funding from other sources. CU65 million was provided in the form of short-term liquidity support to Company Y. The full amount was repaid within fourteen days of the funding being advanced and no additional support has been provided since that date. XYZ Bank was not contractually obliged to provide funding, but did so to prevent the fund going into administration. In addition, XYZ Bank considered the risk associated with providing the funding to be minimal.