



Ms. Françoise Flores
Chair
Technical Expert Group
EFRAG
Square de Meeûs 35
B-1000 BRUXELLES

E-mail: commentletter@efrag.org

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Ref.: ACC/HvD/TS/ID

Dear Ms. Flores,

Re: FEE Comments on EFRAG's Draft Comment Letter on IASB Exposure Draft Conceptual Framework for Financial Reporting: The Reporting Entity

- (1) FEE (the Federation of European Accountants) is pleased to comment on the EFRAG Draft Comment Letter on Exposure Draft Conceptual Framework for Financial Reporting: The Reporting Entity (the "ED").
- (2) We generally agree with the views expressed by EFRAG in its draft comment letter.
- (3) It is appropriate that the Framework contains a description of the notion of reporting entity in broad terms. However, some concepts such as "link to management", "will be conducted" and "objectively distinguished" need further clarification, in order that the description is clearly understood.
- (4) While we agree that reporting entities should be described in broad terms, more robust principles are necessary nonetheless on how the boundaries between economic activities should be drawn. In particular, we are concerned that the link ("glue") connecting these economic activities is not comprehensively described. What constitutes a link needs to be further debated.
- (5) Paragraph RE3 of the ED, which lists features of a reporting entity, states that "these features are necessary but not always sufficient to identify a reporting entity". We recommend that the IASB clarifies what other features may be necessary to identify a reporting entity. If no other features are necessary, the sentence should be deleted.
- (6) We agree that it is necessary to provide a definition of control as part of the Conceptual Framework but we believe that definition should be included at a higher level of the Conceptual Framework to reflect the fact that control is a pervasive concept which influences many different aspects of the financial statements.

- (7) We regret that the ED does not address whether financial reporting about a reporting entity should reflect the entity perspective or the perspective of the owners of the entity. We agree with EFRAG that a full debate is needed on this issue.
- (8) We note in paragraph P10 of the ED that standards can be established based on principles that are inconsistent with the framework. We believe that the Framework should have the formal status of principles upon which all standards are based and be referred to when an individual standard does not cover a particular issue. We suggest that EFRAG encourage the Board to reconsider the authoritative status of the Framework.
- (9) We agree that a portion of a reporting entity can qualify as a reporting entity if it meets the description and characteristics of a reporting entity.
- (10) We agree that the completion of the reporting entity chapter should not be delayed until the consolidation standards are issued. We believe that it is imperative that the IASB completes its work on the Conceptual Framework as a whole with some higher priority since this will provide structure and direction to the development of the standards.
- (11) We agree that consolidated financial statements should be prepared when a reporting entity controls another entity.
- (12) We also agree that parent-only financial statements provide useful information and the Conceptual Framework should not address the manner or the timing of the presentation of such financial statements.
- (13) More generally, the Conceptual framework should not specify how to prepare financial statements whether they are consolidated, parent only and combined financial statements. The Conceptual Framework should merely provide a framework for general purpose financial statements to the extent that sets the boundaries upon which a detailed guidance can be outlined at standards level. Therefore, we would support that the Conceptual Framework is an appropriate basis upon which a general purpose financial statement about a reporting entity can be prepared but the detailed application should be addressed in the relevant standards.
- (14) We are concerned that the ED does not set clear principles on when financial information about a portion of an entity would represent general purpose financial information.

Our Comments on Appendix 1 and 2 of the EFRAG draft comment letter including responses to the questions in the Invitation to comment of ED are contained in the Appendix to this letter.

For further information on this letter, please contact Tibor Siska, Project Manager.

Yours sincerely,



Hans van Damme

President

Appendix – Comments on Appendix 1 and 2 of the EFRAG draft comment letter including responses to the questions in the Invitation to comment of IASB Exposure Draft Conceptual Framework for Financial Reporting: The Reporting Entity

Appendix 1

Question 1: Do you agree that a reporting entity is a circumscribed area of economic activities whose financial information has the potential to be useful to existing and potential equity investors, lenders and other creditors who cannot directly obtain the information they need in making decisions about providing resources to the entity and in assessing whether the management and the governing board of that entity have made efficient and effective use of the resources provided? If not, why?

Broad description of a reporting entity

- (15) Like EFRAG, we agree in principle with the first part of the proposed broad description of a reporting entity at this level of the Framework. The reporting entity should not be determined by its legal structure alone but the economic substance should also be taken into consideration.
- (16) We note that the ED is deliberately using the term “description”, not “definition”, and avoids forming a precise definition of a reporting entity. The Framework should only provide a conceptual meaning of terms through an articulated rationale. Therefore, we agree with EFRAG that the proposed description appropriately captures the key concepts of a reporting entity.
- (17) However, we have some concerns with certain elements and features of the description of a reporting entity as well as with the objective of the financial information about a reporting entity as described later in the letter.

Specific comments on certain of the elements of the proposed description

Circumscribed area of economic activities

- (18) We agree that reporting entities should be described in broad terms. However, we consider that more robust principles are necessary on how the boundaries between economic activities should be drawn. In particular, we are concerned that the link (“glue”) connecting these economic activities is not comprehensively described. What constitutes a link needs to be further debated.

Potential to be useful to potential equity investors, lenders and other creditors

- (19) Chapter 1 of the Framework states that the objective of the General Purpose Financial Reporting (“objective of financial reporting”) is to provide information about the reporting entity that is useful for potential equity investors, lenders, and other creditors in making decisions in their capacity as capital providers. The description of a reporting entity is using the same terminology to describe the potential users of the financial information about a circumscribed area of economic activities. On this basis, similar to EFRAG, we suggest that the IASB avoid duplicating the definition of the objective within the description of the reporting entity and should instead merely include a reference to Chapter 1 of the Framework.

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- (20) We reaffirm our view, previously expressed in our response to the Exposure Draft on Chapter 1 of the Conceptual Framework, that the term *capital providers* does not adequately reflect the current understanding of that category being the providers of equity capital. Capital providers are defined as present and potential equity investors, lenders and other creditors.

Efficient and effective use of resources provided

- (21) As stewardship is already addressed in Chapter 1 of the Conceptual Framework, there is no need to reintroduce this concept as part of the description of a reporting entity. It would be sufficient to include a reference to the objective of general purpose financial statements outlined in Chapter 1 of the Framework as part of the description of a reporting entity.
- (22) We do not share EFRAG's view that the "efficient and effective" criteria should be removed from the objective of financial reporting. We do not believe that the inclusion of this precision is taking away from the general stewardship principle rather than built up on that.

Link to management

- (23) We share EFRAG's concern that the link to management and governing board could be misinterpreted and read as a requirement for entities to always have some sort of common management in place to identify a reporting entity. Like EFRAG, we believe that this would limit the entity's ability to prepare general purpose financial statements when for example parts of an existing group are being carved out to form a "new" reporting entity.
- (24) In such circumstances, we believe that the existence of a management and governing board at the existing company could justify the preparation of general purpose financial statements for the carved-out parts as a single reporting entity (provided that other criteria of a reporting entity are met) even though the carved-out entity does not have a specific management team in place yet.

Specific comments on the proposed features of a reporting entity

Will be conducted

- (25) We agree with EFRAG that this specific feature lacks clarity. However, we are not convinced that EFRAG's proposal to replace "will be conducted" with "has the potential to be", "planned to be", or "capable of being conducted", will resolve all the clarification issues.
- (26) The reference to "will be conducted" could be interpreted as permitting the preparation of general purpose financial statements on the basis of pro-forma information. Therefore, we believe that it is necessary for the Board to outline principles on how financial information about certain reporting entities would constitute general purpose financial information rather than special purpose financial statements, such as pro forma financial statements.

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- (27) We note that the ED proposes that parts of an entity can represent a reporting entity when an investor is considering purchasing these parts. This would be the case when an entity contemplates a carve-out transaction. However, the historical financial information of the parts being carved-out is not necessarily representative of the financial situation of the carved-out entity subsequent to the transaction. For example, the financing available, or the existence of intercompany transactions, may change significantly depending on whether the carved-out entity is part of a larger entity or operates on a stand-alone basis. In this context, the Board should explain how the presentation of financial information for the parts to be carved out would constitute general purpose financial statements. That being said, specific accounting requirements on the preparation of financial statements such as consolidated, parent only and combined financial statements should be dealt with at standards level.
- (28) More broadly, the Board should explain when financial information about a reporting entity represents general purpose financial information.

Those economic activities can be objectively distinguished from those of other entities and from the economic environment in which the entity exists

- (29) As does EFRAG, we believe that the requirement for the economic activities of a reporting entity to be *objectively distinguished* is inadequately explained. Due to the lack of clarity provided in the description, it is likely to be difficult to apply in practice and could result in significant divergence of use in the determination of whether a set of activities represents a reporting entity or not.

Sufficiency of the features provided in the ED

- (30) Paragraph RE3 of the ED, which lists features of a reporting entity, states that “these features are necessary but not always sufficient to identify a reporting entity”. We recommend that the IASB clarifies what other features are necessary to identify a reporting entity. If no other features are necessary, the sentence should be deleted.

Question 2: Do you agree that, if an entity that controls one or more entities prepares financial reports, it should present consolidated financial statements? Do you agree with the definition of control of an entity?

- (31) We agree that consolidated financial statements should be prepared when a reporting entity controls another entity.
- (32) However, this principle could be perceived as excluding the current exemption provided in IAS 27 that permits intermediate parents not to prepare consolidated financial statements in certain circumstances. This ambiguity should be addressed.
- (33) Like EFRAG, we believe that it is necessary to provide a definition of control as part of the Conceptual Framework. Control is a pervasive concept that influences many different aspects of the financial statements. Accordingly, it does not seem appropriate to include a definition of control in this chapter of Framework. Rather, that definition should be included at a higher level of the Conceptual Framework.

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- (34) We also believe that the specific issues about control and the practical implementation of the definition should be addressed at standard level, in IAS 27 Consolidated and Separate Financial Statements.
- (35) We agree with EFRAG that paragraph RE8 on control in relation to consolidation should be revised to avoid its potential misinterpretation. The direct link made between control and the controlling entity's cash flow dependence is not uniquely indicative for the parent-subsiary relationship. There are many instances where an investor significantly relies on the cash flow from a joint venture or an associate but does not necessarily consolidate these investees. Conversely, a parent may not be dependent on the cash flow from its investment but the parent is in control and therefore consolidates the investee.
- (36) We refer to our comment letter on IASB ED 10 Consolidated Financial Statements issued on 25 March 2009, which sets our recent perspective on the proposed definition of control.

Question 3:

Do you agree that a portion of an entity could qualify as a reporting entity if the economic activities of that portion can be distinguished from the rest of the entity and financial information about that portion of the entity has the potential to be useful in making decisions about providing resources to that portion of the entity? If not, why?

- (37) We agree with EFRAG that a portion of an entity, or a combination of portions of different legal entities, can qualify as a reporting entity if they meet the description of a reporting entity.
- (38) However, as noted at various places in this letter, we believe that further guidance is necessary to properly identify what constitutes a reporting entity.

Question 4: The IASB and the FASB are working together to develop common standards on consolidation that would apply to all types of entities. Do you agree that completion of the reporting entity chapter of the *Conceptual Framework* should not be delayed until those standards have been issued? If not, why?

- (39) We agree with EFRAG that the completion of the reporting entity chapter should not be delayed until the consolidation standards are issued. It is imperative that the IASB completes its work on the Conceptual Framework as a whole since this will provide structure and direction to the development of the standards.
- (40) We also share EFRAG's view that no part of the Conceptual Framework should be completed until the current active phases of the Conceptual Framework project are finalised.
- (41) As stated in our response to the ED on Chapter 1 of the Conceptual Framework, once all parts of the project have been dealt with, we suggest that the complete proposed Framework be exposed again for comment to provide the opportunity to reconsider decisions taken in the different phases. We suggest that the IASB should consider accelerating the remaining phases in order to allow for sufficient time to expose the entire revised Framework for public comment.

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Appendix 2

Some additional observations

Parent-Only Financial Statements

- (42) We fully agree with EFRAG that the Conceptual Framework should affirm that the parent-only financial statements provide useful information but in the meantime the Framework should not specify the timing or the manner in which such financial statement is presented.

Joint control and shared control

- (43) We agree with EFRAG that the IASB should further analyse the decision-usefulness of the financial information where the joint control concept could be used to determine boundaries of a group reporting entity before entirely excluding it from the reporting entity concept.

Combined financial statements

- (44) Paragraph RE12 appears to limit the preparation of combined financial statements in situations where entities are under common control, but the Board does not explain the reason for this restriction. In our opinion, the combined financial statements would also provide useful information in particular situations. For example, in certain cooperative arrangements, separate legal entities may be bound by various agreements. Even though the entities are owned by their members and are not commonly owned, information about the cooperation as a whole may be useful.
- (45) Accordingly, we believe that the Board should set out clear principles that are underlying the presentation of combined financial statements and what is the necessary link that determines the boundaries between the combined entities in this part of the Framework.

A legal entity may fail to represent a reporting entity

- (46) Paragraph RE5 of the ED indicates that “a single entity may not qualify as a reporting entity”. In certain jurisdictions all legal entities must prepare financial statements. We are concerned that, as a result of the principle set out in RE5, certain legal entities may be prevented from presenting general purpose financial statements under IFRSs. Accordingly, we suggest that EFRAG raises this issue with the Board.

Perspective from which the financial statement should be presented

- (47) Like EFRAG, we believe that the perspective is a critical element of the Conceptual Framework and therefore we are strongly supportive that there is a need for further debate before final conclusion is reached.



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- (48) Like EFRAG, we believe that the proprietary perspective may not be satisfactory when preparing general purpose financial statements. However, as noted in our comment letter on the ED on Chapter 1 of the Conceptual Framework, while we see more merits in the entity approach since it is a principle-based model, we believe that the practical consequences of such a model need further thoughts in particular on issues like the dividing line between equity and debt and the treatment of goodwill under IFRS 3.

Authoritative status of the Framework

- (49) We note in paragraph P10 the fact that standards may be established based on principles that are inconsistent with the framework. We believe that the Framework should have the formal status of principles upon which all standards are based and be referred to when an individual standard does not cover a particular issue. We suggest that EFRAG encourage the Boards to reconsider the authoritative status of the Framework.