5 July 2010

Our ref: ICAEW Rep 63/10

Mme Françoise Flores
Chair
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By email: commentletter@efrag.org

Chère Mme Flores

IASB ED *Conceptual Framework for Financial Reporting: The Reporting Entity*

The ICAEW welcomes the opportunity to comment on EFRAG's draft comment letter, published in March 2009, on the International Accounting Standards Board Exposure Draft ED/2010/2 *Conceptual Framework for Financial Reporting: The Reporting Entity*. Our responses to the main issues highlighted by EFRAG are set out below. A draft of our response to the IASB, which has not yet been finalised, is attached to this letter. This provides further explanation of our views and also considers some additional points not brought-up in the EFRAG response.

Question 1:

- **EFRAG agrees with the proposed broad description of a reporting entity.**

We disagree with the description as currently stated:

Firstly, we are concerned that the exposure draft does not contain a description of an 'entity'. Paragraph RE2 considers a description of a 'reporting entity' without first attempting to describe what an 'entity' is. It is important that the framework should tell us what kind of thing could be subject to the accounting requirements, before moving on to consider which of these could actually report.

Secondly, while we have no particular concerns with the first part of the description of a 'reporting entity' as a 'circumscribed area of economic activities', we are concerned that the remainder of the description repeats concepts surrounding the objective of financial reporting which are already addressed in chapter 1 of the framework. We feel that this concept is best described uniquely in chapter 1 and that the Reporting Entity chapter should therefore refer back to the original description.

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Question 2

- **EFRAG considers that a definition of 'control' should be included in the Conceptual Framework. However, EFRAG believes that the definition of 'control' should not be developed in the chapter dealing with the Reporting Entity; rather it should be developed so that its application can be considered more broadly.**

We agree. We believe that a single definition of control should be contained within IASB literature, and that The Reporting Entity chapter is not the appropriate place for the definition to be made. Rather, this chapter should refer to a unique definition of control that is contained elsewhere.

- **The Reporting Entity chapter should identify control as the basis for the aggregation of economic activities in preparing financial statements.**

We believe it is not the place of the framework to mandate when a particular accounting treatment should be applied. Therefore this chapter should be silent on whether control should be the basis for aggregating economic activities. Rather, this chapter should contain descriptions of what consolidated; parent-only; and combined financial statements are and then leave the application of these concepts to the standards level.

Question 3:

- **EFRAG agrees that a portion of an entity can qualify as a reporting entity if that portion meets the description and characteristics of a reporting entity.**

We would add a qualification to this point. We believe that this concept needs further development in the context of creditors. RE2 identifies creditors as one of the sub-groups of users of financial statements. Creditors will be interested in the legal boundaries of an entity; either that surrounding a limited liability entity, or the contractual boundary for a borrower group in a debt agreement. In such situations creditors will be interested in legal liability, whether statutory or contractual, as one of the factors that may be relevant in defining the information in the financial statements

Branches should also be considered in more detail. In particular we note the question surrounding whether a branch can be an independent reporting entity when it is a sub-set of a larger legal entity which itself reports. Articulation of this relationship and when it would be appropriate for a branch to report separately would be helpful.

Question 4:

- **EFRAG agrees that the project should not be delayed until the standards on consolidation have been issued.**
- **EFRAG continues to urge the IASB to give the completion of the different chapters of the Conceptual Framework a high priority.**

We agree. Appropriate description of the reporting entity at the framework level is necessary to ensure that the concept can be applied consistently in the development of standards. Therefore work to complete this chapter of the framework should proceed without delay to support the further development of standards in this area.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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16 July 2010

Our ref: ICAEW Rep XX/10

Your ref. ED/2010/2

Sir David Tweedie
Chairman
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Dear Sir David

CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING: THE REPORTING ENTITY

The ICAEW is pleased to respond to your request for comments on the Exposure Draft *Conceptual framework for Financial Reporting: The Reporting Entity*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

EXPOSURE DRAFT CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING: THE REPORTING ENTITY

Memorandum of comment submitted in July 2010 by the ICAEW, in response to IASB Exposure Draft *Conceptual Framework for Financial Reporting: The Reporting Entity,* published in March 2010.

Contents	**Paragraph**

INTRODUCTION

1. The ICAEW welcomes the opportunity to comment on the Exposure Draft *Conceptual Framework for Financial Reporting: The Reporting Entity*, published by the International Accounting Standards Board (IASB/the Board).

WHO WE ARE

2. The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained. We are a founding member of the Global Accounting Alliance, which has over 775,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure that these skills are constantly developed, recognised and valued.

MAJOR POINTS

Scope and Terminology

4. We are concerned that the exposure draft does not contain a description of an 'entity'. Paragraph RE2 considers a description of a 'reporting entity' without first attempting to describe what an 'entity' is. It is important that the framework should tell us what kind of thing could be subject to the accounting requirements before moving on to consider which of these could actually report. Therefore we would suggest that the description of the 'reporting entity' in RE2 be preceded by a description of the 'entity'. It may be possible to achieve this by unpacking the description of the reporting entity into those elements relating to the entity component and those to the reporting component. A possible approach is to represent the entity as 'a set of assets, liabilities and / or activities with boundaries that have been set by law or contract or that can be demonstrated in some other way'.

5. We question whether 'reporting entity' is the most appropriate term in the context of the conceptual framework. In practice there is a variety of entities with social or economic objectives whose financial information has the potential to be decision-useful to their stakeholders. Not all of these entities actually produce financial reports; for example, in the United States privately-held companies do not have a public reporting requirement. So, in the US example, most entities that would meet the definition of 'reporting' are not required to report and do not report to most of their stakeholders. At least, this Chapter should note that it is really talking about 'reportable' entities. Which ones are actually reporting is a matter for regulators and others, not for the IASB. Therefore we feel it would be useful for the text to contain a statement upfront on the interaction between local legal requirements for certain entities to report and the aims of the conceptual framework in this regard. One approach would be for the framework to contain a statement to the effect that local legal requirements may or may not require a wide variety of entities to prepare financial statements and that the framework requirements do not seek to disturb this.

Boundary of the Reporting Entity

6. Further consideration may be necessary of the boundary of the reporting entity in the context of creditors. Paragraph RE4 states that 'the existence of a legal entity is neither necessary nor sufficient to identify a reporting entity'. Creditors, who are identified as a sub-group of primary users in RE2, are likely to be interested in the legal boundaries of an entity; either the

boundary for a limited liability entity (where there is no further security from outside the legal entity), or the contractual boundary for a borrower group in a debt agreement. In such situations the creditor will be interested in legal liability, whether statutory or contractual, as one of the factors that may be relevant in defining the information in the financial statements..

7. Branches should also be considered, particularly in light of the statement that legal liability may not be a defining criterion. Clarification is necessary as to whether an individual branch could be deemed a reporting entity and how this would operate in practice where the branch was a sub-set of a larger reporting entity, including what the relationship was between branch and ‘mother-ship’.

Overlap with Chapter 1 of the Conceptual Framework

8. We think that the reporting entity chapter of the conceptual framework should not reiterate elements of the objective of financial statements which are already outlined in Chapter 1. We have no particular concerns with the first part of the description in paragraph RE2 that ‘a reporting entity is a circumscribed area of economic activities’. However, we feel that beyond that the description repeats concepts expressed in Chapter 1. This repetition does not add usefully to the description of the reporting entity, and by re-visiting the same concepts differences could arise in their interpretation. We suggest that the description be revised to refer to Chapter 1. This is illustrated in the following wording; ‘…whose financial information [if presented in the form of general purpose financial statements] has the potential to be useful to [parties identified in chapter 1 as being the users of general purpose financial statements].

Features of a Reporting Entity

9. There is an unhelpful lack of precision in the description in paragraph RE3 of the features of a reporting entity. The paragraph lists three such features which appear fully to cover the criteria in S1 and RE2. There is then a qualification that, while these three features are necessary, they are not always sufficient to identify a reporting entity. This raises the question of what any additional features might be. Prior to this point the paragraph appears to be attempting to portray a comprehensive list, defined deliberately in broad terms. By adding the final, qualifying sentence, the three features are shown to be not comprehensive after all. If the Board knows what the additional necessary features are, they should tell us. If not, the last sentence of RE3 should perhaps be deleted. Otherwise, the basic definition will remain unclear and, hence, not fit for purpose.

Control should not be described in this chapter of the conceptual framework

10. We feel particularly strongly that the reporting entity chapter of the conceptual framework is not the correct place to describe control. Control is a pervasive concept. It not only determines the identification of a subsidiary, it also informs the more pervasive definition of an asset. In our opinion the board should give further consideration as to how a single unique description of this concept of control could be set out in IASB literature. Wherever that is, we believe this chapter of the conceptual framework is not the appropriate place to do it.

Requirement to prepare consolidated financial statements

11. We feel that it is not the place of the framework to specify when a particular accounting requirement should be applied – this is best addressed at the standards level. Paragraph RE8 requires controlling entities to prepare consolidated financial statements, while RE8 – RE12 contain other requirements specifying when certain types of accounting should be adopted. It would be preferable if the framework were to limit itself to providing descriptions of consolidated, parent-only and combined financial statements as available types or options and then leave the standards to decide when these should be prepared.

Exemption for Sub-groups

12. The description in paragraph RE8 needs to be re-visited to avoid any suggestion that intermediate controlling entities should necessarily prepare consolidated financial reports. The

ED does not explicitly recognise this situation and additional clarity may be needed to ensure that exemptions may continue to be offered to intermediate controlling entities. This is particularly necessary if our suggestion above is not accepted, that specification of when consolidated accounts should be prepared is only made at standards level.

Dependence on Cash Flows

13. We are also concerned about the rationale that is used in justification of the conclusion in RE8. We do not accept that dependence on cash flows is a sufficiently specific indicator to identify uniquely the relationship between a controlling entity and the entities it controls. Paragraph RE8 suggests that consolidated accounts should be prepared because investors in the controlling entity often 'depend significantly' on cash flows from the entities controlled. Dependence on the cash flows of another entity is neither necessary nor uniquely indicative of a parent-subsidiary relationship. There are, for example, many cases where an entity depends on material cash flows from an investment but does not have control of it. Thus we conclude that application of the concept of reliance on cash flows is not relevant to the determination of which entities should present consolidated statements.

14. In our view, RE8 misses the point. Assets are things controlled. If entity A controls entity B, then it controls entity B's assets, so all the assets should be added together in the group entity's balance sheet.

Joint Control

15. We feel that the proposals as presented are incomplete without adequate consideration of proportionate consolidation. Paragraph RE9 excludes jointly controlled entities from consolidation without any consideration of whether proportionate consolidation may be appropriate, while BC26 explains that the board has decided not to address this area. In our response to ED9 *Joint Arrangements* we explained that we felt the case had not yet been made as to whether or not proportional consolidation is appropriate where control is shared. In our view this area needs further consideration before the method can be excluded as it currently is in RE9. If our suggestion in paragraph 11 above is heeded, proportionate consolidation can simply be described as a method of combining accounts, leaving appropriateness of use to the standards level.

Parent-only Financial Statements

16. We agree that controlling entities should be able to present 'parent-only' financial information. We believe that, where this is done, it is essential for the information to be clearly differentiated from consolidated financial information. However, we believe that the requirement in paragraph RE11 that parent-only financial statements should be presented together with consolidated financial statements is unnecessarily prescriptive, and in some territories may be in conflict with local jurisdictional requirements. With appropriate controls in place, it may be acceptable for parent-only financial statements to be published on a different date or in a different document. For example, a parent and its group might present statements under different GAAPs. Any restriction would be better tackled at the standards level, not in the conceptual framework, and consideration should be given as to whether this is purely a regulatory issue beyond the scope of standard IFRS.

Combined Financial Statements

17. We agree that combined financial statements might provide useful information about commonly-controlled entities as a group. However, we think that a proper assessment of management's stewardship necessitates the presentation of results attributable to a cohesive group under unified direction. This may not be the case for combined financial statements, in cases where different entities have the same owner but management and governing boards that are completely separate and isolated from each other. Therefore, while we support provision for combined financial statements, it may be appropriate to restrict the definition to a

set of commonly directed entities to ensure consistency with the objective of general purpose financial reporting.

RESPONSES TO SPECIFIC QUESTIONS

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? (See paragraphs RE2 and BC4–BC7.) If not, why?

18. There are several aspects of the presentation or context of the reporting entity description with which we do not agree: Firstly we note that the description progresses straight to the 'reporting entity' without first describing the 'entity'. In telling us what kind of entities can report we believe it is essential that the framework first consider what an 'entity' is. It may be possible to achieve this by unpacking the description into those parts that describe the entity and those that relate to reporting.

19. While we have no particular concerns with the first part of the description of a reporting entity as 'a circumscribed area of economic activities', we are concerned that the remainder of the description repeats concepts surrounding the objective of financial reporting which are already addressed in Chapter 1 of the conceptual framework.

20. We feel that the objective of financial statements is best addressed solely in Chapter 1. The re-visiting of concepts between chapters could lead to a divergence in interpretations. Duplication of the concept serves no additional purpose.

21. In addition, we are concerned that the proposals do not currently give any consideration to the interplay between local legal requirements for certain entities to report and the aims of the conceptual framework in this respect. The framework should acknowledge that local legal requirements may or may not require a wide variety of entities to prepare financial statements, and that it does not seek to disturb these.

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? (See paragraphs RE7, RE8 and BC18–BC23.) If not, why?

22. We believe that it is not the place of the framework to specify when a particular accounting requirement should be applied and therefore we do not agree with the various requirements contained in paragraphs RE8-RE12. Such restrictions are best dealt with at the standards level. Rather, we suggest that the framework should contain descriptions of what consolidated, parent only and combined financial statements are, and then should leave their application to the appropriate standard.

23. If this is not done, further adjustments and amendments will be required. As currently drafted for example, the description does not consider parents that are intermediate controlling entities. For these parents (in practice, the majority of parents), the production of consolidated financial reports at the sub-consolidation level would often not justify the cost. The current description should therefore be re-considered to avoid its potential interpretation as a prohibition on exempting intermediate controlling entities from the consolidation requirement.

24. We also feel strongly that the description of control should not be incorporated in the reporting entity chapter of the conceptual framework. The description of control is relevant not only for determining which entities should be consolidated, but also in the wider identification of an asset. It is not desirable that these two purposes should be separated if the term itself is identical. Rather, there should be a single description of control.

25. Currently, there is one definition of control in ED 10 *Consolidated Financial Statements* to be used in the determination of subsidiaries, and another in paragraph 57 of the current framework to identify where an entity may recognise an asset. This ED represents a third iteration of the concept. We urge the Board to develop a single description of control, but reiterate that this chapter of the conceptual framework is not the appropriate place for it. The definition could be *applied* here in the context of groups.

26. Furthermore, we do not agree entirely with the description of control as stated in paragraph RE7. In our response to the preceding discussion paper (ICAEW REP 107/08), we explored issues surrounding ‘the ability to direct’, notably the question of how ‘present’ the ability needs to be. We do not feel that this chapter is the appropriate place to consider these issues further.

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? (See paragraphs RE6 and BC10.) If not, why?

27. We believe that this requirement needs further development in the context of creditors. RE2 identifies creditors as one of the sub-groups of users of financial statements. Creditors will be interested in the legal boundaries of an entity; either that surrounding a limited liability entity, or the contractual boundary for a borrower group in a debt agreement. In such situations the creditor will be interested in legal liability, whether statutory or contractual, as one of the factors that may be relevant in defining the information in the financial statements.

28. .Branches should also be considered in more detail. In particular we note the question surrounding whether a branch can be an independent reporting entity when it is a sub-set of a larger legal entity which itself reports. Articulation of this relationship and when it would be appropriate for a branch to report separately would be helpful. In addition, we note that we would not expect the requirement to result in practice in a compulsion for inappropriate fractional reporting. The ED uses the term ‘could qualify’. Any strengthening of this term that could imply a blanket compulsion to examine entities for possible granularisation would be inappropriate and unhelpful.

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 concept should not be delayed until those standards have been issued? (See paragraph BC27.) If not, why?

29. We agree. Appropriate description of the reporting entity at the framework level is necessary to ensure that the concept can be applied consistently in the development of standards. Therefore work to complete this chapter of the framework should proceed without delay to support the further development of standards in this area.

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