

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London
United Kingdom
EC4M 6XH

Email: commentletters@iasb.org

16 July 2010

Dear Sir David,

Re: Exposure Draft ED/2010/2 Conceptual Framework for Financial Reporting – The Reporting Entity

Deloitte Touche Tohmatsu is pleased to respond to the International Accounting Standards Board's (the IASB's) *Exposure Draft ED/2010/2 Conceptual Framework for Financial Reporting – The Reporting Entity* (referred to as the 'exposure draft' or 'ED').

We generally agree with the proposals. In particular, we agree with the proposed definition of a reporting entity and with the requirement that a parent should present consolidated financial statements when it controls another entity. However, we do not believe that it is appropriate to define the concept of control as part of this chapter of the Conceptual Framework. For the purpose of defining the reporting entity, it is sufficient to explain why consolidated financial statements should be presented when an entity controls one or more entities. We believe that the concept of control transcends this project because control is used elsewhere in IFRSs (e.g., the proposed revenue recognition model and derecognition). Accordingly, we recommend that the Board undertakes a project that would analyse how control is used in existing and proposed IFRSs and develops the concept of control that can be used to underpin the definitions of control used in various IFRSs. However, this future project should not delay completion of the chapter on the reporting entity or the projects that rely on the notion of control.

We agree with the conclusion that parent-only financial statements may provide useful information. However, we do not believe that the Conceptual Framework should specify the timing and the manner in which parent-only financial statements should be presented in relation to consolidated financial statements. In several jurisdictions, the filing deadline for parent-only financial statements is set at an earlier date than the filing of consolidated financial statements. The Board's proposals would be difficult to implement in these jurisdictions and may hinder a wider acceptance of IFRSs.

The Board appears to suggest that combined financial statements should only be prepared for a group of entities under common control. We question why such a restriction is warranted as it appears to be at odds with the broad definition of what constitutes a reporting entity.

Our view on the reporting entity may continue to evolve given the other phases of the proposed Conceptual Framework that are still in progress or yet to be started. Further, we believe that the individual chapters of the

Conceptual Framework should not be finalised (or at least not made effective) until all chapters are finalised to ensure that the overall Framework forms a cohesive set of principles.

Our detailed comments and responses to your questions on the exposure draft along with other comments are included in the Appendices to this letter.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 207 007 0884.

Sincerely,

A handwritten signature in black ink, appearing to read 'V Poole', with a stylized flourish at the end.

Veronica Poole
Global IFRS Leader – Technical

Appendix 1

Response to questions on Exposure Draft ED/2010/2 Conceptual Framework for Financial Reporting – The Reporting Entity

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?

We generally agree with the proposed definition of a reporting entity. However, we note that as part of the development of Chapters 1 and 2 of the Conceptual Framework, the Board has established the objective of general purpose financial statements. The Board also established that the primary user group includes both present and potential equity investors, lenders and other creditors, regardless of how they obtained, or will obtain, their interests. Given that the primary user group is already identified in another chapter of the Conceptual Framework, we believe that it would be more appropriate for the definition of the reporting entity to refer to this established primary user group rather than to redefine it. This would assist in linking the concepts defined in the various chapters of the Conceptual Framework. Accordingly we suggest that the definition of the reporting entity be amended as follows:

“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 the primary user group of general purpose financial statements, as defined in Chapter 1 of the Conceptual Framework.”

If our suggestion is not incorporated into the final Chapter, we believe the definition of the reporting entity should not specify that users of the financial statements need to assess whether management and the governing board “*have made efficient and effective use of the resources provided.*” Instead, the definition should establish more broadly that the users need to obtain the information to “assess management’s performance in discharging its stewardship responsibilities.”

In connection with the definition of the reporting entity, paragraph RE3 of the ED describes three features that are necessary “but not always sufficient to identify a reporting entity.” However, the ED does not provide circumstances in which these features would not be sufficient and what other features may be necessary. We believe that the Board should clarify paragraph RE3.

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?

We agree with the principle that consolidated financial statements provide useful information and should be presented whenever an entity that controls one or more entities prepares financial reports.

We note that IAS 27 includes an exemption that permits intermediate parents not to prepare consolidated financial statements in certain circumstances. We also note that the Board is considering an exception to IAS 27 with respect to certain investment companies. We believe that the Board should address how these exceptions/exemptions interact with the principle in RE8 as part of the basis for conclusions in the consolidation and investment company standards.

While we agree that control is a fundamental concept, we do not believe that it should be defined as part of the chapter on the reporting entity. Control is used in IFRSs not only to determine the entities that should be

consolidated by the reporting entity but also, among other things, to determine the assets to be recognised by the reporting entity, when items should be derecognised from financial statements and it is a key concept in the proposed revenue recognition standard. Hence, if the concept of control is included in the Conceptual Framework, it would need to be addressed in its broader sense. We believe that the definition of control in paragraphs RE7 and RE9 should be removed, together with the definition of significant influence in paragraph RE10. For the purposes of defining the reporting entity, it is sufficient to explain *why* consolidated financial statements should be presented when an entity controls one or more other entities. We recommend that the Board undertakes a project to analyse how the notion of control is used in existing and proposed IFRSs and develops the concept of control that can be used to underpin the definitions of control used in various IFRSs. However, this should not delay completion of the chapter on the reporting entity or of the various projects at the Standard-level that rely on the notion of control.

If the Board rejects our suggestion and decides to maintain a definition of control within the chapter on the reporting entity, we believe that the definition needs to be improved and should not be finalised until the revised consolidation standard is completed. The proposed definition fails to capture certain key elements. For example, it is unclear whether a reporting entity would consolidate a special purpose entity whose day-to-day decisions are predetermined (i.e., entities on auto-pilot).

Paragraph RE8 implies that the reason why consolidated financial statements should be prepared when a parent controls a subsidiary is that parent entities often depend significantly on the cash flows and other benefits they obtain from their subsidiaries. We do not agree that dependence on cash flows and on the benefits obtained from subsidiaries is indicative of control or justifies consolidation. In fact, in some industries, entities conduct substantial activities through joint ventures and may be dependent on the cash flows and benefits obtained from these joint ventures. This does not mean that joint ventures should be consolidated by their venturers.

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?

We agree that a portion of a legal entity could qualify as a reporting entity. We believe that this concept is clear by itself in the ED. However, the examples provided in paragraphs RE6, BC20 and BC21 do not provide additional clarity and may be interpreted as imposing some criteria that are unnecessary and potentially inappropriate. Hence, we suggest eliminating these examples in the final Chapter. It would be sufficient to include the principle that a subset of a legal entity would be a reporting entity if it meets the definition established in the Conceptual Framework.

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?

Following on from our response to Question 2 where we expressed the view that the definition of control should not be included in the chapter on the reporting entity, we believe that the reporting entity concept can be finalised even though the consolidation standard has yet to be finalised. The Conceptual Framework should be viewed as an evolving document that is updated as necessary. We encourage the Board to pursue completion of its projects on the Conceptual Framework.

However, should the Board decide to maintain a definition of control within the reporting entity chapter, we believe that it would be preferable to delay completion of this chapter until the revised consolidation standard is finalised. This will avoid the need to revise the definition of control in the Conceptual Framework as a result of the revised consolidation standard.

Appendix 2

Additional Comments

Below are additional comments we would like the Board to consider when finalising the concept of the Reporting Entity.

Authoritative status of the framework:

We agree with the conclusion in paragraph P10 of the ED that the Conceptual Framework does not override authoritative Standards and some may be inconsistent with the Conceptual Framework. Nonetheless, we believe that when the Board decides to deviate from the Conceptual Framework in developing a Standard, the reasons that led to this decision should be explained in the Basis for Conclusions of that Standard. This would ensure a more consistent application of IFRSs, in particular when management must use its judgement in developing an accounting policy in accordance with IAS 8.10. We suggest that paragraph P10 be modified to address this issue.

A legal entity may fail to represent a reporting entity

Paragraph RE5 of the ED indicates that “a single entity may not qualify as a reporting entity”. We understand that the Board wants to ensure that two entities that are identical, except for the fact that one of them has divided its activities into two or more separate legal entities, present comparable financial statements. We agree with this objective. However, we note that 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 of these entities may be prevented from presenting general purpose financial statements under IFRSs. Hence, we encourage the Board to reconsider the principles in paragraph RE5. Also, the discussion in paragraph BC20 as an example of the principle in RE5 should require the preparation of consolidated financial statements in situations of control.

Parent-only financial statements

We agree with the conclusion in paragraph RE11 that parent-only financial statements may provide useful information. In fact, these financial statements often provide useful information. However, we do not agree that the Conceptual Framework should specify the timing and the manner in which parent-only financial statements are presented in relation to consolidated financial statements. In particular, we disagree with the requirement that parent-only financial statements *must* be presented together with the consolidated financial statements. As a matter of principle, we believe that it would be sufficient for the consolidated financial statements to be **available** if parent-only financial statements are presented and the availability of the consolidated financial statements is communicated in the parent-only financial statements.

Further, we believe that paragraph RE11 should be clarified to specify that the parent-only financial statements are prepared in accordance with IFRSs. In many jurisdictions, parent-only financial statements are prepared in accordance with national standards. It would be inappropriate to impose restrictions on the production of these parent-only financial statements as part of the Conceptual Framework.

Combined financial statements

We agree with the conclusion in paragraph RE11 of the ED that combined financial statements may provide useful information and that such financial statements could represent general purpose financial statements. However, the ED appears to propose that combined financial statements should be restricted to the combination of entities under common control. The Board has not provided an explanation for this restriction that seems to be at odds with the broad definition of the reporting entity.

In practice, we believe that combined financial statements may also provide useful information about entities that are under the common ownership of a group of individuals, rather than under common control. Further, combined financial statements may also provide useful information when entities are not controlled by a single entity but are bound by some business links. Accordingly, we believe that the appropriateness of the presentation of combined financial statements should be based on the definition of a reporting entity.

As a separate matter, we believe that the Board should clarify that, to the extent one of the combining entities itself controls one or more entities, the combined financial statements should include all of the controlled entities.

General vs. special purpose financial statements

As part of the development of Chapter 1 of the conceptual framework, the Board has indicated that it intends to consider the boundaries of general purpose financial reporting in a later phase of the conceptual framework project. We believe that this remains an important issue to be addressed. The current ED includes a section that addresses “other types” of financial statements. This section includes parent-only financial statements and combined financial statements. RE4 states that a reporting entity can be portion of a single entity. This appears to imply that general purpose financial statements can be prepared for a carved-out entity. However, the ED does not address whether, and under which circumstances, this may be appropriate. We believe that it would be useful to clarify this matter.