

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

Email: commentletters@iasb.org

29 September 2008

Dear Sir David,

Discussion Paper Preliminary Views on an improved 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) *Discussion Paper Preliminary Views on an improved Conceptual Framework for Financial Reporting – The Reporting Entity* (referred to as the 'discussion paper' or 'DP').

We agree with, and support, the majority of the proposals made by the Board in this DP. We conceptually agree with the proposed definition for a reporting entity and support the proposal to keep the definition broad. However, we believe that the broadness of the definition should be supplemented by more discussion on why it is important to define the concept of what constitutes a reporting entity. Similarly, while we concur that control should be defined at the conceptual level and that the controlling model should be used to define entities to be included within consolidated financial statements, we suggest that the Board expands its discussion on the matter and clarifies certain aspects. One of the key aspects of the controlling model that needs to be clarified at the conceptual level is whether consolidation is appropriate when an entity (the investor) controls at the present time another entity (the investee) or whether it is appropriate when the investor has the ability to obtain control, at present, over the investee. The ambiguity is evidenced by the fact that, on the one hand, the DP defines control as "having the *ability* to determine..." while on the other hand it indicates in paragraph 154 that "the ability to take control" does not translate in having control at the present time.

Finally, we agree that there is a need to allow the preparation of general purpose "group" financial statements in certain circumstances not captured by the controlling entity model. However, we believe that the common control model fails to capture all of these circumstances and we find that the restriction on the preparation of combined financial statements contradictory to the principle of allowing for a broad definition of a reporting entity.

Our detailed comments and answers to your questions on the DP are included in the Appendix to this letter.

If you have any questions concerning our comments, please contact Ken Wild in London at +44 (0)20 7007 0907.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Ken Wild', with a long horizontal stroke extending from the end of the signature.

Ken Wild
Global IFRS Leader

Appendix

Response to questions on Discussion Paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting – The Reporting Entity*

Scope

Section 1: The reporting entity concept

Question 1

Do you agree that what constitutes a reporting entity should not be limited to business activities that are structured as legal entities? If not, why?

We agree with the Board's proposal that a reporting entity should not be defined based on the existence of a legal entity. The existence of a legal entity may be indicative of a reporting entity, but it should not be a determinative factor.

While we agree that the concept of reporting entity should remain broadly defined, we believe that it would be useful to provide factors that might indicate that a unit is a reporting entity. In particular, we believe that there should be a valid reason that justifies that the label "reporting entity" can be used to define a group of activities, such as a framework (e.g. a management structure) that helps define the activities of a reporting entity.

Question 2

Do you agree that the conceptual framework should broadly describe (rather than precisely define) a reporting entity as a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers? If not, why? For example, do you believe that the conceptual framework should establish a precise definition of a reporting entity? If so, how would you define the term? Do you disagree with including reference to equity investors, lenders and other capital providers in the description (or definition) of a reporting entity? If so, why?

We support the Board's suggestion to keep the definition provided at the conceptual framework broad. We believe that flexibility is required in defining the concept of a "reporting entity" to meet the needs that may arise with respect to financial reporting in various jurisdictions.

However, we believe that in order to compensate for the vagueness of the definition, it would be helpful if the Board provided an explanation of why it is important to define the concept of what constitutes a reporting entity. We would expect that the concept of a "reporting entity" is required to determine whether general purpose financial statements can be prepared for a set of activities and to determine what should be included or excluded from the reporting entity's financial statements. Such guidance could be used to ensure that reporting entities are defined in practice in a manner that is consistent with the purposes for which the concept was drawn. In the absence of further guidance, the concept of a "circumscribed area of business activity" may be applied inconsistently. For example, if an individual held an operating entity (say entity A), real estate assets used by entity A and also other real estate used for personal purposes, would it be appropriate to define the reporting entity as being comprised solely of entity A? Should the circumscribed area of business activity also include the real estate used by A? Could the reporting entity be expanded to include the personal real estate?

Additionally, while we agree with the underlying concept used in the definition, we have some concerns about the fact that the words chosen (in particular “business activities”) could be interpreted as not encompassing not-for-profit and non-commercial entities or dormant structures. We encourage the Board to consider whether wording could be found that would ensure that all of these entities could be considered as reporting entities.

Section 2: Group reporting entity

Question 3

Do you agree that the risks and rewards model does not provide a conceptually robust basis for determining the composition of a group reporting entity and that, except to the extent that it overlaps with the controlling entity model (as discussed in paragraphs 102 and 103), the risks and rewards model should not be considered further in the reporting entity phase of the conceptual framework project? If not, why?

In principle, we agree that it is reasonable to consider the control model as superior. However, we find the level of discussion provided in the DP insufficient to assess whether the risks and rewards model could represent a robust model.

Question 4

Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that:

(a) control should be defined at the conceptual level?

(b) the definition of control should refer to both power and benefits?

If not, why? For example, do you have an alternative proposed definition of control?

We generally agree with the Board’s proposals. Given that control is an essential concept that is used in various Standards, it needs to be defined at the conceptual level to ensure consistency in application of the concept.

While we agree that it is appropriate that the definition of control refers both to power and benefits, we believe that the nature and the extent of the benefits available as a result of control should be explained. An explanation of the benefits normally derived from control would help in distinguishing whether the relationship that parties, such as trustees or managers exercising powers delegated to them, have with an entity does in fact represent control.

We also note that the definition of control provided in the DP, by itself, will be difficult to apply in practice. The definition overlooks the fact that the existence of control and power is not an on/off switch. Control and power are often a continuum. Cases are rare where one party has absolute control over all decision making. What determines if an entity has enough control? How is the existence of control assessed in a situation where governing documents define or pre-set most activities (allowing for little discretion)? Who has control when one party has power over a set of decisions and another party has power over another set of decisions? These questions will need to be addressed by the Board at the standards level but we believe that it would be useful if the DP acknowledged that the existence of control and power is often not a black or white situation.

As a separate matter, we are unclear about what aspect of a relationship evidencing control is meant to be covered by the part of the definition of control that indicates “*and increase, maintain or protect the amount of those benefits (or reduce the amount of those losses)*” and why this part is needed. To ensure that the definition of control is well understood and applied consistently, we suggest that the Board should clarify this part of the definition.

Question 5

Do you agree that the composition of a group reporting entity should be based on control? If not, why? For example, if you consider that another basis should be used, which basis do you propose and why?

We agree that control is the appropriate basis on which the composition of a group reporting entity should be determined.

Question 6

Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that the controlling entity model should be used as the primary basis for determining the composition of a group entity? If not, why?

We agree that the primary basis for determining the composition of a group entity should be the controlling entity model. However, we believe that the Board needs to clarify at the conceptual level whether, under the controlling model, consolidation is appropriate when an entity (the investor) controls at the present time another entity (the investee) or whether it is appropriate when the investor has the ability to obtain control, at present, over the investee. The ambiguity is evidenced by the fact that, on the one hand, the DP defines control as “having the *ability* to determine...” while on the other hand it indicates in paragraph 154 that “the ability to take control” does not translate in having control at the present time.

Question 7

Do you agree that the common control model should be used in some circumstances only? If not, why? For example, would you limit the composition of a group reporting entity to the controlling entity model only? Or would you widen the use of the common control model? If you support the use of the common control model, at least in some circumstances, do you regard it as an exception to (or substitute for) the controlling entity model in those circumstances, or is it a distinct approach in its own right? Please provide reasons for your responses.

We believe that there is a need to allow the preparation of general purpose “group” financial statements in certain circumstances not captured by the controlling entity model. We would view the financial statements prepared in these circumstances as distinct from consolidated financial statements and accordingly they should carry a different label, such as “combined financial statements”. Similarly to the definition of reporting entity, we believe that, in such circumstances, a valid reason would be needed to justify the existence of a group reporting entity, for example an agreement joining the various entities as a group. The existence of common control would be one of these reasons. However, we are concerned that the common control model may not capture all the structures for which we believe group reporting would be justified. More specifically, we believe that there is an apparent contradiction to permit a very broad definition of reporting entity but a restrictive definition of group reporting entity. It also brings into question whether there is a basis to justify restricting the circumstances in which combined financial statements can be prepared. For example, if the existence of a *circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers* can be demonstrated, it appears that the restrictions surrounding combined financial statements could be avoided by defining the reporting entity more broadly. Accordingly, we suggest that the Board reconsider the basis for restricting the preparation of combined financial statements.

Section 3: Parent entity financial reporting

Question 8

Do you agree that consolidated financial statements should be presented from the perspective of the group reporting entity, not from the perspective of the parent company's shareholders? If not, why?

We agree that consolidated financial statements should be presented from the perspective of the group reporting entity.

Question 9

Do you agree that consolidated financial statements provide useful information to equity investors, lenders and other capital providers? If not, why?

We generally agree with the Board's proposals. However, we recognise that, depending on the business model followed by an entity, the preparation of consolidated financial statements may not provide all of the useful information required by users, in particular, for investment companies for which the business model is to buy, hold and sell investments. For these entities, users may find that the preparation of financial statements that present investments at fair value, rather than on a consolidated basis, may also result in meaningful information since it provides a more representationally faithful reflection of their business activities.

Question 10

Do you agree that the conceptual framework should not preclude the presentation of parent-only financial statements, provided that they are included in the same financial report as consolidated financial statements? If not, why?

Parent-only financial statements serve a different purpose than the consolidated financial statements and accordingly we believe that entities that wish to do so should be permitted to prepare parent-only financial statements. We do not agree with the requirement to include parent-only financial statements in the same report as the consolidated financial statements. We believe that the current requirement that the consolidated financial statements should be available is sufficient, as long as the parent-only financial statements disclose the fact that consolidated financial statements are also available.

Section 4: Control issues

Question 11

With regard to the concept of control, in the context of one entity having control over another, do you agree that:

- (a) establishing whether control exists involves assessing all the existing facts and circumstances and, therefore, that there are no single facts or circumstances that evidence that one entity has control over another entity in all cases, nor should any particular fact or circumstances—such as ownership of a majority voting interest—be a necessary condition for control to exist? If not, why?**

We agree with the proposal.

- (b) the concept of control should include situations in which control exists but might be temporary? If not, why?**

We agree with the proposal.

- (c) the control concept should not be limited to circumstances in which the entity has sufficient voting rights or other legal rights to direct the financing and operating policies of another entity, but rather should be a broad concept that encompasses economically similar circumstances? If not, why?**

We agree with the proposal.

- (d) in the absence of other facts and circumstances, the fact that an entity holds enough options over voting rights that, if and when exercised, would place it in control over another entity is not sufficient, in itself, to establish that the entity currently controls that other entity? If not, why?**

We believe that this issue is more suited to be addressed at the standard level. However, as noted in our response to Question 6, we believe that the Board needs to clarify at the conceptual level whether, under the controlling model, consolidation is appropriate when that an entity (the investor) controls at the present time another entity (the investee) or whether it is appropriate from the investor having the ability to obtain control, at present, over the investee.

- (e) to satisfy the power element of the definition of control, power must be held by one entity only? In other words, do you agree that the power element is not satisfied if an entity must obtain the agreement of others to direct the financing and operating policies of another entity? If not, why?**

We believe that this issue cannot be addressed without a description of what constitutes protective and participating rights. As such, this issue is more suited to be addressed at the standard level and we will provide further comments in our response to the exposure draft on Consolidation .

- (f) that having ‘significant influence’ over another entity’s financing and operating policy decisions is not sufficient to establish the existence of control of that other entity? If not, why?**

We agree with the proposal, although we do not believe that the proposal is needed since it appears self-evident that having significant influence over an entity is not sufficient to establish the existence of control over that entity.

Question 12

Should any of the above control issues be addressed at the standards level rather than at the concepts level? If so, which issues and why?

Please refer to our response to question 11.

Question 13

Are there any other conceptual issues, relating either to the control concept or to some other aspect of the reporting entity concept, that are not addressed in this discussion paper and should be addressed at the concepts level? If so, which issues and why?

We are not aware of other conceptual issues relating to the control concept or to some other aspect of the reporting entity concept that should be addressed at the conceptual level.