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Mr Kevin Stevenson
 Chairman
 Australian Accounting Standards Board
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Dear Mr Stevenson

Kevin

**EXPOSURE DRAFT 193 CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING:
 THE REPORTING ENTITY**

The Heads of Treasuries Accounting and Reporting Advisory Committee welcomes the opportunity to provide comments to the Australian Accounting Standards Board on IASB Exposure Draft 193 *Conceptual Framework for Financial Reporting: The Reporting Entity*.

Comments by HoTARAC on questions from the Exposure Draft are in Attachment 1.

HoTARAC generally agrees with the concept of control that has been explored within the Exposure Draft, but notes inconsistencies with the IASB's Consolidations Project. However, HoTARAC has not been able to fully consider the ramifications to the public sector within the timeframe provided.

HoTARAC considers that it would be opportune for the AASB to explore the IASB's proposed reporting entity concept under the current Framework, and notes that the Board has undertaken a joint Project with the New Zealand Financial Reporting Standards Board on control in the public sector. This joint Project may change the concept of control.

The fundamental principle underpinning the Accounting Standards and the Framework is that reporting entities should prepare general purpose financial statements, and that Accounting Standards are developed for such entities. HoTARAC is concerned that the reporting entity chapter for the Framework does not address this principle. HoTARAC is of the opinion that identifying the principle and describing the characteristics of the types of entities that should prepare general purpose financial statements is essential guidance for preparers and regulators in all jurisdictions. Including such a principle does not preclude individual jurisdictions from determining who prepares general purpose financial statements. Rather, such guidance assists regulators in determining the types of entities that it may be appropriate to require to prepare general purpose financial statements.

If you have any queries regarding HoTARAC's comments, please contact Peter Gibson from the Australian Department of Finance and Deregulation on (02) 6215 3551.

Yours sincerely

A handwritten signature in black ink, appearing to read "D W Challen". The signature is written in a cursive, slightly slanted style.

D W Challen

CHAIR

HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

17 June 2010

Encl

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HOTARAC RESPONSE TO AASB ED 193 CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING: THE REPORTING ENTITY

AASB Specific Matters for Comment

Question 1

Consistent with the initial scope of the IASB-FASB Conceptual Framework Project being for-profit entities in the private sector, are there any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals by for-profit entities in the private sector.

No comment.

Question 2

The AASB plans to undertake additional consultation with constituents in relation to the applicability of the IASB-FASB proposals in the not-for-profit and public sectors. In the meantime, it would be helpful to the Board to be informed of issues that might arise if the proposals were to be applied in the not-for-profit/public sector. Accordingly, are there any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals relating to:

- (a) not-for-profit entities; and
- (b) public sector entities.

- (a) HoTARAC is unable to provide comments for not-for-profit entities in the private sector.
- (b) HoTARAC considers that the reporting entity boundary may not be appropriate to some users for the public sector, for example, when there is no legal parent entity (re objectively distinguishable – see comments to IASB Questions below). Additionally, the boundaries of a public sector reporting entity may be better based on accountability for achievement of objectives, rather than the generation of benefits or limitation of losses.

HoTARAC would also like to remind the AASB that its comments on the 2008 Discussion Paper are still valid. In particular;

- the nature of users differs in the public sector;
- the purposes of financial reporting also differ; and
- therefore, the IASB's control of an entity concept needs to be adapted to accommodate broader accountability purposes of financial reporting.

There is a need for the AASB to consider additional guidance for the public sector in regards to the circumstances when it is appropriate for a portion of an entity to be treated as a reporting entity. This is a particularly important issue for government departments. The AASB may need to fill the gap in this area and it is understood that this will be addressed in the AASB's separate Project. This is an example of where SAC 1 provides additional guidance not provided by the IASB, regarding the characteristics of a reporting entity, for example, separation between management and owners and the principle of accountability.

Question 3

Whether, overall, the proposals would result in financial statements that would be useful to users.

A minority of HoTARAC members believe that the AASB's SAC 1 is of superior quality to the Exposure Draft and consider that the AASB should carefully consider this in the creation of a Chapter on the Definition of a Reporting Entity as part of the Conceptual Framework Project.

Question 4

Whether the proposals are in the best interests of the Australian and New Zealand economies.

No comment.

IASB Invitation to Comment

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?

The majority of HoTARAC members broadly agree with the reporting entity definition, however, additional comments follow regarding the features of a reporting entity, contained in RE3, which are an integral part to the definition.

Three features of a reporting entity:

- **Economic activities** (as opposed to 2008 DP's business activities) - HoTARAC supports the change in terminology from business to economic, as this has greater applicability in the for-profit sector and the not-for-profit sector. HoTARAC is concerned that the use of the term "circumscribed area of economic activities" fails to incorporate the concept of control, which HoTARAC believes is an integral part of the definition of a reporting entity. Control needs to be made explicit in the definition. However, as currently drafted, the Exposure Draft is inconsistent as it only explicitly uses control in terms of a group reporting entity and consolidations, but it does not use control in terms of defining a single reporting entity.

Without considering control, a segment as currently defined in IAS 8 could be considered a circumscribed area of economic activities and a reporting entity, even though a segment has no capacity to control or deploy resources. HoTARAC is of the opinion that the IASB needs to include a definition or description of what constitutes an entity, rather than referring to a circumscribed area of economic activities. In Australian Accounting Standards, control is incorporated into the definition of an entity, by referring to "...the capacity to deploy scarce resources in order to achieve objectives" (SAC 1, Paragraph 6). This links with the concept of control, that is, the phrase "capacity to deploy scarce resources".

- **Objectively distinguishable** - HoTARAC considers that more guidance needs to be provided, and that there are potential issues for the public sector in applying the phrase "entity may not qualify as a reporting entity if ... its economic activities are commingled with the economic activities of another entity and there is no basis for objectively distinguishing their activities". An example that could assist the IASB in providing guidance to identify separate reporting entities would be the existence of an identical management team or governing board across economic activities with similar objectives. This, in the absence of any other legal structures, may be an indicator that all such activities are in the one reporting entity, and satisfy the concept of control of assets. It is a question of substance over form.
- **Potential to be useful** (as opposed to 2008 DP's of interest) - HoTARAC supports the change in terminology. However, additional guidance is required as the terminology is still vague. It should clarify that the users rely on the financial information of the circumscribed area of economic activities to make decisions about providing resources etc. One of the fundamental problems with accounting is that the users of the information are not well defined.

HoTARAC continues to disagree with the reference to equity investors, lenders and other creditors, especially its applicability in a not-for-profit/public sector context. This issue was previously raised by HoTARAC in its response to the 2008 Discussion Paper and is likely to be an issue when the IASB looks at Phase G: Application to not-for-profit entities. Therefore, a majority of HoTARAC members prefer the term "users" to equity investors, lenders and other creditors.

In the future, the needs of other users that are not capital providers are likely to become increasingly important, in both the public and the for-profit sectors, with the widening perspective of corporate responsibility. The use of a generic term is a more robust approach that will accommodate not-for-profit entities, but which is equally relevant to for-profit entities. However, a minority of HoTARAC members would prefer the term "resource providers" as they view the term "users" to be too general.

HoTARAC notes that RE3 states that the three features of a reporting entity are necessary but not always sufficient to identify a reporting entity. What is the meaning of "but not always sufficient"? What other criteria might there need to be for there to be a reporting entity? For example, in relation to RE3(a), if an entity is yet to conduct operations and has no assets, liabilities, revenue or expenses, then it will have nothing to report. Therefore, the first feature might be better if it includes the existence of such elements for the entity to report.

A minority of HoTARAC members disagree with the reporting entity description because they believe that a description is too ambiguous to be operationalised.

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?

Consolidated statements

HoTARAC agrees that in such situations consolidated financial statements should be presented. However, the majority of HoTARAC members question the appropriateness of including material about consolidated financial statements under the sub-heading Consolidated financial statements in the Exposure Draft, as well as inclusion of the section titled "Other types of financial statements" in such a high level conceptual document. HoTARAC considers this information is better placed in the revised Consolidation Standard. Basis for Conclusions BC11 outlines that the exploration of controlling an entity would be discussed at the Standards level and thus the information on consolidated financial statements and other types of financial statements might also be more appropriate at the Standards level. Therefore, the conceptual material should go no further than to explain how a reporting entity may comprise a parent entity and other entities controlled by that parent, and to explain the concept of an economic entity.

Regarding combined financial statements, HoTARAC considers it to be unclear as to whether this also pertains to situations where there is no entity identifiable as the controlling entity, such as in government. In which case, it is not a matter of excluding information about the controlling entity. That is, the controlling entity is included, but it is not explicitly identified. It is also unclear as to whether combined financial statements that exclude the controlling entity are general purpose financial statements or whether this constitutes a reporting entity.

The Exposure Draft implies that a parent entity may be a reporting entity, as it states that parent-only financial statements might provide useful information if they are presented together with consolidated financial statements (Paragraph RE11). However, there is no explanation to support why, and more particularly, when a parent entity may be a reporting entity. Further, the Exposure Draft does not address, at a conceptual level, why it may be appropriate in IAS 27 to exempt parent entities from preparing consolidated financial statements where they are wholly owned subsidiaries.

A minority of HoTARAC members believe that concepts regarding which model is being adopted, for example, controlling entity or common control model need to be addressed at the conceptual level. In contrast, the concern is that by including consolidated financial statements alongside combined financial statements, the Framework is unclear at the conceptual level as to which control model is being adopted, and when it may be appropriate to depart from it.

Definition of control of an entity

The majority of HoTARAC members agree with the definition of control of an entity, although, as per HoTARAC's response to the 2008 DP, clarification is required in regards to benefits – are these only financial? If yes, this should be broadened to cover other aspects like the achievement of outcomes/objectives. However, HoTARAC also notes inconsistencies between this definition of control, which is more consistent with the related 2008 Discussion Paper, and the tentative decision relating to the definition of control in the April 2010 IASB Consolidations Project (refer Paragraph 8 of IASB's Consolidations Project Report). This is of significance given that the focus of the Conceptual Framework Project is simply to define the control of an entity whereas the Consolidations Project would explore the details further (refer BC11); therefore both Projects would ideally need to use the same definition. However, a minority of HoTARAC members disagree with the definition.

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?

HoTARAC agrees. However, as mentioned in HoTARAC's response to IASB Question 1, HoTARAC considers that guidance should be provided on objectively distinguishing economic activities to assist in determining when it is a separate reporting entity. For example, if there is difficulty in distinguishing between assets within a business, then this probably implies that there are not objectively distinguishable activities. There are likely to be situations where there is too much subjectivity and it is open to manipulation by management.

A portion of an entity should only be a reporting entity when it is an entity itself, that is it has the capacity to deploy resources to achieve objectives, per the definition of an entity in Australian SAC 1, Paragraph 6. Control should be considered in defining both a single and group reporting entity. On this basis, a minority of HoTARAC members do not believe that a segment or a branch constitutes a reporting entity, as they are not capable of controlling/deploying resources.

HoTARAC considers that there is a need for a clearer distinction between a segment and a reporting entity based on a grouping of economic activities.

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?

HoTARAC agrees with the approach in principle, though care should be taken in ensuring that the results of the two Projects are consistent and do not conflict. HoTARAC notes that there are already inconsistencies between the two Projects, for example, the Conceptual Framework Project uses benefits whilst the Consolidations Project uses returns in defining control.