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Professor David Boymal
The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

9 October 2008

Dear David

Exposure Draft ED 164 and Invitation to Comment ITC 17

I am enclosing a copy of the PricewaterhouseCoopers responses to the following two documents issued by the International Accounting Standards Board:

- Exposure Draft of *An improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information*
- Discussion Paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity.*

The letters reflect the views of the PricewaterhouseCoopers network of firms and as such include our own comments on the matters raised in the Exposure Draft and the Discussion Paper.

We would welcome the opportunity to discuss our views at your convenience. Please contact me on (02) 8266 2549 or Meina Rose on 0432 320 540 if you would like to discuss this further.

Yours sincerely

Susan Horlin
Partner
Assurance

PricewaterhouseCoopers is committed to providing our clients with the very best service. We would appreciate your feedback or suggestions for improvement. You can provide this feedback by talking to your engagement partner, calling us within Australia on 1800 792 111 or visiting our website http://www.pwcfeedback.com.au/

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29 September 2008

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RE: File Reference No. 1580-100: Preliminary Views - Conceptual Framework for Financial Reporting: *The Reporting Entity*

We are responding to your invitation to comment on Phase D of the Boards' Conceptual Framework project on behalf of PricewaterhouseCoopers. "PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

Throughout this letter, references to 'discussion paper' and 'preliminary views' are used interchangeably to refer to the IASB's Discussion Paper and the FASB's Preliminary Views.

We agree with the Boards' view that to consistently achieve useful financial reporting, the body of standards taken as a whole, and the application of those standards, should be based on a framework that is sound, comprehensive and internally consistent. Until such time as IFRS is adopted in the United States, we agree that a single framework shared by both Boards is more likely to lead to convergence on a set of high-quality solutions.

We agree with the Boards that the conceptual frameworks underpin the development of financial reporting standards. This leads, however, to a need to further clarify for whom the framework is intended. We believe that some may be of the view that the framework is principally written for standard setters. While the GAAP hierarchy will be addressed in a later phase of the project, it is important that preparers understand that the Framework may have wider consequences for financial reporting.

With regard to the Boards' views on the Reporting Entity, we object to the selection of the entity perspective ahead of the parent perspective. While we agree that a reporting entity exists apart from its owners, and so support the entity perspective ahead of the proprietary perspective, as discussed in our comment letter in response to Phase A *The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-Useful Financial Reporting Information*, we believe that information regarding an entity's performance from the perspective of the parent company's shareholders is of primary importance. Information presented for the economic entity, without regard to the needs of the primary users of financial reporting, appears to be contrary to the objective of financial reporting, which is to provide decision-useful information. Furthermore, we do not believe that the perspective of the non-controlling interests, who rarely, if ever, consider the consolidated financial statements when making investment decisions, is relevant. We provide the basis for our support of the parent perspective in Appendix 1.

As noted above, we agree with the Boards that the conceptual framework underpins the development of financial reporting standards. Principles are established and key concepts defined in the framework, and these are put into practice at the standards level. We believe that, in certain instances, the Boards have gone into too much detail in the discussion paper and have covered subjects that would be better addressed outside of the conceptual framework at the standards level. Examples include the preliminary view that parent-only financial statements may be presented only if included in the same financial report as consolidated financial statements (Section 3), and certain control issues (Section 4).

The control issues, in particular, are more appropriately addressed in the IASB's current consolidation project as opposed to within the conceptual framework. We also note that amendments to the definition of control, as currently used in IFRS, as a result of the consolidation project, should be reflected in definition of control proposed in the Preliminary Views to ensure consistency.

In Appendix 2, we have included our responses related to these matters and all other specific questions posed by the Boards.

As the Boards' current discussion paper is the first of a series of perhaps as many as eight Conceptual Framework publications for consideration, our comments in this letter are subject to revision in light of the content of subsequent discussion papers, exposure drafts and standards issued by the Boards. In this context, we believe that the 'look back' contemplated in Phase H to consider whether issues addressed in earlier phases of the project require revision in the light of subsequent debate is an essential element of the development of a coherent framework and encourage the Boards not to underestimate the importance of this phase.

* * * * *

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We invite the Boards to address questions in relation to this letter to any of the following individuals. We suggest, however, in order that we may respond in the most timely manner, that the IASB initially contact either Richard Keys (+44 20 7212 4555) or Peter Hogarth (+44 20 7213 1654), while the FASB initially contact either Dave Kaplan (+1 973 236 7219) or Valerie Wieman (+1 973 236 5887).

Yours faithfully,

PricewaterhouseCoopers LLP

APPENDIX 1

The Case for the Parent Perspective

In our letter of 3 November 2006 in response to the Boards' discussion paper on the objective of financial reporting, we commented that the Boards should not prejudge the selection of the entity perspective until there had been full debate. We note the Boards acknowledgement in the feedback statement issued at the conclusion of Phase II of the business combinations project that there had not yet been comprehensive debate about the relative benefits of the economic entity and parent entity perspectives. We agree that Phase D of the conceptual framework project is the appropriate place for that debate.

Objective of financial reporting

We support the proposed objective of general purpose financial reporting from Phase A of the conceptual framework project, which is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders and other creditors in making decisions in their capacity as capital providers. Clearly, the concepts underpinning consolidated financial statements need to be consistent with this objective.

The Boards take the view that general purpose financial reports reflect the perspective of the entity rather than the perspective of the entity's equity investors, a particular group of its equity investors or any other group of capital providers. We agree that financial reports are of interest to a wide range of users that is not restricted to providers of capital, but we do not agree that financial reports are of equal importance to all interested parties.

In 2005, we met with a group of users from the investor community to solicit their views on the primary purpose of consolidated financial statements and many other financial reporting issues. While these discussions were not conclusive given our limited outreach, they did help to confirm our belief that information regarding investment performance from the perspective of the parent company's shareholders is of critical importance. This is not to say that the requirements of other users should be ignored. But accounting should not develop in a way that subordinates the interests of the parent company shareholders and makes financial reports less useful to them.

Does the entity perspective provide 'decision useful' information to parent shareholders?

We have heard arguments that the entity and parent company approaches provide equally useful information to parent shareholders so that the debate around which is the more appropriate model is irrelevant. Similarly, we note from the feedback statement issued at the conclusion of Phase II of the business combinations project that the Boards do not believe that the accounting arising from that project obscures the financial performance of the parent.

In revising the objective of financial reporting, the Boards have recognized the importance of stewardship. This concept is now firmly embedded in the exposure draft of Chapter 1 of the conceptual framework. Amongst the most important decisions that management of an entity may make are those relating to investment in and disposal of businesses. It is obvious, therefore, that capital providers will need information to enable them to assess whether management has made sensible decisions. For example, where there has been a partial disposal of a subsidiary, capital providers will seek information to enable them to determine whether this was a sound management decision. Similarly, purchases of additional interests are investments of available resources for which shareholders expect to realize economic returns. We believe that the economic substance of such transactions from a parent company perspective is similar to exchange transactions between the parent and a third party. Such accounting provides information that is more useful for parent company shareholders, but does not reduce (or impact in any way) decision usefulness from the perspective of the non-controlling interests or any other capital providers.

We note in paragraph 118 that the Boards have not rejected the parent company approach in its entirety. Additional information may be presented that is primarily directed towards the information needs of a particular group of capital providers, such as the parent company shareholders. However, we believe that this adds further complexity to what are already acknowledged to be highly complex financial reporting requirements if the parent company shareholders are required to make adjustments in order to understand the results and financial performance of the entities in which they have invested. In our view, the Boards' case in support of the entity approach is not sufficiently compelling to justify such additional complexity.

Are consolidated financial statements 'decision useful' for non-controlling interests?

As noted above, we support the proposed objective of general purpose financial reporting, which is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders and other creditors in making decisions in their capacity as capital providers. Central to this definition is the principle that information should be 'decision useful', which the Boards elaborate on in the context of assessing both cash flow prospects and stewardship. In paragraph BC1.29 of the Basis for Conclusions section of the draft Chapter 1, the Boards refer to "decisions that are made by capital providers at least in part on the basis of their legitimate reliance on financial reporting information."

While we can accept that financial reports are of interest to all providers of capital, their information needs differ. For example, there is substantial empirical evidence that equity and fixed income investors have a different focus when examining a company's annual report. In the same vein, although parent shareholders and non-controlling interests may have equity investments with similar characteristics, their information needs differ. The parent shareholders have an interest in the performance of the whole group, while the fortunes of non-controlling interests are determined only on the basis of the performance of that part of the group in which they have a financial interest, albeit that they may have an interest in transactions with the rest of the group and the broader financial and operational health and governance of the group as a whole.

We believe that a non-controlling interest would rarely, if ever, base an investment decision solely on information contained within a group financial report. Such financial information would be of limited use to them and we do not believe that they could place 'legitimate reliance' on a group annual report as a basis for an investment decision. They would instead seek out the separate or consolidated financial statements of the subsidiary entity in which they have an interest. Any concerns they may have about the impact of trading with the rest of the group would rightly be addressed in those financial statements in disclosure about related party transactions. We acknowledge that information about the broader financial and operational health and governance of the group as a whole would be obtained from consolidated financial statements, but these would not need to be prepared on an entity basis to provide this information.

It follows from the above that group financial reports do not provide information that is 'decision useful' for non-controlling interests.

Other capital providers

We agree that financial reports are of interest to a wide range of users that is not restricted to providers of equity capital. As the proposed objective of general purpose financial reporting makes clear, lenders and other creditors have a legitimate interest in financial information about a reporting entity. There are also many other interested parties, such as employees and members of the public, but we agree that they should not be the primary focus of general purpose financial reporting.

Paragraph OB6 of Chapter 1 of the draft conceptual framework describes the different information needs of equity investors, lenders and other creditors. While they have many needs in common (for example, the amount, timing and uncertainty of future cash flows) their focus may be different. Typically, lenders and other creditors have a greater interest in the security of their investment and a lesser interest in increases in the market value of the entity. But all capital providers would be concerned with the stewardship objective, to assess whether management has discharged its responsibilities.

We believe that information about the resources available to repay a loan or other creditor is more helpful if it is prepared from the parent perspective. As noted above, lenders and other creditors have an interest in the security of their investment. Accordingly, they need to understand how much cash is available or can be generated within the group and how much is leaving the group. From the perspective of a lender or other creditor, transactions with non-controlling interests are transactions with third parties. Cash paid to a non-controlling interest represents a reduction in resources available within the group. For example, where there has been a partial disposal of a subsidiary, lenders and other creditors will seek information to enable them to determine whether the proceeds received are reasonable compensation for the reduced group interest (and, hence, reduced cash flow potential) in the subsidiary. They will also, like equity investors, seek information to enable them to determine whether this was a sound management decision. For the reasons given above, we believe this information is more transparent from the parent perspective.

Theory versus pragmatism

Current standards define liabilities and equity with no mezzanine class in between. On the basis of those definitions, non-controlling interests are a separate component of equity that is treated like any other class of equity.

We acknowledge that there is no provision for separate classification for non-controlling interests. However, we believe a non-controlling interest is equity, but a different type of equity, separate and distinct from the equity interests of the parent entity shareholders.

The IASB has recently been dealing with the problem of how to treat puttable financial instruments. These instruments met the definition of a financial liability and were classified as such. However, concerns were expressed about the consequences of this treatment and IAS 32 was amended to, effectively, create a separate class of equity. The IASB made the following comment in concluding the project:

> *"The Board also agreed with constituents that additional disclosures and adapting the format of the entity's financial statements did not resolve the problem of the lack of relevance and understandability of that current accounting treatment."*

While we acknowledge that this project represented a short-term solution to a specific problem, it does highlight the problems that can flow from rules that have insufficient regard to the 'decision usefulness' of the information they require to be produced.

It is for the above reasons that we object to the entity perspective and believe that the Boards should embed in the conceptual framework, and in future standards, a foundation for financial reporting that is of the greatest use to the greatest number of users. Reporting financial results from the perspective of parent company shareholders is the most effective and efficient means to communicate decision-useful information to capital providers, and is therefore the approach most consistent with the objective of financial reporting.

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APPENDIX 2

Section 1: The reporting entity concept

Q1. 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?

> ***PwC Response:***
>
> Yes. We agree that what constitutes a reporting entity should not be limited to business activities structured as legal entities as not all businesses are operated through legal entities.

Q2. 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?

> ***PwC Response:***
>
> We agree that a broad description of a reporting entity is helpful. Because there is currently only limited mention of the reporting entity in the existing frameworks, regulators, preparers and accounting firms have developed their own notions of what constitutes a reporting entity and group reporting entity. We support inclusion of a broad description of a reporting entity in the conceptual framework as a means to maintain the ability of individuals to apply judgment, while providing sufficient parameters to support consistency in the application of that judgment.
>
> We believe that a precise definition would limit the exercise of such professional judgment and potentially limit the issuance of decision-useful information to interested parties.

Section 2: Group reporting entity

Q3. 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?

> ***PwC Response:***
>
> We agree that the risk and reward model is insufficient as a primary basis for determining the components of a group reporting entity. Risk and reward, however, is an important aspect of the 'all facts and circumstances' that need to be considered in determining whether control exists. We recommend that the Boards expand the discussion of risk and reward within the description of the control model.

Q4. 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?

PwC Response:

Yes. We believe that a broad definition of what constitutes control is appropriate at the conceptual level as it supports the conceptual discussion of the components of a group reporting entity. Specific guidance relative to determining when control exists, however, should be addressed at the standards level.

As mentioned in our cover letter, we believe that the proposed definition should be amended to the extent the current definition used in IFRS is amended through the consolidation project in order to maintain consistency.

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

PwC Response:

We agree that both power and benefits are relevant to the definition of control, but believe the reference to reducing the amount of losses is also important to retain, as suggested in paragraph 49.

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

Q5. 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?

PwC Response:

Yes. We believe that control is the appropriate basis for determining the composition of a group reporting entity.

Q6. 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?

PwC Response:

The Boards' preliminary view is that a reporting entity is a circumscribed area of business activity of interest to capital providers. This definition is intentionally broad. The concept of control is to be used to help provide parameters as to what falls within that circumscribed area. While we believe that capital providers will often use consolidated financial statements, we foresee numerous occasions where combined financial statements may be better suited to the particular needs of certain capital providers. We do not believe that the conceptual framework should identify either controlling entity or common control as a primary basis, as we believe each is appropriate under the proposed description of a reporting entity. We would prefer that capital providers and management be allowed to exercise judgment in determining which format is more decision-useful.

Q7. 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.

PwC Response:

As discussed in our response to Question 6, we believe that the common control model is a distinct approach in its own right and is not necessarily an exception to the controlling entity model. Both may be useful in establishing the boundaries of a group reporting entity. We agree with the Boards that the determination of when use of the common control model is appropriate is an issue to be dealt with at the standards level and not as part of the conceptual framework. In our view, the conceptual framework should define broad concepts and principles and should not seek to determine when particular accounting methods need to be applied.

With regard to the Boards' description of the common control model, we are concerned that the language in paragraphs 90 and 91, and the reference in paragraph 93 to these paragraphs, may be misinterpreted as requiring that, to be considered under common control, entities must have been managed together. Specifically, the final sentence of paragraph 91 may be read to imply that only entities that are managed together could represent a circumscribed area of business activity. We are aware of situations, such as certain legal reorganizations in connection with a capital raising transaction, where entities are under common control, but are not directly managed together in advance of the reorganization. We believe, in these circumstances, that combined financial statements are appropriate. We would not want the framework, or any relevant standards, to limit the application of the common control model as long as the requirements described in paragraph 93 are met.

Section 3: Parent entity financial reporting

Q8. 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?

PwC Response:

As discussed in Appendix I, we continue to strongly support presentation of financial statements from the perspective of the parent company's shareholders.

Q9. Do you agree that consolidated financial statements provide useful information to equity investors, lenders, and other capital providers? If not, why?

PwC Response:

Yes. We agree that consolidated financial statements provide useful information. However, we also believe that parent-only and combined financial statements may, at times, meet the particular needs of certain capital providers and other users of financial statements.

Q10. 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?

PwC Response:

We believe that the acceptability of parent-only financial statements and the circumstances under which they should be provided is more appropriately addressed at the standards level. We do not believe that this level of detail is appropriate at the conceptual level.

If, however, the Boards choose to retain this discussion in the conceptual framework, we believe that the Boards should consider the inconsistencies this would create with regulatory requirements in numerous jurisdictions. Many jurisdictions require IFRS-compliant, parent-only financial statements for statutory purposes. This currently does not present a conflict, due to the existing exemption in IAS 27, *Consolidated and Separate Financial Statements*, to allow for parent-only financial statements if certain criteria are met. A decision to require parent-only financial statements only if presented alongside consolidated financial statements would represent a significant burden on companies who have not previously been required to prepare consolidated financial statements. Alternatively, significant time and effort would be needed to attempt to amend existing legislation in jurisdictions that currently permit parent-only financial statements, with no guarantee of success.

In our view, parent-only financial statements satisfy a particular need and, accordingly, provide decision-useful information. Hence, their presentation should be neither precluded nor made more restrictive.

Section 4: Control Issues

Q11. 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?

PwC Response:

We agree that all facts and circumstances should be assessed. We believe that this point needs to be made more prominently, as this particular phrase does not appear until Section 4 within the discussion of specific control issues.

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

PwC Response:

We agree that all facts and circumstances should be considered as they exist at the point in time at which a determination is being made. As a result, we believe that control should include situations where control might be temporary, although in such circumstances we believe that disclosure should be required. However, for the reasons set out in our response to Question 12 below, we believe that this and the other detailed control issues discussed in Question 11 should be addressed at the standards level and omitted from the conceptual framework.

(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?

PwC Response:

We agree that control should be a broad concept encompassing circumstances that are "economically similar" to majority voting or other legal rights.

(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?

PwC Response:

We analogize this situation to a condition of temporary control and reiterate our support for an assessment of all facts and circumstances in existence at the time the assessment is made. We agree that options that, if exercised, would give an entity control over another entity should be considered, but that they are not in and of themselves sufficient to demonstrate control.

(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?

PwC Response:

We agree that the power element is not satisfied if an entity must obtain the agreement of others, unless those others are themselves controlled by the entity.

(f) 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?

PwC Response:

We agree that having "significant influence" over another entity's financing and operating policy decisions is not sufficient to establish the existence of control.

Q12. 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?

PwC Response:

We believe that it is appropriate for the conceptual framework to specify the use of a control model for purposes of determining the components of a group reporting entity and, as noted in our response to Question 4, agree that the conceptual framework should provide a broad definition of control. However, each of the circumstances discussed in Question 11 (a) to (f) is a specific case requiring a determination as to whether control exists or not. In our view, the conceptual framework should define the broad objectives and principles that underpin financial reporting. It should not seek to provide detailed answers to specific accounting questions. Hence, we believe that control should be defined at the conceptual level, and put into practice at the standards level. Accordingly, we believe that the matters discussed in Question 11 should be addressed at the standards level and omitted from the conceptual framework.

Q13. 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 conceptual level? If so, which issues and why?

PwC Response:

None noted.