

23 June 2010

Mr Kevin Stevenson  
Chairman  
Australian Accounting Standards Board  
PO BOX 204  
Collins Street West VIC 8007

Email: [standard@asb.gov.au](mailto:standard@asb.gov.au)

Dear Kevin

**ED 193 Conceptual Framework for Financial Reporting: The Reporting Entity**

Thank you for the opportunity to comment on the AASB Exposure Draft ED 193 Conceptual Framework for Financial Reporting: the Reporting Entity. CPA Australia, the Institute of Chartered Accountants in Australia (the Institute), and the National Institute of Accountants (the Joint Accounting Bodies) have considered ED 193 and our comments follow.

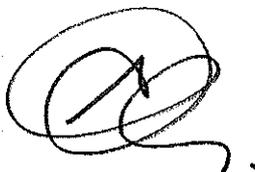
The Joint Accounting Bodies represent over 180,000 professional accountants. Our members work in diverse roles across public practice, commerce, industry and academia throughout Australia and internationally.

The Joint Accounting Bodies supports the principles set down in the Statement of Accounting Concepts 1 'The definition of the reporting entity' (SAC 1) as they have provided sound guidance for the domestic reporting environment in the past. There are features of SAC 1 that could be given greater emphasis than they currently receive in the IASB's framework that would, in the view of the Joint Accounting Bodies, provide useful guidance for preparers, users and regulators of financial statements. Commentators are divided on the extent to which principles contained in SAC 1 may have been misapplied in practice but few accountants dispute the value of a principles-based system of financial reporting.

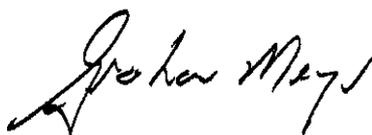
Our detailed comments in response to the AASB's questions are attached, as is our submission to the IASB.

If you require further information on any of our views, please contact Mark Shying, CPA Australia, [Mark.Shying@cpaaustralia.com.au](mailto:Mark.Shying@cpaaustralia.com.au), Kerry Hicks, the Institute, [kerry.hicks@charteredaccountants.com.au](mailto:kerry.hicks@charteredaccountants.com.au), or Tom Ravlic, the National Institute of Accountants, [tom.ravlic@nia.org.au](mailto:tom.ravlic@nia.org.au).

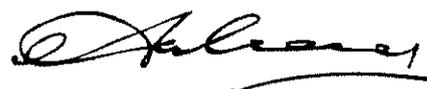
Yours sincerely



Alex Malley  
Chief Executive Officer  
CPA Australia Ltd



Graham Meyer  
Chief Executive Officer  
Institute of Chartered  
Accountants in Australia



Andrew Conway  
Chief Executive Officer  
National Institute of  
Accountants

**Representatives of the Australian Accounting Profession**



The Institute of  
Chartered Accountants  
in Australia



## AASB Specific Matters for Comment

The AASB would particularly value comments on the following:

- 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;**

Because the proposals have been drafted with the for-profit private sector in mind, we see no difficulty in applying them to the for profit private sector.

From the point of view of ease of use in Australia and clarity in drafting for constituents around the world, we would like to see some expansion of the comment in paragraph RE2 on the needs of users for financial information, leading into how the existence of such users determines whether an entity should prepare general purpose financial statements. This could be done by cross-reference to Chapter 1 of the Conceptual Framework, which deals with the objective of financial reporting. Once this need has been established, it is easier to apply the control criterion to set the boundaries for the economic activity to be reported (see paragraph 14 onwards of SAC 1 for further information). This aspect is dealt with in greater detail in our submission to the IASB, attached.

- 2. as indicated above, 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;**

Because the IASB's standards have been written for the for-profit capital markets sector, the Joint Accounting Bodies are of the view that the AASB should consider developments in overseas jurisdictions in the not-for-profit and public sectors. Some jurisdictions are developing separate suites of standards for the not-for-profit sectors and others are looking to introduce International Public Sector Accounting Standards (IPSASs). We strongly believe that developments such as this should be guided by the Single Economic Market initiative which encourages Australia and New Zealand to work together to achieve common outcomes in areas such as this.

Because the IASB proposals have been drafted with the for-profit private sector in mind, the statement does tend to focus on equity investors and potential equity investors. This would have to be broadened for the statement to be applicable across all sectors. For a more general discussion of groups of users of both private and public sector for-profit and not-for-profit accounts, see paragraph 19 onwards of SAC 1.. Nevertheless, this version of *The Reporting Entity* chapter is drafted more generally than the preliminary views issued by the IASB. In particular, we like the change of the term business activity to economic activity and the removal of some of the detail on control to a consolidation standard.

As the standard setters are aware, issues of control in the public sector are problematic as it can be argued that the government controls everything in the area of its jurisdiction. For public sector purposes, the discussion of control needs to canvass the sorts of issues dealt with in the Aus

## **AASB Specific Matters for Comment**

paragraphs of AASB 127 *Consolidated and Separate Financial Statements*, such as the accountability of an entity to Parliament or a particular minister. A focus on the user is again helpful in assessing whether the reporting entity is a department, a statutory authority or a whole government. Once this is established, the setting of the boundaries of the economic activity using a control criterion may be less problematic.

### **3. whether, overall, the proposals would result in financial statements that would be useful to users; and**

The concepts outlined in this statement will be compatible with current Australian practice and will result in decision-useful financial statements in the private sector with greater clarity in drafting as described in our response to the IASB. Further work needs to be done before it can be applied to the public sector.

### **4. whether the proposals are in the best interests of the Australian and New Zealand economies.**

The issue remains to be resolved for Australian constituents as to how this statement will fit with SAC 1 and Australian differential reporting in the foreseeable future given that the IASB's framework is still incomplete. Gaps in guidance will continue to be filled by domestic material. While Australia is committed to accepting the IASB's framework it may be worth the AASB considering how to retain some of the guidance related to users of financial statements in some form if the IASB is not more explicit on this in their final version of Chapter 2. The AASB could consider using aspects of SAC 1, not inconsistent with the IASB's framework, in a policy document the standard setter could use when setting differential reporting requirements in the future. The Joint Accounting Bodies acknowledge that a removal of existing Australian concept statements is a consequence of the move towards adoption of the IASB's framework. This does not mean user-related guidance in a policy statement would be inappropriate as a tool to assist the board in decision making on domestic financial reporting matters. These matters should be further discussed by the Board to determine an appropriate response.

23 June 2010

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

Email: [CommentLetters@iasb.org](mailto:CommentLetters@iasb.org)

Dear Sir David

**ED/2010/2 Conceptual Framework for Financial Reporting: The Reporting Entity**

Thank you for the opportunity to comment on the IASB Exposure Draft ED/2010/2 *Conceptual Framework for Financial Reporting: the Reporting Entity*. CPA Australia, the Institute of Chartered Accountants in Australia (the Institute), and the National Institute of Accountants (the Joint Accounting Bodies) have considered ED/2010/2 and our comments follow.

The Joint Accounting Bodies of Australia represent over 180,000 professional accountants. Our members work in diverse roles across public practice, commerce, industry and academia throughout Australia and internationally.

The Joint Accounting Bodies support the principles set down in the exposure draft, but suggest that further consideration of the role of users of financial reports would assist in determining the boundaries of the reporting entity.

The current proposals are an improvement on the preliminary views paper on the reporting entity, issued in 2008. In particular we congratulate the boards on taking up constituents' comments recommending that some of the detail be moved to an accounting standard on consolidation and describing the area of activity as economic rather than business activity.

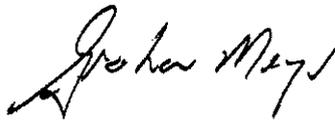
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Yours sincerely



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## IASB specific matters for comment and general comments on the text of the exposure draft

- 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 agree with this definition, but note that it would require broadening for use outside the for-profit private sector.

Paragraph RE2 picks up on the objective of financial reporting dealt with in the draft of Chapter 1 of the Conceptual Framework, ie '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' (referred to in this submission as 'the users'). We would like to see some expansion on this comment on the needs of users for financial information, because consideration of the users assists in determining the boundaries of the reporting entity. Once the users have been established, the control criterion is then used to establish the boundaries of the economic entity to be reported on. For example, the existence of external shareholders at an intermediate level in a consolidated group would indicate the need for sub-consolidation of a reporting entity preparing general purpose financial statements at the level of these intermediate external shareholders as well as at ultimate holding company level.

Paragraph RE3 expands on the three elements of the definition of a reporting entity in paragraph RE2. We consider it is therefore inconsistent to then state that when these three elements are present, it is not always sufficient to identify a reporting entity.

As currently drafted, it could be argued that a reportable segment might satisfy the criteria for being a reporting entity, in that per paragraph RE4 "it can be a portion of a single entity". A focus on users would assist here in making it clear that a reportable segment or other portion of an entity for which there is no separate user group is not a reporting entity as it has no reason to report, unless legislation or regulations require the preparation of general purpose financial statements at that level.

Paragraph RE6 considers that a prospective purchaser of a division could be a user as described in paragraph RE2. We do not find this example helpful as a prospective purchaser would be carrying out additional due diligence procedures prior to purchasing the assets or division and would be requiring specific information for a particular purpose. Such a branch or division would not normally be a reporting entity as discussed in the paragraphs above, although it might perhaps form a reportable segment. Further, case law in Australia limits the ability of prospective purchasers to rely on the acquiree's annual report without permission from the auditor.

We consider that the insertion of a definition of entity would also assist with the delineation of the reporting entity and the confusion displayed in paragraph RE6, as noted above. Statement of Accounting Concepts 1 *The Definition of the Reporting Entity*, an Australian specific concept statement, defines an entity as 'any legal, administrative or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives'. An economic entity is then defined as 'a group of entities comprising a controlling entity and one or more controlled entities operating together to achieve objectives consistent with those of the controlling entity'. These two definitions in our view achieve the same end as that proposed by the IASB but are clearer than paragraphs RE2 to RE5.

**IASB specific matters for comment and general comments on the text of the exposure draft**

- 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 this proposal and the rationale in BC18–BC23.

- 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 consider that paragraph RE6 leads to difficulties in ascertaining where the boundaries of the reporting entity lie. Greater focus on the needs of users would help to delineate the boundaries of the reporting entity and examples such as the following would assist. Where a group contains a partially owned subsidiary, the external stakeholders are interested in that entity and any sub-consolidation it may need to produce to make economic decisions about their investment in that subgroup. Similarly, there may be instances where an entity within a group needs to report separately for prudential reporting reasons, for example where there is an insurance company within a diversified group. However, generally, in the absence of any legal requirement to the contrary, a branch or division that is not a separate entity and has no external users would not be a reporting entity in its own right, but might be a reportable segment.

As discussed in our response to Question 1 we consider the example in paragraph RE6 to be misleading, as an investor considering purchasing a branch or division of a reporting entity would perform his or her own due diligence investigations. We further consider that a financial report produced for this purpose would be a tailor-made report prepared for the needs of the potential purchaser.

- 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?**

This proposed concept statement is now sufficiently high level not to interfere with the subsequent publication of a detailed consolidation standard. In our view it can be published now.