

1 September 2008

Professor David Boymal
Chairman
Australian Accounting Standards Board (AASB)
PO BOX 204
COLLINS ST WEST VIC 8007

Via email: standard@asb.gov.au

Dear David

ITC 17 Request for comment on IASB Discussion Paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity*

CPA Australia and the Institute of Chartered Accountants in Australia (the Institute) are pleased to respond to the Request for comment on ITC 17 IASB Discussion Paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity*.

CPA Australia and the Institute have jointly considered the ITC. Our specific comments directed to the International Accounting Standards Board (IASB) are provided as an attachment for your information.

This letter addresses the specific matters requested by the AASB only. Our preference would be that any reporting entity concept that is eventually decided upon by the Boards should be appropriate for application across the different sectors. However we note in the attached appendix, that this may not be possible given the IASB's initial focus on the for-profit sector. We further note the significant amount of work currently under way to better understand the implications of the proposed Conceptual Framework for Financial Reporting for the different sectors. Some of these projects are incomplete or have not yet commenced. We understand the work of the Chairs and Senior Staff of the AASB, CASB, NZASB and UKASB *A Report on the Application to Not-for-profit Entities in the Private and Public Sectors* is likely to be ongoing. We have considered their recently published Report and think that work is valuable. We note that the International Public Sector Accounting Standards Board (IPSASB) is developing its framework separately. We encourage the AASB to continue to give appropriate consideration to the deliberations and the developments of the IPSASB.

CPA Australia and the Institute accept that there may be some circumstances unique to the not-for-profit and public sectors which requires certain amendments to measurement, recognition and disclosures. We encourage the AASB to develop a policy as a matter of priority to enable these changes to be done in a consistent manner which may take into account obvious 'signposts' such as nature, impact, cost and prevalence considerations. Dependent on the outcome of this policy, it may be determined that a separate conceptual framework is warranted, even if terminologies are the only changes made.

We encourage the AASB to contend to the IASB that consideration of not-for-profit issues is a major area in many jurisdictions that should not be left to the end of the framework project and should be done concurrently as each section is developed.

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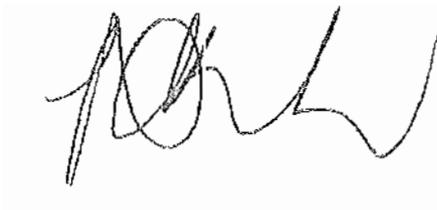


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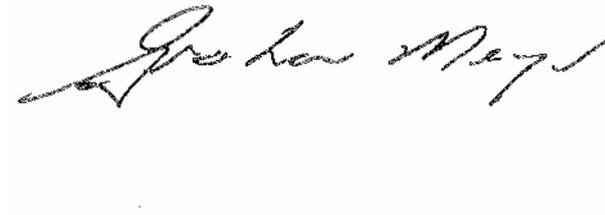
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If you require further information on any of our views, please contact John Ngiam, CPA Australia's Financial Reporting and Governance Policy Adviser via email at john.ngiam@cpaaustralia.com.au, or Kerry Hicks, the Institute's Head of Reporting by email to kerry.hicks@charteredaccountants.com.au.

Yours sincerely



**Chief Executive Officer
CPA Australia Ltd**



**Chief Executive Officer
Institute of Chartered Accountants**

Copy: Sir David Tweedie, Chairman of the International Accounting Standards Board

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Appendix - AASB Specific Matters for Comment

(a) as indicated above, because the IASB-FASB joint conceptual framework project has an initial focus on for-profit entities in the private sector, the AASB plans to undertake additional consultation with constituents in relation to not-for-profit issues. In the meantime, in relation to the topic of 'reporting entity' covered by the Discussion Paper, the AASB would welcome comments on the issues that would need to be considered if the proposed concepts were also to be applied in Australia to not-for-profit entities in the private and public sectors and for-profit entities in the public sector;

In our view the IASB/FASB decision to produce a conceptual framework focussed on the private sector for-profit needs of capital providers was unhelpful to standard setters in other countries that have replaced their national GAAP with IFRS for use in the not-for-profit sector also. We have recommended to the IASB that not-for-profit consideration be addressed at each stage of development of the framework, rather than leaving this to the end of the framework project.

The joint project by the Canadian, NZ, Australian and UK standard setters on the implications of the conceptual framework for the not-for-profit sector should be referred to in this instance in order to determine whether a conceptual framework can incorporate both profit and not-for-profit considerations in the one framework, as was done in the predecessor AASB conceptual framework.

The AASB is placed in a difficult position in deciding how to apply the conceptual framework in Australia for both the profit and not-for-profit sectors. Whilst we would like to see one framework that applies across all sectors, it is hard to see how this can be achieved, given the drafting constraints imposed by the adoption of IFRS. The insertion of Australian paragraphs into our standards has led to the mistaken perception in some overseas jurisdictions that the Australian standards are not the same as IFRS, according to Sir David Tweedie on his recent visit to Australia. This impression, while incorrect, must be strenuously addressed.

We therefore reluctantly suggest that the AASB should consider preparing a separate Framework, based on those prepared by the IASB/FASB and IPSASB, for use in the public and not-for-profit sectors.

We agree with the issues raised in *A Report on the Application to Not-for-profit Entities in the Private and Public Sectors of the IASB/FASB Conceptual Framework Projects* by standard setters in Australia, Canada, New Zealand and the UK and commend that group on their work. As they note, the control criterion is particularly difficult to apply in the context of the not-for-profit sector in setting the boundaries of the reporting entity, for example where a not-for-profit has quasi independent branches.

For example, the individual RSL branches would be reporting entities as they each have their own members with a need for financial information. Whether the umbrella body, while providing charitable services to returned servicemen and widows using the funds raised by the RSL branches, actually controls those clubs is less obvious.

In its current state, the following modifications will be needed for it to apply to the public and not-for-profit sectors:

- Modification of the definition "a circumscribed area of *business* activity of interest to present and potential *equity investors, lenders and other capital providers*". The italicised terms are too narrowly focussed on the for-profit sector. The public and not-for-profit have a wider user group and material from SAC 1 *Definition of the Reporting Entity* and SAC 2 *Objective of General Purpose Financial Reporting* may be of use in redefining this concept.
- A consideration of control in the context of how entities operate in the not-for-profit and public sectors. The notion of control over another entity in order to receive benefits would need to be expanded to include the subsidiary meeting the non-financial objectives of the parent.

Appendix - AASB Specific Matters for Comment (cont'd)

(b) whether the proposals would result in financial reports that are useful to users; and

As you will see from our submission to the IASB, we have indicated that the discussion of control should be at the standards level within the consolidation standard. This is particularly important given the low status of the FASB framework (see para P11) and the inability to ascertain at this point whether the Framework will still be referred to with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* in the hierarchy when determining accounting policies.

However, generally the discussion of control determining the composition of the group is consistent with long standing Australian practice and we support the proposals for consolidation using a controlling entity model.

(c) whether the proposals in the Discussion Paper are in the best interests of the Australian economy.

The proposals relating to control are unlikely to have any impact on the Australian economy.

However, the use of the terminology 'reporting entity' will be problematic as its use in this paper is very different from prevailing Australian usage and will prevent the application of differential reporting as practiced to date. These proposals are likely to give rise to confusion among practitioners. The AASB will clearly need to communicate these changes in a simple rational manner.

While we acknowledge there have been some difficulties with the practice of differential reporting, the examination of the applicability of the IFRS for Private Entities is starting to show that there is some merit in allowing practitioners some discretion in how they apply the standards (wholly-owned subsidiaries for example). In the interests of cutting red tape, the AASB should continue to explore how real concessions in differential reporting can be preserved.

1 September 2008

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

Via "Open to comment" page on www.iasb.org

Dear Sir David

Request for comment on IASB Discussion Paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity*

Thank you for the opportunity to comment on the IASB Discussion Paper (DP) *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity*.

CPA Australia and the Institute of Chartered Accountants in Australia (the Institute) are professional membership bodies representing professional accountants in Australia. We represent over 160,000 members who work in diverse roles across public practice, commerce, industry, government, academia throughout Australia and internationally.

CPA Australia and the Institute have jointly considered the Discussion Paper. While much of what the DP has to say is familiar to the Australian reader from the commentary on control and the economic entity in the old Australian Accounting Standard AASB 1024 *Consolidated Accounts*, we question the way in which the paper has been drafted and whether this material would be more appropriately placed as application guidance to IAS 27 *Consolidated and Separate Financial Statements*. Our response to matters on which specific comment is requested is included in the attached Appendix.

We also continue to have concerns with the approach of the board to:

- delay their consideration of private sector not-for-profit entity issues until the end of the project; and
- publish each chapter of the Conceptual Framework for Financial Reporting at the time of its completion.

We encourage the board to contemporaneously consider issues as they relate to all private sector entities. We believe the work of the Chairs and Senior Staff of the AASB, CASB, NZASB UKASB *A Report on the Application to Not-for-profit Entities in the Private and Public Sectors* and the International Public Sector Accounting Standards Board on its conceptual framework project may be informative. We have included our submission to the Australian Accounting Standards Board (AASB) addressing not-for-profit issues as an attachment for your information. Further, we encourage the board to delay publication of individual chapters until the finalisation of all chapters to ensure internal consistency and remove the need for consequential amendments to earlier parts.

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If you have any questions regarding this submission, please do not hesitate to contact either Kerry Hicks (the Institute) at kerry.hicks@charteredaccountants.com.au or Mark Shying (CPA Australia) at mark.shying@cpaaustralia.com.au.

Yours sincerely



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Appendix - Specific questions posed by the paper

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 this proposal. Business activities may be conducted through entities that do not have a separate legal existence, but are still part of the economic entity and should therefore still be reported.

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 would prefer the use of a term other than 'reporting entity', as reporting entity has different connotations and understanding in the Australian jurisdiction over an extensive number of years. We would prefer to use the term economic entity to describe a circumscribed area of business activity of interest.

Because we see consolidation as an extension of asset accounting, we see no reason why this material could not remain as guidance to the consolidation standard. This would also have the effect of enhancing the status of the material.

This is particularly important given the low status of the FASB framework (see para P11) and the inability to ascertain at this point whether the Framework will still be referred to with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in the hierarchy when determining accounting policies.

The restriction of the conceptual framework to for-profit entities is inconvenient for Australia as our standards are sector neutral. We would therefore prefer a broader description of stakeholders in the definition, to include other stakeholders such as employees and the community at large. While we understand the IASB will be considering not-for-profit issues at a later stage in the project, in our view, this will be too late and not-for-profit issues should be considered at each stage of the project. We draw your attention to the work being done by the Chairs and Staff off the Australian Accounting Standards Board, The Canadian Accounting Standards Board, the new Zealand Financial Reporting Standards Board and the UK Accounting Standards Board on the application of the IASB/FASB's Conceptual Framework Projects to not for profit 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?

We agree with the stance taken in the paper that the risks and rewards model is not sufficiently robust to use on its own. In our view it is best used to assist with the decision as to whether one entity controls another when the issue is indistinct as in the case of special purpose entities.

Appendix - Specific questions posed by the paper (cont'd)

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 agree the control should be defined at the conceptual level and we agree with the definition proposed.

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 the composition of the group should be based on control. As noted in our answer to Question 3, in some circumstances a risks and rewards approach may be needed to throw light on where control actually lies.

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 with this proposal.

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 view the controlling entity model as the appropriate model to use for establishing the composition of the group, but we acknowledge that there may be occasions when a common control model would generate meaningful financial information, for example in the case of stapled securities. We would like such instances to be dealt with specifically in the standards rather than at the concept level. We are not convinced that common control gives rise to a pervasive principle.

We suggest that it would be a mistake to attempt to apply the common control model at the concept level as, more often than not, its application would lead to the production of misleading information. For example as described in paragraph 82 onwards, it could lead to the blurring of distinctions between a family's private assets and those of the entities it controls, ie they might include assets that are not available to external lenders and creditors.

Similarly, where two corporations are under common control, but both have separate external shareholdings, the external shareholders only have recourse to the assets in the company they actually own shares in.

Given that separate legal personality is a business reality (particularly in the unfortunate eventuality that the business fails), in our view, issues of common control are better dealt with by inclusion of narrative related party disclosures.

Appendix - Specific questions posed by the paper (cont'd)

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 support the use of the entity perspective in financial reporting. We note Australia's long history of using the entity perspective and not the proprietary or parent entity perspectives.

Question 9

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

We agree that consolidated financial statements provide useful information to those parties, but some parent entity information may also be needed by these stakeholders to assess the liquidity and solvency of the company in which they hold a direct investment.

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?

We agree with this proposal. In Australia, the parent company information (not necessarily parent-only financial statements) is still significant from the point of view of paying dividends, since our current Law requires dividends to be paid out of the profits of the individual company.

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

Appendix - Specific questions posed by the paper (cont'd)

We agree with these proposals, which have long been the practice in Australia.

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?

We would prefer these issues, issue (a) in particular, to be dealt with in the consolidation standard as underlying principles to give them more emphasis. Some of the other issues addressed above are better addressed in application guidance attached to the consolidation standard.

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?

No other issues noted.