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Shane Buggle
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Mr David Boymal
Chairman
Australian Accounting Standards Board
P.O. Box 204
Collins Street West VIC 8007

Dear David

Invitation to Comment 17: Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity

Thank you for this Invitation to Comment (ITC).

While we are generally supportive of the proposals contained in the ITC, the major area of concern highlighted in our submission is that the ITC does not take a firm enough stance on the requirement to prepare parent financial statements. The approach taken in the ITC is to 'not preclude' the preparation of parent financial statements provided they are included in the same financial report as the consolidated financial statements. Our position is that parent entity financial statements should no longer be required where consolidated financial statements are prepared. Our detailed comments on this issue as well as other matters raised in the ITC are attached to this letter.

Should you have any queries on our comments, please contact Alane Fineman, Senior Manager of Financial Policy at Alane.Fineman@anz.com.

Yours sincerely

SHANE BUGGLE
Group General Manager Finance

Section 1: The reporting entity concept

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?*

Agreed. This approach is well understood by Australian constituents since the issue of SAC 1 Definition of Reporting Entity.

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?*

While we favour a broad definition of reporting entity over a precise definition, in order for the reporting entity concept to be operational, some further clarification may be required. For example:

- **What is meant by a "circumscribed area"?**
- **What constitutes a "business activity"?**
- **The reference to "of interest" in the definition may be regarded as vague and therefore require additional conceptual guidance.**
- **There is no requirement in the definition that equity investors, lenders and other capital providers must depend on general purpose financial reports produced by the reporting entity for making economic decisions (or, for example, that it is reasonable to expect that they may depend on such reports for making economic decisions). This should be clarified.**

Section 2: Group reporting entity

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, the risks and rewards model should not be considered further in the reporting entity phase of the conceptual framework project? If not, why?*

Agreed. We concur with the preliminary view of the boards that the requirement under the risks and rewards model that two entities should be combined into a group reporting entity when the activities of the second entity affect the wealth of the residual shareholders of the first entity is too broad, and therefore unlikely to be workable.

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?*

Agreed. Detailed guidance on control, including the indicators of control, should be prescribed at the financial accounting standards level.

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

Agreed. This is consistent with the concept of control that has been applied in Australia for many years.

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?*

Agreed. Of the three approaches considered by the boards to determine the composition of a group reporting for financial reporting purposes, we consider the controlling entity model to be the most suitable.

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?*

Agreed. However, as noted in the ITC, there can be difficulties in applying the controlling entity model to special-purpose entities with predetermined financing and operating policies. Whilst the boards' preliminary view "is that the difficulties encountered in practice when applying the controlling in the model to SPEs does not necessarily indicate that the concept is flawed" (para. 79) we are uncertain whether the boards therefore intend to deal with the particular issues surrounding SPEs at a conceptual level or as part of standards-level activities. Our preference is that the application of the controlling entity model to SPEs should be dealt with at the financial account standard level.

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 do not support the common control model and would limit the composition of a group reporting entity to the controlling entity model only. We consider that the absence of the controlling entity from a group reporting entity under the common control model would not be meaningful, as it would not show the results of all entities that are operating as a single economic entity.

Section 3: Parent entity financial reporting

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 consider that consolidated financial statements should be presented from the perspective of the group reporting entity. This approach is more consistent with the entity perspective considered in the first phase of the boards' conceptual framework project.

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

Agreed. Consolidated financial statements enhance the ability of users to assess the performance, financial position, and financing and investing activities of the group of entities comprising the reporting entity, rather than having to rely solely on individual financial statements.

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 do not think it sufficient that the conceptual framework merely "not preclude the presentation of parent-only financial statements, provided that they are included in the same financial report as consolidated financial statements". We are strongly of the view that parent-only financial statements have limited usefulness, and therefore that the requirement for such statements be removed.

We consider that parent entity financial statements are limited in usefulness for a number of reasons including:

- **parent entity financial statements do not indicate all the resources at the disposal of the parent entity because many of these resources not exist in various subsidiaries;**
- **the ability of the parent to pay its debts and to provide a return to capital providers is normally dependent on the profits on cash flows of the subsidiaries, however these are not revealed in the parent financial statements;**
- **dividends received by a parent from its subsidiaries, or the profits in the parent, may not be a good indicator of the ability of the parent to generate net cash inflows for the providers of capital.**

In some cases, the parent entity may be nothing more than a shell or holding company, with the majority of assets, liabilities etc in the subsidiaries, rendering the parent entity financial statements of questionable utility and certainty not warranted on a cost/benefit perspective. Parent entity financial statements are also questionable where entities controlled by the parent have agreed to guarantee each other's debts.

We query why the boards have not undertaken any research or other enquiries in relation to the usefulness of parent entity financial statements, but rather appear to have accepted that "some regard information provided on the basis of legal boundaries as decision useful" and therefore have concluded that "if that is so, provided that parent-only financial statements and are included in the same financial report is the consolidated financial statements, there seems no reason to object to the presentation" (para. 139).

Section 4: Control issues

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?*

Agreed

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

Agreed

- (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?*

Agreed

- (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?*

Agreed

- (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?*

Agreed. There must be a singular line of power between the controlling entity and the entity being controlled.

- (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 significant influence is not sufficient to establish the existence of control.

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?*

concepts level because the issues raised may require detailed guidance that is more appropriately addressed by specific standards.

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?*

None noted