BASEL COMMITTEE ON BANKING SUPERVISION

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

Via email: commentletters@iasb.org

Sir David Tweedie
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30 Cannon Street
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Exposure Draft – Conceptual Framework for Financial Reporting: The Reporting Entity

Dear Sir David

The Committee welcomes the opportunity to comment on the exposure draft *Conceptual Framework for Financial Reporting: The Reporting Entity* (ED). The ED is part of a joint project between the IASB and the US Financial Accounting Standards Board (FASB) to develop a common and improved conceptual framework. The Committee has long supported the development of high quality accounting standards for the financial services industry. Creating a sound framework for future standards is paramount to ensuring that those standards are principles-based, internally consistent and internationally converged.

The Committee generally supports the reporting entity concept outlined in the ED and the general requirement to present consolidated financial statements when an entity controls one or more entities. However, we believe that some aspects of the ED could be improved. Our comments and suggested changes for improving the proposals are included below.

Commingling of economic activities

Paragraph RE3(b) states that, as one of its three features, a reporting entity has economic activities that can be objectively distinguished from those of other entities and from the economic environment in which the entity exists. Paragraph RE5 adds that a single legal entity may not qualify as a reporting entity if, for example, its economic activities are commingled with the economic activities of another entity and there is no basis for objectively distinguishing their activities. Paragraph BC9 further notes that, in some situations, the boundaries between two legal entities may be artificial (eg when two legal entities commingle their resources, claims and operations to the extent that the economic activities of the two entities cannot be objectively distinguished). We question whether such guidance runs counter to the Board's conclusion in paragraph BC22 that the boundaries of a reporting entity should be determined on the basis of control of an entity. Indeed, two legal entities may significantly commingle their economic activities without one entity exercising control over the other. We suggest that the Board clarify its intent in this area.

Shared power and proportionate consolidation

Paragraph RE9 notes that two or more entities may share the power to direct the activities of another entity to generate benefits for (or limit losses to) themselves, and that in those instances none of the entities with shared power would consolidate the entity whose activities are jointly directed. Paragraph BC26 notes that the Board decided not to address proportionate consolidation because it is a method of accounting for an investment, not a method of reporting economic resources and claims of a controlled entity. The Board's rationale for concluding that proportionate consolidation should not be considered when determining a reporting entity is not fully explained. The practice of recognising an entity's proportionate share of the economic resources and claims of a jointly controlled entity could provide added transparency with respect to assets and liabilities contained within joint venture type entities. Absent proportionate consolidation, a cliff effect exists within the accounting standards – jointly controlled entities are either within the reporting entity in their entirety or excluded from the reporting entity (and presumably accounted for under the equity method by the venturer) depending on an evaluation of the decision-making rights of the jointly controlling entities. We suggest that the Board more fully develop its treatment of proportionate consolidation within the ED and more fully evaluate the appropriateness of using proportionate consolidation for entities whose activities are jointly directed.

Consistent use of "control"

As noted in the ED, the concept of control is used in both the definition of assets and in accounting standards for determining the composition of a group of entities. Paragraph BC12 states "*the Board affirmed its view in the discussion paper*[1] *that it is not necessary to align the basis for determining the composition of a group of entities to be reported as a single reporting entity with the definition of assets."* We recommend that the Board use the control concept consistently at both the framework and standards level, particularly since both notions of control contemplate power and benefits. In our view, this would not preclude an ordering of control determinations whereby an institution would first determine the composition of the reporting entity (on the basis of control of one or more entities or commingling of economic activities) and then consider the resources controlled by the reporting entity.

Negative benefits

Paragraph RE7 states that an entity controls another entity when it has the power to direct the activities of that other entity to generate benefits for (or limit losses to) itself. Paragraph BC15 adds that benefits are both positive and negative and could have been loosely described as risks and rewards. Consistent with the Committee's previous comments in an October 2008 comment letter on the IASB's reporting entity discussion paper and a July 2009 comment letter on the IASB's exposure draft on derecognition, we do not believe that the notion of a "negative benefit" is well understood. As such, we recommend that the Board replace the notion of "negative benefits" with "risk of loss" as used in paragraph RE7. If the

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1 In May 2008, the IASB and the FASB published for public comment a discussion paper, *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity.* The discussion paper was followed by this ED.

term is retained, we recommend that the Board clearly describe the linkage between risk and negative benefits (eg whether the Board is contemplating gross realised losses, negative deviations from expected amounts, or both).

Non-economic benefits

An entity could direct the activities of another entity to generate non-economic benefits as well as economic benefits. For example, a bank may direct the activities of a non-profit entity in order to ensure that the entity performs services that assist the bank in demonstrating that it is satisfying legal and regulatory requirements with respect to the bank's obligation to serve and invest in its local communities. We believe that the Board should clarify that non-economic benefits are not excluded from the definition of control.

Ongoing evaluation

We note that the ED makes no reference to the frequency with which an institution should evaluate the bounds of a reporting entity. We believe the Board intends for preparers of financial statements to evaluate which entities or economic activities should be included in a group reporting entity on an ongoing basis. We support this position and encourage the Board to explicitly include this position in the final version of this chapter of the framework.

Requirement to prepare financial reports

Paragraph RE8 states that if an entity controlling one or more entities prepares financial reports, it should present consolidated financial statements. However, within a group structure, individual legal entities may be required by national company legislation to prepare individual financial statements under national law, and at the same time be caught by the requirement in paragraph RE8 to prepare consolidated financial statements as well. This could lead to consolidated financial statements being produced at many different levels within a group, without regard to the needs of users of that information. For example, in some jurisdictions, companies are not required to provide consolidated financial statements if their shareholders do not object and consolidated statements are produced at a higher level in the group. We do not believe that it is the Board's intention to alter the scope of reporting requirements as set by company law, so we encourage the Board to ensure that the final version of this chapter of the framework does not inadvertently create conflicts in this area.

These comments have been prepared by the Committee's Accounting Task Force (ATF), chaired by Sylvie Mathérat, Director of the Banque de France, and have been approved by the Committee. The Committee trusts that you will find its comments useful and constructive.

If you have any questions regarding our comments, please feel free to contact Sylvie Mathérat (+33 1 4292 6579); the co-chairs of the Conceptual Framework Issues Subgroup Arthur Lindo (Board of Governors of the Federal Reserve System at +1 202 452 2695) and Jerry Edwards (Senior Advisor to the ATF at +41 61 280 8055); or Rob Sharma (+41 61 280 8613 or 8007) at the Basel Committee Secretariat.

Yours sincerely,

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