

16 July 2010

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

Email: CommentLetters@iasb.org

Dear Sir/Madam

SAICA SUBMISSION ON EXPOSURE DRAFT ON *CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING: THE REPORTING ENTITY*

In response to your request for comments on the IASB's exposure draft, *Conceptual Framework for Financial Reporting: The Reporting Entity*, attached is the comment letter prepared by The South African Institute of Chartered Accountants (SAICA). Please note that SAICA is not only a professional body, but also secretariat for the Accounting Practices Board (APB), the official standard-setting body in South Africa. The SAICA comment letter results from deliberations of the Accounting Practices Committee (APC), which is the technical advisory body to the APB.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph
Project Director – Accounting

cc: Moses Kgosana (Chairman of the Accounting Practices Board)
Prof Alex Watson (Chairman of the Accounting Practices Committee)

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GENERAL COMMENTS

We commend the Board for providing a definition of a reporting entity in light of the objective of financial reporting. Our concerns on the proposals are set out in the responses to the specific questions below.

SPECIFIC COMMENTS

Question 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?*

Whilst we agree in principle with the proposed definition of a reporting entity, we have certain concerns with the application of the definition, as identified below. We also agree that the definition should be linked to the objective of financial reporting.

Application of the Definition of the Reporting Entity

While we understand that the Board's motive for providing a definition of reporting entity used in the objective of financial reporting was to ensure consistent application of the term 'reporting entity', we are concerned that the application of the definition is not clarified sufficiently. Our concerns with the application of the proposed definition of a reporting entity are as follows:

Firstly, we agree with the conclusion of the Board in BC22 "*that the boundaries of a reporting entity should be determined on the basis of control of an entity.*" RE4 refers to the 'boundaries of economic activities' to identify a reporting entity, but that does not specifically establish the principle that the 'boundaries of financial reporting' are determined on the basis of control of an entity. The principle that all entities controlled by the reporting entity should be included in consolidated financial statements is created in RE7 to RE10 under the heading 'Consolidated financial statements'. Some of the constituents are concerned that the exposure draft refers to the consolidated financial statements at a conceptual level. They are of the view that the concept of consolidation should be dealt with at a standards level. Others were of the view that if the concept of consolidation is dealt with in the conceptual framework, the concept of stand-alone financial statements should also be addressed. Whilst we acknowledge that the requirements to prepare financial statements are often governed by local legislation, we propose that the 'boundaries of a reporting entity' principle should be determined on the basis of control of a reporting entity and should be clarified in the text of the standard and not in the Basis for Conclusions. We therefore recommend that a paragraph be included under the section 'Description', to establish the principle that a reporting entity is firstly determined based on all entities controlled by that reporting entity. This will establish the principle on which consolidated financial statements are based. RE5 already clarifies that "*A single legal entity that conducts economic activities and does not control any other*

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entity” qualifies as a reporting entity. Such a clarification should also be included for reporting entities that control other entities.

If the Board retains a section on consolidated financial statements in the final chapter, we propose that a section on stand-alone financial statements is also included to clarify any possible misinterpretations.

Secondly, we are concerned regarding the preparation of financial statements for a portion of an entity. The exposure draft only refers to parent-only financial statements and combined financial statements under the heading “*other types of financial statements*”. Under the main principle that financial statements are based on control, the question is whether financial statements should or could be prepared for any portion of the consolidated or stand-alone financial statements that meets the definition of a reporting entity. RE6 only states that: “*A portion of an entity could qualify as a reporting entity*”, but does not clarify under which circumstances financial statements must or could be prepared for a portion of a reporting entity. If financial statements are required in terms of IFRS to be prepared for any portion of consolidated or stand-alone financial statements that meets the definition of a reporting entity, the requirement could be costly and onerous for large entities. We recommend that the conceptual framework clarify that financial statements could (as a non-mandatory option) be prepared under IFRS for any portion of the consolidated or stand-alone financial statements that meets the definition of a reporting entity, but that this is not an IFRS requirement.

Thirdly, it is unclear how this definition of a reporting entity will interact with the definition of an operating segment in IFRS 8 – *Operating Segments*. Information about portions of a reporting entity is provided through applying the principles of operating segments. In the previous paragraph we indicated that it is not clear whether or not all reporting entities within a group should prepare financial statements, or whether this merely serves as guidance to assist constituents in identifying a reporting entity where general purpose financial statements should or could be prepared. We believe the latter should be applicable.

Fourthly, also regarding RE5, we are concerned that there could be situations where local legislation could prescribe that certain legal entities, which are not a reporting entity according to the proposed definition, must prepare general purpose financial statements complying with IFRS. Since the legal entity would not meet the proposed definition of a reporting entity, it would not qualify in terms of IFRS to prepare general purpose financial statements, thus leading to a potential contravention of the relevant legislation. We propose that the option is provided that legal entities may prepare general purpose financial statements complying with IFRS in the same manner that a reporting entity would.

Fifthly, a potential conflict may exist between the exposure draft and local legislation with regard to the presentation of parent-only financial statements. RE11 provides that such parent-only financial statements might provide useful information if they are provided with consolidated financial statements, while RE8 requires that consolidated financial statements must be prepared. Whilst it could be argued that RE11 could be used to mitigate any potential contravention of local legislation, this paragraph seems to be confirming the requirement of RE8 that parent-only financial statements would, in most cases, not be useful. In these circumstances local legislation will be contravened since local legislation may require companies to prepare separate parent-only financial statements. The question

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is whether such separate financial statements could be prepared in terms of IFRS. Further, we draw attention to the interaction between RE11 and paragraph 10 of IAS 27 – *Consolidated and Separate Financial Statements*, which exempt intermediate parent entities from preparing consolidated financial statements. While we certainly do not disagree with the exemption, we are concerned that the result of RE11 is that these entities would not be able to only prepare parent-only financial statements in terms of IFRS.

Sixthly, it is unclear how the reporting entity concept should be applied to dual listed companies. We are concerned that diversity could exist in practice where some group companies could account for these companies as two separate reporting entities and others as one reporting entity. We request that the Board clarify whether or not these companies represent two separate reporting entities that should be preparing consolidated financial statements in both jurisdictions.

Question 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, in principle, that if an entity controls one or more entities, consolidated financial statements should be prepared. We are, however, concerned with the deliberate use of the term ‘entity’ to define consolidated financial statements, where the objective of financial statements makes reference to a reporting entity. In principle a link should be created between the use of the concepts ‘entity’ and ‘reporting entity’ in the *Framework*.

We agree with the definition of control of an entity. Whilst we acknowledge that practical application of the definition of control of an entity should be addressed at a standards level, we agree that the definition of control should be included in the conceptual framework to support the main principle that financial statements should be prepared based on control.

Question 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 agree that a portion of an entity could qualify as a reporting entity. As articulated in the application of the definition of a reporting entity in our response to question 1, it is not clear from the wording of the exposure draft whether or not all portions of an entity, which qualify as reporting entities, are compelled to prepare financial statements. As stated in response to question 1, we believe this should only be optional.

Question 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?

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Whilst we agree that the completion of the reporting entity concept should not be delayed until the standards on consolidation have been issued, we request that the Board closely monitors the developments in the consolidation standards (particularly the definition of control) to ensure that there are no fundamental differences between the consolidation standards and the reporting entity concept. In addition, the main principle that financial statements be prepared based on control should be established at a conceptual level.

OTHER COMMENTS

Terminology ‘reporting entity’ and ‘entity’

The exposure draft only defines ‘reporting entity’ and not the concept ‘entity’. Some members of the committee are of the view that the term ‘entity’ should be described or defined so as to distinguish it from an ‘asset’ or ‘business’ as defined in IFRS. For instance, in the case of a shopping centre and an undivided share in the shopping centre, it could be difficult to determine whether the shopping centre or the undivided share is an asset, business or an entity. The definition or description should allow the reader to decide whether a shopping centre, or an individual share in a shopping centre, is an asset, an entity or a business. Furthermore, it is unclear based on the proposals whether or not a reporting entity would necessarily constitute an entity as contemplated in other IFRSs, for example IAS 27 – *Consolidated and Separate Financial Statements*’ definition of a subsidiary.

Other financial statements

Some of the constituents are concerned that the concepts of parent-only and combined financial statements are introduced on a conceptual level. We have proposed that the principle is introduced that financial statements are based on the concept of control of other entities, which would include stand-alone financial statements. Parent-only and combined financial statements move away from the principle. Therefore, the conceptual framework should also establish a secondary principle that other financial statements such as parent-only, combined and reporting entities in a group can be prepared, provided the nature of such other financial statements are clarified at a standards level.

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