

NESTLÉ S.A.

HERMANN WIRZ  
SENIOR VICE PRESIDENT

**INTERNATIONAL ACCOUNTING STANDARDS  
BOARD**  
30 Cannon Street,  
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16 July 2010

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**EXPOSURE DRAFT ED/2010/2 – CONCEPTUAL FRAMEWORK FOR FINANCIAL  
REPORTING : THE REPORTING ENTITY**

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Ladies and Gentlemen,

Please find below our answer to your invitation to comment on the above mentioned exposure draft. We outline some general comments below and answer the specific questions of the ED in the annexe.

**GENERAL COMMENTS**

While we agree with the definition of the reporting entity and with the fact that an entity that controls other entities shall prepare consolidated financial statements, we do not believe that the Board has substantially modified its approach of focussing on the control model as a criterion to prepare consolidated financial statements. We consider the ED does not unambiguously imply that the risks and rewards approach is embedded in the control definition and we would recommend to anchor in the Framework that the control and risks and rewards models are interrelated. In the absence of such a clarification, we consider that the future IFRS on consolidation may result in the requiring the consolidation of less entities than the current combination of IAS 27 and SIC 12, which could therefore open the door to structuring deals to create more off-balance sheet entities than it is currently the case.

Thank you very much for your attention to the above.

Yours very truly,

NESTLÉ S.A.

H. Wirz  
Senior Vice President  
Head of Group Accounting and Reporting

Encl.

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## ANSWERS TO SPECIFIC QUESTIONS AND OTHER POINTS

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### **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?*

In our comment letter on the DP on preliminary views on the reporting entity (the DP), we said that we agreed that the Framework should broadly define the reporting entity and that, when defining the needs of users, it should limit its reference to the current and future equity investors and lenders. We consider that the definition of § RE1 has addressed these comments and we agree with it.

### **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 that an entity that controls one or more entities shall prepare consolidated financial statements. However our comment letter on the DP raised issues about the control model vs. the risk and rewards model and we said that the Board should develop a definition of the group reporting that encompasses both the control and risk and rewards models. We do not believe that the Board has addressed these issues in the ED. This problem is not specific to our Group and several other constituents raised it.

In the ED, the Board has not fundamentally changed the definition of control by saying in § RE7 that it refers to “*the power to direct the activities of that other entity to generate benefits for (or limit losses to) itself*” and it has basically simplified the wording of the definition of § 49 of the DP<sup>1</sup>. The ED is now using the expression “power to direct” instead of “ability to direct” and the basis for conclusion just reaffirms in § BC15 the conclusions of the DP that the notion of risks and rewards is not sufficiently robust for determining the composition of a group.

We are not convinced by the arguments of the last part of § BC15 saying the risks and rewards notion would have involved to draw bright lines in terms of minimum exposure to risks or entitlement to benefits. While we would agree that these minimum levels of risks should not be defined in the Framework but in the standard on consolidation or in its application guidance, this should not preclude from making a clear statement in the Framework that the control and risks and rewards models are not mutually exclusive. We would recommend to *amend* § RE7 to say that “An entity controls another entity when it has the power to *organise* and direct the activities of that other entity to generate benefits *and* rewards for (or limit losses or risks to) itself *be either directly or indirectly*”. For example, an

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<sup>1</sup> Full text of § 49 was “Control of an entity is the ability to direct the financing and operating policies of an entity, so as to access benefits from that entity (or to reduce the incidence of losses) and increase, maintain or protect the amount of those benefits (or reduce the amount of those losses)”.

entity may enjoy the returns and bear the obligations of another entity because it has exercised its power by organising another entity in such a way as to obtain advantages and bear obligations while apparently not controlling that entity. Then it would be up to the standard on consolidation to establish the levels of benefits and exposure and the practical application of the principle of the Framework. If there exists no principle in the Framework to allow to include special purpose vehicles and other similar types of entities in the consolidation, then this would be difficult to require the consolidation of such entities in the future consolidation IFRS and this would open the door to structuring operations to create off balance sheet entities.

**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.

**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?*

We would certainly agree that, in a principle based standards environment, the conceptual definitions and principles of the Framework should be established prior to the development of any accounting standard. However such definitions should not preclude a given accounting treatment on grounds that such definitions and principles are not robust enough or do not draw bright lines as was said in our comments on § BC15 concerning the risks and rewards.