

INTERNATIONAL ACCOUNTING STANDARDS BOARD

ED CONCEPTUAL FRAMEWORK : THE REPORTING ENTITY

CBI RESPONSE

JULY 2010

I INTRODUCTION AND SUMMARY OF CBI POSITION

1. The Confederation of British Industry (“CBI”) is pleased to comment on the Board’s Exposure Draft.

Scope and terminology

2. It may be preferable for the Framework to define an “entity”, rather than “reporting entity”, along the lines set out in RE 2 and RE 3, and then it would be for local jurisdictions to determine who should be a reporting entity required to prepare general purpose financial statements. Also the different configurations of activities which may constitute an entity, including such as a branch, should be clarified.

Control model

3. We agree that control is an appropriate factor to use in determining a group of entities that may prepare consolidated financial statements. However the reporting entity chapter of Framework is perhaps not the best place to describe control. Control is a pervasive concept. It not only determines the identification of a subsidiary, it also informs the more pervasive definition of an asset. The Board should give further consideration as to how a single unique definition of this concept of control should be set out within the Framework.

4. In our response to the earlier Discussion Paper, we also supported application of risk and rewards concepts in determining control. We are therefore concerned that this appears to have been rejected in BC 15. Whilst a risks and rewards model alone may not provide a conceptually robust basis for determining the composition of a group reporting entity, the flow of risks and rewards should nevertheless be taken into account in determining control.

Requirement to prepare consolidated financial statements

5. We are not sure that the Framework is the place to specify when a particular accounting requirement should be applied – that may be best addressed at the Standards level. Paragraph RE 8 requires controlling entities to prepare consolidated financial statements, whilst RE8 – RE12 contain other requirements specifying when certain types of accounting should be adopted. It may be preferable if the Framework limited itself to providing descriptions of consolidated, parent-only and combined financial statements as available types or options and then leave the Standards to decide when these should be prepared.



Clive Edrupt Company Affairs
DL: 0207 395 8042 E: clive.edrupt@cbi.org.uk

Exemption for sub-groups

6. Paragraph RE 8 should make clear that intermediate controlling entities should not necessarily prepare consolidated financial reports. The ED does not explicitly recognise this situation and additional clarity may be needed to ensure that exemptions may continue to be offered to intermediate controlling entities.

Dependence on cash flows

7. We are concerned about the rationale that is used in justification of the conclusion in RE 8. We do not accept that dependence on cash flows is a sufficiently specific indicator to identify uniquely the relationship between a controlling entity and the entities it controls. Para RE 8 suggests that consolidated accounts should be prepared because investors in the controlling entity often 'depend significantly' on cash flows from the entities controlled.

8. Dependence on the cash flows of another entity is neither necessary nor uniquely indicative of a parent-subsidiary relationship. There are, for example, many cases where an entity depends on material cash flows from an investment but does not have control of it. Thus we conclude that application of the concept of reliance on cash flows is not relevant to the determination of which entities should present consolidated statements.

Joint control

9. While we agree that control is the test for full consolidation, the ED should not rule out the use of proportionate consolidation for jointly controlled entities. Paragraph RE 9 excludes jointly controlled entities from consolidation without any consideration of whether proportionate consolidation may be appropriate, while BC 26 says that the Board has decided not to address this area.

10. As we said in our response to the ED on Joint Arrangements, we consider that proportionate consolidation is not any less consistent with the Framework than equity accounting, and a revised Framework should make clear that there is a role for both proportionate consolidation and equity accounting for a joint arrangement, as the company considers most appropriate.

Presentation perspective

11. The ED does not seem to make clear the perspective from which consolidated financial statements should be prepared. Clarification, and discussion of the Board's conclusions and recommendation, is requested.

Conceptual Framework Project

12. Completion of the Reporting Entity chapter of the Conceptual Framework should not be delayed until the completion of the standards dealing with consolidation. Consistency between the Conceptual Framework and Standards should be set as a general principle in IFRS standard setting. Hence no change in fundamental concepts should be implemented at standard level before being fully debated at the conceptual level.

13. As we have indicated previously, the IASB should give the completion of the different chapters of the Conceptual Framework a high priority. This would allow improvements in financial reporting to follow a thorough debate of why and how concepts should evolve, and ensure that standards are developed in full consistency with the conceptual framework, rare and circumscribed well reasoned exceptions being put aside.

II RESPONSES TO CONSULTATION QUESTIONS

Q.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? If not, why?

It may be preferable for the Framework to define an “entity”, rather than “reporting entity”, along the lines set out in RE 2 and RE 3, and then it would be for local jurisdictions to determine who should be a reporting entity required to prepare general purpose financial statements. Also the different configurations of activities which may constitute an entity, including such as a branch, should be clarified.

We consider that the objective of financial statements referred to here is best addressed solely in Chapter 1 of the Framework. The revisiting of concepts between chapters could lead to a divergence in interpretations.

In addition, we are concerned that the proposals do not currently give any consideration to the interplay between local legal requirements for certain entities to report and the aims of the Framework in this respect. The conceptual framework should acknowledge that local legal requirements may or may not require a wide variety of entities to prepare financial statements, and that it does not seek to disturb these.

Q. 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? If not, why ?

We strongly agree that the control model is the most appropriate method for drawing a boundary around a group of entities that may prepare consolidated financial statements. The control model is a binary and relatively unambiguous concept that is widely understood and applied.

We also support application of risk and rewards concepts in determining control. We are therefore concerned that this appears to have been rejected in BC 15. Whilst a risks and rewards model alone may not provide a conceptually robust basis for determining the composition of a group reporting entity, the flow of risks and rewards should nevertheless be taken into account in determining control.

We are not sure that the Framework is the place to specify when a particular accounting requirement should be applied – that may be best addressed at the Standards level. Paragraph RE 8 requires controlling entities to prepare consolidated financial statements, whilst RE8 – RE12 contain other requirements specifying when certain types of accounting should be adopted.

It may be preferable if the Framework limited itself to providing descriptions of consolidated, parent-only and combined financial statements as available types or options and then leave the Standards to decide when these should be prepared.

The description in paragraph RE 8 needs to be re-visited to avoid any suggestion that intermediate controlling entities should necessarily prepare consolidated financial reports. The ED does not explicitly recognise this situation and additional clarity may be needed to ensure that exemptions may continue to be offered to intermediate controlling entities.

While we agree that control is the test for full consolidation, the ED should not rule out the use of proportionate consolidation for jointly controlled entities without proper debate. Paragraph RE 9 excludes jointly controlled entities from consolidation without any consideration of whether proportionate consolidation may be appropriate, while BC 26 says that the Board has decided not to address this area.

As we said in our response to the ED on Joint Arrangements, we consider that proportionate consolidation is not any less consistent with the Framework than equity accounting, and a revised Framework should make clear that there is a role for both proportionate consolidation and equity accounting for a joint arrangement, as the company considers most appropriate.

Q.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? If not, why?

Generally, the different configurations of activities which may constitute an entity, including such as a branch, should be clarified. However, in line with our comments above, a portion of an entity should not be considered a “reporting entity”, if it is not otherwise required to produce general purpose financial statements.

Q.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? If not, why?

We agree. Appropriate description of the reporting entity at the framework level is necessary to ensure that the concept can be applied consistently in the development of Standards. Therefore work to complete this chapter of the framework should proceed without delay to support the further development of Standards in this area.