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International Accounting Standards Board  
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14 July 2010

Dear Sir

**IASB Exposure Draft ED/2010/02: Conceptual Framework for Financial Reporting - The Reporting Entity**

We are pleased to comment on the above exposure draft (the ED). Following consultation, this letter summarises the views of the BDO network<sup>1</sup>.

We agree with the majority of the proposals in the ED, and note that the principles set out therein are intended to provide a broad structure around which the more detailed requirements of specific accounting standards can be built. We consider that it would be appropriate to include some discussion around what an 'entity' represents before setting out guidance about a 'reporting entity'. A definition of an entity would assist in linking, for example, a series of legal entities whose economic activities are commingled to that of a reporting entity (which might be all of those legal entities combined).

However, we disagree with the proposals in relation to an entity's separate financial statements. We note at paragraph RE11 that 'parent only' financial statements '....might provide useful information if they are presented together with consolidated financial statements.' We do not agree that a parent's separate financial statements can only provide useful information if they are presented with the related consolidated financial statements (and therefore, by inference, that they cannot provide useful information by themselves). For example, the information that they include can, depending on the jurisdiction, indicate to investors whether it is legally possible for the entity to pay dividends. We also note that the existing IAS 27 contains exemptions from the requirement for an entity to prepare consolidated financial statements, which we assume (based on the proposals set out in ED 10 Consolidated Financial Statements) will be continued in some form in any revised consolidations standard that may be issued.

Our responses to the specific questions included in the ED are set out in the attached Appendix.

We hope that our comments and suggestions are helpful. If you would like to discuss any of them, please contact Andrew Buchanan at +44 (0)20 7893 3300.

Yours faithfully

BDO IFR Advisory Limited

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## Appendix

### 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?***

We are broadly in agreement with this description of a reporting entity, although we consider that the reference to ‘existing and potential equity investors, lenders and other creditors’ is too narrow (see below), and that a reporting entity should not be limited to business activities that are structured as legal entities. However, in many jurisdictions, the requirement for a legal entity to prepare and present separate or consolidated financial statements is a legal or regulatory requirement. Therefore we suggest the reporting entity concept in paragraph RE2 be clarified to include a reference which acknowledges that an entity may be required to prepare those financial statements by legal or regulatory requirements.

Financial information may be useful to other parties in addition to ‘existing and potential equity investors, lenders and other creditors’. For example, a potential customer that is seeking a long term supplier for certain products to be used in its business will be interested in the financial position of potential suppliers, and will often include this as one of its bidding criteria to be fulfilled by those potential suppliers when bidding for the supply contract. We suggest that the text in paragraph RE2 is amended to read:

‘...has the potential to be useful to existing and potential equity investors, lenders, other creditors and other stakeholders who cannot directly.....’

We believe that the use of the term ‘stakeholders’ may assist when the Board addresses the question of not-for-profit entities. In our view, an approach which minimises differences between the definition of a ‘for profit’ and ‘not for profit’ entity is appropriate. We note that the Board has already acknowledged this point in its use of ‘economic’ rather than ‘business’, as discussed in paragraph BC6.

We note from paragraph RE5 that a single legal entity may not qualify as a reporting entity if, for example, its activities are commingled with the economic activities of another entity and there is no basis for objectively distinguishing their activities. We are not convinced that this is wholly appropriate, nor of the Board’s conclusions in paragraph BC9, as equity investors hold shares issued by separate legal entities and creditors generally enter into agreements with legal entities and not with a circumscribed area of economic activity. Therefore the preparation of financial statements by a single legal entity may be useful to equity investors and creditors, even if its activities are commingled with those of another entity. We suggest the Board reconsiders the drafting of this paragraph.

### **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 with the proposal in paragraph RE7 and RE8 that when an entity controls one or more entities it should present consolidated financial statements. However, we note that the existing consolidation standard, IAS 27, includes exemptions from consolidation which, as noted in our covering letter, we assume will be continued in some form when the revised consolidations standard is issued. It would be helpful for the Conceptual Framework to include a reference to circumstances where consolidated financial statements might not need to be prepared (for example, by a wholly owned intermediate holding company whose parent prepares consolidated financial statements).

We also agree with the definition of control of an entity in paragraphs RE7 and RE8, and note that this would permit our suggested approach of adding a risk and rewards test in determining control to the approach proposed in ED 10 *Consolidated Financial Statements* (see our comment letter of 20 March 2009). We note that the definition of control in paragraph RE7 and RE8 does not appear consistent with the control concepts in paragraphs 13 to 15 of IAS 27 which could lead to an inconsistency between the Conceptual Framework and IAS 27. However, we acknowledge the comments set out in paragraph BC11 of the Board's Basis for Conclusions, and suggest that it is ensured that the broad definition of control in the revised Conceptual Framework is consistent with the more detailed definition of control arising from the Board's current consolidation project.

### **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 the 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 BC 10.) In not, why?***

We agree that a portion of an entity could qualify as reporting entity, provided that portion meets the all of the characteristics of a reporting entity as documented in paragraphs RE2 to RE 5 of the ED.

We note an inconsistency with the proposals in paragraph RE6, and in paragraphs RE2 and RE3 since paragraphs RE2 and RE3 include the term 'management and governing board of the entity'. It is conceivable that a portion of an entity, such as a branch or a wholly owned subsidiary, may meet all of the other requirements to be considered a reporting entity except that it may not have separate management and a governing board. We suggest that paragraphs RE2 and RE3 are amended to clarify that the existence of management and/or a governing board may be indirect via another entity.

In addition, while many larger listed entities will typically have separate management and governing boards, this will not be the case for all entities. We suggest that it is made clear that the test to be applied is whether one or more individuals or teams exist who carry out those roles or functions, whether explicitly or implicitly.

**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 agree that completion of the reporting entity concept should not be delayed until the standards on consolidation have been issued.