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Conceptual Framework for Financial Reporting The Reporting Entity. ED.

Dear Sir David

I am very grateful for the chance to give you my Comments on the ED Conceptual Framework for Financial Reporting: The Reporting Entity. I believe it will be useful in creating Framework acceptable all over the world. My comments relate to the question 3 of the Invitation to comment: “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?”

I strongly believe that a portion of an entity could not qualify as a reporting entity even if the economic activities of that portion can be distinguished from the rest of the entity.

I 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 stakeholders (equity investors, lenders and other creditors). The key point is the potential to be useful. But when we speak about the portion of an entity we can not be sure about independence of that portion from the decision of the management of the entity as whole.

The concept of the possibility of the portion of an entity being the reporting entity contradicts the definition of the reporting entity given in S1 and the objective of the of general purpose financial reporting given in RE1:

S1: “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.”

RE1: “The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful 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. The reporting entity concept is intended to further this objective.” For example, some company has a branch in the other geographic region with its own economic activity and staff. If this branch decide to finance its activity from additional resources (not the headquarter treasury) it may prepare its own financial reports for the potential lender. But will these financial reports be useful for the potential lender? How that potential lender can rely on the financial reports of the branch if the existence of the branch, its policy, its decisions (financial and operational) are under the control of the headquarter. Usually even the opportunity of the external financing it is not the decision of the branch but the headquarter.

Moreover, it can be argued that the economic activity of the portion of an entity could be clear distinguished from the rest of the entity.

RE3 contain main features of f reporting entity:

- “(a) economic activities of an entity are being conducted, have been conducted or will be conducted;
- (b) those economic activities can be objectively distinguished from those of other entities and from the economic environment in which the entity exists; and
- (c) financial information about the economic activities of that entity has the potential to be useful in making decisions about providing resources to the entity and in assessing whether the management and the governing board have made efficient and effective use of the resources provided.

These features are necessary but not always sufficient to identify a reporting entity.”

I believe that a part of the entity does not meet the requirement of RE3 because:

- (a) Conduction of the economic activities of the part of the entity is under the control of the management as a whole and part of the entity can not decide itself if it be a going concern activity;
- (b) It is very difficult to objectively distinguish the activity of the part from the activity of the entity as a whole. For example, we need some base to distribute administrative or financial cost;

(c) financial information about the economic activities of the part entity has no the potential to be very useful in making relevant decisions about providing resources to the entity and in assessing whether the management and the governing board have made efficient and effective use of the resources provided.

If some potential lender needs information about some particular part of the entity it can obtain it, for example, from the consolidated financial if that part of the entity is the segment under IFRS 8 Operating Segments.

I believe the necessity of preparing its own financial reports for portion of the entity may exist only in the case of the requirement of the local laws. Occasionally part of the entity can prepare some kind of financial reports for some particular stakeholder. But the point is that these financial reports must be out of the International Financial Reporting Standards. It is very important to reach balance between cost of preparing financial reports on the regular basis under IFRS and benefits from it to potential users.

Yours sincerely

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