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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **November 2008, London**

Project: **Conceptual Framework – phase D**

Subject: **Comment letter summary: Discussion Paper "Reporting Entity" (Phase D) (Agenda paper 4)**

INTRODUCTION

1. The comment period on the Discussion Paper (DP), *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity,* ended on September 29, 2008.

2. As of November 4, 2008, the IASB and the FASB (the Boards) received 78 comment letters, grouped by constituent type in the following table:

Constituent Type	**Number**	**Percent**
Academics	3	4
Investors/Analysts/Users	2	2
Preparers	23	29
Individuals	4	5
Accounting firms	6	8
Professional organizations	17	22
National standard-setters	14	18
Governments/Regulators	6	8
Others	3	4
Total	**78**	**100**

3. Responses received, classified by geographical region can be summarized as follows:

Region	Number	Percent
Europe	38	49
Americas	14	18
Asia-Pacific	15	19
Africa	2	3
Multi-regional	9	11
Total	**78**	**100**

4. This memorandum summarizes the comments received from constituents that specifically address the questions in the DP. It does not include any staff analysis of the validity or importance of the comments. The memorandum concludes with the staff's tentative plans towards issuing an Exposure Draft.

5. Many respondents commented on the short preface of the DP, which discussed the objectives of the conceptual framework project, the authoritative status of the existing frameworks of each Board, and some process issues in the project. Because most of those comments on the preface of the DP also apply to the Exposure Draft, *An Improved Conceptual Framework for Financial Reporting: Chapter 1: The Objective of Financial Reporting and Chapter 2 Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information* (the Phase A ED) and vice versa, such comments will be summarized in a separate memorandum.

GENERAL COMMENTS

Role of the Conceptual Framework

6. Several respondents asked the Boards to clarify that it is not within the role of the conceptual framework (or any standard) to determine **who** should prepare financial statements or to determine **what type** of financial statements (consolidated, combined, parent-only, and the like) should be prepared.

Interaction with Standards-Level Projects

7. The DP states that the practical difficulties of applying the description of a reporting entity may indicate the need for guidance at the standards level. One

respondent urged the Boards to issue detailed standards-level guidance when or before the chapter in the conceptual framework on the reporting entity becomes effective. Without standards-level guidance, this respondent is concerned that inconsistent practices may develop and, if other parties such as regulators step in to fill the void, there is a risk of jurisdictional interpretation of how to prepare such types of financial statements.

8. Several respondents noted that the DP was too detailed to be part of the conceptual framework. Some of these respondents noted that, given the lower authoritative status of the conceptual framework, non-compliance with the conceptual framework might not subject the entity to the same enforcement penalties as non-compliance with an approved standard if guidance related to control were only included in the conceptual framework.

9. One respondent suggested that some or all parts of the DP may be more appropriately placed as application guidance to IAS 27, *Consolidated and Separate Financial Statements*. Another respondent noted that the IASB is currently working on amending IAS 27 and, therefore, the DP should be revisited once the consolidation project is completed. Yet another respondent noted that it is difficult to provide meaningful input on the DP because the Boards are not undertaking the consolidations project jointly.

General Purpose Financial Statements

10. Several respondents noted that the distinction between general purpose and special purpose financial statements is unclear. One of these respondents suggested that, in developing guidance in this area, the Boards should consider the definition of *general purpose financial statements* adopted by the International Auditing and Assurance Standards Board[1] so that the accounting and auditing guidance are aligned.

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[1] The International Auditing and Assurance Standards Board defines *general purpose financial statements* as "financial statements prepared in accordance with a financial reporting framework that is designed to meet the common information needs of a wide range of users."

Terminology

11. Several respondents noted that the DP refers to the terms *entity*, *controlling entity*, *reporting entity*, *legal entity*, and *group reporting entity* in numerous ways such that in some cases they may be interpreted to be used as synonyms while in other cases they are not. A few of these respondents noted that the term *entity* is a pervasive term widely used in IFRSs but sometimes with different meanings.

Comment Period

12. A few respondents noted that the comment period for the DP was too short and that the Boards should consider extending the comment period for future exposure documents. One of these respondents suggested at least six months.

SECTION 1: THE REPORTING ENTITY CONCEPT

Q1. Do you agree that what constitutes a reporting entity should not be limited to business activities that are structured as legal entities? If not, why?

13. Most respondents who commented on this issue agreed with the Boards' preliminary view that what constitutes a reporting entity should not be limited to business activities that are structured as legal entities.

Reporting Entity Should be Limited to Legal Entities

14. A few respondents disagreed with the Boards' preliminary view and noted that financial statements prepared for external reporting purposes should refer to a legally identified entity. One of these respondents noted that a broader description may inadvertently include business activities that do not act as reporting entities which in turn could create an unreasonable level of reporting.

Legal Entity and Legal Personality

15. One respondent suggested that by deciding that a reporting entity need not be structured as a legal entity, the Boards are confusing the notion of legal entity with separate legal personality. In this respondent's view, all of the organizations mentioned in the DP (that is, a sole proprietorship, branch, corporation, trust,

partnership, and group of entities) are legal entities governed in law by contractual or statutory obligations, notwithstanding corporate organizations are distinguished from other forms by the fact that the owners of the entity are legally distinct from the entity itself.

Status of a Legal Entity

16. Several respondents suggested that there be a presumption that a legal entity (and any controlled entities, as envisioned for a group reporting entity) should be the starting point in determining what constitutes a reporting entity and that the final document should specifically state that a legal entity meets the definition of a reporting entity.

Q2. Do you agree that the conceptual framework should broadly describe (rather than precisely define) a reporting entity as a circumscribed area of business activity of interest to present and potential equity investors, lenders, and other capital providers? If not, why? For example, do you believe that the conceptual Framework should establish a precise definition of a *reporting entity*? If so, how would you define the term? Do you disagree with including reference to equity investors, lenders, and other capital providers in the description (or definition) of a reporting entity? If so, why?

17. Most respondents who commented on this issue agreed with the Boards' preliminary view that the conceptual framework should broadly describe (rather than precisely define) a reporting entity.

Reporting Entity should be Described or Defined

18. A few respondents argued that *reporting entity* is too important a concept to merely describe. These respondents did not agree that being too prescriptive would result in a failure to meet the objective of financial reporting, as stated in the DP.

19. One respondent preferred that the conceptual framework not contain a **precise** definition of a reporting entity so that the use of IFRS or IFRS-equivalent standards would not be restricted by that definition.

20. A few respondents noted that any wording used to describe a reporting entity will become a de facto definition. In fact, many respondents referred to the **definition** of a reporting entity even though the DP made it clear that the Boards' intention is to provide a broad **description** of a reporting entity.

Reporting Entity should *Not* be Described or Defined

21. Several respondents noted that a reporting entity should not be described or defined. Comments from these respondents include:
    a. In most cases, what constitutes a reporting entity is self-evident
    b. The application of IFRSs has not been hindered by the absence of a description or a definition
    c. If there must be a description or definition, it should be limited exactly to the purpose of general purpose financial reporting
    d. If the term *control over assets* is clearly defined, the term *control over an entity* would be unnecessary
    e. The key question is not whether an area of business activity constitutes a reporting entity but whether particular activities should fall within the scope of a reporting entity's accounts.

Describing the Reporting Entity First and then Identifying Parts of the Reporting Entity

22. The DP broadly describes the reporting entity first and then identifies, through the definition of control, the items included as part of the reporting entity. One respondent noted that attempting to describe the reporting entity separately from control causes the description or definition of each to become circular and incomplete.

23. On the other hand, one respondent noted that it did not see any contradiction between jurisdictions deciding on which entities should be required to prepare financial reports and the proposal that the conceptual framework should set out a description of a reporting entity. This respondent noted that it is the law that determines whether or not an entity should report; the conceptual framework and standards set out the scope of that entity for general purpose financial reports.

Reporting Entity

24. One respondent preferred to use a term other than *reporting entity* because that term has different connotations and understanding in the Australian jurisdiction over an extensive number of years. This respondent suggested that the Boards use the term *economic entity* instead.

Circumscribed Area

25. One respondent suggested that the idea of a *circumscribed* area of business activity be expanded by saying that the area will usually be circumscribed by legal or contractual rights or, in their absence, by an effective mechanism of sanctions (such as in the case of local branches of a political or charitable organization).

26. Another respondent noted that the term *circumscribed area of business activity* is too vague. In this respondent's view, for example, a segment could be interpreted as a *circumscribed area of business activity* and this could lead to the incorrect assumption that a segment is a reporting entity.

27. Yet another respondent suggested that the Boards use a simpler term, such as *limited, specified,* or *particular*, instead of *circumscribed*.

Business Activity

28. Many respondents urged the Boards to clarify whether the term *business* in the description of a reporting entity has the same meaning as that defined in IFRS 3 (revised 2008), *Business Combinations,* or FASB Statement No. 141 (revised 2007), *Business Combinations*[2]. Most of these respondents suggested that the two should not have the same meaning and, accordingly, the Boards should consider other descriptions. One of these respondents noted that not all reporting entities would meet the definition of a *business* because a reporting entity should not be required to have economically integrated operations and that the definition of a

[2] Both IFRS 3 and Statement 141(R) define *business* as "an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members or participants."

business would preclude at least some special purpose entities (SPEs) from being a reporting entity.

29. Several respondents noted that the description of a reporting entity in the DP is missing something important in terms of *unity*, *unified purpose*, or *cohesion* of business activities. One of these respondents suggested that there must be a cohesive purpose to the *entity* around which the line is drawn and that this would generally be evidenced by the ability to *direct* the entity, an idea that is explicit in the definition of control.

30. Several other respondents noted that the reference to *business activities* would be problematic for not-for-profit and non-commercial entities or entities that are inactive. Alternatives proposed by these respondents included *economic activities* and *activities that further the legal purpose of the entity*.

Of Interest To

31. A few respondents noted that the nature of the interest of capital providers that the Boards are referring to is unclear. One of these respondents suggested that the Boards clarify that the nature of interest be one that is *decision useful*.

Reference to Equity Investors, Lenders, and Other Capital Providers

32. A majority of the respondents who commented on this issue agreed with the Boards' preliminary view that the description of a reporting entity should tie into the objective of financial reporting. On the other hand, a few respondents noted that it is not necessary to incorporate the objective of financial reporting or the potential users of financial statements into the definition of reporting entity and suggested that the reference be deleted.

33. Nearly a third of the respondents who commented on this issue disagreed with the Boards' preliminary view because the reference implied that financial statements should be presented from an entity perspective, which they did not support.

34. Nearly half of the respondents who commented on this issue agreed with the Boards' preliminary view that the description of a reporting entity should make reference to "equity investors, lenders, and other capital providers."

35. Other respondents who commented on this issue suggested the Boards refer to *users* in general rather than the narrower term *capital providers* and that the term *users* would be relevant to both for-profit entities and not-for-profit organizations.

36. One respondent suggested that the Boards clarify that the capital providers are those who are present or potential capital providers of **that** circumscribed area of business activity.

SECTION 2: GROUP REPORTING ENTITY

Q3. Do you agree that the risks and rewards model does not provide a conceptually robust basis for determining the composition of a group reporting entity and that, except to the extent that it overlaps with the controlling entity model (as discussed in paragraphs 102 and 103), the risks and rewards model should not be considered further in the reporting entity phase of the conceptual framework project?

37. Most respondents who commented on this issue agreed with the Boards' preliminary view that the risks and rewards model, as a standalone model, does not provide a conceptually robust basis for determining the composition of a group reporting entity.

38. Moreover, most respondents who commented on this issue agreed with the Boards' preliminary view that the risks and rewards model (or the notions included in that model) should be used to complement the controlling entity model. One of these respondents noted that the inclusion of the risks and rewards model in the context of benefits in the controlling entity model will remove the misconception that the controlling entity model is flawed in the context of SPEs.

39. Respondents were split as to whether the risks and rewards aspects used to complement the controlling entity model should be addressed at the conceptual level or the standards level.

40. A few respondents argued that both the controlling entity model and the risks and rewards model have a place in the conceptual framework and that the model to be applied in particular cases can be decided at the standards level. These

respondents noted that the risk and reward model's so-called "overlap" with the controlling entity model is sufficient to justify its presence and justifies it being developed further.

41. A few other respondents noted that they were not convinced that the controlling entity model, the common control model, and the risks and rewards model were the only "reasonable candidates" in determining the composition of a reporting entity.

> Q4. Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that:
>
> a. Control should be defined at the conceptual level?
>
> b. The definition of control should refer to both power and benefits?
>
> If not, why? For example, do you have an alternative proposed definition of control?

42. Most respondents who commented on this issue agreed with the Boards' preliminary view that control should be defined at the conceptual level.

43. Several respondents disagreed and preferred that control be discussed at the standards level. One of these respondents noted that it should be discussed at the standards level so that it will be given a higher authoritative status.

44. Most respondents who commented on this issue agreed with the Boards' preliminary view that control should refer to both power and benefits. However, several of these respondents suggested that the definition of control also refer to risks.

45. The working definition of *control* provided in the DP was as follows:

> 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 losses).

Relationship with "Control over Assets"

46. Several respondents suggested that the Boards consider the definition of *control over an asset* when considering the definition of *control over an entity* because these concepts are interrelated. One of these respondents noted that IAS 17, *Leases,* refers to a risks and rewards approach to determine control over an asset. Another one of these respondents noted that aligning the composition of a group reporting entity with a definition of assets would allow for a clearer definition of income. Yet another one of these respondents argued that the definition of control must be compatible with standards on consolidation and derecognition.

47. On the other hand, one respondent agreed with the Boards' preliminary view that one should first determine what constitutes the **entity** that is reporting, and only then should the asset definition (and other element definitions) be applied to **that** entity. This respondent noted that this notion is useful in understanding the link between the identification of the reporting entity and the preparation of financial statements.

Causality

48. Several respondents suggested the causality between power and benefits should be strengthened. These respondents noted that control is exercised to obtain benefit, and the benefits are not incidental to the exercise of control but the primary motive for having it.

49. Several other respondents suggested that the nature and extent of the benefits available as a result of control be explained and noted that such explanation would help in distinguishing whether the relationship that parties, such as trustees or managers exercising powers delegated to them, have with an entity does in fact represent control.

Present Control and Present Ability to Control

50. Several respondents noted that the DP did not make a clear distinction between *present control* and *present ability to control.* A few of these respondents noted that it is unclear which approach the Boards intend to use, and that diversity in

practice is likely to continue unless the determination is made and articulated clearly by the Boards.

Control as a Continuum

51. One respondent noted that the definition of control in the DP would be difficult to apply in practice because the existence of control is oftentimes not an on/off switch, but rather a continuum. This respondent noted that many questions need to be answered at the standards level, but it would be useful if the framework acknowledged that the existence of control is often not a black or white situation.

Ability to Direct

52. Regarding the term *ability to direct*, one respondent suggested that the Boards consider the term in the Australian Accounting Standards Board's SAC 1, *Definition of the Reporting Entity*: "capacity to dominate decision-making, directly or indirectly…" This respondent noted that the reference to "direct and indirect" would be useful in capturing SPEs.

Financing and Operating Policies

53. One respondent suggested that the Boards explain that the financing and operating policies of an entity are those policies that would impact the success of that entity. In this respondent's view, this is an area of ambiguity today in IFRSs.

54. Another respondent noted that the Boards should refer to the term *financing, operating and **investing** policies* (emphasis added) so that it is consistent with the Boards' preliminary views on financial statement presentation.

"So As To"

55. One respondent noted that the phrase "so as to" is difficult for some non-native English speakers to understand and, therefore, suggested the Boards find a simpler phrase.

Access Benefits

56. Several respondents were not comfortable with the term *access benefits* because there may be a connotation that the term *benefits* refers to only financial or cash flow benefits. Alternatives suggested by respondents included: *achieving the objectives*, *access rewards*, and *access risks and rewards*.

57. One respondent noted that the reference to benefits implies that the *rewards* component of the risks and rewards model is being considered, although by a different name. This respondent suggested that the Boards call *rewards* and *benefits* by the same name if they mean the same thing.

58. Several respondents noted that the definition of control does not adequately address principal-agent issues. An example would be trustees, asset managers, and others who are delegated a power to direct in return for a fee that may be based on the value of the assets underlying that direction, or a performance-related fee. One of these respondents suggested that a notion of *minimum benefits* is needed to support the control model. Another one of these respondents suggested that the Boards provide guidance on how to measure benefits.

59. A few respondents noted that the definition of control should make an overt reference not only to the benefits but also the exposure to risks that arise from one entity controlling another entity.

60. One respondent asked the Boards to clarify *benefits* in relation to variability in returns. Specifically, this respondent asked whether an investor who is expected to have the majority of returns, or an investor who is expected to have the majority of the *variability* of returns, should consolidate an SPE.

Or to Reduce the Incidence of Losses

61. A few respondents noted that the reference to reducing the amount of losses is important in the definition of control.

And Increase, Maintain, or Protect the Amount of those Benefits

62. Several respondents questioned why the phrase "and increase, maintain, or protect the amount of those benefits" was necessary. A few of these respondents suggested that the Boards clarify this part of the definition so that the definition is understood and applied consistently. Another one of these respondents suggested that this part of the definition be deleted.

Claims on the Benefits or Residual Rights

63. One respondent noted that the definition of control should incorporate some description of claims on the benefits or residual rights.

Q5. Do you agree that the composition of a group reporting entity should be based on control? If not, why? For example, if you consider that another basis should be used, which basis do you propose and why?

64. Most respondents who commented on this issue agreed with the Boards' preliminary view that the composition of a group reporting entity should be based on control, assuming that the definition of control is complemented by the "risks and rewards" notion.

Group Reporting Entity Based on Control is Too Restrictive

65. One respondent noted that there is an apparent contradiction to permit a very broad definition of a reporting entity but a restrictive definition of a group reporting entity.

66. Another respondent suggested that the conceptual framework describe an overarching basis for determining the composition of a reporting entity based on identifying the key shared characteristics of such an entity.

Group Reporting Entity is Vaguely Defined

67. One respondent noted that the term *group reporting entity* is vaguely defined. This respondent asked the Boards to clarify whether a portion of an entity that constitutes a business activity could be included in a group reporting entity and

noted that, if so, there could be more than one set of general purpose financial statements that relate to a controlling entity. This respondent raised the following concerns:

a. If there can be only one set of general purpose financial statements for a group reporting entity, how should the ‘primary’ set of general purpose financial statements be determined?
b. How does the controlling entity model apply to control of a business activity?
c. What is the boundary between general purpose and special purpose financial reports?

The Term *Group Reporting Entity* is Unnecessary

68. One respondent noted that by default general purpose financial statements should equate to group financial statements and, therefore, questioned the need for the term *group reporting entity*.

Q6. Assuming that control is used for the basis for determining the composition of a group reporting entity, do you agree that the controlling entity model should be used as the primary basis for determining the composition of a group reporting entity? If not, why?

Q7. Do you agree that the common control model should be used in some circumstances only? If not, why? For example, would you limit the composition of a group reporting entity to the controlling entity model only? Or would you widen the use of the common control model? If you support the use of the common control model, at least in some circumstances, do you regard this as an exception to (or substitute for) the controlling entity model in those circumstances, or is it a distinct approach in its own right? Please provide reasons for your responses.

69. Most respondents who commented on this issue agreed with the Boards’ preliminary view that, assuming that control is used for the basis for determining the composition of a group reporting entity and that the definition of control is complemented by the “risks and rewards” notion, the controlling entity model

should be used as the primary basis for determining the composition of a group reporting entity. Moreover, a majority of respondents who commented on this issue agreed with the Boards' preliminary view that the common control model should be used in some circumstances only.

Limiting and Prioritizing the Models

70. Several respondents noted that both the controlling entity model and the common control model are distinct approaches in their own right and the Boards should not specify which model should be primary and which model should be secondary.

71. Several other respondents noted that there may be financial statements prepared using other models that do not fit within either the controlling entity model or the common control model but have a wide range of users and, therefore, appear to meet the definition of general purpose financial statements. Financial statements for dual-listed companies and stapled entities were raised as examples (A detailed explanation of dual-listed companies and stapled entities by one respondent is reproduced in the Appendix).

Implications of Adopting the Controlling Entity Model

72. Several respondents indicated their concern that the adoption of the controlling entity model may lead to the elimination of exceptions to consolidation. Examples of exceptions that these respondents suggested the Boards to consider include:
    a. Investment companies that regularly buy and sell interests in controlled entities (as exempted in the AICPA Audit and Accounting Guide, *Investment Companies*)
    b. Intermediate holding companies (as exempted in IAS 27)
    c. Where severe long-term restrictions hinder the exercise of rights of the parent undertaking over the assets or management of the subsidiary undertaking (as exempted in UK GAAP standard FRS 2, framed by UK Company Law).

73. Another respondent noted that the control concept should not be so broad that it would inevitably include all the franchisees as being part of the group reporting entity of the franchisor.

Common Control Model Provides Useful Information

74. Respondents raised the following situations where the common control model provides useful information:
    a. When producing general purpose financial statements for a prospectus
    b. When one investor (such as an individual) or a group of investors (such as a family) owns a controlling interest in several companies with strong operational and financial ties
    c. Stapled securities
    d. Dual listed companies
    e. Certain legal reorganizations in connection with a capital raising transaction, where entities are under common control, but are not managed together in advance of the reorganization
    f. In the public sector context when there is no identifiable parent entity (for example, the general government sector or at the whole-of-government level).

Common Control Model Does *Not* Provide Useful Information

75. Several respondents noted that the common control model should not be considered further in the conceptual framework. Comments from these respondents include:
    a. Reintroducing some form of pooling without specific constraints could lead to the presentation of misleading information
    b. Financial statements based on the common control represent special purpose financial statements
    c. Financial reporting required under the common control model is merely a subset of any group financial statements and, if necessary, any accounting required of common controlling entities can be dealt with at the standards level as a possible subset of group financial reporting.

Common Control Model may be Unnecessary

76. A few respondents noted that, if a controlling entity does not need to be a legal entity, it might be possible to circumscribe two legal entities and determine that these two entities constitute a controlling entity and thus a reporting entity. These respondents noted that this interpretation would be useful for dual-listed

companies and stapled entities and is likely to alleviate the need to have a separate common control model.

Who Decides Which Model to Use

77. Several respondents suggested that when and how to apply these models should be circumstance-driven and should not be left to the discretion of the preparer. On the other hand, one respondent suggested that preparers should be given latitude to apply judgment in determining the appropriate model for determining the composition of a group reporting entity.

78. Several respondents suggested that the Boards do not identify the circumstances in which the common control model should be used in the conceptual framework.

79. One respondent noted that the description in the DP may be misinterpreted as requiring that, in order to be considered under common control, entities must have been managed together. This respondent noted that the use of the common control model should not be restricted in such manner.

Consolidated and Combined Financial Statements

80. One respondent noted that the Boards should clearly indicate that financial statements prepared using the controlling entity model would be *consolidated* financial statements, while financial statements prepared using the common control model would be *combined* financial statements. This respondent noted that, although the DP hints at this distinction, it is not explicit.

SECTION 3: PARENT ENTITY FINANCIAL REPORTING

Q8. Do you agree that consolidated financial statements should be presented from the perspective of the group reporting entity, not from the perspective of the parent company's shareholders? If not, why?

81. A majority of respondents who commented on this issue agreed with the Boards' preliminary view that consolidated financial statements should be presented from the perspective of the group reporting entity.

82. A few respondents emphasized that presentation from the perspective of the group reporting entity is the only realistic option. In these respondents' view, the parent company's shareholders are only one (albeit important) group of capital providers and preparing consolidated financial statements from their view would rob the financial statements of neutrality. One of these respondents noted that having a broad range of users is the essence of general purpose financial reporting.

83. On the other hand, several respondents noted that reporting financial results from the perspective of the parent company shareholders is the most effective and efficient means to communicate decision useful information to capital providers, and is therefore the approach most consistent with the objective of financial reporting.

84. Several other respondents noted that the Boards have not adequately discussed or debated this issue to justify their conclusion.

Separation from Owners and Focus on Parent Company Shareholders

85. Several respondents noted that they agree with the entity perspective in the sense that the entity is separate from its owners, but did not believe that financial reports are of equal importance to all interested parties. Specifically, these respondents noted that information regarding an entity's performance from the perspective of the parent company's shareholders was of primary importance.

86. A few of these respondents added that consolidated financial statements were not decision-useful to holders of non-controlling interests. These respondents noted that a holder of a non-controlling interest would rarely, if ever, base an investment decision solely on information contained within consolidated financial statements. On the other hand, one respondent noted that the performance of management, which also relates to subsidiaries, is considered both by parent entity shareholders and the holders of non-controlling interests in their resource allocation decisions.

87. A few of the respondents who do not believe that financial reports are of equal importance to all interested parties also noted that consolidated financial statements were not decision-useful to lenders of the parent company. On the other hand, one respondent noted that academic research has found that providers

of debt capital base debt covenants on financial statement information that is reported in consolidated or parent-only financial statements, which suggests that consolidated financial statements could provide useful information to lenders

88. A few respondents asked the Boards to explain how the entity perspective is consistent with the stewardship objective of financial reporting.

Parent Company Information under the Entity Perspective

89. The DP states that there are circumstances in which the Boards have concluded at the standards level that the parent company approach provides useful information to financial statement users (such as the presentation of earnings per share information and allocation of net income between controlling and non-controlling interests). One respondent noted that this adds further complexity to what is already acknowledged to be highly complex financial reporting requirements if the parent company shareholders are required to make adjustments to understand the results and financial performance of the entities in which they have invested. Another respondent suggested that the Boards should explicitly acknowledge that they have not abandoned the parent company approach because they do require entities to present information based on the parent company approach.

Implications of the Entity Perspective on Standard-Setting

90. A few respondents noted that adopting the entity perspective is a fundamentally different approach to that generally practiced in many parts of the world when producing financial reports and that this approach is likely to have a fundamental impact on later phases of the conceptual framework project as well as on the development of new accounting standards.

91. Another respondent noted that the IASB has accepted the parent company approach in measuring goodwill based only on the parent's interest in a subsidiary, as permitted by IFRS 3 (revised 2008), *Business Combinations,* and that this treatment would not be possible under an entity perspective.

Proprietary Perspective in the Not-for-Profit Context

92. One respondent noted that the entity perspective is more appropriate for not-for-profit organizations as a proprietorship interest would have no practical meaning for not-for-profit organizations.

Q9. Do you agree that consolidated financial statements provide useful information to equity investors, lenders, and other capital providers? If not, why?

93. Most respondents who commented on this issue agreed with the Boards' preliminary view that consolidated financial statements provide useful information to equity investors, lenders, and other capital providers.

94. However, many of these respondents added that consolidated financial statements are not the only type of financial statements that provide useful information. One of these respondents noted that, for investment companies, for which the business model is to buy, hold, and sell investments, users of financial statements may find that the financial statements that present investments at fair value, rather than at a consolidated basis, may also result in meaningful information.

95. As described in paragraphs 86 and 87 of this memorandum, a few respondents noted that consolidated financial statements are not useful to all users.

Q10. Do you agree that the conceptual framework should not preclude the presentation of parent-only financial statements, provided that they are included in the same financial report as consolidated financial statements? If not, why?

96. A majority of the respondents who commented on this issue agreed with the Boards' preliminary view that the conceptual framework should not preclude the presentation of parent-only financial statements, provided that they are included in the same financial report as consolidated financial statements.

97. Several respondents disagreed with the Boards' preliminary view and noted that consolidated financial statements should not be required when parent-only

financial statements are presented in a financial report. A few of these respondents questioned why the Boards would preclude any additional statement or information, provided its significance or insignificance is clearly defined and distinguished. Another one of these respondents noted that if it is possible to define a component of a group reporting entity, it seems inconsistent to say that it is not possible for a parent entity to be such a component.

98. Several other respondents argued that the consolidated financial statements and parent-only financial statements should be required to be presented together in the financial reports. A few of these respondents added that the Boards should require a consistent format whenever both consolidated and parent-only financial statements are presented.

99. A few other respondents noted that it is not within the Boards' purview to prescribe which financial statements should or should not be prepared. In their view, the Boards should focus on developing a conceptual framework that is available for the broadest possible group of preparers of general purpose financial reports for any reporting entity.

Usefulness of Parent-Only Financial Statements

100. A few respondents disagreed with the Boards' preliminary view that parent-only financial statements are incomplete and potentially misleading. These respondents noted that parent-only financial statements can provide information that is useful to equity investors, lenders and other capital providers and can constitute general purpose financial statements. They also noted that parent-only financial statements are unlikely to be misleading when they are published alone.

101. On the other hand, a few respondents stated that parent-only financial statements have limited usefulness and, therefore, the requirement for such statements should be removed. One of these respondents further noted that, in some cases, the parent entity may be nothing more than a shell or a holding company, with the majority of assets, liabilities, and the like in the subsidiaries, rendering the parent entity financial statements of questionable utility and certainly not warranted from a cost/benefit perspective.

Whether Parent-Only Financial Statements are for General Purpose

102. Several respondents argued that parent-only financial statements do not represent general purpose financial statements. A few of these respondents noted that they believed that an entity cannot have more than one set of general purpose financial statements, and parent-only financial statements would not be the most representationally faithful set of financial statements to be considered general purpose. However, some of these respondents added that financial information about the parent entity can be highly relevant.

Disclosures for Parent-Only Financial Statements

103. One respondent suggested that the Boards consider reducing the disclosures required in parent-only financial statements presented in the same report as its consolidated financial statements.

Parent-Only Financial Statements Required by Law

104. A few respondents noted that many jurisdictions require IFRS-compliant, parent-only financial statements for statutory purposes and that the proposal to require consolidated financial statements whenever parent-only financial statements are presented would represent a significant burden on companies who have not previously been required to prepare consolidated financial statements.

Parent-Only Financial Statements based on IFRSs and Other National GAAP

105. Several respondents stated that some jurisdictions require the presentation of parent-only financial statements based on IFRSs or other national GAAP and that the DP was unclear as to whether it was excluding parent-only financial statements based on other national GAAP. Some of these respondents noted that parent-only financial statements should include parent-only financial statements based on other national GAAP.

SECTION 4: CONTROL ISSUES

Q11. With regard to the concept of control, in the context of one entity having control over another, do you agree that:

a. Establishing whether control exists involves assessing *all* the *existing* facts and circumstances and, therefore, that there are no single facts or circumstances that evidence that one entity has control over another entity in all cases, nor should any particular fact or circumstances – such as ownership of a majority voting interest – be a necessary condition for control to exist? If not why?
b. The concept of control should include situations in which control exists but might be temporary? If not, why?
c. The control concept should not be limited to circumstances in which the entity has sufficient voting rights or other legal rights to direct the financing and operating policies of another entity, but rather should be a broad concept that encompasses economically similar circumstances? If not, why?
d. In the absence of other facts and circumstances, the fact that an entity holds enough options over voting rights that, if and when exercised, would place it in control over another entity is not sufficient, in itself, to establish that the entity currently controls that other entity? If not, why?
e. To satisfy the power element of the definition of control, power must be held by one entity only? In other words, do you agree that the power element is not satisfied if an entity must obtain the agreement of others to direct the financing and operating policies of another entity? If not, why?
f. Having "significant influence" over another entity's financing and operating policy decisions is not sufficient to establish the existence of control of that other entity? If not, why?

Q12. Should any of the above control issues be addressed at the standards-level rather than at the concepts level? If so, which issues and why?

All the Existing Facts and Circumstances

106. Almost all respondents who commented on this issue agreed with the Boards' preliminary view that the determination of control should involve the assessment of **all** the **existing** facts and circumstances. A majority of these respondents

suggested that this point be clarified at the conceptual level. One of these respondents suggested that this point should be made more prominently.

107. Several respondents noted that control over 50% of the voting rights would clearly demonstrate control and suggested that there be a presumption that holding over 50% of the voting rights would clearly demonstrate control.

Control Might be Temporary

108. Most respondents who commented on this issue agreed with the Boards' preliminary view that the concept of control should include situations in which control exists but might be temporary.

109. Several respondents noted that this is only one of the many circumstances that would be taken into account when considering whether an entity has control over another.

110. Several other respondents noted that it is important to include temporarily-controlled subsidiaries in the financial statements of the reporting entity, but the appropriate presentation of such subsidiaries is a separate issue. These respondents suggested that temporarily-controlled subsidiaries may be exempt from consolidation and be reported as investments. One of these respondents suggested that the Boards clarify that the definition of control would not preclude different presentation of entities under control. On the other hand, one respondent noted that it did not support providing exemptions from consolidation when control is temporary.

111. One respondent disagreed with the Boards' preliminary view because of the possibilities of manipulation it could create. In this respondent's view, for example, management may manipulate profitability by buying and holding assets long enough to consolidate the profit.

112. Respondents were split as to whether this issue should be addressed at the conceptual level or the standards level.

Voting Rights, Other Legal Rights, and Economically Similar Circumstances

113. A majority of respondents who commented on this issue agreed with the Boards' preliminary view that the control concept should be a broad concept that encompasses economically similar circumstances.

114. Several respondents noted that this is one of the many circumstances that would be taken into account when considering whether an entity has control over another.

115. One respondent disagreed with the Boards' preliminary view and noted that control should be limited to sufficient voting rights or legal rights in order to avoid inconsistency in developing and applying standards in practice. Another respondent suggested that the initial economic intention should be considered. Yet another respondent asked the Boards to clarify how veto rights should be analyzed.

116. Respondents were split as to whether this issue should be addressed at the conceptual level or the standards level.

Options over Voting Rights

117. A majority of respondents who commented on this issue agreed with the Boards' preliminary view that the fact that an entity holds enough options over voting rights that, if and when exercised, would place it in control over another entity is not sufficient, in itself, to establish that the entity currently controls that other entity.

118. Several respondents noted that this situation should be considered in the context of considering all existing facts and circumstances. A few of these respondents raised concerns because this situation implies that a single factor can determine whether control exists. Another one of these respondents noted that it is unnecessary to decide whether the holding of options is, in itself, sufficient to establish whether control exists.

119. Several other respondents noted that the answer to this question would depend on whether consolidation is appropriate when there is 'present control' or 'present

ability to control.' One of these respondents noted that it was not convinced that the guidance currently in IAS 27 (based on 'present ability to control') should be changed.

120. A few respondents noted that, holding sufficient, currently exercisable options to ensure that the holder can exert 'active' control is sufficient to demonstrate that the holder already controls the potential subsidiary. Another respondent noted that, if an entity holds options over voting rights, that entity presumptively would have control.

121. A majority of respondents who commented on this issue supported discussing this issue at the standards level. Other respondents supported discussing this issue at the conceptual level.

Power Must be Held by One Entity Only

122. Most respondents who commented on this issue agreed with the Boards' preliminary view that, in order to satisfy the power element of the definition of control, power must be held by one entity only.

123. One respondent noted that shared power is power and a 'fact and circumstance' analysis is needed to determine whether the limitations involved preclude control. This respondent further noted that there is no difference in how subsidiaries and joint ventures are combined to optimize the group's future cash flows and that it is unclear that shared power brings more restrictive limitations to the entity's power than those that the legal framework of a jurisdiction can provide to protect minority interest rights.

124. Another respondent noted that the Boards should clarify that power held by entities within a group reporting entity is considered to be included in the "one entity."

125. A few other respondents suggested that the Boards clarify that regulatory power does not constitute control by the government or regulator. For example, although a government authority may have the power to close down the operations

of entities that do not comply with emission control regulations, this power does not constitute control by that authority because it only has a regulatory power.

126. Respondents were split as to whether this issue should be addressed at the conceptual level or the standards level.

Significant Influence

127. Most respondents who commented on this issue agreed with the Boards' preliminary view that having 'significant influence' over another entity's financing and operating policy decisions is not sufficient to establish the existence of control of that other entity.

128. A few respondents noted that this guidance is not needed because it appears self-evident that having significant influence over an entity is not sufficient to establish the existence of control over that entity.

129. Respondents were split as to whether this issue should be addressed at the conceptual level or the standards level.

Q13. Are there any other conceptual issues, relating either to the control concept or to some other aspect of the reporting entity concept, that are not addressed in this Preliminary Views and should be addressed at the conceptual level? If so, which issues and why?

Joint Control and Shared Control

130. Some respondents suggested that the Boards address joint control (two or more jointly control; none can decide without the consent of others) and shared control (two or more have control for their share) at the conceptual level.

Significant Influence

131. A few respondents suggested that the Boards address significant influence (or equity method accounting) at the conceptual level. On the other hand, a few respondents suggested that the Boards should make no reference to significant influence at the conceptual level at all.

Proportionate Consolidation

132. One respondent noted that there may be circumstances when proportionate consolidation would provide useful information and therefore standard-setters should leave open the option to use proportionate consolidation.

Accounting for Investments in Subsidiaries in Parent-Only Financial Statements

133. One respondent suggested that the Boards address how investments in subsidiaries should be accounted for in parent-only financial statements. This respondent asked the Boards to consider between the cost method, equity method, and fair value, and present their view in the next document for public exposure.

Issues in FRS-37 *Not* Addressed in the DP

134. One respondent noted that the following areas from FRS-37, *Consolidating Investments in Subsidiaries*, by the Financial Reporting Standards Board of the New Zealand Institute of Chartered Accountants, could be useful to be discussed in the Boards' Framework:

a. 'Auto pilot' and SPE
b. Ownership versus fiduciary relationships
c. Restrictions on activities
d. Power of veto
e. Delegated power
f. Receipts of benefits by parent not required
g. Other benefits from control over net assets
h. Benefits from complementary activities
i. Responsibility for loss with or without entitlement to benefit.

Not-for-Profit Considerations

135. Several respondents urged the Boards to consider for-profit entities and not-for-profit organizations concurrently. One of those respondents noted that the following issues could be addressed in that regard:

a. The fact that power to regulate does not of itself equate to control
b. The role of accountability in understanding control

c. When the government has the residual financial interest in the net assets of the other entity
d. Ministerial approval/control/directions
e. The role of legislation; that is, when the mandate of an entity us established/limited by enabling legislation
f. The controlling entity's ability to deploy scarce resources to achieve objectives; specification of separate objectives
g. The fact that financial dependency is not control
h. Control versus day-to-day management.

TENTATIVE PLANS FOR REDELIBERATIONS

Redeliberation Sequence

136. The staff expects to redeliberate the issues in three Board meetings. At the first Board meeting, the staff expects to discuss (a) the description of a reporting entity and (b) consolidated and parent-only financial statements. At the second Board meeting, the staff expects to discuss (a) the definition of control, (b) the group reporting entity, and (c) other control issues. At the third meeting, the staff expects to discuss the entity perspective. The discussion for the third meeting will be conducted jointly with Phase A.

Roundtable Considerations

137. Based on the analysis of the comment letters received, the staff does not think that it is necessary to schedule a roundtable or other formal public information-gathering meeting. The comments received are sufficiently straight-forward and understandable, and the Boards should be able to make informed decisions during redeliberations.

Drafting and Publication

153. The project plan currently calls for the Exposure Draft to be issued in the second half of 2009. The staff believes this target continues to be appropriate.

APPENDIX: DUAL LISTED COMPANIES AND STAPLED ENTIIES

A1. This Appendix reproduces the detailed explanation of dual-listed companies and stapled entities provided by one respondent.

Dual Listed Companies

A2. The Australian Stock Exchange allows entities to list as a "dual listed company (DLC) arrangement." In such arrangements, the activities of the two entities are managed as a single economic entity under a contractual arrangement, while retaining their separate legal identities. In these cases neither entity has necessarily acquired an ownership interest in the other entity, and the individual legal entities have not been combined into a new legal entity. The securities of the entities comprising the DLC are normally quoted, traded or transferred independently of each other in different capital markets. The contractual agreements underlying a DLC result in an economic entity in which the shareholders of the legal entities have a common economic interest, including arrangements to ensure that all shareholders receive equivalent dividends and voting entitlements, irrespective of the particular contracting company in which they hold shares. The legal entities also enter into cross guarantees. This means that investors, creditors, and others should have regard to the net assets of the combined entities. In addition, in the event of liquidation, equalization arrangements ensure distribution of any surplus assets to ordinary shareholders of each entity. Prior to transition to IFRS, it was considered that the creation of a DLC did not give rise to a parent-subsidiary relationship between the entities. Consequently, combined financial reports were typically prepared as the DLCs were considered to be a reporting entity.

A3. Under IFRS the DLCs have generally identified a parent entity and applied IAS 27 in producing consolidated financial statements. However, 100% of the equity of the "subsidiary" entity is minority interest, which is generally believed to fail to represent the underlying substance of the arrangement.

Stapled Entities

A4. Stapled arrangements are common in Australia in the property and infrastructure sectors, and are used occasionally in other jurisdictions (including the US). Usually the arrangement involves a company and a trust, and while the trust owns the assets, the operations are conducted through the company. Such an arrangement facilitates the streaming of tax benefits – not to different classes of equity holder (as they are all the same) but with different tax characteristics. A stapled arrangement involves the equity holders in two entities agreeing to "staple" their securities together. For example: entity A's shareholders agree to staple each of their shares in A to a share in B, while allowing A to issue shares to the B shareholders so that they can also staple each of their B shares to an A share. Stapled securities cannot be traded or transferred independently and are quoted at a single price. The stapling of the equity securities of two or more legal entities results in those entities having equity holders in common. As such, the financial performance of an investment in a stapled security is dependent on the financial performance of all the entities whose securities are stapled. The performance of all the entities is reflected in the price of the stapled security.

A5. Stapling transactions are usually treated as business combinations and accounted for under IFRS 3, although sometimes they are just asset acquisitions. Many staplings occur at formation of the entities and thus IFRS 3 has no real effect. Currently in Australia the practice is to identify one of the entities (usually the company/operations entity) as the parent under IAS 27 and consolidate the other. Prior to the adoption of IFRS, Australian GAAP had a local interpretation that concluded that stapled entities were reporting entities, and that they should provide combined financial statements as general purpose financial statements. The problem with IAS 27 is that it forces one entity to be identified as the "controlling entity." However, 100% of the equity of the other entity is minority interest. This provides the strange outcome that we have minority interest which is represented by one of the pieces of the stapled securities.