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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
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United Kingdom

Berlin, 30 September 2008

Dear David,

IASB Discussion Paper "Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity"

We appreciate the opportunity to respond to the International Accounting Standards Board's Discussion Paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity* (discussion paper). This letter represents the view of the German Accounting Standards Board (GASB).

In general, we support the IASB's and FASB's (the Boards) objective to develop a common conceptual framework for financial reporting. We also agree that the conceptual framework should be principle-based. However, we disagree with some of the views the Boards expressed in the discussion paper. Our comments set out in detail in *Appendix 1* are structured according to the questions raised by the Boards in the discussion paper.

Our main concerns are as follows:

Firstly, we are missing a definition of the scope of IASB standards and the conceptual framework that addresses (a) what the standards and the conceptual framework should and should not deal with and (b) which topics should be dealt with on the framework and the standard level, respectively. The discussion paper covers several issues that we believe do not lie within the responsibility of the Boards, e.g. the definition of the reporting entity, the question who has to prepare financial statements and the issue how and when to present financial statements. The responsibility for these issues lies with the respective national legislative or regulatory authorities.

Secondly, we are concerned that the currently proposed control definition in the discussion paper does not consider circumstances of joint control. Control can, in our view, be defined as either exclusive control or as a concept including shared control and joint control. The GASB supports the first alternative of defining control as 'exclusive control'.

Additionally, we observe that different control concepts are currently developed in different phases of the conceptual framework project and the Staff Exposure Draft on Consolidation. We believe that the definitions should not differ and that if 'control over an asset' was appropriately defined there would be no need for a separate definition of 'control over an entity'.

Furthermore, many of the issues discussed in the discussion paper should, in our view, be addressed at the standards level rather than at the conceptual framework level, e.g. the accounting requirements in circumstances of joint and shared control, control through economically similar circumstances to sufficient voting rights and other legal rights etc.

Since the Staff Exposure Draft on *Consolidation*, Version 3 as of 9 September 2008 (Staff ED) covers the majority of issues already covered in the discussion paper on the *reporting entity* we include in this comment letter some issues we would like to already point out on the Staff ED at this early stage.

Overall it appears as if the Staff ED would anticipate the results of the due process on the conceptual framework phase D on the *reporting entity*, e.g. on the model for determining the composition of the group reporting entity (the Staff ED applies the entity perspective and precludes the risks and rewards model) and the question whether or not certain issues should be covered on the standards rather than on the conceptual framework level.

Additionally, the Staff ED sets in its scope the exemptions from presentation of consolidated financial statements. As already mentioned above, it is not for the IASB to decide who must and who need not prepare financial statements.

Lastly, the control definition in the Staff ED differs significantly from the working definition set out in the discussion paper. Apart from our view that the control definitions should not differ, we refer to our detailed comments, which in our view are also valid for the Staff ED, on the control concept in *Appendix 1*.

If you would like to discuss any aspects of this comment letter in more detail, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr

President

Appendix

GASB comments on the questions set out in the IASB's "Discussion Paper of *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity*

> *Question 1:*
> ***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?***

1 We agree.

> *Question 2:*
> ***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?***

2 Firstly, we agree that the conceptual framework should be principle based, i.e. only contain principles. Detailed requirements should be provided in the respective standards. We believe that detailed requirements in the conceptual framework are contrary to the objective of keeping the conceptual framework principles-based. In addition, we are concerned that detailed requirements in the conceptual framework would lead to the conceptual framework having to be amended following each amendment or revision of standards.

3 Following this approach, we believe that neither a definition of a reporting entity nor the proposed broad description of a reporting entity as "*a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers*" should be included in the conceptual framework. We believe that it is not within the scope of the IASB's mandate to define either the subject that has to prepare financial statements or how and when to present financial statements. We believe that the IASB's mandate is limited to define the content of IFRS financial statements and to provide the principles and requirements to be applied when preparing financial statements in accordance with IFRSs. Therefore, in our view, the conceptual framework should only provide the definition or description of an *entity*, not of a *reporting entity*. The responsibility to decide who must prepare financial statements (the reporting entity) or may do so voluntarily lies solely with the national legislative or regulatory authorities, not with the Boards.

4 We propose the IASB provide a model of the typical subject it has in mind when setting requirements for general purpose financial statements of a reporting entity without limiting the application of the IFRS standards to only those entities consistent with that model. We refer, as an example, to the Exposure Draft of the IFRS for Small and Medium-sized Entities (IFRS for SME, now IFRS for Private Entities) where in deciding on the content of the proposed IFRS for SMEs, the IASB focused on the types of transactions and other events and conditions typically encountered by SMEs with about 50 employees without ultimately limiting the application of the SME standard to those entities.

5 In our opinion it is also not the IASB's mandate to decide whether separate financial statements or consolidated financial statements for subgroups are allowed to be prepared under IFRSs. Such financial statements may not be what the IASB has in mind when creating IFRS accounting rules, and the IASB may express such different focus. But it is then up to the national regulators to decide whether they nevertheless require or allow the application of IFRSs to such financial statements. However, we propose that for those financial statements to be in accordance with IFRS, the composition of the reporting entity (e.g. the subgroup) should be disclosed in the notes under the heading 'basis for presentation'. If the reporting entity is part of a larger group, it should also be disclosed in the notes which entities of that larger group are not included in the financial statements.

6 We disagree that separate financial statements or consolidated financial statements for subgroups are not general purpose financial statements per se. In our view, it is not the aggregation level that defines which financial statements are general purpose financial statements but rather the stakeholders interest in the information provided by the respective financial statements.

Question 3:
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? If not, why?

7 In our view, control is the primary concept for determining the composition of a group reporting entity. We agree that the risks and rewards model does not provide a sufficiently robust basis for determining the composition of a reporting entity. However, in our view, risks and rewards may serve as indicators of control. Therefore, we believe that no concept should be excluded from discussion in the conceptual framework.

Question 4:
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?

8 Control is currently defined in various standards as well as conceptual framework phases, e.g. in the existing conceptual framework when defining an asset, in the Staff Exposure Draft on Consolidation, and in the present discussion paper on the reporting entity. However, the various control definitions differ.

9 In principle, we believe that everything that is controlled by an entity should be recognised in the financial statements of the respective entity. Consequently, we believe that the control concept is significant for financial reporting and agree that control should be defined at the conceptual framework level and a definition of control should refer to both power and benefits. Nevertheless, in our view the control concept should only be addressed on a conceptional basis in the framework.

10 However, taking above mentioned principle into consideration, we believe that an appropriate description of “control over an asset” should be sufficient to determine the elements to be included in the financial statements of an entity. When applying this concept of control (over assets) appropriately, i.e. across entities, we believe that a separate definition of “control over an entity” is not necessary since the boundaries of the reporting entity would be defined by the control over assets. The same concept should be applied for liabilities respectively. We ask the Boards to analyze and discuss the possibility of a corresponding definition of control. In this context, we see a strong link to the conceptual framework phase B *Definitions of elements, recognition and derecognition*. In our view, the description of control over an asset is within the scope of phase B of the conceptual framework.

Question 5:
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?

11 As already mentioned in our comments to question 4, the GASB believes the control concept to be significant for financial reporting and the determination of the group reporting entity’s composition. Consequently, the GASB agrees with the Boards’ proposal that the composition of a group reporting entity should be based on control.

12 The GASB acknowledges that in a majority of cases, usually for tangible assets, control is only held by one party. However, scenarios of shared control (two or more share the control over an asset, i.e. each has control over its share, e.g. for intangible assets) and joint control (two or more jointly control an asset, none can decide without the consent of the other, e.g. for joint ventures) exist and therefore the

conceptual framework should not exclude the possibility of shared control and joint control.

13 In this context we also refer to our comment letter on the *IASB's Exposure Draft on Joint Arrangements dated 7 January 2008 in which we address our concerns regarding the concept of control. The current definition of an asset in par. 49(a) of the Framework does not explicitly require 'exclusive' control. In our comment letter to ED 9 we explain in detail and by means of examples why we believe that shared control can exist.*

14 However, in our view, control needs to be clearly defined in the conceptual framework as either 'exclusive control', i.e. power held by one, or as a concept including shared control and joint control The GASB prefers the definition of control as "exclusive control".

15 Additionally, we like to point out that, in our view, if control was defined by the IASB as 'power held by one', every issue in the discussion paper referring to control would also have to be discussed in the context of joint and shared control.

Question 6:
Assuming that control is used as 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 entity? If not, why?

16 In reference to our comments to question 5, the GASB agrees with the Boards' proposal that the composition of a group reporting entity should be based on control and consequently, the controlling entity model should be applied as primary basis for determining the composition of a group entity.

17 However, referring to our proposal of a model, we believe that when applying an appropriate, control-based model to determine the composition of the group reporting entity, a separate model to define the group reporting entity's composition is, in our view, not necessary.

Question 7:
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 it as an exception to (or substitute for) the controlling entity model in those circumstances, or is it a distinct approach in its own right?

18 In general, we agree that the common control model should be used in some circumstances only and should only be considered as an exception to the controlling entity model.

19 However, please refer to our comments on question 2. In our view, providing a control-based model in the conceptual framework of what the Boards have in mind when referring to a reporting entity leads to the discussion of the concept of common control as a means to determine the extent of the group reporting entity being superfluous.

20 By providing a model demonstrating the IASB’s idea of a reporting entity, preparers will sufficiently be able to determine the extent of the group reporting entity.

21 For example, consider a group of two entities controlled by an individual. Since the individual does not need to prepare consolidated financial statements, applying the controlling entity model would lead to no financial statements being prepared in accordance with IFRS at all. If the common control model could be applied in this situation as an exception to the controlling entity model, the two entities would be able to prepare financial statements comprising these two entities in accordance with IFRS.

Question 8:
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?

22 We believe it would be premature to reach a conclusion on the perspective from which the consolidated financial statements should be presented. In our view, the discussion paper does not provide a sufficiently extensive and detailed analysis of the different perspectives and the consequences of their application. The discussion provided in the discussion paper as well as in the Exposure Draft to Framework Phase A on objectives and qualitative characteristics of financial reporting is not sufficient in this regard.

23 Therefore, without the above mentioned analysis of the different perspectives and consequences of their application, the GASB does not feel to be in a position to provide the Boards with a concluding answer to question 8. We propose that the analysis and discussion should also cover possible approaches between the entity perspective and proprietary perspective. In this context, we ask the IASB to define and discuss the terms used in the discussion paper, e.g. the differences in perspectives when applying the parent company approach as the ‘view of the parent company’s shareholders’ versus the proprietary perspective as the ‘perspective of the entity’s owners or a particular class of owners’.

24 Additionally, we would like to point out, that in the current standards both approaches are existent: IFRS 2 (*Share-based Payment*) applies the parent company approach; IFRS 3 (rev) (*Business Combinations*) applies the entity perspective. Disallowing the application of the parent company approach would, in our view, result in a situation where expenses from share-based payment transactions would no longer be recorded and we believe that such drastic changes must be highlighted to provide an appropriate basis for developing a view on question 8.

Question 9:
Do you agree that consolidated financial statements provide useful information to equity investors, lenders and other capital providers? If not, why?

25 We agree that consolidated financial statements are generally capable of providing useful information to equity investors, lenders and other capital providers. However, whether they actually do provide useful information depends on the complexity of the rules applied in preparing the financials and the appropriate level of detail in the disclosures. In this respect we believe that the decision usefulness of consolidated financial statements has lessened over the past years. Therefore, the framework should, in our view, specifically discuss the impact of complexity on decision usefulness to provide a clear mandate for keeping financial reporting rules at the lowest complexity level feasible.

Question 10:
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?

26 We do not agree with the Boards' decision that the presentation of parent-only financial statements should only be allowed under the condition that they are included in the same financial report as the consolidated financial statements.

27 In this context, we also refer to our comments on question 2 regarding the IASB's mandate.

28 Each set of financial statements provides a different perspective of an entity's resources, claims and activities. Therefore, we believe that separate financial statements should also be captured under the definition of general purpose financial statements since it is not the kind of financial statements but the parties interested in the information provided in the respective financial statements who define whether or not financial statements represent general purpose financial statements.

29 Overall, the conceptual framework should therefore not preclude the presentation of parent-only financial statements or separate financial statements in general, provided it is clear from their caption what kind of financial statements they are. We also propose that an entity that presents separate financial statements and that is itself part of a broader group, should disclose this fact in the notes to its separate financial statements, the name of the broader group and whether and where the consolidated financial statements of the broader group are available. Such appropriate caption and note disclosure sufficiently protect users with reasonable business knowledge from misunderstanding the extent of information included.

Question 11:
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?

30 We agree.

(b) the concept of control should include situations in which control exists but might be temporary? If not, why?

31 In principle, we agree that the conceptual framework should cover circumstances where control exists only “temporary”.

32 However, we believe that the details of temporary control should be addressed at the standards level while the conceptual framework should only cover temporary control on a generic level by explaining that an entity over which control only exists for a “short time period” should not be consolidated but recorded as an investment in the group financial statements. Entities over which control exist for a longer period than the ‘short’ one should be consolidated. Furthermore, we propose not to use the word “temporary” in the conceptual framework since it is understood differently in different contexts. The timeframe representing a “short period of time” should be discussed on the standards level.

33 To illustrate, we believe that an entity that was acquired with the purpose of being sold within one year after acquisition and that meets the requirements of IFRS 5 (*Non-current Assets held for Sale and Discontinued Operations*) should not be consolidated in the group financial statements, in contrast to the current application of consolidating the entity and presenting it as discontinued operations.

(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?

34 We agree. All existing facts and circumstances should be considered.

35 We believe that the details for accounting should rather be addressed at the standards level than at the conceptual framework level.

(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?

36 We agree that holding enough options over voting rights that would place an entity in control over another entity if the voting rights were exercised is not sufficient, in itself, to establish that the entity currently controls the other entity.

37 In our opinion, holding enough options over voting rights that, if and when exercised, would place an entity in control over another entity would be a strong indicator for control. However, all existing facts and circumstances should be considered when establishing whether control exists, including the holding entity's motivation for currently not exercising the options.

38 We believe that the requirement on accounting when an entity holds enough options over voting rights to gain control over the other entity when exercising the options should be addressed at the standards level rather than at the conceptual framework level.

(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?

39 The answer to this question depends on the definition of control as discussed in our comments to question 5.

40 As already mentioned in our comments to question 5, we propose to define control as exclusive control in the conceptual framework. The requirements on the accounting should be addressed at the standards level rather then at the conceptual framework level.

(f) 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? If not, why?

41 We agree with the Boards' view that having 'significant influence' over another entity's financing and operating policy decisions is not sufficient to establish the existence of control over that other entity. All other existing facts and circumstances need to be considered as well.

Question 12:
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?

42 Generally, we believe that the concepts to the respective issues discussed in question 11 should be defined in the conceptual framework. However, as already mentioned above in our comments to question 11, the details regarding the issues 11b) temporary control, 11c) control through economically similar circumstances to sufficient voting rights or other legal rights, 11d) potential voting rights and, 11e) control exclusively held by one entity should be addressed at the standards level rather than at the conceptual framework level.

43 We are of the opinion that the discussion paper covers too many issues that should generally be addressed at the standards level. Addressing requirements in the conceptual framework leads to a deviation from the objective of a principles-based framework and bears the risk of having to amend the conceptual framework as standards are amended or revised.

Question 13:
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 discussion paper and should be addressed at the concepts level?
If so, which issues and why?

44 We propose that the conceptual framework should address at the beginning of the text what the standards and the conceptual framework do and, especially, what they do not address. Regarding the latter, we propose that the conceptual framework clearly sets out that neither the standards nor the framework cover issues regarding the definition of the subject of financial reporting (i.e. who must prepare financial statements) and the presentation of financial statements (i.e. who must present financial statements, when financial statements are to be published and how financial statements are to be published) since this responsibility lies with the respective national legislative or regulatory authorities.