Deutsches Rechnungslegungs Standards Committee e.V.
Accounting Standards Committee of Germany
® Der Standardisierungsrat

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DSR – öffentliche SITZUNGSUNTERLAGE

DSR-Sitzung:	**145. Sitzung / 07.06.2010 / 11:00-12:30 Uhr**
TOP:	**03 – IASB ED Conceptual Framework – Reporting Entity**
Thema:	**Stellungnahmen zu ED/2010/02**
Papier:	**145_03a_CF RE_Overview**

Overview of the DP-Content, ED-Content and DSR comments on the discussion paper

ISSUE	IASB	DSR comments on the discussion paper
Section 1: The reporting entity concept (Q1-2)		
Whether a definition of the term reporting entity is necessary DP 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? […] **ED Q1: Do you agree that a reporting entity is a circumscribed area of economic activities whose financial information has the potential to be useful to existing and potential equity investors, lenders and other creditors who cannot directly obtain the information they need in making decisions about providing resources to the entity and in assessing whether the management and the governing board of that entity have made efficient and effective use of the resources provided?**	*DP*: The boards' preliminary view is that developing a precise definition of a reporting entity is unnecessary. However, the question remains whether the conceptual framework should provide a general description of, or some explanation about, what constitutes a reporting entity in the context of general purpose financial reporting. *ED RE2-3*: A reporting entity is described as 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 management and the governing board of that entity have made efficient and effective use of the resources provided. Furthermore ED enumerates three main features of what a reporting entity is.	- We believe that neither a definition of a reporting entity nor the proposed broad description of a reporting entity 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 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 disagree that separate financial statements or consolidated financial statements for subgroups are not general purpose financial statements per se.

Whether a reporting entity must be a legal entity DP Q1: Do you agree that what constitutes a reporting entity should not be limited to business activities that are structured as legal entities? **ED Q3: 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?**	*DP*: The boards' preliminary view is that a reporting entity should not be limited to business activities that are structured as legal entities. Rather, a reporting entity should be broadly described as being a circumscribed area of business activity. *ED RE4-6*: The existence of a legal entity is neither necessary nor sufficient to identify a reporting entity. A reporting entity can include more than one entity or it can be a portion of a single entity.	- We agree.
Link between the objective of financial reporting DP Q2: […] Do you disagree with including reference to equity investors, lenders and other capital providers in the description (or definition) of a reporting entity?	*DP*: Broadly describing a reporting entity as a circumscribed area of business activity may be too vague to be of use when developing financial reporting standards because it does not provide a clear link to the objective of financial reporting. Given that the conceptual framework establishes concepts for general purpose financial reports, any discussion of the reporting entity in the framework should be clearly linked to that objective. *ED RE1-2*: Still included.	

Section 2: Group reporting entity (Q3-7)		
Control over an entity – what does control mean? DP 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? **ED Q2, part 2: Do you agree with the definition of control of an entity?**	*DP*: The boards' preliminary view is that control should not be based upon power alone, but also should include the ability to benefit from that power (or to reduce the incidence of losses). The boards also noted that if control is used as the basis for determining the composition of a group reporting entity, control would be a key component of the reporting entity concept. Therefore, the boards' preliminary view is that control should be defined at the conceptual level. A working definition of control: 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 those losses). *ED RE7*: An entity controls another entity when it has the power to direct the activities of that other entity to generate benefits for (or limit losses to) itself.	- We agree that control should be defined at the conceptual framework level and a definition of control should refer to both power and benefits.
Relationship between the control concept in the context of control over another entity and in the context of the asset definition	*DP*: The boards' preliminary view is that the reporting entity concept 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. Hence, it is not necessary for the basis for determining the composition of a group reporting entity to be aligned with the asset definition—it would be possible to do so, but it is not necessary. *ED BC 12*: The Board affirmed its view in the discussion paper that it is not necessary to align the basis for determining the composition of a group of entities to be reported on as a single reporting entity with the definition of assets. The	- We think 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.

	definitions of assets in existing conceptual frameworks refer to an entity and, thus, it could be argued that it is circular to use the definition of assets to determine what constitutes the entity.	
Determining the composition of a group reporting entity DP 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? **ED Q2, part 1: Do you agree that if an entity that controls one or more entities prepares financial reports, it should present consolidated financial statements?**	*ED RE8*: If an entity that controls one or more entities prepares financial reports, it should present consolidated financial statements.	- In our view, control is the primary concept for determining the composition of a group. - Scenarios of shared control and joint control exist and therefore the conceptual framework should not exclude the possibility of shared control and joint control. - 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".
- *Controlling entity model* DP Q6: 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?	*DP*: The boards' preliminary view is that the difficulties encountered in practice when applying the controlling entity model to SPEs do not necessarily indicate that the concept is flawed. *ED*: Is applied but not directly expressed.	- 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. - 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 not necessary.

- *Common control model* DP 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 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?	*DP*: Because the controlling entity model is more consistent with the objective of financial reporting than is the common control model, the boards' preliminary view is that the controlling entity model should be used as the primary basis for determining the composition of a group reporting entity. However, because there are occasions when application of the common control model would provide useful information to equity investors, lenders and other capital providers, the conceptual framework chapter on the reporting entity should also include discussion of the common control model. It would be determined at the standards level when the common control model should (or may) be applied. *ED RE12*: Combined financial statements include information about two or more commonly controlled entities. Combined financial statements do not include information about the controlling entity and are often prepared when the controlling entity does not prepare financial reports. Combined financial statements might provide useful information about the commonly controlled entities as a group.	- 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. - However, 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.
- *Risk and rewards model* DP 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, the risks and rewards model should not be considered further in the reporting entity phase of the conceptual framework project?	*DP*: The boards' preliminary view is that the risks and rewards model does not provide a conceptually robust basis for determining the composition of a group reporting entity. The basic idea is so broad that, in order to place what seem like reasonable and necessary limits on which entities should be included in the group, it would be necessary to develop criteria that would involve drawing some bright lines, such as the minimum level of exposure to risks or entitlement to rewards. *ED:* No Reference to this issue.	- 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.

Section 3: Parent entity financial reporting (Q8-10)		
Parent company approach to consolidated financial statements DP 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?	*DP*: Given that the boards have decided to adopt the entity perspective, this may imply that they have rejected the parent company approach in its entirety. However, that is not so. As noted in the exposure draft for phase A and its accompanying Basis for Conclusions, adopting the entity perspective does not preclude including in financial reports information that is primarily directed to the needs of a particular group of capital providers. *ED*: No Position directly expressed.	- We believe it would be premature to reach a conclusion on the perspective from which the consolidated financial statements should be presented. - 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'.
Parent-only financial statements and consolidated financial statements DP Q9: Do you agree that consolidated financial statements provide useful information to equity investors, lenders and other capital providers? DP 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?	*DP*: The preliminary view of the boards is that a parent entity should always present consolidated financial statements. The conceptual framework should not preclude the presentation of parent-only financial statements, provided that they are included in the same financial report as the consolidated financial statements. *ED RE11*: A controlling entity may present financial statements that provide information about its investments in the entities it controls, and the returns on those investments, rather than the economic resources and claims, and changes in those economic resources and claims, of those entities it controls. Such 'parent-only' financial statements might provide useful information if	- 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. - 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

	they are presented together with consolidated financial statements.	the same financial report as the consolidated financial statements. We 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.
Section 4: Control issues (Q11-13)		
Determining when one entity has control over another DP Q11a: Do you agree that 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?	*DP*: The boards' preliminary view, whether one entity has control over another entity involves an assessment of all the existing facts and circumstances. Furthermore: (a) 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 regarded as a necessary condition for control to exist. (b) the concept of control does not exclude situations in which control exists but it might be temporary; in other words, the possibility that circumstances might change in the future, and that such a change in circumstances might result in the loss of control, does not affect whether control exists at present.	- We agree.

Control other than by legal rights DP Q11c: Do you agree that 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?	*DP*: The boards' preliminary view is that the control concept in the conceptual framework 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.	- We agree. All existing facts and circumstances should be considered. - We believe that the details for accounting should rather be addressed at the standards level than at the conceptual framework level.
Latent control and the treatment of options DP Q11d: Do you agree that 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?	*DP*: The general conclusion that holding an option does not, in itself, give the option holder control of another entity (or the underlying asset, in the case of options over assets), does not rule out the possibility that there could be situations in which the holding of options, taken in conjunction with other facts and circumstances, might result in the option holder controlling the other entity. This is because an assessment of whether one entity has control over another entity should be based on an assessment of all the facts and circumstances.	- 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. - 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.
Power is not shared with others DP Q11e: Do you agree that 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?	*DP*: For power to exist, it must be held by one entity only—an entity does not have power over another if it must obtain the agreement of others to direct the financing and operating policies of that other entity. This does not imply that power must be absolute—an entity is not required to have total, unrestricted power over another entity's financing and operating policies for power to exist. There are often limits on power that are imposed by law, regulations, fiduciary responsibilities and contractual rights. Those limits or restrictions are usually protective in nature, and do not usually deprive	- The answer to this question depends on the definition of control as discussed in our comments to question 5. - 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.

	the controlling entity of the ability to direct the operating and financing policies of the controlled entity. Rather, to have the ability to direct another entity's financing and operating policies, the first entity must have that ability itself, rather than in conjunction with others.	
Control, joint control and significant influence DP Q11f: Do you agree that 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?	*DP*: In joint ventures, in which financing and operating policy decisions require the unanimous consent of the venturers, it might be said that, *as a group*, the venturers control the joint venture. However, none of the individual venturers has control over the joint venture. Therefore, the boards concluded that the relationship between an individual venture and the joint venture is not a control relationship. Similarly, the boards' preliminary view is that the relationship referred to as 'significant influence' is not a control relationship. In the absence of other facts and circumstances, the fact that an entity might have some influence over the financing and operating policy decisions of another entity does not mean it has control over that entity. *ED RE9-10* Two or more entities may share the power to direct the activities of another entity to generate benefits for (or limit losses to) themselves. In this case, none of the entities that share the power to direct the activities of this other entity individually controls this other entity. Accordingly, none of these entities would present information about itself and this other entity on a consolidated basis. (BC26: Despite its name, proportionate consolidation is a method of accounting for an investment in another entity, instead of a method of reporting economic resources and claims of a controlled entity. Thus, the Board decided not to address proportionate consolidation.) If one entity has significant influence over another	- 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.

	entity, it does not control that other entity. The entity's ability to influence the activities of another entity without actually being able to direct those activities does not constitute power over that other entity.	
DP 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?		- Generally, we believe that the concepts to the respective issues discussed in question 11 should be defined in the conceptual framework. - 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.
DP 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 discussion paper and should be addressed at the concepts level? If so, which issues and why?		- 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.
ED Q4: The IASB and the FASB are working together to develop common standards on consolidation that would apply to all types of entities. Do you agree that completion of the reporting entity concept should not be delayed until those standards have been issued?		