



EFRAG

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Ref: CESR/10-835

RE: EFRAG's draft response on the IASB's Exposure Draft *Conceptual Framework for Financial Reporting: The Reporting Entity*

The Committee of European Securities Regulators (CESR), through its standing committee on corporate reporting (CESR-Fin), has considered EFRAG's draft comment letter on the IASB's Exposure Draft (ED) *Conceptual Framework for Financial Reporting: The Reporting Entity*.

We thank you for this opportunity to comment on your draft letter and we are pleased to provide you with the following comments.

CESR is supportive of the IASB's and FASB's joint initiative to define in the Framework what constitutes a reporting entity as there is no further guidance in current accounting literature.

We particularly welcome the fact that the ED observes that combined financial statements might provide useful information about commonly controlled entities as a group. Current IFRSs do not provide an adequate solution for the practice in several European countries of having entities that are commonly controlled by two different listed entities. We believe that further guidance should be developed at standards level.

In its draft response EFRAG is broadly supportive of the IASB's direction. CESR is supportive of EFRAG's draft comment letter and thus of the IASB's proposal. CESR has however some concerns that are set out in the response to the detail questions in the appendix the more important ones of which are as follows:

- (a) CESR is of the opinion that a definition of what constitutes *control* should be provided in the Framework but does not believe the current wording is appropriate. For example it seems as SIC 12 – *Consolidation: Special Purpose Entities* would no longer be in line with the Framework. We believe that a high level definition of *control* should be provided within the Framework and that a more detailed and operational definition should be provided at standards level.
- (b) CESR remains of the view that no individual part of the Framework should be finalised until the Framework as a whole is ready to be finalised. We are concerned that a piecemeal approach to developing and approving the individual chapters may jeopardize the coherent and consistent application of the Framework as a whole. Asking for final comments on the *Reporting Entity* before its implications on later chapters of that new material is in our view not appropriate. Also, as those implications appear not to be fully reflected in the consequential changes being proposed, it seems that for the next five years or so the IASB's Framework will be an incoherent mixture of the old Framework and the new. Bearing in mind the role the Framework plays in the hierarchy, we do not think this incoherence is acceptable. We believe that future amendments to the Framework should reflect necessary consequential amendments to its other parts.

Our detailed comments on EFRAG's draft response are set out in the Appendices.



I would be happy to discuss all or any of these issues further with you.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'K. A.', written over a horizontal line. A long, sweeping underline extends from the signature.

Chairman of CESR-Fin



APPENDIX 1 – CESR’S DETAILED ANSWERS TO THE QUESTIONS IN THE ED

Question 1

Do you agree that a reporting entity is a circumscribed area of economic activities whose financial information has the potential to be useful to existing and potential equity investors, lenders and other creditors who cannot directly obtain the information they need in making decisions about providing resources to the entity and in assessing whether the management and the governing board of that entity have made efficient and effective use of the resources provided? If not, why?

In CESR’s view the notion of a reporting entity is central to the Framework. Therefore we believe that the Framework needs to contain some sort of description of a reporting entity. However, we recognize that it is for each jurisdiction to decide which entities should be required to provide regular financial reports and what form these should take, but see no contradiction between this statement and the proposal that the Framework should set out some sort of description of what constitutes a reporting entity.

CESR agrees that what constitutes a reporting entity should not be limited by legal boundaries and believes that specific guidance on how to consider such boundaries and how the notion of control should be applied in practice (i.e. temporary control, de facto control...) can be addressed at the standards level.

We have however some concerns relating to paragraph RE3 that defines three features necessary but not always sufficient to identifying a reporting entity. The second criterion set out in RE3 (b) states that ‘*those economic activities can be objectively distinguished from other entities and from the economic environment in which the entity exists*’. Similar to our response to question 3 CESR is supportive of the idea that those economic activities should be *objectively* distinguished, i.e. supported by evidence. We would however welcome the IASB clarifying what is meant by *economic environment* and that the economic activities include those situations where the contribution is negative as well as positive.

Question 2

Do you agree that, if an entity that controls one or more entities prepares financial reports, it should present consolidated financial statements? Do you agree with the definition of control of an entity?

In its draft comment letter EFRAG believes that the definition of ‘control’ should be developed in the *Conceptual Framework* at a higher level than in the Reporting Entity chapter. CESR is of the opinion that a definition of what constitutes *control* should be provided in the Framework but does not believe that the current wording is appropriate. For example it seems as SIC 12 – *Consolidation – Special Purpose Entities* would no longer be in line with the Framework. We believe that a high level definition of *control* should be provided within the Framework and that a more detailed and operational definition should be provided at standards level and that these two elements should be aligned (including the projects currently under revision).

In line with our comments on the interaction between the separately developed chapters of the Framework we believe that what constitutes ‘control’ has high importance for the development of several current IASB projects such as the ED10 Consolidated Financial Statements. When developing this definition we particularly believe it should capture the concept of negative economic situations. CESR would be surprised if as a result of developing a new definition of *control* fewer entities would be consolidated.

In addition, we note that RE8 states that ‘*if an entity that controls one or more entities prepares financial reports, it should present financial statements. Consolidated financial statements are most likely to provide useful information to the greatest number of users*’. We would encourage the IASB to reflect on the interaction of this paragraph with the exceptions to the preparation of consolidated financial statements provided in IAS 27 – *Consolidated and Separate Financial Statements*.



Question 3

Do you agree that a portion of an entity could qualify as a reporting entity if the economic activities of that portion can be distinguished from the rest of the entity and 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? If not, why?

We agree with the IASB 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. However, we believe that it is necessary that the portion can be distinguished from the rest of the entity objectively, i.e. supported by evidence.

Question 4

The IASB and the FASB are working together to develop common standards on consolidation that would apply to all types of entities. Do you agree that completion of the reporting entity concept should not be delayed until those standards have been issued?

CESR remains strongly of the view that no part of the Framework should be finalised until the Framework as a whole is ready to be finalised. Asking for final comments on the *Reporting Entity* before its implications on later chapters of that new material is in our view not appropriate. Also, as those implications appear not to be fully reflected in the consequential changes being proposed, it seems that for the next five years or so the IASB's Framework will be an incoherent mixture of the old Framework and the new. Bearing in mind the role the Framework plays in the hierarchy, we do not think this incoherence is acceptable. We believe that future amendments to the Framework should reflect necessary consequential amendments to its other parts.



APPENDIX 2 – CESR COMMENTS ON EFRAG’S ADDITIONAL OBSERVATIONS

Parent-Only Financial Statements

In Appendix 2 of its comment letter EFRAG draws attention to the requirement in the proposed Framework chapter that ‘parent-only’ financial statements might provide useful information if they are presented together with consolidated financial statements.

CESR agrees with EFRAG that details about timing and issuance of those financial statements should not be included in the *Conceptual Framework*. We believe that information about (1) when ‘parent-only’ financial statements should be issued, (2) whether or not they must be issued at the same time as consolidated financial statements, and (3) whether or not they should be included in the same financial report to be relevant to be defined at the conceptual level.

Joint control and shared control

We are supportive of EFRAG’s appeal to the IASB to provide an analysis of the decision-usefulness of the information derived from using joint control or shared control concepts to determine the boundaries of the group reporting entity. We would welcome further elaboration on why control needs to be exclusive and what the difference between exclusive and non-exclusive control is in terms of usefulness of the resulting financial information.

Perspective from which financial statements should be presented

CESR agrees with EFRAG that the perspective from which financial statements should be presented is critical to the *Conceptual Framework* and believes that a comprehensive and in-depth debate is needed on the perspective from which financial statements should be prepared.

While the IASB concluded in its Discussion Paper *Preliminary Views on an Improved Conceptual Framework for Financial Reporting: The Reporting Entity* that the entity perspective is more consistent with the fact that the vast majority of today’s business entities engaged in financial reporting have an identity distinct from that of their capital providers. We would like to point out that the Board’s final discussion and views regarding the group reporting entity should ultimately align with the Boards’ final descriptions of the ‘entity perspective’ as described in the Exposure Draft: *Conceptual Framework for Financial Reporting: The objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-Useful Financial Reporting Information*.

In our view, although the ED proposes the use of the entity perspective, the material in the Basis for Conclusions is insufficient to enable that debate to take place. In the absence of such a debate, we think it is premature to reach a conclusion at this stage of the Framework project. We are also concerned that, as the IASB itself acknowledges, the implications of that proposal for the rest of the Framework have not yet been identified.