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N°44

IASB
Comment letters
30 Cannon Street
LONDON EC4M 6XH
UNITED KINGDOM

Re : Exposure Draft ”Conceptual framework for financial reporting”

Dear Sir or Madam,

I am writing on behalf of the Autorité des Normes Comptables (ANC) to express our views on the exposure draft 2010/2.

The ANC concurs with the decision of the Board to define broadly the reporting entity and to address the different types of financial statements that may be useful.

However, the ANC is concerned by the continuing reference to a group of investors, lenders and other creditors which appears again in the definition of a reporting entity. We are of the view that their central role has not been sufficiently analysed and that other groups of users should be considered more extensively. We challenge the idea that investors, lenders and other creditors correspond to a homogeneous group with common needs. We also consider that a partial assessment of users needs could lead to improper decision regarding other subsequent issues such as defining general purpose financial statements versus specific purpose financial statements.

In addition, we think that the definition of a reporting entity needs to be clarified regarding the following topics developed in our detailed answers set out in the Appendix I:

- The condition according to which it is possible to assess that the management and governing board have made efficient and effective use of the resources provided, seems to put an emphasis on current management and governing board. Therefore, we think that the exposure draft wording may scope out reporting entities which have new management or governing board and/or are recently created.
- More guidance or explanation should be given to assess how a circumscribed area of business can be “objectively distinguished” so that an entity or a portion of an entity can be qualified as a reporting entity.

- The financial statements enumerated by the exposure draft do not include some financial statements that may correspond to a reporting entity as defined in the same document. We refer mainly to financial statements corresponding to a group comprising a controlling entity together with only some of the commonly controlled entities but not all of them, and to some pro-forma financial statements (please refer to our answer to question 4).

Regarding the definition of control, we consider that the IASB should devote a whole chapter of the conceptual framework to the definition of control as it is a central notion within IFRSs. We are not convinced that the proposed definition is either relevant or considered in the appropriate place.

If you have any questions concerning our comments, we would be pleased to discuss them.

Yours sincerely,

Jérôme HAAS

Appendix I
Detailed comments

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 and in assessing whether the management and the governing board of that entity have made efficient and effective use of the resources provided? (See paragraphs RE2 and BC.4-BC.7.) If not, why?

Parallel to the proposed definition of a reporting entity, ED 2010/2 indicates that a reporting entity has three features. This first feature is whether economic activities are being conducted, have been conducted or will be conducted. The second feature is related to the distinction of the economic activities of an entity from those of other entities and from the economic environment in which the entity exists. The third feature is about the potential usefulness of financial information in making decisions about providing resources and in assessing whether management and governing board have made efficient and effective use of the resources provided.

The ANC fully agrees that the framework should contain a broad description of a reporting entity that focuses on a circumscribed area of economic activities. However, we are of the view that it is necessary to give sufficient guidance on how to “objectively distinguish” a circumscribed area of business from the rest of an entity or from the economic activities of other entities. The notion of “potential to be useful” also needs to be clarified.

We are also concerned about the current wording which refers to “management and the governing body”. This could be read as requiring a reporting entity to have had a form of management in place. Considering, for example, a reorganization where parts of existing entities are carved out and a newco has been created just before the IPO. Should this group (the activities carved out and the newco) be considered as a reporting entity even if it does not have a common management yet? If not, what type of general purpose financial statements could be established?

In addition, regarding the three features enumerated in the exposure draft (§ RE3), we think it would be also useful to clarify the circumstances under which these features “are not always sufficient to identify a reporting entity” as it is not clear what additional features should be identified.

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? (See paragraphs RE7-RE8 and BC.18-BC.23.) If not, why?

The ANC agrees that if an entity controls one or more entities and prepares financial reports, it should present consolidated financial statements to the extent that relevant exemptions continue to be addressed by the standards on consolidation, when necessary and as it is currently done for intermediate controlling entities (cf. IAS 27 § 10).

Regarding the importance of the notion of control in current IFRSs and its various acceptations, the ANC recommends that a specific chapter in the conceptual framework be dedicated to it.

Several IASB projects such as the consolidation project or the derecognition project have discussed or still are discussing the concept of control. We note that the definition of control is not stabilised yet and that fundamental questions are still to be addressed. Moreover, this notion is used for consolidation purposes and for assets recognition requirements. For these reasons, we are not convinced that the definition of control proposed by this exposure-draft constitutes a satisfactory answer to all of these issues. At least, we are not sure it addresses ‘autopilot’ entities.

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? (See paragraphs RE6 and BC10.).If not why?

We are concerned that an unintended consequence of the current wording would imply the preparation of financial statements whenever a portion of an entity could qualify as a reporting entity and suggest therefore that financial statements of a portion of an entity shall be prepared when it is decided by the entity's management.

As stated in our answer to question 1, another concern relates to how the economic activities of a portion of an entity can be objectively distinguished from the rest of the entity. In practice, many issues may arise while defining the assets, liabilities, income and expenses of a portion of an entity. Some of these issues may relate for example, to push-down accounting issues, others to the allocation of certain costs (overheads costs, funding costs, tax charges, etc). Although these issues should be addressed at the IFRSs level, it is important that general principles be defined so that the definition of a portion of an entity is complete and well understood.

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 chapter of the conceptual framework should not be delayed until those standards have been issued? (See paragraph BC2.27.) If not, why ?

Yes, we agree.

More generally, we think that the most relevant process is that the IASB write the concepts first and then the standards. This is all the more important as the framework is intended to assist the board in the development of future IFRSs and in its review of existing IASs ad IFRSs.

However as different chapters of the framework may interact and thinking may evolve, it seems reasonable once the conclusions have been reached on one chapter that the finalised chapter be published and reassessed based on the conclusions reached on another chapter. Such process would permit better consistency between the different chapters and would permit to take into account the latest reflections.

Other comments

Combined financial statements

The exposure draft indicates that combined financial statements do not include information about the controlling entity (cf. exposure draft §RE12). We think that such a restriction is not relevant because in some cases it may be appropriate that general purpose financial statements be prepared for a circumscribed area of activities that comprises only some of the commonly controlled entities but not all of them, together with a controlling entity.

Other financial statements

The exposure draft deals with a limited number of financial statements namely the consolidated financial statements, the parent-only financial statements and the combined financial statements.

We think that some general purpose financial statements do not correspond to any of these kinds of financial statements as defined in the exposure draft, and suggest that such cases be considered and analysed in order to clarify or amend the categories of financial statements listed in the exposure draft.

In some cases, entities may wish to present pro-forma information in particular by preparing financial statements corresponding to a situation that does not exist already for example, financial statements corresponding to entities or businesses that are intended to become a group under the scope of IAS 27 in the future. This may occur when activities carved out from existing entities are put under the control of a new entity.

Entities may also need to prepare financial statements with the objective of restoring the comparability of accounting data, following a specific event. These latest pro forma accounts are then based on historical accounts and on the agreements reflecting the impact of this specific event.

We are of the view that such financial statements correspond to a circumscribed area of economic activities whose financial information is useful to primary users and should be addressed by the reporting entity chapter of the framework. We encourage therefore the IASB to continue its analysis on this matter to make clear when pro-forma accounts can be qualified as general purpose financial statements and to indicate to which type these financial statements belong ("combined financial statements" or another category that is still to be determined?).

Parent only financial statements

The ANC does not agree with the proposal in paragraph RE11 which states that parent-only financial statements provide useful information if they are presented *together* with consolidated financial statements (emphasis added).

We think parent-only financial statements and consolidated financial statements have different objectives. For this reason, we think that both of these financial statements should be published but not necessarily in the same document or simultaneously. When they are presented separately, the notes in the separate financial statements may usefully indicate that consolidated financial statements have already been presented or will be presented in the near future.

Authoritative status of the framework and link with IFRSs

The exposure draft rightly indicates that neither the IASB's framework nor FASB Concept statements override authoritative standards even though some may be inconsistent with them.

However, it seems important that the new version of the framework confirms its status and that any new or revised IFRSs be consistent with this last version unless there is a clear explanation and justification.