

July 14, 2010

Submitted electronically via www.iasb.org

International Accounting Standards Board
30 Cannon Street,
London EC4M 6XH
United Kingdom

Dear Sirs:

**Re: Exposure Draft, Conceptual Framework for Financial Reporting:
The Reporting Entity**

The following comprises the response of the staff of the Canadian Accounting Standards Board (AcSB) to the IASB's Exposure Draft on *The Reporting Entity*, issued March 11, 2010. In developing this response, AcSB Staff held discussions with the AcSB, the AcSB's Academic Advisory Council, and the Conceptual Framework Discussion Group (which advises the Board on matters relating to the conceptual framework).

The views expressed in this letter take into account comments and perspectives raised by members of the AcSB, its Academic Advisory Council, the Conceptual Framework Discussion Group, and AcSB staff members. The views expressed in this letter do not necessarily reflect a common view of the AcSB or any other group. Views of the AcSB are developed only through extensive due process.

Consistency with the objective of financial reporting

We agree with paragraph BC4 that the description of a reporting entity should be "... designed to be consistent with the objective of financial reporting." However, paragraph RE1 appears to be an incomplete, differently worded, summary of the objective that was set out in the IASB Exposure Draft *An Improved Conceptual Framework for Financial Reporting*. We are concerned that any differences may give rise to confusion as to the objective of financial reporting. We think that paragraph RE1 should be replaced with a simple reference to the pertinent paragraphs of the framework chapter that set out the objective of financial reporting. Further, we suggest that there be a clear explanation of how the proposed description of a reporting entity follows from, and is consistent with, this objective.

Description – “A reporting entity is a circumscribed area of economic activities” (paragraph RE2)

We agree that a reporting entity is “a circumscribed area of economic activities”, but believe that this description is incomplete, because it does not address what circumscribes (provides the boundaries that define) a reporting entity. The balance of the description provides that useful information should result, and that the circumscribed area of reporting entity can be “objectively distinguished”; these are important supporting conditions, but they do not define the basis for determining the boundaries of a reporting entity. The fundamental conceptual framework question is: What are the essential economic phenomena or features that define (circumscribe) this area of economic activities?

Later in the Exposure Draft the concept of “control” is introduced and defined. The Basis for Conclusions, paragraph BC22, states: “The Board concluded that the boundaries of a reporting entity should be determined on the basis of *control of an entity*.” But this is not stated in the text of the proposed framework chapter itself. We agree that the boundaries of a reporting entity are logically determined on the basis of the economic activities that it controls, and urge that that this be made explicit in paragraphs RE2-RE3.

In summary, we think that a reporting entity should be described as a circumscribed area of economic activities that it controls.

Balance of description (paragraphs RE2-RE6)

We agree with the balance of the description of a reporting entity, subject to the following comments:

- Paragraph RE3(a) states that one of the features of a reporting entity is that: “Economic activities of an entity are being conducted, have been conducted, or will be conducted” (also in RE4). We agree that “inactive entities or entities that have not begun to operate” should not be excluded (paragraph BC8). However, we do not agree that an entity must have economic activities that “are being conducted, have been conducted, or will be conducted” to be a reporting entity. We do not believe that future economic activity need be anticipated, but that financial information about an entity that may never become active could still have the potential to be useful to capital providers. An example might be an entity that is only holding mining claims and may ultimately be wound up if the claims prove to be without value. We suggest that paragraphs RE3a and RE4 be amended to explain that an entity need not be active, and that future activity need not be anticipated, for it to be a reporting entity.
- The final sentence of paragraph RE3 states that the features set out “are necessary but not always sufficient to identify a reporting entity”. We strongly believe that the conceptual framework description (definition) of a reporting entity and its features should be complete. The description is incomplete, and therefore inadequate, if it does not constitute both its necessary and sufficient conditions. If the boards believe that a definition of a reporting entity could require additional features or conditions to make it operational in some circumstances, then they should be clearly set out and explained. Otherwise, the inclusion of this sentence suggests that the concept of a reporting entity needs further thought. As noted above, we

believe that the definition of a reporting entity cannot be complete without incorporating the concept of control.

- We think that the paragraphs RE4-RE6 should be clearly presented and justified as applications of the description of a reporting entity set out in paragraphs RE2 and RE3. In other words, we suggest that paragraphs RE4-RE6 be reworded to make clear how the features of a reporting entity apply to legal entities and portions of entities, rather than seeming to be somewhat disconnected modifications of these features.
- We are puzzled by the last sentence of paragraph RE5, that: “In some jurisdictions, there may be questions about whether those entities are separate entities under the law.” We do not see the need for this sentence as it is expressed, and recommend that it be removed or its relevance made clear.

Control and consolidated financial statements

We agree with the definition of “control” in paragraph RE 7. As noted above, we strongly recommend that this definition be explicitly incorporated within the description of the boundaries of a reporting entity.

We think that it is important that the relationship between control in defining a reporting entity and its application to the presentation of consolidated financial statements be clearly deducible from the relevant chapters of the conceptual framework. We are of the opinion, however, that the sections on Consolidated Financial Statements and Other Types of Financial Statements do not belong in the Conceptual Framework, but are standards level issues.

On the application of control to the presentation of consolidated financial statements

We presume that consolidation means line-by-line inclusion of the underlying assets and liabilities of qualifying subsidiaries. We agree that control is a necessary condition for consolidation (that a reporting entity must have control of another entity to consolidate it), but we propose that control is not a fully sufficient condition for consolidating controlled entities.

Specifically, we disagree with the proposal in paragraph RE8 that “... if an entity that controls one or more entities prepares financial reports, it should present consolidated financial statements.” The basis for our disagreement is evidenced by investment companies. We understand that the boards have tentatively decided in their joint project on consolidation that there should be an exception to consolidation for investment companies. We agree that consolidation is not appropriate to investment companies, and the AcSB advocated this in its response to the boards’ December 2008 Exposure Draft on *Consolidation*. But we think it very unsatisfactory to label it as an “exception”. A fundamental objective of the conceptual framework is that “standards be clearly based on consistent principles”, and “to be consistent, principles must be rooted in fundamental concepts, rather than a collection of conventions” (Exposure Draft of *An improved Conceptual Framework for Financial Reporting*, Preface, paragraph P4). It thus seems very unsatisfactory, and in conflict with this fundamental conceptual framework objective, to state a principle (that a reporting entity should present consolidated financial statements of all entities that it controls) and then provide for an exception to the principle.

Rather, we think that the business purpose of investment companies demonstrates an additional condition for the consolidation of controlled entities, and we think it essential that the basis for

this condition be identified and clearly stated. We suggest that this is a unit-of-account issue (and we understand that unit of account is to be addressed as a separate conceptual framework project). The unit-of-account issue pertains to determining when financial statement items should be aggregated and when they should be disaggregated. We suggest that the objective should be to recognize assets, liabilities, revenues, and expenses at units of account that are appropriate to the reporting entity's business and operating purposes and processes. Applying this objective to investment companies, the business of investment companies pertains to acquiring, holding, and disposal of investments for the purpose of capital appreciation and/or investment income. The appropriate unit of account for entities controlled by investment companies is then the investments themselves, not the individual assets and liabilities of the controlled entity. (We do believe, however, that capital providers and other users of the financial statements of investment companies would benefit from information about the assets, liabilities, and income of controlled entities that are not consolidated, which information could be disclosed in the notes to the statements. This information would be appropriately required by the standard on consolidation.)

We note that the Basis for Conclusions, paragraph BC12, states that: "... the Board concluded that the reporting entity concept should first determine what constitutes the entity that is reporting, and only then should the definition of assets (and other elements of financial statements) be applied to *that* entity." We agree with this, and suggest that, carried to its logical conclusion, the application of the definition of assets and other elements requires defining what units-of-account for them are appropriate to the business of that entity.

In summary, we believe that:

- The concept of control should be explicitly incorporated within the description of the boundaries of a reporting entity.
- The fundamental implications of the concept of control for the presentation of consolidated financial statements should be clearly deducible from the relevant chapters of the conceptual framework.
- Control is a necessary but not a sufficient condition for the presentation of consolidated financial statements, but that an additional units-of-account principle reflecting the nature of the business activities of a reporting entity, should be recognized.
- The sections on Consolidated Financial Statements and Other Types of Financial Statements do not belong in the Conceptual Framework, but are standards level issues.

Parent-Only financial statements (paragraph RE11)

We think that a position on the provision of "parent-only" financial statements should be consistent with the concept of a reporting entity, but that it should be addressed within the standards on consolidation rather than as a conceptual framework matter.

Proportionate consolidation

We disagree with the claim at paragraph BC26 that “proportionate consolidation is a method of accounting for an investment in another entity”. In our view it is a form of consolidation, because it results in including (consolidating) a proportion of the assets, liabilities, revenues, and expenses of another entity with those of the reporting entity. This accounting conflicts with the principle that control is a necessary condition for consolidation. We recommend that paragraph BC26 be omitted from the Reporting Entity framework chapter, or that it simply state that the issue of proportionate consolidation will be dealt with in the consolidation and related standard setting projects. We think that it has been reasonably addressed in the IASB project on joint ventures.

Standards-Level Project on Consolidation

We agree that that completion of the reporting entity concept should not be delayed until standards on consolidation have been issued.

The appendix to this letter responds to the questions asked in the Exposure Draft.

We would be pleased to elaborate on any of our comments in more detail if you require. If so, please contact Peter Martin, Director of Accounting Standards, at +1 416 204-3276 (e-mail peter.martin@cica.ca) or Alex Milburn, Consultant to the AcSB, at + 416 204-3272 (e-mail alex.milburn@cica.ca).

Yours truly,



Peter Martin, CA
Director
Accounting Standards

Appendix – Responses to questions asked in Exposure Draft, *The Reporting Entity*

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?

See comments in our letter.

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?

*We disagree that investment companies (that is, companies that are in the business of acquiring, holding, and disposing of investments in entities for the purpose of capital appreciation and/or investment income) should consolidate entities that it controls that are held as investments. We believe, therefore, that control is a necessary, but not a fully sufficient condition for consolidation, and that there are additional unit-of-account issues that need to be addressed. See the explanation of our position and our recommendation in the accompanying letter under the heading **On the application of control to the presentation of consolidated financial statements.***

We agree with the definition of control of an entity.

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?

*We agree, but think that this conclusion should be clearly expressed as an application of the features of a reporting entity. See second last point under the heading **Balance of description** in our accompanying letter.*

4. The FASB and the IASB 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?

We agree.

*See also our comments in our accompanying letter on **Parent-only financial statements and Proportionate consolidation.***