ASC
ACCOUNTING STANDARDS COUNCIL

29 June 2010

International Accounting Standards Board
1st Floor 30 Cannon Street
London EC4M 6XH
United Kingdom

(By online submission)

Dear Sir,

RESPONSE TO EXPOSURE DRAFT ON CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING: THE REPORTING ENTITY

The Singapore Accounting Standards Council (ASC) appreciates the opportunity to comment on the Exposure Draft on *Conceptual Framework for Financial Reporting: The Reporting Entity* (the ED) issued by the International Accounting Standards Board (IASB) in March 2010.

We support the IASB's and Financial Accounting Standards Board (FASB)'s (collectively the Boards') efforts to establish a common understanding of the reporting entity concept at the conceptual level. However, we believe that there are some aspects of the ED that require further refinement and clarification by the Boards. Our broad views are as follows:

<u>Interaction with the legal framework of each jurisdiction</u>

To determine what constitutes a reporting entity, the Boards have focused on the economic activities of an entity, rather than its legal form.

Under the ED[1], certain legal entities may no longer qualify as reporting entities under the Framework. Two examples are provided below for illustration:

(a) a legal entity may have several distinct businesses, whereby each business is potentially a reporting entity while the legal entity itself may not qualify as a reporting entity, and

[1] Paragraph RE5 of the ED articulates that "*Most, if not all, legal entities have the potential to be reporting entities. A single legal entity may not qualify as a reporting entity, if, for example, its economic activities are <u>commingled</u> with the economic activities of another entity and there is no basis for <u>objectively distinguishing</u> their activities. In some jurisdictions, there may be questions about whether those entities are separate entities under the law.*"

Paragraph BC9 in the Basis for Conclusions further explains that "*Some respondents said that all legal entities should qualify as reporting entities by themselves. The Boards disagreed because in some situations the boundaries between two legal entities may be artificial ….. two such entities are likely to constitute a single reporting entity*".

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(b) a legal entity may be a subsidiary set up solely to provide services to its parent and related companies, where such a subsidiary may not qualify as a reporting entity if the economic activities of the subsidiary are construed to be comingled with the economic activities of the parent and the related companies.

Nevertheless those legal entities may still be required to prepare general purpose financial statements in accordance with IFRS, as mandated by the legislative requirements, in order to meet the objective of financial reporting[2]. This will result in a conflicting situation where the legal entity does not qualify to be a reporting entity, which is the subject of the financial statements, and yet it is required to prepare financial statements in accordance with IFRS. We believe that it is not the Boards' intention to prohibit the preparation of such legal entity financial statements based on IFRS as they meet the objective of financial reporting as stipulated by the jurisdiction. Thus we strongly urge the Boards to include a clarification that the Framework permits a legal entity to qualify as a reporting entity if the legislation in the relevant jurisdiction specifies the reporting entity which is required to prepare financial statements in accordance with IFRS.

Overall, we believe that the proposed requirements would be useful in providing a common conceptual framework for general purpose financial statements of entities which do not fit into a traditional reporting structure, such as carve-out financial statements for spin-off businesses, entities that are engaged in merger and acquisition activities and entities preparing for listing. At the standards level, there should also be further detailed requirements, such as disclosures about the identity of the reporting entity and the wider entity of which it is a component, to clarify on the reporting entity that each set of general purpose financial statements purports to represent.

Our comments on the specific questions to the ED are as follows:

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?

Subject to our comments in the first part of the comment letter *"Interaction with the legal framework of each jurisdiction",* we generally agree with the proposed description of a reporting entity, which is consistent with the objective of general purpose financial reporting in Phase A of the Conceptual Framework project, with specific comments as follows:

In the first part of the description, we agree with the reference to "existing and potential equity investors, lenders and other creditors", which is the same as the primary user group in

[2] The legislative requirements in Singapore require legal entities to prepare general purpose financial statements. Such legal entity financial statements primarily serve purposes such as maintenance of capital and legal claims to or interests in the group of resources, and provide financial information about the entity that is useful to the equity investors, lenders and other creditors for making decisions in their respective capacities.

Phase A of the Conceptual Framework project. These capital providers have the most critical and immediate need for general purpose financial information about the economic resources of an entity.

In the second part of the description, we agree with the reference to management's stewardship role, except that we do not think it is necessary to include "efficient and effective" in the description. To simply state "how management has made use of the resources provided" should suffice to illustrate the stewardship objective.

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? If not, why not?

Consolidated financial statements
We agree with the general principle in the conceptual framework that "if an entity that controls one or more entities prepares financial reports, it should present consolidated financial statements." We understand that exemptions from consolidation can be provided at the standards level and the standards will take precedence over the framework where there are inconsistencies. We propose that the Boards fine-tune the wording in the ED to reaffirm its position that there are exceptions to the general requirement of preparing consolidated financial statements for an entity that controls other entities.

Control definition
We agree with the definition of control of an entity, which is consistent with that in the Consolidation project. The application and practical implementation of the control definition should be set out at the standards level to deal with specific issues on consolidation. We reiterate to the Boards our comments on ED 10 *Consolidated Financial Statements* submitted on 20 March 2009, where we set out our views on the definition of "control" in the context of consolidated financial statements. In response to ED 10, ASC reinforced to the Boards the practical challenge in the determination of the governing body in Real Estate Investment Trusts (REITs) setups where power/control is shared amongst/between the board of directors of the manager, the manager, the trustee and the unitholders. ASC also proposed that additional guidance be provided that would rest the definition of control with the final approving authority.

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 objectively from the rest of the entity and financial information about the 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 not?

We agree that a portion of an entity could qualify as a reporting entity if the economic activities of that portion can be distinguished objectively from the rest of the entity and

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financial information about the portion of the entity has the potential to be useful in making decisions about providing resources to that portion of the entity.

We suggest that the Boards provide clarification on the following:

- What does an "entity" refer to in a "portion of an entity"? Does it refer to a "legal entity" or a "reporting entity"? We think that an example of a portion of a legal entity may be a division, while an example of a portion of a group reporting entity may be the parent entity. This will be useful in the determination of the boundaries of a reporting entity, and whether there can be more than one set of general purpose financial statements relating to a reporting entity, depending on how its economic activities are circumscribed.

- How can the economic activities of that portion of an entity be objectively distinguished from the rest of the entity? This is one of the three key features of a reporting entity and it would also help to address the issues highlighted in the first part of the comment letter under *"Interaction with the legal framework of each jurisdiction".*

- How does an operating segment under IFRS 8 *Operating Segments* interact with an operating segment which may qualify as a reporting entity? It is noted in the ED that a branch or division may qualify as a reporting entity. Using the same inference, it appears that an operating segment could possibly qualify as a reporting entity too if it displays features of a reporting entity.

Additionally, there are other practical issues to be considere*d as highlighted in the first part of the comment letter unde*r "*Interaction with the legal framework of each jurisdiction*". For instance, when a reporting entity is defined as a portion of a legal entity, creditors of an entity may have recourse to assets other than those of the reporting entity, and vice versa. This could possibly be addressed by including further detailed requirements at the standards level, such as disclosures about the identity of the reporting entity and the wider entity of which it is a component.

Question 4

The IASB and 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? If not, why not?

We agree that the completion of the reporting entity concept should not be delayed until the common standards on consolidation have been issued. Since the main purpose of the conceptual framework is to help in developing standards, the concepts should come before the standards. We also urge the Boards to give the completion of the different chapters of the *Conceptual Framework* a high priority.

<u>**Other comments not relating to the specific questions in the ED**</u>

We have a few comments below to share on certain areas which do not relate to the specific questions in the ED:

Control versus significant influence

The ED states that significant influence that one entity has over another does not constitute control over that other entity. In the Basis of Conclusion of the ED, significant influence is defined as the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. While we understand that the conceptual framework is only meant to set out the broad principles, the vague definition of significant influence in the ED is not sufficient for users to distinguish between control and significant influence. We suggest that the Boards should at least bring in the definition in the basis of conclusion to the ED itself. In addition, we expect that the detailed guidance should be dealt with at the standards level.

Parent entity financial reporting – entity perspective versus proprietary perspective

We note that the ED does not explicitly state whether consolidated financial statements should be presented from the perspective of the group reporting entity or the parent company's shareholders, unlike the Discussion Paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity*. We think that it is important for the ED to clearly articulate the perspective from which financial statements of the reporting entity are presented as it is helpful to determine the primary user group and the objective for financial reporting.

In addition, certain existing financial statements disclosure requirements specific to the parent company approach, such as presentation of earnings per share information, can be maintained at the standards level.

Parent-only financial statements and combined financial statements

We agree that parent-only financial statements and combined financial statements can be sources of useful information to be addressed in the conceptual framework. We note that the ED is intended to be brief on these issues and we expect that the detailed issues should be dealt with at the standards level.

We hope that our comments will contribute to the Boards' deliberation on this ED. Should you require any further clarification, do contact me. Thank you.

Yours faithfully,

Dexter Tan
Secretary, Accounting Standards Council