Committee of European Banking Supervisors

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International Accounting Standards Board
30 Cannon Street,
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Dear Madam, dear Sir,

Exposure Draft ED/2010/2 Conceptual Framework for Financial Reporting: The Reporting Entity

The Committee of European Banking Supervisors (CEBS), comprised of high level representatives from banking supervisory authorities and central banks of the European Union, welcomes the opportunity to comment on the IASB's Exposure Draft ED/2010/2 Conceptual Framework for Financial Reporting: The Reporting Entity.

Banking supervisory authorities and central banks have a strong interest in promoting sound and high quality accounting and disclosure standards for the banking and financial industry, as well as transparent and comparable financial statements that would strengthen market discipline.

CEBS welcomes the ongoing efforts of the IASB to improve financial reporting, and agrees with the underlying need for a sound framework to establish the concepts and principles that guide the development of accounting standards, as a way to ensure that those standards are principles-based and internally consistent.

Accordingly, CEBS is of the view that the achievement of internationally converged standards requires the frameworks of the IASB and FASB to be consistent, and therefore supports the development of a common conceptual foundation. Thus, CEBS would like to reiterate the concern that a discrepancy as regards the authoritative status of the Framework in IFRS on one side and US GAAP on the other might impair the implementation and understanding of this project.

Concerning Phase D of the Conceptual Framework project, CEBS generally supports the reporting entity concept outlined in the ED, as well as the IASB's approach of first defining the subject of financial reporting – i.e. 'who' will have to undertake financial reporting - as a basis to establishing its objective. This not only solves a conceptual deficiency of the existing Framework, but more importantly sets out the boundary of entities that may produce financial reports, thereby providing the backbone to avoid structuring of activities aimed at merely obscuring transactions. Nonetheless, the proposal as it stands also raises some concerns as outlined in the appendix.

The comments put forward in this letter have been coordinated by CEBS's Expert Group on Financial Information (EGFI) chaired by Mr. Didier Elbaum (Deputy Secretary General, Autorité de Contrôle Prudentiel) - in charge of monitoring any developments in the accounting area and of preparing related CEBS positions - and in particular by its Subgroup on Accounting under the direction of Mr. Ian Michael of the UK FSA. If you have any questions regarding our comments, please feel free to contact Mr. Elbaum (+33.1.4292.5801) or Mr. Michael (+ 44.20.7066.7098).

Yours sincerely,

Giovanni Carosio
Chair, Committee of European Banking Supervisors

Appendix - CEBS comments on the ED

Concept of a reporting entity (RE3)

CEBS agrees with a reporting entity concept that is based on user needs and furthermore considers that the three features a reporting entity should have to qualify as such – as described in RE3 – are adequate.

However, there is a concern about how these features interact with the fact that they are not always sufficient to identify a reporting entity. The Board should further clarify under what circumstances these features are not sufficient to identify a reporting entity, what further information would be needed and what the consequences would be.

Moreover, the fact that identifying a reporting entity in a specific situation requires consideration of the boundary of the economic activities and, in that context, the consideration of the notion of control, should be further clarified. In particular, the Board should clarify that the notion of reporting entity is first and foremost governed by the user's needs and defined on the basis of the features put forward in RE3 (with control being only a subordinate concept).

The notion of control, which should at least be consistent with the conclusion of the Board's deliberations on the proposals put forward in ED 10, should then be considered in the context of whether the reporting entity should report on a consolidated and/or on a different basis (e.g. combined financial statements, sub-consolidated basis, solo).

In any case, the considerations around the reporting entity and its boundaries should not alter or undermine any legal requirements that an entity may be subject to, in terms of reporting level or other reporting requirements. This is discussed in further detail below.

Portion of an entity

CEBS generally agrees that – as stated in RE6 - the specific case of a branch could qualify as a separate reporting entity. In fact, some EU jurisdictions require branches of foreign entities to prepare financial statements.

However, CEBS has some concerns about implications of the proposal that a portion of an entity could qualify as a reporting entity This could be in conflict with the provisions regarding operating segments (as presented in current IFRS 8). It should be noted that the ultimate usefulness of information for investors is often affected by legal structures, since, for instance, the "return" for these investors arises from dividends and changes in the value of the shares held which are based on the whole legal entity.

In particular, the example in paragraph RE6 ("a potential equity investor could be considering a purchase of a branch or division of an entity") is illustrative of the need to clarify the distinction of situations in which there should be different "reporting entities" or different "operating segments".

Parent-only, subsidiary-only and sub-consolidated financial statements

Information needs of financial statement users can (and in fact do) differ. That is the case with parent and non-controlling shareholders: parent shareholders have an interest in the performance of the whole group, while the decisions of non-controlling interests are based primarily on the performance of the legal entity in which they participate (though they may also be interested in the broader group perspective).

Many jurisdictions therefore require separate subsidiary or sub-consolidated financial statements to be prepared alongside consolidated financial statements, as they can provide useful financial information. CEBS believes that the preparation of such statements should not be restricted by the conceptual framework.

More generally, CEBS believes that the conceptual framework should not conflict with national legislation on which entities are required to prepare financial statements, and that the IASB should ensure that this is not the case in the final text. While CEBS does not believe that this is the IASB's intention, paragraph RE8 could have unintended consequences where national law requires all legal entities to produce financial statements. Within a group structure, individual legal entities may be required to produce financial statements, and therefore should present consolidated financial statements in line with RE8. This would lead to consolidated financial statements being produced at all levels of a group, which would not always lead to useful information (for example, within a chain of subsidiaries that are all wholly owned by the entity directly above them in the chain).

It is CEBS's view that paragraphs RE11 and RE12 ("Other types of financial statements") do not address the boundary of the reporting entity, but rather how entities should report on activities in circumstances in which parent-only or combined financial statements may be decision useful.

To be exhaustive, the list of circumstances in which financial statements are decision useful should also include subsidiary-only financial statements, sub-consolidated financial statements as well as "stand-alone" entity (ie entities without subsidiaries) financial statements – even though the latter are in our understanding already covered by the framework. This enhancement of the list will help to prevent the conflicts between the conceptual framework and national legislations mentioned above.

Joint ventures (common control) and other types of financial statements

Paragraph BC17 states that only one entity can control another entity. In the case of joint ventures, even though none of the joint venturers would be allowed to consolidate the entity whose activities are jointly controlled, we believe that disclosures are important so that users are aware of the investment of each of the joint venturers in a particular entity. Such disclosures should flow from the definition of a reporting entity as set out in the Framework, and should be borne in mind when working on other projects.

When it comes to commonly controlled entities where the controlling party is not required to prepare financial reports, it is CEBS's opinion that again a definition of the reporting entity based on user needs should naturally result in the best suited reporting approach. In this sense, some legal/regulatory frameworks require entities under common control to present combined financial statements, which, as stated in paragraph RE12, provide useful information about the commonly controlled entities as a group.

Combined financial statements could also be appropriate for some groups where there is no control relationship between any of the entities of the group. In several countries this is applied to the specific structure of groups of mutual banks. It is not clear from the ED if the financial statements produced by such groups could be qualified as combined financial statements.

Negative benefits

According to paragraph RE7 an entity controls another entity when the power to direct the activities is aimed at generating benefits or limiting losses to itself. In this connection, paragraph BC15 adds that benefits can be both positive and negative. However, CEBS believes that the notion of negative benefits is not well understood, and therefore recommends that the ED clearly describes the linkage between risk and negative benefits, as already hinted in paragraph BC15. In particular, in order to be consistent with the definition of control in ED10 "Consolidated financial statements", the term "benefits" might be replaced with the term "returns".

Ongoing evaluation of the boundaries of a reporting entity

Since the ED does not deal with the frequency with which the bounds of a reporting entity must be assessed, CEBS understands that the intention of the IASB is for preparers of financial statements to perform such assessment on an ongoing basis taking into account all the existing facts and circumstances. If that were the case, CEBS would fully support IASB's position, although it would be necessary to address the interaction between changes in the scope/boundaries of a reporting entity and the concept of business combinations in IFRS 3.