



9 July 2008

To: **Members of the Hong Kong Institute of CPAs**
All other interested parties

**INVITATION TO COMMENT ON IASB DISCUSSION PAPER ON PRELIMINARY
VIEWS ON AN IMPROVED CONCEPTUAL FRAMEWORK FOR FINANCIAL
REPORTING: THE REPORTING ENTITY**

Comments to be received by 29 August 2008

The Hong Kong Institute of Certified Public Accountants' (Institute) Financial Reporting Standards Committee (FRSC) is seeking comments on the IASB Discussion Paper which has been posted on the Institute's website at:

www.hkicpa.org.hk/professionaltechnical/accounting/exposedraft/content.php.

The IASB and the US Financial Accounting Standards Board (FASB) (collectively the boards) are working on a joint project to develop a common conceptual framework for financial reporting that is both complete and internally consistent. The common conceptual framework will provide a basis for developing future accounting standards.

This Discussion Paper presents preliminary views for determining what constitutes a reporting entity for the purposes of financial reporting. Although the reporting entity concept determines some important aspects of financial reporting, the boards' existing frameworks do not address it specifically. The boards' preliminary views are:

- A reporting entity is a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers.
- Control is the basis for determining the composition of a group reporting entity and the controlling entity model should be used as the primary basis for determining the composition of a group reporting entity.
- Consolidated financial statements should be prepared from the perspective of the group reporting entity.

A summary of the preliminary views in the Discussion Paper is set out in the Appendix.

In accordance with the Institute's Convergence Due Process, comments are invited from any interested party. The FRSC would like to hear from both those who do agree and those who do not agree with the proposals contained in the IASB Discussion Paper.

Comments should be supported by specific reasoning and should be submitted in written form.

To allow your comments on the IASB Discussion Paper to be considered, they are requested to be received by the Institute on or before **29 August 2008**.



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Comments may be sent by mail, fax or e-mail to:

Steve Ong
Deputy Director, Standard Setting Department
Hong Kong Institute of Certified Public Accountants
37th Floor, Wu Chung House
213 Queen's Road East
Wanchai, Hong Kong

Fax number (+852) 2865 6776
E-mail: commentletters@hkipa.org.hk

Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

Summary of the preliminary views in the Discussion Paper

The Reporting Entity Concept

The Discussion Paper discusses whether a definition for the term “reporting entity” should be developed. The boards’ preliminary view is that developing a precise definition of a reporting entity is unnecessary and that a reporting entity should not be limited to business activities that are structured as legal entities. Rather, a reporting entity should be broadly described as being a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers. That description would apply to, for example, a sole proprietorship, branch, corporation, trust, partnership and group of entities.

Group Reporting Entity

In this Discussion Paper, the term “group reporting entity” refers to a reporting entity that comprises two or more entities that are presented as a single unit. The Discussion Paper discusses three potential models to help determine what constitutes a group reporting entity.

The Controlling Entity Model

In this model, a group reporting entity is determined based on control which is defined as the ability to direct the financing and operating policies of an entity, so as to access benefits from that entity (or to reduce the incidence of losses) and increase, maintain or protect the amount of those benefits (or reduce the amount of those losses). A group reporting entity comprises the controlling entity (ie the parent) and other entities under its control (ie its subsidiaries).

The Common Control Model

Under this approach, a group reporting entity consists of the combination of entities that are under the common control of the same controlling entity. In contrast to consolidated financial statements, combined financial statements do not include the controlling party (ie parent) as part of the group reporting entity.

The Risks and Rewards Model

In this model, entities that affect the risk and rewards of the reporting entity are combined into one group reporting entity.

In the boards’ preliminary view, the controlling entity model is more consistent with the objective of financial reporting than is the common control model and the risks and rewards model does not provide a conceptually robust basis for determining the composition of a group reporting entity. Accordingly, the Discussion Paper proposes that the composition of a group entity should be based on control and that the controlling entity model should be used as the primary basis for determining the composition of a group reporting entity, although in some circumstances the common control model may provide useful information.



Parent Entity Financial Reporting

The Discussion Paper considers whether consolidated financial statements should be prepared from the entity's perspective or from the owner's perspective. Under the entity's perspective approach, the entity is considered to be separate from its owners while under the owner's perspective approach there is no distinction between the entity and the owners. The Discussion Paper proposes that consolidated financial statements are prepared from the perspective of the group reporting entity, not from the perspective of the parent company's shareholders.

The Discussion Paper states that consolidated financial statements provide useful information and should therefore always be prepared. It also states that the conceptual framework should not preclude the presentation of parent-only financial statements, provided that they are included in the same financial report as the consolidated financial statements.

Control issues

The Discussion Paper further discusses issues related to control and proposes that:

- Control should not be limited to situations in which an entity has sufficient voting or legal rights to direct the financing and operating policies of an entity, but rather should be a broad concept in which all facts and circumstances must be considered.
- Holding an option does not in itself give the option holder control of another entity.
- The decision-making capacity that satisfies the power element of control must be unilateral. The capacity cannot be shared with others.
- Significant influence is not a control relationship.