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Ms Li Li Lian  
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Dear Ms Lian

### **PRELIMINARY VIEWS ON AN IMPROVED CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING - THE REPORTING ENTITY**

The Head of Treasuries Accounting and Reporting Advisory Committee welcomes the opportunity to respond to IASB Discussion Paper *Preliminary Views on an Improved Conceptual Framework for Financial Reporting – the Reporting Entity*.

HoTARAC broadly supports the propositions contained in the Paper for application to most entities, and particularly those that are "for-profit".

However, HoTARAC believes that there are a range of issues that need to be reviewed, and these are set out in the Attachment to this letter. While most relate to application to the not-for-profit public sector, a number are also relevant to the for-profit sector.

The Attachment has been prepared with an Australian focus. However, HoTARAC believes the IASB will be able to apply the comments to its own consideration of the issues.

If you have any queries please contact Peter Gibson from the Australian Government Department of Finance and Administration on 61 2 6215 3551 or [peter.gibson@finance.gov.au](mailto:peter.gibson@finance.gov.au).

Yours sincerely

D W Challen

**CHAIR**

**HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE**

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Encl  
Contact: Suzi Ransom  
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Our Ref: D/14421 SR/CJ

**Comments on ITC17 - Request for Comment on IASB Discussion Paper Preliminary Views on an Improved Conceptual Framework for Financial Reporting: The Reporting Entity**

**1. The Reporting Entity Concept (Questions 1 and 2)**

It is noted that the IASB has tentatively proposed the following description for a reporting entity:

“a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers”

It is noted that the present definition in Australia specifies identification “by reference to the existence of users who are dependant on General Purpose Financial Reports for information for making and evaluating resource allocation decisions”<sup>1</sup>. IPSASB has considered a very similar view, covering GPFR users who use the information for “accountability purposes and for making resource allocation, political and social decisions”<sup>2</sup>.

It is agreed that the IASB definition does not need to specify the uses that users have for the information, as this is intended to be covered in Part A of the Framework project, covering Objectives of Financial Reporting.

HoTARAC recommends that the IASB amend its definition to be less prescriptive about the users, as the users for not-for-profit entities in both the public and private sectors will be different from those in the for-profit sector. While it is acknowledged that the IASB only currently sees its mandate as applying to for-profit entities, description of the users in more general terms will facilitate easier extension to other types of entities, and potentially simplify Part G of the Conceptual Framework Project (application of the framework to not-for-profit entities). If the IASB is unwilling to undertake this change, the AASB will need to separately consider how this is applied to the Australian not-for-profit sectors (both public and private).

HoTARAC agrees that a reporting entity should not be limited to a legal entity.

HoTARAC also agrees that a more general description/definition is preferred over a more precise one. The majority of HoTARAC members support the statement being a definition – with some authority – over a description – which may not have sufficient authority.

Of potentially greater concern is the lack of reference to a type of financial report in the definition. IASB has indicated that it does not intend to deal with this issue in this Paper.

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<sup>1</sup> *Statement of Accounting Concepts 1: Definition of the Reporting Entity*, paragraph 12.

<sup>2</sup> IPSASB Agenda paper 2.1 for meeting June 2008, paragraph 5.11

In contrast, the Australian definition presently includes reference to users dependant on General Purpose Financial Reports for their information. The issue with not containing this specification in the IASB definition is that either:

- i) the IASB will need to deal with differential reporting in some other way; or
- ii) the standard-setters in each country/jurisdiction (the AASB in Australia) will need to address differential reporting needs for Australian entities.

This is not an issue unique to the public sector, although in the corporate sector there is clearer Australian guidance in respect of small entities in determinations etc under the Corporations Act.

HoTARAC would not see it as an appropriate outcome if the proposed IASB definition was used to justify application of full IFRS (or even “small IFRS”) to very small entities where the cost would outweigh the benefits.

Further, HoTARAC notes that in the public sector, the more complex series of accountability and reporting relationships means the definition needs to remain flexible to allow for different boundaries of the entity for different purposes. For example<sup>3</sup>:

- i) users such as parliamentarians and media may be interested in the entity being the “whole-of-government”;
- ii) some users including statistical authorities and economists may be interested in the entity being the General Government Sector;
- iii) parliamentarians, citizens and others may be interested in a group entity encompassing all individual entities within a Ministry (for assessment of accountability of the Minister); and
- iv) parliamentarians, citizens and others may be interested in a group entity encompassing all individual entities reporting to an agency chief executive (for assessment of accountability of that chief executive).

Accordingly, in the public sector there is more often a greater need to define an entity in accord with varying accountability requirements, and as a result the scope of the entity will vary from purpose to purpose. This requires some flexibility in the definition of the entity.

## **2. Control/Group Reporting Entities (Questions 3 and 4)**

The IASB proposal, particularly in relation to group reporting entities, is that an entity is defined in relation to control. This concept is appropriate for the for-profit sector. The majority of HoTARAC members believe it is also appropriate in most circumstances for the public sector.

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<sup>3</sup> This is not intended to be an authoritative list, but merely to demonstrate the different users and roles.

However, control is problematic in a variety of situations for the public sector:

- i) the concept of control is particularly difficult to apply in theory to the General Government Sector entity, because it is not always controlled in practice by an entity in a conventional sense;
- ii) the concept of control may be difficult to apply to whole-of-government accounts, because there is no parent entity in some jurisdictions;
- iii) the concept of control is complicated in the public sector through reserve powers vested in Ministers under legislation and other matters mentioned in the public sector provisions of AASB 127 *Consolidated and Separate Financial Statements*;
- iv) the concept of control is difficult to apply clearly to local governments (although in practice convention has circumvented this difficulty in Australia); and
- v) as noted above, there is a need in the public sector to flexibly apply the reporting entity concept given multiple and complex accountabilities.

Currently in Australia, the concept of control is applied in a practical manner by the public sector (such as by use of “common control” principles) to achieve reasonable outcomes.

A minority of HoTARAC members believe that for application to the Australian public sector, the concept of control needs to be modified. To accord with the different accountabilities, the boundaries of a reporting entity should be drawn with reference to accountability rather than control i.e. individual agencies would report on transactions, balances etc for which they are accountable; group entities would be comprised of those individual entities for which there is common accountability.

Control should be defined at the conceptual level as it impacts a range of accounting standards and is central to much of financial reporting.

The definition should include references to both power and benefits to avoid including arrangements such as agency and trusteeship. However, the reference to “access to benefits” should be broadened if the connotation is only financial benefits. One possibility is that the terminology used should be close to that used in Australia’s SAC1, “achieving the objectives”.

### **3. Section 3 (Questions 8-10)**

HoTARAC agrees.

### **4. Section 4 (Questions 11-12)**

HoTARAC agrees with the issues raised in Question 11. Most of these questions are of a sufficiently high level to be addressed conceptually.

## 5. Other Issues

### a) Concern about the links between the aspects of the conceptual framework

HOTARAC notes that the IASB Project is releasing parts of the proposed Conceptual Framework in stages, in order to manage the workload. However, there is a concern that there will be inconsistencies between parts, that items may be omitted because the boundaries between parts are not adequately defined, or that conclusions reached in one part will lead to unintended consequences in other parts.

An example of this concern would be reference to the entity concept (IASB Question 8). It is difficult at this time to identify all the potential consequences of this in order to make informed comment.

HoTARAC requests that the IASB – and the AASB in respect of the application in Australia – develops a process for consulting with constituents on the total final package, to identify and deal with the inter-dependencies between the parts. In the interim, the concluded parts of the package should not have application.

### b) Other issues

IASB (question 13) asks whether there are other issues related to control that need to be considered. HoTARAC is of the view that the issue of control where there is less than a majority interest (either in capital or voting rights) needs to be clarified by the IASB. The IASB has issued a statement that de-facto control may exist at this level in certain circumstances, but this statement does not form part of a Standard or an Interpretation, and has not been the subject of due process.