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Re: Discussion Paper *Preliminary views on an Improved Conceptual Framework for Financial Reporting: The Reporting Entity*

Dear Sirs,

We are pleased to provide our comments on your draft comment letter to Discussion Paper *Preliminary views on an Improved Conceptual Framework for Financial Reporting: The Reporting Entity.*

OIC - Organismo Italiano di Contabilità is supportive of the project to revise the Conceptual Framework. However, we have already expressed our serious concern and we reiterate our worries as to the way to proceed in the change by approving and adopting specific parts of the Conceptual Framework rather than completing the project and approving it as whole. We strongly believe that this comment needs to be repeated, even though - we know - it has been clearly expressed in the past as well as in the recent comment letter on the ED on Chapters 1 and 2 of the Conceptual Framework.

The DP considers various issues for the purpose of developing a reporting entity concept.

The Draft Comment letter includes a brief summary of EFRAG main comments. We agree with those comments except for the issue related to the joint control. EFRAG agrees with the DP that to satisfy "the power element of the definition of control, power must be held by one entity only". In our view the matter of joint control requires a deeper analysis of its possible effects when providing financial information to users' of financial reporting. An increasing number of businesses and operations are carried out jointly by business enterprises and these different circumstances need to be analyzed in depth to identify issues related to satisfy the information needs of present and potential equity investors, lenders and other creditors. We believe that a debate on this issue would be beneficial to the development of a high quality Conceptual Framework.

We agree with the view expressed by EFRAG that the concept of "risks and rewards" need to be fully exploited since there are circumstances where the model based on control may not be sufficient to assess the effective existence of control. In addition to the situation cited for SIC 12, we may mention other situations where the application of the control model may be not sufficient to assess control. For example, controlling shares given as a pledge to a financial institution as a guarantee for a debt. The pledge may take different form from the legal point of view and the specific assessments of those conditions may lead to different conclusions as to the existence of control. In those situations the application of the control model may not be sufficient, since the legal control of the debtor may be limited in certain specific circumstances or business transactions, while the risks and rewards may remain with the debtor.

Comments related to EFRAG's responses to the questions asked in the Discussion Paper are presented below.

Question 1
Do you agree that what constitutes a reporting entity should not be limited to business activities that are structured as legal entities? If not, why?

We concur with the position expressed by EFRAG.

Question 2
Should the framework contain some sort of description or definition of the reporting entity?
We agree with the broad definition contained in the DP considering that the conceptual framework must be applicable to a variety of entities at the international level. We noted that EFRAG has reached a somewhat different conclusion by stating that the framework should set out some sort of description or definition of the reporting entity without defining it, as it is requested by ITC of IASB. We are not sure that such statement is consistent with what is expressed on point 7 ("Efrag agrees that a broad description of the reporting entity …rather than a precise definition is a satisfactory way to capture the subject of a reporting entity)

Is the broad description of a reporting entity proposed in the DP sufficient and appropriate?
We agree with Efrag.

The reference to capital providers in the description of a reporting entity. We agree with that reference. We noted that EFRAG makes reference to financial statements and not to financial reporting. Since the two terms may not be equivalent (the notion of financial reporting has not been defined yet), we would prefer to stick to the terminology used by IASB to avoid misinterpretation. We strongly disagree with the decision taken by IASB to introduce a new concept without defining it.

Question 3
Do you agree that the risks and rewards model does not provide a conceptually robust basis for determining the composition of a group reporting entity and that, except to the extent that it overlaps with the controlling entity model (as discussed in paragraphs 102 and 103), the risks and rewards model should not be considered further in the reporting entity phase of the conceptual framework project? If not, why?

We agree with EFRAG that the DP needs to discuss further the concept of risks and rewards and its possible application in those situations (like SPE) where the control model is insufficient to assess the existence of control. In certain jurisdictions the pledge of equity shares as a guarantee for financings may limit the power of the controlling entities over certain transactions and therefore it is worthwhile to explore the appropriateness of supplementing the control model concept with the risks and rewards concept, as suggested by EFRAG. The conceptual Framework should be a robust structure of concepts developed to cover all the possible situations to avoid the risk that developed standards are not aligned to the framework.

Question 4
Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that:

(a) control should be defined at the conceptual level?
(b) the definition of control should refer to both power and benefits?
If not, why? For example, do you have an alternative proposed definition of control?

We agree that control should be defined at conceptual level. Accounting standards should provide detailed guidance. However, with regard to the issue that control should refer to both power and benefits, we believe that DP should better clarify the concept of power and its possible limitations. In certain business transactions or decision regarding the life of an entity special agreements may limit the power of the majority shareholder and therefore a better qualification of power could be beneficial.

Question 5
Do you agree that the composition of a group reporting entity should be based on control? If not, why? For example, if you consider that another basis should be used, which basis do you propose and why?

We agree with the response provided by EFRAG.

Question 6
Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that the controlling entity model should be used as the primary basis for determining the composition of a group entity? If not, why?

We concur with EFRAG that, assuming the control model is the only model to be applied, the controlling entity model should be used as a primary basis for determining the composition of a group reporting entity.

Question 7
Do you agree that the common control model should be used in some circumstances only? If not, why? For example, would you limit the composition of a group reporting entity to the controlling entity model only? Or would you widen the use of the common control model? If you support the use of the common control model, at least in some circumstances, do you regard it as an exception to (or substitute for) the controlling entity model in those circumstances, or is it a distinct approach in its own right? Please provide reasons for your responses.

We do agree with DP that there are occasions when application of the common control model would provide useful information to equity investors, lenders, and other capital providers. However, we believe that the common control model should be applied only to present supplementary information, or in those situations (which we believe are rare) where the common control model provides superior and better financial information to the users' of financial reporting.

Question 8
Do you agree that consolidated financial statements should be presented from the perspective of the group reporting entity, not from the perspective of the parent company's shareholders? If not, why?

We agree with EFRAG proposal that a comprehensive debate is needed on the concept of the reporting entity before accepting the proposal that consolidated financial statements should be presented from the perspective of the reporting entity.

Question 9 and Question 10
Do you agree that consolidated financial statements provide useful information to equity investors, lenders and other capital providers? If not, why?

Do you agree 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 consolidated financial statements? If not, why?

We agree that consolidated financial statements provide useful information to equity investors, lenders, and other capital providers. However, such information may be not sufficient in certain situations to satisfy the information needs of all users (the capital providers and lenders of the controlling entity may not have sufficient information regarding the resources and claims of that controlling entity) and therefore, we believe that consolidated financial statements should be supplemented by the controlling entity financial statements accompanying the same financial reports.

Question 11

With regard to the concept of control, in the context of one entity having control over another, do you agree that:

(a) establishing whether control exists involves assessing all the existing facts and circumstances and, therefore, that there are no single facts or circumstances that evidence that one entity has control over another entity in all cases, nor should any particular fact or circumstances—such as ownership of a majority voting interest—be a necessary condition for control to exist? If not, why?

(b) the concept of control should include situations in which control exists but might be temporary? If not, why?

(c) the control concept should not be limited to circumstances in which the entity has sufficient voting rights or other legal rights to direct the financing and operating policies of another entity, but rather should be a broad concept that encompasses economically similar circumstances? If not, why?

(d) in the absence of other facts and circumstances, the fact that an entity holds enough options over voting rights that, if and when exercised, would place it in control over another entity is not sufficient, in itself, to establish that the entity currently controls that other entity? If not, why?

(e) to satisfy the power element of the definition of control, power must be held by one entity only? In other words, do you agree that the power element is not satisfied if an entity must obtain the agreement of others to direct the financing and operating policies of another entity? If not, why?

(f) having 'significant influence' over another entity's financing and operating policy decisions is not sufficient to establish the existence of control of that other entity? If not, why?

We agree with EFRAG answers, except for question (e) for which we hold a strong view that joint control should be debated in the DP. The elimination of the joint control concept would lead to the elimination of the proportionate consolidation, thus limiting the usefulness of financial information for the participants to the venture. We have made extensive comments on the subject in our comment letter of January 8 of this year with reference to the ED 9 Joint venture. The following are excerpts from that letter which we believe are useful to understand our position:

> «Last, we would point out that the use of the equity method for jointly controlled entities results in the omission from financial statements of important elements, such as financial indebtedness also including that part for which an entity is co-responsible (at least in terms of management if not legally – but nor in the case of subsidiaries is there a legal obligation on the controlling entity).
>
> In important industrial sectors, business activity is principally carried on through joint ventures, often these are specially formed in order to undertake important projects in partnership. In these cases, the use of the equity method would lead to the elimination from the venturer's financial statements of the revenues (and costs) that in fact constitute the representation of the business and its outcome, which instead would be reported a) only in net terms for contribution to profit, and b) as a share of profit of associates. We do not believe that this reporting would give a faithful representation of the business, or that it would be useful in predicting the venturer's future cash flows and the related risks.

For the above reasons, and in support of the goal of reducing accounting options, the OIC believes that the accounting of jointly controlled entities should require measurement using the proportional method rather that the equity method. Alternatively, considering that other projects are underway (including the long-term convergence project with the USA) that could have significant effects on the issue in question, the OIC believes it would be appropriate in the meantime to retain the options provided for in IAS 31.»

Yours sincerely,

Angelo Casò
(OIC Chairman)