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**International
Accounting Standards
Board**

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: 19 September 2007, London

Project: Conceptual Framework – Reporting Entity

Subject: Comments on Pre-Ballot Draft (Agenda paper 7)

Introduction

1. The staff distributed to board members a pre-ballot draft of the reporting entity Discussion Paper in mid-July, with a request for comments by late July. That draft was also distributed to five external reviewers, of which four provided comments.
2. [Paragraph omitted from observer note].
3. [Paragraph omitted from observer note].
4. The purpose of this paper is to:
 - a. explain the substantive issues raised, the staff proposals on how to address those comments, and ask whether the boards agree with the staff proposals;
 - b. ask the boards whether there are other issues that they wish to discuss before proceeding with publication of the Discussion Paper; and
 - c. ask the boards whether they agree with the staff proposal to proceed with the preparation of a ballot draft of the Discussion Paper.

Comments received on Section 1

5. Of the substantive issues raised by board members and external reviewers, many relate to Section 1 of the pre-ballot draft [which addresses general issues in the context of an individual reporting entity], including concerns about:
 - a. the lack of clarity about what the discussion in Section 1 is trying to achieve, such as why particular issues are discussed or the manner in which they are discussed; and
 - b. the lack of clarity about how the discussion in Section 1 links with Section 2 [which addresses issues relating to a group reporting entity], including concerns that the two sections may be inconsistent.
6. The staff recently discussed these points in a small group meeting, comprising two board members who had raised substantive comments on Section 1, several other members of the concepts team and the FASB director of technical activities.
7. Based upon the input from that discussion and the comments received on the pre-ballot draft, the staff has prepared a revised draft of Section 1.
8. In preparing that revision, the following points should be noted about the revised Section 1:
 - a. It explains why the boards considered whether to develop a definition of a reporting entity, including what the implications of doing so would be;
 - b. It does not refer to legal existence as being *sufficient* to establish that a reporting entity exists—Section 1 of the pre-ballot draft did not clearly explain why legal existence is sufficient, and some found it inconsistent with the Section 2 discussion of disregarding legal boundaries. Instead, the revised Section 1 explains that, in the context of an individual entity that does not have an interest in another entity, legal existence can help to establish the boundaries of the entity reporting.
 - c. Following on from the above point, the revised Section 1 explains more fully why the boards concluded that a component of a legal entity, such as an unincorporated branch, can be a reporting entity. The staff also plans to draw upon this discussion later in the document, to address another point raised in comments received—that the document does not clearly explain

if, and why, a subsidiary entity can be itself the subject of general purpose financial reports, as distinct from the financial reports of the group entity of which the subsidiary entity is a component.

9. In addition, the revised Section 1 is more clearly linked with the objective of financial reporting. The description of a reporting entity has also been slightly modified, from “circumscribed area of economic interest to investors, creditors and others” to become “a circumscribed area of business activity of interest to present and potential investors and creditors”. There are several points to note about those modifications:
 - a. The word “business” is used rather than “economic”, given the current focus of conceptual framework project on business entities;
 - b. The word “activity” is now included, to separate the “thing” that is of interest (the entity) from the users to whom it is of interest (present and potential investors and creditors); and
 - c. The description refers to present and potential investors and creditors, rather than users more generally, consist with the decisions in Phase A of the framework project.
10. A board member disagrees with referring to investors and creditors in the description of a reporting entity. The board member argues that a reporting entity exists, irrespective of whether there are any existing or potential external investors or creditors with an interest in that entity. For example, if the entity prepared general purpose external financial reports and *never* distributed those reports to external users, it nevertheless would be a reporting entity.
11. The staff notes that the argument in paragraph 10 is consistent with the boards’ decision that any entity that chooses to, or is required to, prepare general purpose external financial reports is a reporting entity, as explained in the pre-ballot draft.
12. However, the staff is concerned that making no reference to users in the description of the reporting entity results in a description that is not clearly linked with the objective of financial reporting—as indicated by some of the other comments on the pre-ballot draft. Moreover, in Section 2, it is clear that the boards used the objective of financial reporting to help determine the

composition of a group entity. In other words, in Section 2, the focus shifts to identifying a circumscribed area of business of activity that is *of interest to investors and creditors*. Hence, some found that the discussion in Section 2 inconsistent with some of the discussion in Section 1.

13. Therefore, the revised Section 1 explains the board member's concern about referring to investors and creditors in the description of a reporting entity. It also explains why having a focus on users is consistent with the decisions in Phase A of the project, and why that does not *preclude* the concepts in the framework from being applied in other circumstances. Furthermore, this discussion is then used to provide a lead-in to the discussion of a group entity.
14. Hence, the discussion of whether a distinction should be drawn between an entity and a reporting entity does not appear in the revised Section 1. In effect, a distinction has been drawn, by focusing on those circumscribed areas of business activity that are of interest to present and potential investors and creditors. Although this appears to represent a change in the boards' original decision, in effect that decision had already changed during the course of the project phase, when the boards discussed the composition of a group entity. It was during those discussions that reference to the users of financial reports was added to the description of a reporting entity. Hence, the staff thinks that the revised Section 1 more closely reflects where the boards ended up.
15. In addition, the revised Section 1 does not explicitly address the issue of whether the framework should provide guidance on which entities should be required (or encouraged) to prepare general purpose external financial reports. Although the boards did discuss and reach a decision on that issue, the comments received from a board member and an external reviewer indicates that it was unclear what the discussion of this issue in the pre-ballot draft was trying to achieve. Instead, the staff has dealt with the issue from another angle, by instead explaining how the description of a reporting entity in the framework may be helpful to other parties who are responsible for establishing requirements to report.
16. [Paragraph omitted from observer note].

Questions for the boards

17. Do you agree with how staff has dealt with comments relating to Section 1?
18. Do you agree that no further discussion is required on these issues at this time, ie before publication of the Discussion Paper?

Other comments received

19. There is one other issue upon which clarification is needed by each board. In the section on parent-only and consolidated financial statements, the pre-ballot draft states:

The majority of FASB members concluded that, in concept, parent-only financial statements should not be a required part of a parent entity's general purpose external financial report. In general, a parent entity should present consolidated financial statements. However, there may be limited circumstances in which aggregated (i.e. one-line) information about a particular subsidiary is more decision-useful than disaggregated information. Those limited circumstances would be addressed at the standards level, and would be considered on a subsidiary-by-subsidiary basis. Hence, a parent entity with several subsidiaries may consolidate some subsidiaries but present others as investments. Examples of these circumstances include when the parent is a venture capital investor, with an investment in a subsidiary that is being held for the purposes of capital appreciation or current income, and/or when there is no (or very little) integration of activities or independencies between the parent entity and subsidiary entity. In these circumstances, the parent entity and subsidiary entity are not being managed or operated as a single economic unit. Hence, aggregated information about the parent's investment in the subsidiary is more decision-useful than the information provided by consolidating the subsidiary entity.

20. The comments received on the pre-ballot draft raised two points:
 - a. Some found the idea of presenting aggregated information about a subsidiary to be inconsistent with the board's earlier conclusion about the controlling entity model. The staff thinks there are (at least) two possible explanations:
 - i. The earlier conclusion about the controlling entity model is a *general* conclusion and these FASB members think that there could be some exceptions to that general conclusion; or
 - ii. These FASB members see this issue as being a matter of display, ie the subsidiary is included in the parent entity's financial statements, and it is a question of whether to display information about that subsidiary in an aggregated or disaggregated manner.

- b. An IASB member and an external reviewer noted that the IASB has rejected this approach in its project on consolidations, and therefore recommended that the IASB's view on this approach should be noted in the Discussion Paper.

Questions for the boards

21. Do the FASB members who support the conclusion that, in limited circumstances, a parent should present aggregated information about a particular subsidiary agree with the explanation in paragraph 20(a)(i) or 20(a)(ii), or do they have another explanation?
22. Do the majority of IASB members disagree that conclusion and wish this point to be made clear in the Discussion Paper?
23. At this stage, the staff has not identified any other issues that require further discussion by the boards before publication of the Discussion Paper.

Question for the boards

24. Are there any other issues that the boards wish to discuss before publication of the Discussion Paper?

Next steps

25. Ideally, after processing the comments received, the staff would like to then proceed directly to ballot draft. [Remainder of paragraph omitted from observer note].

Question for the boards

26. Do the boards agree that the staff should proceed with preparing a ballot draft of the Discussion Paper?