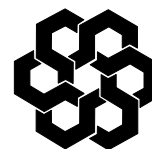




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*This document is provided as a convenience to observers at the IASB-FASB joint meeting, to assist them in following the Boards' discussion. It does not represent an official position of the IASB or the FASB. Board positions are set out in Standards (IASB) or Statements or other pronouncements (FASB).*

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

## **INFORMATION FOR OBSERVERS**

**IASB/FASB Meeting: 21 April 2008, London**

**Project: Conceptual Framework: Reporting Entity (Phase D)**

**Subject: Comments on Second Pre-Ballot Draft (Agenda paper 2A)**

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### **Introduction**

1. The second pre-ballot draft of the Discussion Paper (Preliminary Views document) for the reporting entity phase (Phase D) of the conceptual framework project was distributed to board members in mid-November 2007, with a request for comments by 30 November.
2. There were two substantive issues raised by board members, relating to Section 3 of the Discussion Paper. That section considers two issues relating to the general purpose financial reports of a parent entity:
  - (a) the parent company approach to consolidated financial statements.
  - (b) parent-only financial statements and consolidated financial statements—determining which set of financial statements meets the objective of general purpose financial reporting, and whether both sets are needed for that purpose.
3. Some IASB members raised concerns about the first issue, in particular, that the Discussion Paper did not adequately address conceptual issues relating to the entity

perspective, proprietary perspective and the parent company approach. Board members also raised concerns about the entity and proprietary perspectives when providing comments on the pre-ballot draft of the Exposure Draft for Phase A, on the objective of financial reporting. IASB Agenda Paper 2/FASB Memorandum 72 addresses this matter. As explained in that memo, staff is proposing some revisions to the basis for conclusions that accompanies the Phase A Exposure Draft and to Section 3 of the Phase D Discussion Paper.

4. In addition, an IASB member raised a concern about the second issue set out in paragraph 2. To date, the IASB has not formed a preliminary view on this issue, after having discussed it several times. Accordingly, the draft Discussion Paper does not contain a common preliminary view on this issue, and instead sets out three views. An IASB member has asked that the IASB re-debate this matter, to try to reach a preliminary view before the Discussion Paper is published.
5. Although re-debating this topic is primarily a matter for the IASB, it should be noted that board members' views on this topic might be linked with their views on issues relating to the entity perspective, proprietary perspective and the parent company approach. Therefore, it seems helpful to reconsider both topics at the same time. In addition, in an attempt to reconcile the different views on this issue, the staff is proposing an alternative way forward for both boards to consider, which is explained below.

#### **Parent-only financial statements and consolidated financial statements**

6. Section 3 of the second pre-ballot draft of the reporting entity discussion paper sets out three views on the usefulness of parent-only and consolidated financial statements in the context of meeting the objective of general purpose financial reporting.
7. Under all three views, consolidated financial statements are regarded as providing useful information to equity investors, creditors and other capital providers. The difference between the three views relates to the usefulness of parent-only financial statements. Some believe that parent-only financial statements also provide useful information and, therefore, should be provided in addition to consolidated financial statements, either generally (View A) or sometimes (View B). In contrast, others believe that parent-only financial *statements* should not be included in the general purpose financial report of a parent entity, although some parent-only *information* might be included, for example, in the notes to the consolidated financial statements (View C).

8. The majority of FASB members support View C. In reaching that view, these FASB members noted that *how* information about the parent's assets, liabilities and activities should be presented in consolidated financial statements raises issues that relate to other phases of the conceptual framework project. For example, one issue is whether, and in what circumstances, aggregated (ie one-line) information about a particular subsidiary may be more useful to capital providers than disaggregated information. These FASB members concluded that this issue should be addressed at the standards-level and involves applying concepts from other phases of the conceptual framework project, such as the definitions of elements (including the unit of account), concepts for measurement, presentation and disclosure, and the qualitative characteristics of financial reporting information. They also concluded that parent-only financial *statements* should not be presented in a parent entity's general purpose financial report, but some parent-only *information* could be provided as supplementary information.
9. As noted above, the IASB has not yet reached a majority view on which view it supports.
10. Some might think that this issue is linked with the issue of the parent company approach to consolidated financial statements. For example, supporters of View C argue that parent-only financial statements are based on the legal form of the parent entity and, therefore, reflect its legal boundary. They might see a link with the parent company approach, which has traditionally reflected the legal form of the parent entity to some extent, for example, in its treatment of non-controlling interests. (Traditionally, non-controlling interests were presented outside of equity because the holders of those interests are not shareholders of the parent company. This treatment implies that the legal boundary between the parent entity and its subsidiaries has been preserved, at least in this respect.)
11. However, supporters of View A or View B may not agree with that analysis. For example, as noted in the discussion of View A, they agree that consolidated financial statements, in which the assets, liabilities and activities of the parent and its subsidiaries are presented as a single unit, provide useful information to equity investors, lenders and other capital providers. However, they argue that parent-only financial statements also provide useful information to capital providers, which complements the information provided in consolidated financial statements.
12. To assist the boards in reconsidering this issue, the staff sets out below:
  - (a) a reminder of the underlying entity issue that the boards have discussed previously;  
and

(b) a possible way forward.

#### Underlying entity issue

13. When the boards first began discussing parent-only and consolidated financial statements, it was noted that there is an underlying issue about the identity of the entity that is the subject of each set of financial statements. That issue concerns whether the two sets of financial statements relate to the same entity or to two different entities.
14. It should be noted that the discussion below focuses on legal entities because that is the context in which the different views arise.
15. Some argue that it is inappropriate to present both parent-only and consolidated financial statements because each reporting entity should have only *one* set of general purpose financial statements. That argument is based on the premise that the same entity is the subject of both sets of financial statements (and that there is only one set of capital providers for which those general purpose financial statements are intended). The staff notes that, even if one agrees that each entity should have only one set of general purpose financial statements, the practice of presenting both parent-only and consolidated financial statements is a problem only if both sets of financial statements relate to the *same* entity. Hence, the argument that a parent entity should not present both parent-only and consolidated financial statements in a general purpose financial report is based on the premise that both sets of financial statements relate to the same entity.
16. Similarly, arguments that parent-only financial statements are incomplete or do not faithfully represent the assets, liabilities and activities of the parent entity are based on the view that the subsidiary's assets, liabilities and activities are also assets, liabilities and activities of the parent. In effect, the subsidiary is viewed as being part of, rather than separate from, the parent entity, akin to an unincorporated branch. (That is, the consolidated form of financial statements does and should look through legal boundaries to reflect the economic substance of the parent entity.)
17. Those who agree with the arguments in paragraphs 15 and 16 are likely to be supporters of View C in Section 3 of the draft Discussion Paper.
18. Others argue that when the parent entity and subsidiary entity are structured as two legal entities, that legal separation between the two entities has significant economic consequences, which means that there is a substantive difference between a subsidiary and an unincorporated branch. For example, legal protections for creditors, non-controlling

shareholders and others with a financial interest in the subsidiary mean that the parent cannot deal with the subsidiary's assets in the same way as its own assets. Similarly, the parent often has no obligation to the subsidiary's creditors. In other words, the legal structure of the parent entity and subsidiary entity is not merely a matter of legal form.

19. Under this view, the group reporting entity is formed by combining the two separate entities, and presenting the results of that combination *as if* the two entities were a single entity. The words "as if" are used deliberately. In both economic and legal terms, the group is regarded as comprising a *group of entities* (ie multiple entities). For financial reporting purposes, that group of entities is combined together, and presented *as if* they were a single entity. Thus, the subsidiary is not part of the parent—rather, both the parent and the subsidiary are part of the group. Similarly, the subsidiary's assets are not assets of the parent—rather, the subsidiary's assets and the parent's assets are part of the group's assets. Under this view, the parent-only financial statements relate to the parent entity. The consolidated financial statements relate to the group entity. Hence, there are two sets of general purpose financial statements, one for each of the two different entities.
20. Supporters of the arguments in paragraphs 18 and 19 above are likely to be supporters of View A or View B in Section 3 of the draft Discussion Paper.
21. The boards discussed the question of whether the parent and group are the same entity or two different entities on several occasions without reaching any resolution. The boards decided not to pursue that issue further. Instead, the boards preferred to focus on the question of determining whether parent-only financial statements or consolidated financial statements (or both) provide useful information to capital providers. Hence, Section 3 of the draft Discussion Paper considers the matter in this context.
22. [Paragraph omitted from observer note].

#### Possible way forward

23. The staff notes that supporters of Views A, B and C agree on the usefulness of consolidated financial statements. They also agree that parent-only *information* may be useful to capital providers. The key difference between the views, therefore, lies in the manner in which parent-only information is presented. Supporters of View C object to presenting parent-only information in the form of parent-only financial *statements* but would not object to similar types of information being presented in the form of additional notes to the consolidated financial statements.

24. In practice, parent-only financial statements are often presented in the same financial report as the consolidated financial statements. For example, it is common for the primary financial statements to include ‘parent’ and ‘group’ columns.
25. The staff notes that if the parent-only financial statements are presented in the same financial report as the consolidated financial statements, this may allay the concerns of supporters of View C that parent-only financial statements are incomplete and, therefore, potentially misleading. The financial report would include information about *all* the assets and activities under the control of the parent entity. In some respects, the parent-only information could be viewed as a form of segment reporting, albeit based on the legal boundaries between entities in the group rather than the way in which the group’s activities are managed. However, as discussed in Views A and B, some regard information disaggregated on the basis of legal boundaries to be decision-useful. If that is so, the question becomes why the Boards should prohibit that information from being presented (either in concept or through standards). Thus, in the staff view, provided that parent-only financial statements are presented in the same financial report as the consolidated financial statements, there seems no reason to object to their presentation. On the contrary, the staff is aware that users in some jurisdictions, in which parent-only financial statements are not commonly made available to external users, are asking for this type of information.
26. Therefore, as a means of reconciling the various views on this topic, staff is recommending that the Boards adopt the following preliminary view:
- (a) A parent entity should always present consolidated financial statements;
  - (b) The presentation of parent-only financial statements should not be precluded at the conceptual level, provided they are included in the same financial report as the consolidated financial statements;
  - (c) It would be a standards-level issue to determine whether parent-only financial statements should be required (either always or in particular circumstances) or merely permitted, or whether similar types of information should be presented in another format; and
  - (d) Similarly, it would also be a standards-level issue to determine the manner in which information should be presented in the consolidated financial statements.

### ***Questions for the boards***

27. Do you support the recommended preliminary view in paragraph 26?

28. If so, do you agree that the discussion paper should continue to set out Views A, B and C, but with the boards' preliminary views revised along the lines discussed above?
29. If you do not support the recommended preliminary view, which of Views A, B or C do you support?
30. If the two boards do not reach a common preliminary view on this matter, do you agree that publication of the Discussion Paper should proceed nevertheless, with the different views explained? This is the staff recommendation. [Remainder of paragraph omitted from observer note].

**Next steps**

31. If there is no need to bring back any issues to the boards at the conclusion of their discussions in April, the staff plans to proceed to ballot draft.
32. [Paragraph omitted from observer note].