



**International
Accounting Standards
Board**

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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: March 2009, London

Project: Conceptual Framework

Subject: The primary user group, entity perspective and parent company approach (Agenda paper 3B)

PURPOSE OF THIS MEMORANDUM

1. This paper addresses the following questions:
 - a. Should financial reports of the *reporting entity* that report on its financial position and changes in financial position also include information about the financial position and changes in financial position of the entity's owners?
 - b. For a group reporting entity, should financial reports of the entity report on the financial position and changes in financial position of the group, rather than the financial position and changes in financial position that are attributable to a specific group of capital providers?
 - c. Should the presentation of general purpose financial reports focus on a primary user group? If yes, who should they be? Should there be a hierarchy within the primary user group?

- d. Should the conceptual framework refer to a labelled perspective, approach or theory?
2. The *Exposure Draft of an improved Conceptual Framework for Financial Reporting: Chapter 1: The Objective of Financial Reporting and Chapter 2: Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information* (the Objective ED) and the Discussion Paper, *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity* (the Reporting Entity DP) discussed these issues and respondents to both documents commented on them. Therefore, this paper addresses these issues together.

WHAT SHOULD FINANCIAL REPORTS REPORT ON?

3. In the Objective ED and the Reporting Entity DP, the Boards stated that general purpose financial reports present information about a particular *reporting entity*. It is the entity itself that is the subject of financial reporting, which the Objective ED and Reporting Entity DP referred to as the *entity perspective*, not its owners or others having an interest in the entity. There is a distinction between the *subject* of general purpose financial reports and the *users* of those reports (such as equity investors and lenders). Economic resources provided by owners or other capital providers become resources of the entity and cease to be resources of the owners or other capital providers and, in exchange for the resources provided, capital providers are granted claims on the economic resources of the reporting entity. Thus, the entity is the focus of financial reporting, rather than its owners or others who have an interest in it.

Feedback from Respondents

4. While there were differing views among respondents regarding other aspects of the term *entity perspective*, no respondent disagreed that the reporting entity is separate from its owners.

Staff Analysis and Recommendation

5. We recommend that financial reports of the reporting entity that report on the financial position and changes in financial position of the entity and do not include the financial position and changes in financial position of the entity's owners. Moreover, in the context of a group reporting entity, we recommend that financial reports of the entity report on the financial position and changes in financial position of the group, rather than the financial position and changes in financial position that are attributable to a specific group of capital providers (such as parent company's shareholders).

Questions:

1. **Should financial reports of the reporting entity that report on the financial position and changes in financial position also include information about the financial position and changes in financial position of the entity's owners?**
2. **For a group reporting entity, should financial reports report on the financial position and changes in financial position of the group, rather than the financial position and changes in financial position that are attributable to a specific group of capital providers?**

SHOULD GENERAL PURPOSE FINANCIAL REPORTS FOCUS ON A PRIMARY USER GROUP?

6. In the Objective ED, the Boards proposed that the presentation of general purpose financial reports focus on a primary group that consists of present and potential equity investors, lenders and other capital providers.
7. General purpose financial reporting stems from the information needs of users who lack the ability to prescribe all the financial information they need from an entity and must therefore rely, at least partly, on the information provided in financial reports. As they provide resources to the entity, they have the most critical and immediate need for general purpose financial information about the economic resources of the entity. Having a primary user provides a focus for

the objective. Otherwise, the framework would risk becoming unduly abstract or vague.

Feedback from Respondents

8. Most respondents to the Objective ED supported having a primary user group.
9. Only a few respondents to the Objective ED stated that general purpose financial reports should not focus on a primary user group. The respondents that disagreed noted that the identification of a primary user group may result in the Boards ignoring the information needs of the non-primary users when setting standards. A group of respondents, the Publish What You Pay group, argued that the IASB had failed its mandate to consider the special needs of emerging economies by identifying a primary user group, particular in their choice of the primary user group. They noted that other users, such as charities and other corporate monitoring groups, use financial reports to monitor how developing economies transfer resources to their citizens and whether these entities are ethical in their conduct.

Staff Analysis and Recommendation

10. We propose that the Boards confirm having a primary user group. Apart from the issues raised by PWYP group (as discussed below), there was no new information that was provided by respondents and we are unaware of any information that the Boards did not consider in reaching their view presented in the Objective ED.
11. The objectives of the IASB are:
 - a. to develop, in the public interest, a single set of global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting **to help participants in the world's capital markets and other users make economic decisions** [emphasis added];
 - b. to promote the use and rigorous application of those standards;

- c. in fulfilling the objectives associated with (a) and (b), to take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies ...
12. The FASB's mission is to establish financial accounting and reporting standards, through an independent and open process, resulting in financial reports that provide decision-useful information for investors.
 13. The main objective of both boards is to assist users of financial reports to make economic decisions. (For the IASB, in fulfilling the special needs of SMEs and emerging economies, the IASB, because of costs-benefit reasons, may exempt some entities or provide additional guidance on how to apply IFRSs. This was demonstrated in the IASB's projects on the *Private Entities* project and the Fair Value project for financial instruments in markets that are no longer active.)
 14. The Financial Crisis Advisory Group (FCAG), in their February meeting, also confirmed that the financial reports should focus on the needs of investors. The PWYP group, in contrast, were not requesting information for users of financial reports to make economic decisions. Rather, they wanted, for example, rather detailed disclosures of amounts paid by particular entities (such as oil, gas and mining companies) to governments in developing or transitional countries. We view their specific disclosure requests as inconsistent with the boards' view on what constitutes general purpose financial reporting and its objectives.
 15. Information about an entity's conduct may be useful for purposes of assessing 'ethical' behaviour but absent financial implications/consequences that kind of information is not necessarily useful to capital providers in making investment or stewardship decisions.
 16. In any case, we note that the IASB's forthcoming DP on extractive activities will invite comments on the PWYP group's requests for specific disclosures.

Question:

- 3. Should the presentation of general purpose financial reports focus on a primary user group?**

WHO SHOULD BE IN THE PRIMARY USER GROUP? SHOULD THERE BE A HIERARCHY WITHIN THE PRIMARY USER GROUP?

17. For those respondents who supported having a primary user group, there were differing views regarding who those primary users should be.
 - a. Most supported the proposed primary user group – the present and potential equity investors, lenders and other creditors.
 - b. Some respondents stated that management should be added to the list of primary users because information that is relevant for capital providers should also be relevant to those who manage the capital and that internal and external reports should be similar.
 - c. Some respondents stated that employees and governments should be added to the list of primary users proposed by the Boards regardless of whether they are acting as capital providers.
 - d. Some respondents stated that the primary users should be limited to present equity investors because they provide the resources that bear the highest risks. These respondents also stated that although other users are important, a broad-based primary user group may lead to too much information presented in financial reports.
 - e. Some respondents more specifically stated that the primary users should be limited to present equity investors of the parent company because, in their view, holders of non-controlling interests rarely, if ever, use consolidated financial statements when making investment decisions.
18. Some respondents to the Objective ED stated that there should be a hierarchy of primary users because each type has different information needs that may conflict with one another.
19. Some respondents to the Objective ED stated that the term *capital providers* implies a focus on providers of equity capital. Those respondents recommended using the term *resource providers* instead. Some added that the term *resource providers* could also be useful because it would more clearly convey that donors,

grant-makers, and similar capital providers of not-for-profit entities are in the primary user group, thus reducing the number of changes that will be needed when the boards consider not-for-profit entities later.

Staff Analysis and Recommendation

20. The boards considered most of the issues raised by respondents about the composition of the primary user group before issuing the DP and the ED for the Objective phase. The only change that we recommend making to the primary user group discussion is to replace the term *capital providers* with the term *resource providers*. Respondents are correct in stating that the conceptual framework should strive to use language that is applicable to both businesses and not-for-profits whenever possible. This is consistent with the boards' direction to the staff.
21. No new information was provided by those who supported expanding the primary user group to include management, employees, and governments. We are not aware of any information that the boards have not already considered in reaching the view in the Objectives ED. Therefore, we recommend that the boards not add them to the list of primary users.
22. The same is true with regard to respondents' recommendations to narrow the focus to present shareholders or present parent company shareholders. We are not aware of any new information that the boards have not already considered. Therefore, we recommend that the boards not change the primary user group. In particular, excluding providers of debt capital and all **potential** capital providers could lead to bias (thus violating neutrality characteristics) given to particular capital providers when standard-setters weigh the costs and benefits of imposing particular requirements. For example, it would likely be in the best interests of potential investors for an entity to provide information about loss contingencies, but not for present investors if they expect to sell their investment of the entity before the contingency is resolved.
23. We cannot verify respondents' statements that holders of non-controlling interest do not use the controlling entity's consolidated financial statements. It would certainly seem that their primary interest would be in the financial

statements of the subsidiary in which they hold an interest. However, those holders have a legitimate interest as capital providers, and it is not clear how excluding them as primary users would change how consolidated financial statements are presented.

24. In fact, the staff is aware of some U.S. based companies that specially created subsidiaries to conduct targeted high-risk research activities or other specific operating activities, to raise capital from a separate pool of minority shareholders willing to accept the higher potential risks and rewards of those activities, and, in some cases, as a way to compensate managers of the subsidiary through option plans, or both. While the staff concurs that minority shareholders generally are primarily interested in the financial reports of the subsidiary, the staff is not convinced that they are not also interested in the financial viability of the parent company, particularly when the parent itself is a likely buyer of the research outcomes of the subsidiary and perhaps of the minority shareholdings themselves.
25. For the above reasons, we also recommend that there be no hierarchy within the primary users. Individual capital providers may have different, and possibly conflicting, information needs and desires. General purpose financial reports are intended to represent a 'common ground' and cannot cater to every request of each present and potential capital provider. It is up to the boards to find the information set that is most likely to fill the needs of the maximum number of users in ways that are cost-beneficial.
26. We also disagree that having a broad-based primary user group will necessarily result in too much information presented in the financial reports. *Too much* is a very subjective judgment, and the understandability criterion and the cost constraint provide discipline to avoid over-reporting.

Questions:

- 4. Should the term *capital providers* be replaced with *resource providers*?**
- 5. Should the primary user group consist of present and potential equity investors, lenders and other capital providers?**
- 6. Should there be a hierarchy within the primary user group?**

SHOULD THE CONCEPTUAL FRAMEWORK REFER TO A LABELLED PERSPECTIVE, APPROACH OR THEORY?

27. In the Objective ED and the Reporting Entity DP, the Boards referred to the *entity perspective* (or *entity theory*), *proprietary perspective* (or *proprietary theory*) and *parent company approach*. Comments from respondents to the two documents imply that these have different meanings to different people. In fact, it is not clear that the boards used the terms with the same meanings in all cases. Consequently, it appears that those labels have not facilitated communication.
28. Therefore, we recommend that the conceptual framework describe the Boards' views without labelling them, particularly in the objectives chapter. For example, the term "entity perspective" could be deleted. The idea could be described more clearly by saying that financial statements should focus on providing information about the financial position (and changes therein) of the entity itself. Information about the owners' positions should be excluded, as it does not pertain to the financial position entity.
29. While some of the same concerns exist in discussion of the reporting entity, it may be more difficult to eliminate any mention of the entity theory and others. Nevertheless we believe these labels should be eliminated if possible and their use should be minimized if they cannot be completely eliminated.

Question

- 7. Should the term “entity perspective” and related labels be removed wherever possible?**