

STAFF PAPER

18 February – 22 February 2012

REG IASB Meeting

Project	Conceptual Framework		
Paper topic	Reporting entity – Proposed approach		
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Purpose

1. The purpose of this paper is to set out the staff's proposed approach to the Reporting Entity in the Conceptual Framework discussion paper.

Background

2. In May 2008, the IASB issued *Preliminary Views on an Improved Conceptual Framework for Financial Reporting – The Reporting Entity* a joint discussion paper with the US Financial Accounting Standards Board (the FASB). This discussion paper set out the IASB and FASB's (the boards') preliminary views on the reporting entity concept.
3. The boards considered comments received on this discussion paper as they developed the exposure draft *Conceptual Framework for Financial Reporting – The Reporting Entity* issued in March 2010.
4. The exposure draft:
 - (a) Described a reporting entity and explained that a reporting entity need not be a legal entity and could be a portion of an entity;
 - (b) Stated that, if an entity that controls one or more entities prepares financial reports, it should present consolidated financial statements;

- (c) Explained that ‘parent-only’ financial statements might provide useful information if they are presented together with consolidated financial statements.
 - (d) Stated that combined financial statements might provide useful information about the commonly controlled entities as a group.
5. The comment period for the exposure draft closed in July of 2010 and a comment letter summary¹ was presented to the boards in October 2010. Work on the Conceptual Framework was suspended in November 2010.

Possible approaches to the reporting entity chapter

6. The IASB could:
- (a) Chose not to discuss the reporting entity in either the discussion paper (DP) to be published this year or the subsequent ED. Instead you could finalise the reporting entity chapter as you finalise the revised Conceptual Framework;
 - (b) Include a full discussion of the reporting entity in the DP;
 - (c) Re-deliberate the reporting entity proposals, including comments received on the 2010 ED, next year as we develop the Conceptual Framework ED.
7. The staff believe that if the IASB had not suspended the Conceptual Framework project in 2010, the IASB would have gone on to finalise the proposals in the 2010 Reporting Entity ED (amended as necessary for points raised in comment letters received). Consequently, it could be argued that there is no need to discuss, reporting entity in either the DP or the future ED. We could simply redeliberate the 2010 ED as we finalise the revised Conceptual Framework. This approach would reduce the amount of work and time needed to complete the Conceptual Framework. However, the staff believe it is important to give interested parties the opportunity to discuss the issues associated with the reporting entity within the context of the whole of the Conceptual Framework. In addition, this approach

¹ This comment letter summary is available to Board members on request.

runs the risk of us encountering an issue with the reporting entity that would require re-exposure. Consequently, we do not recommend this approach.

8. Including a full discussion of the reporting entity within the DP would maximise the opportunities for interested parties to provide feedback on our proposals. However, we have already issued both a DP and an ED on the reporting entity. The issues associated with the reporting entity are well understood. Inviting comments on the reporting entity in the DP is unlikely to provide us with any new information and may be viewed as a waste of time by those who have already responded to the Reporting Entity DP and ED.
9. Consequently, the staff recommend the following approach:
 - (a) Re-deliberate the reporting entity proposals, including comments received on the 2010 ED, next year as we develop the Conceptual Framework ED.
 - (b) Include in the discussion paper an appendix that:
 - (i) Explains the proposed approach to the Reporting Entity;
 - (ii) Summarises the content of the 2010 ED;
 - (iii) Summarises the comment letters received.The appendix to this paper includes a draft of what could be included in the DP.
10. This approach will provide interested parties with the opportunity to comment on the reporting entity within the context of the Conceptual Framework as a whole, without reopening issues that have already been through extensive due process.

Question 1

Does the IASB support the approach to the reporting entity chapter outlined in paragraph 9 above?

Appendix

The following is a draft of the appendix that would be included in DP if the IASB support the approach to reporting entity outlined in this paper.

Reporting Entity

1. In May 2008, the IASB issued *Preliminary Views on an Improved Conceptual Framework for Financial Reporting – The Reporting Entity* a joint discussion paper with the US Financial Accounting Standards Board (the FASB). This discussion paper set out preliminary views of the IASB and FASB (the boards) on the reporting entity concept.
2. The boards considered comments received on this discussion paper as they developed the exposure draft *Conceptual Framework for Financial Reporting – The Reporting Entity* issued in March 2010. The comment period for the exposure draft closed in July of 2010 and a comment letter summary was presented to the boards in October 2010. Work on the Conceptual Framework was suspended in November 2010. Consequently, the Reporting Entity ED was not finalised.
3. Because a discussion paper and exposure draft have already been issued on the reporting entity, the IASB believe it is unnecessary to include a discussion of the issues associated with the reporting entity in this discussion paper. Instead the IASB intend to re-deliberate the reporting entity proposals, including comments received on the 2010 ED, as it develops an exposure draft on a revised Conceptual Framework.
4. This appendix summarises both the proposals in the 2010 exposure draft and the comments received.

Summary of the exposure draft *Conceptual Framework for Financial Reporting – The Reporting Entity* issued in March 2010

5. The exposure draft discussed the following:
 - (a) Description of a reporting entity;

- (b) Consolidated financial statements;
- (c) Other types of financial statements.

Description

6. The exposure draft:

- (a) Described a reporting entity as a circumscribed area of economic activities whose financial information has the potential to be useful to existing and potential equity investors, lenders and other creditors who cannot directly obtain the information they need in making decisions about providing resources to the entity and in assessing whether management and the governing board of that entity have made efficient and effective use of the resources provided;
- (b) Explained that most, if not all, single legal entities have the potential to be reporting entities. However, a legal entity may not qualify as a reporting entity if, for example, there is no basis for objectively distinguishing its economic activities from those of another entity.
- (c) Stated that a portion of an entity could qualify as a reporting entity if the economic activities of that portion can be distinguished objectively from the rest of the entity and financial information about the portion of the entity has the potential to be useful in making decisions about providing resources to that portion of the entity.

Consolidated financial statements

- 7. The exposure draft described control of another entity as the power to direct the activities of that other entity to generate benefits for the controlling entity .
- 8. The exposure draft stated that if an entity controls one or more entities and prepares financial statements, it should present consolidated financial statements because consolidated financial statements are most likely to provide useful information to the greatest number of users.
- 9. The exposure draft also stated that:

- (a) If two or more entities share the power to direct the activities of another entity, none of the entities individually controls the other entity.
Accordingly, none of these entities would present information about itself and the other entity on a consolidated basis.
- (b) If one entity has significant influence over another entity it does not control that other entity.

Other types of financial statements

- 10. The exposure draft explained that ‘parent-only’ financial statements (ie financial statements that include controlled entities as investments rather than consolidating those entities) might provide useful information if they are presented together with consolidated financial statements.
- 11. In addition, the exposure draft stated that combined financial statements might provide useful information about entities under common control.

Summary of comments received on the March 2010 Exposure Draft

- 12. The following is a high-level summary of comments received on the March 2010 Reporting Entity exposure draft. A more detailed comment letter summary was presented to the IASB at its October 2010 meeting and can be obtained from the IASB’s website.

Overall comments

Purpose of the chapter

- 13. Respondents commented that the ED did not clearly state the purpose of the reporting entity chapter. In particular they stated it was unclear whether the ED was proposing who *must*, *should* or *could* prepare general purpose financial reports. These respondents asked the IASB to clarify the purpose of the reporting entity chapter.

Entity perspective and propriety perspective

14. The Discussion paper, *Preliminary Views on an Improved Conceptual Framework for Financial Reporting: The Reporting Entity* included a discussion of the entity perspective and the propriety perspective but this was not carried forward to the ED. Many respondents requested that the reporting entity chapter should include a discussion of perspective from which financial statements are presented.

Description of a reporting entity

15. Most respondents to the ED generally agreed with the proposed description of a reporting entity. However, the following alternatives were suggested:
- (a) Use the description of a reporting entity in the existing IASB *Framework*;
 - (b) Describe a reporting entity as a legal entity;
 - (c) Leave the description of a reporting entity to governments and regulators.
16. Many respondents stated that all legal entities that are required to report should qualify as a legal entity and some respondents stated that all legal entities should be reporting entities, regardless of whether they are required to report.
17. Most respondents agreed that a portion of an entity could qualify as a reporting entity if the economic activities of the portion can be objectively distinguished from the rest of the entity and the financial information about that portion has the potential to be useful to users.
18. In addition a number of clarifications and amendments to the proposed description of a reporting entity were suggested.

Consolidated financial statements

19. Most respondents agreed with the proposed description of control of an entity². However, many noted that the concept of control is a pervasive notion and,

² Control of an investee has since been defined in IFRS 10 *Consolidated Financial Statements*.

therefore, should not be defined in the reporting entity chapter. Instead control should be defined at a higher more general level in the conceptual framework³.

20. Most respondents agreed that an entity that controls one or more other entities should present consolidated financial statements. However, several respondents stated that it is not the responsibility of the IASB to decide which entities have to prepare consolidated financial statements because such responsibility lies solely with governments and regulators.

Other types of financial statements

Parent-only financial statements

21. Several respondents disagreed with the statement in the ED that parent-only financial statements provide useful information if they are presented together with consolidated financial statements for the following reasons:
- (a) Entities should be permitted to present parent-only financial statements on a different date or in a different document from their consolidated financial statements;
 - (b) Parent-only financial statements are useful on their own;
 - (c) Some governments and regulators require the presentation of parent-only financial statements without accompanying consolidated financial statements.

Combined financial statements

22. Many respondents to the ED disagreed with the proposal that combined financial statements should be restricted to the combination of entities under common control and gave examples of situations where combined financial statements may be useful for combinations of entities not under common control including:
- (a) Entities under common management;
 - (b) Groups of mutual banks.

³ The Recognition section of this discussion paper includes a discussion of the control concept.

Dual Listed companies

23. A few respondents to the ED noted that it is unclear how the reporting entity concept should be applied to dual listed companies, stapled entities and similar entities.