

INTERNATIONAL FINANCIAL REPORTING BULLETIN 2010/12

CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING, THE REPORTING ENTITY



Background

The International Accounting Standards Board (IASB) has issued an Exposure Draft (the ED) for public comment which sets out proposed changes to the concept of what constitutes a reporting entity within the conceptual framework for financial reporting.

The ED has been issued as part of a joint project being undertaken by the IASB and the US Financial Accounting Standards Board (FASB). The ultimate goal of this project is the adoption of an improved and converged conceptual framework by both boards as a replacement of their present frameworks. In developing their proposals for a revised conceptual framework, both boards concluded that a comprehensive reconsideration of all concepts did not appear necessary and noted that many aspects of their existing frameworks are consistent with each other. Consequently, the boards gave priority to issues that are likely to yield standard-setting benefits in the near term.

In addition to the reporting entity, other active phases of the conceptual framework project cover topics which include:

- the objective of financial reporting and the qualitative characteristics of financial reporting information;
- the elements of financial statements; and
- measurement.

Later phases will consider matters on presentation and disclosure.

In developing the proposals in this ED, the IASB reviewed the 84 comment letters received on a joint IASB/FASB discussion paper, *Preliminary Views on an Improved Conceptual Framework for Financial Reporting: The Reporting Entity* published in May 2008. The proposals in the ED also consider feedback and views received by the IASB through other outreach initiatives which were undertaken.

Proposals

Description

The ED is proposing that a reporting entity be described as a circumscribed area of economic activities whose financial information has the potential to be useful to various users of that information who themselves are unable directly to obtain the financial information.

The ED describes these users of an entity's financial information as consisting of existing and potential:

- equity investors;
- lenders; and
- other creditors.

These users are considered to require an entity's financial information so they may:

- make decisions about providing resources to the entity; and
- assess whether the entity's management and governing board has made efficient and effective use of those resources.

STATUS

Exposure Draft

EFFECTIVE DATE

n/a

ACCOUNTING IMPACT

n/a

It is proposed that the following three features are necessary (but not always sufficient) to identify a reporting entity:

1. Economic activities are being, have been, or will be conducted;
2. Those activities can be objectively distinguished from those of other entities and from the economic environment in which the entity exists; and
3. Financial information about the economic activities of that entity has the potential to be useful in decision making and about providing resources to the entity, and in assessing whether the entity's management and governing board has made efficient and effective use of those resources.

Identifying a reporting entity in any specific situation would require consideration of the boundary of the economic activities that are, have been, or will be conducted by that entity. The existence of a legal entity is neither a necessary nor sufficient condition to identify a reporting entity although a single legal entity that conducts economic activities and does not control any other entity is likely to qualify as a reporting entity.

A portion of an entity (such as a branch or division) could qualify as a reporting entity as long as the economic activities of that portion can be distinguished objectively from the rest of the entity, and financial information about that 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

An entity would be viewed as controlling another entity when it has the power to direct the activities of that other entity to generate benefits for, or limit losses to, itself. If an entity that controls one or more entities prepares financial reports, it would be required to present consolidated financial statements since those statements are most likely to provide useful information to the greatest number of users.

The ED notes that when two or more entities share power to direct the activities of another entity to generate benefits (or limit losses) to themselves, neither entity that shares that power controls the other entity. In such situations, none of these entities would present consolidated financial statements. It is also noted that if one entity has significant influence over another entity it does not control that other entity.

Other types of financial statements

The ED suggests that 'parent-only' financial statements, which are financial statements presented by a controlling entity that provide information about its investments in entities it controls, and the return on those investments, might provide useful information if they are presented together with consolidated financial statements. This may be controversial, as in some jurisdictions wide use is made of parent-only financial statements without them accompanying consolidated financial statements.

The ED also notes that combined financial statements might provide useful information about commonly controlled entities as a group.

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