

Proposals to describe the reporting entity

Overview

Presently, IFRS sets out the requirements for how a reporting entity should report financial information, but there is no clear description within IFRS of what a reporting entity actually is, or how it should be identified. This has caused problems in preparing financial statements for reporting entities whose make-up or component structure differs from a traditional group reporting structure.

To address this problem, the International Accounting Standards Board (IASB) and US Financial Accounting Standards Board (FASB), collectively the "Boards", recently published an exposure draft (ED) *Conceptual Framework for Financial Reporting: The Reporting Entity*. The ED is part of a broader joint project to improve the current conceptual framework for financial reporting. This ED is a response to the Discussion Paper (DP) issued by the Boards in May 2008.

Summary of proposals

The ED proposes that a reporting entity has three features:

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

The ED proposes that these features are necessary, but are not always sufficient, to identify a reporting entity.

Economic activities

The ED uses the term 'economic activities' in the description of a reporting entity, instead of 'business', which was used in the DP. The Boards believe that the term 'business', as defined in the standards on *Business Combinations*, is too restrictive in the context of developing financial reporting objectives.

Legal entities

The ED proposes that the existence of a legal entity is neither necessary nor sufficient to identify a reporting entity. Consequently, a reporting entity can include more than one legal entity or it can be a portion of a single legal entity, assuming that it includes the features noted above.

The ED proposes that a single legal entity that conducts economic activities and does not control any other entity is likely to qualify as a reporting entity.

Portions of an entity

The ED notes that a portion of an entity (such as a branch or division) 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 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

The ED states that if an entity that controls one or more entities prepares financial reports, then it should present consolidated financial statements. In this context, it is proposed that an entity controls another entity when it has the power to direct the activities of the other entity to generate benefits for (or limit losses to) itself. The definition of 'control' is similar to the definition being discussed by the Boards in their project *Consolidated Financial Statements*.

Combined financial statements

The ED describes combined financial statements as those that include information about two or more commonly controlled entities without information about the controlling entity. The ED observes that combined financial statements might provide useful information about the commonly controlled entities as a group.

Parent-only financial statements

Some jurisdictions require the preparation of parent-only financial statements. The ED describes parent-only financial statements as those in which the controlling entity provides information about its investments in the entities it controls, and the returns on those investments, rather than the economic resources and claims, and

changes in those economic resources and claims, of those entities it controls. The ED acknowledges that parent-only financial statements might provide useful information if they are presented together with consolidated financial statements.

Application issues

By describing the reporting entity within the conceptual framework for financial reporting, it should be easier for preparers to identify:

- What types of financial statements can be prepared as 'general purpose' financial statements
- What information regarding the underlying assets and liabilities should be included in those financial statements

In addition, by providing a description of 'reporting entity,' the Boards are effectively creating a basis for developing standards that address the preparation of financial statements.

Often, particularly in the context of the sale of a portion of a business or a spin-off transaction, questions arise as to whether financial statements may be prepared for just the business (or 'economic activities') being sold or spun-off. Regulators, investors and lenders frequently request or require such information in these types of transactions. Having a description or a conceptual understanding of a reporting entity will allow preparers, regulators, and auditors to have a more consistent view of particular situations.

Further analysis will be needed to determine whether the ED is successful in achieving this goal, and whether the ED will bring about a change to current practice.

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