



## JOINT CONCEPTUAL FRAMEWORK PROJECT: THE CONCEPT OF A REPORTING ENTITY

Private Company Financial Reporting Committee  
July 2007

### Background

1. Today, neither of the conceptual frameworks of the FASB and IASB includes discussion of a concept of a reporting entity. Filling that conceptual “hole” is one of the objectives of the conceptual framework project. The FASB and IASB (the Boards) recently completed initial deliberations and have formed a preliminary view on what the reporting entity concept should be. They plan to seek comment on that preliminary view later this year. Thus, the July PCFRC discussion provides a timely opportunity to discuss the tentative decisions and, in particular, their implications for small businesses.
2. A reporting entity concept determines the boundaries and composition of a reporting entity. Developing such a concept should be particularly helpful to the Boards in developing common standards for determining when an entity or group of entities should provide **consolidated** or **combined** financial statements, and perhaps also **unconsolidated** (so-called *parent-only*) financial statements or **consolidating** or **combining** financial statements. (Consolidating or combining financial statements show, for example, parent-only and legal subsidiary information and a reconciliation of the eliminating entries for consolidated financial statements.) Matters relating to combined financial statements or combining may be of special interest to small businesses that operate in cooperation with related entities that are owned and controlled by a parent company, an individual, or a family.

Note: These materials are provided to facilitate understanding of the issues to be addressed at the July 26-27, 2007 PCFRC meeting. These materials are for discussion purposes only; they are not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

## Purpose of PCFRC Discussion

3. The objective of this session is to inform PCFRC members about the decisions reached on the concept of a reporting entity. The Boards are especially interested in learning more about whether the tentative decisions reached to date will result in sound concepts and principles that can be applied broadly.
4. Members will be asked if the description of a reporting entity and the notion of control applied in determining the composition of a potential group of entities are (a) satisfactory or perhaps are either too broad and vague or too narrow and restrictive, and (b) workable for all business enterprises, whether they are operating as corporations, partnerships, or unincorporated proprietorships, widely-held or closely-held, or are big and well capitalized or small and thinly capitalized.

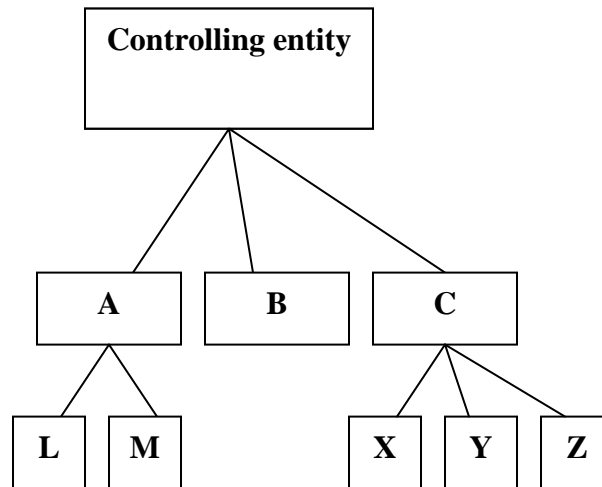
## Key Tentative Decisions

5. Decisions that have been reached by the Boards collectively in preparation for drafting the discussion document are as follows:
  - (a) The conceptual framework should describe what constitutes an entity for the purposes of financial reporting, but should not define it.
  - (b) An entity for financial reporting purposes does not need to be a legal entity. Rather, an entity includes other types of arrangements or organizational structures, which could be broadly described as **a circumscribed area of economic interest to external users of financial reporting**. Examples include a company, trust, partnership, association, sole proprietorship, natural person, and, in some circumstances, a branch or segment (which may have an existence separate from its parent-owner).
  - (c) An entity that meets that description—a circumscribed area of economic interest—and chooses to, or is required to, prepare general purpose external financial reports (GPEFR) is a reporting entity. The reporting entity concept

should not specify (or provide guidance on) which entities should be required to prepare GPEFR.

- (d) The composition of a group entity also should be based upon control. Typically, a group would comprise a parent and other entities under its control. In addition, there might be occasions when general purpose external financial reports may be prepared for a group of entities under common control, such as combined financial statements for two or more entities under the control of a single investor, that collectively are a circumscribed area of economic interest to external users of financial statements.
  - (e) Control, in the context of one entity controlling another entity, should be defined at the conceptual level and should include the notions of **power** (to make decisions) and **benefits**.
6. Regarding the presentation of general purpose external financial statements for a group entity, the FASB and IASB reached a common preliminary view on some, but not all, issues. The FASB decided that a parent entity must provide consolidated financial statements that present information about all of the assets, liabilities, and activities of the parent and its subsidiaries. It also decided that there may be limited circumstances in which aggregated (one-line) summary information is more decision-useful. Those circumstances would be addressed at the standards-level.
7. The IASB also decided that a parent entity must provide consolidated financial statements that present information about all of the assets, liabilities, and activities of the parent and its subsidiaries. However, the IASB did not reach a decisive conclusion regarding presentation of parent-only financial statements. About half of the IASB members reached conclusions similar to those of the FASB, while the other half decided that both consolidated and parent-only financial statements should be required for groups of entities.

8. Using the following illustration, the staff will explain in more detail at the meeting the combinations of entities that would be consistent with the Boards' preliminary views.



### QUESTIONS FOR DISCUSSION

9. Is the concept and description of a reporting entity (paragraph 5(b)) satisfactory or must it be more precisely defined?
10. Is it appropriate, in concept, that a reporting entity does not need to be a legal entity and may have an existence separate from its controlling parent-owner?
11. Will the preliminary views reached (paragraphs 6, 7, and discussion of illustration in paragraph 8) provide the appropriate combinations of entities for general purpose external financial reporting?