



## The status of SAC 1 *Definition of the Reporting Entity* in the revised AASB Conceptual Framework

### Purpose of this Paper

1. This paper discusses options for describing the status of SAC 1 *Definition of the Reporting Entity* in the revised AASB Conceptual Framework, in the light of concerns expressed by four AASB members about how this is done in the second pre-ballot draft of the revised Framework.

### Background

2. As a refresher on this issue, the background information regarding the depiction of SAC 1 set out in the covering memorandum to the second pre-ballot draft is repeated below in paragraphs 3 – 4.

### Second pre-ballot draft

3. “At its meeting on 28 October 2010, the Board decided to retain a reference in SAC 1 in the body of its revised Conceptual Framework and explain that the meaning of ‘reporting entity’ in the text repeated from the revised IASB Conceptual Framework differs from the meaning of ‘reporting entity’ in SAC 1. The reason for this decision is that the concept of a reporting entity in SAC 1 is currently being used by the Board to identify which entities should prepare general purpose financial reports (GPFs). However, referring to SAC 1’s concept of a reporting entity in the body of the revised AASB Conceptual Framework could cause confusion, for the reasons explained below:
  - (a) The existing AASB *Framework* says “The term ‘reporting entity’ is defined in SAC 1 *Definition of the Reporting Entity*.” This statement follows the sentence repeated from paragraph 8 of the existing IASB *Framework* (i.e., the version being superseded) that “The *Framework* applies to the financial statements of all commercial, industrial and business reporting entities, whether in the public or the private sectors.” It replaced the sentence in the existing IASB *Framework* that: “A reporting entity is an entity for which there are users who rely on the financial statements as their major source of financial information about the entity.”

- (b) The revised IASB *Framework* does not include the above-mentioned text presently set out in paragraph 8 of the existing *Framework*. Therefore, there is no hook in the revised IASB *Framework* for a reference to SAC 1 to be made.
  - (c) The numerous references to a ‘reporting entity’ in new Chapters 1 and 3 of the revised IASB Conceptual Framework all mean an entity that prepares GPFRs (regardless of its characteristics). This meaning is less specific than that given to a ‘reporting entity’ in the existing IASB *Framework*. Therefore, if reference were made to the concept of a reporting entity in SAC 1, it would seem necessary to explain the difference between that concept of a reporting entity and the meaning given to ‘reporting entity’ in the revised AASB Conceptual Framework. It is debatable whether adding such complexity to the body of the revised AASB Conceptual Framework would be necessary or appropriate.
  - (d) The primary application of the reporting entity concept in SAC 1 is in relation to AASB 1053 (which uses a slightly different definition of ‘reporting entity’ than in SAC 1). Therefore, it seems unnecessary to make the concept of a ‘reporting entity’ in SAC 1 integral to the revised AASB Conceptual Framework.
4. In view of these aspects, staff propose explaining the nature and role of the reporting entity concept in SAC 1 in the Foreword and (in greater detail) in the Basis for Conclusions.”
5. Consequently, AASB members were asked:
- “Do you agree with the staff’s proposal that reference to SAC 1 *Definition of the Reporting Entity* should not be made in the body of the revised AASB Conceptual Framework, and instead SAC 1 should be referred to in the Foreword and AASB Basis for Conclusions to the revised *Framework*?”

**Board members’ feedback on the second pre-ballot draft**

6. All four members who specifically answered this question agreed with the proposal on how SAC 1 should be dealt with. However, two of them found the explanation of the status of SAC 1 confusing and/or inappropriate. Another two members who did not specifically answer this question said they also found the explanation of the status of SAC 1 confusing and/or inappropriate.

7. The specific concerns of those AASB members are set out in Agenda Paper 11.2. The concerns expressed were essentially that:
- (a) it is confusing to say the definition (concept) of a reporting entity in SAC 1 is retained at a standards level to support the application of AASB 1053 *Application of Tiers of Australian Accounting Standards* but that SAC 1 is excluded from the revised AASB Conceptual Framework from the time that revised Framework is first applied; and
  - (b) some members thought SAC 1 would remain part of the revised AASB Framework (either within the body of the Framework or only by reference from the Foreword) until completion of the IASB chapter on Reporting Entity or the next phase of the Differential Reporting project.

### **Possible Approaches**

8. Possible approaches identified by staff for responding to these concerns are set out below. Each of these approaches is premised on the view that AASB 1053 retains reference to ‘reporting entity’ in its application paragraph at this stage. Staff’s comments on those approaches are presented under them in italics.

- (A) Include SAC 1 as part of the revised AASB Framework (by reference, as occurs under the existing AASB Framework). Explain that the meaning of ‘reporting entity’ in Chapters 1 and 2 of the revised AASB Framework is different from the meaning of that term in SAC 1

*Staff thinks this approach would be likely to cause confusion because ‘reporting entity’ would have two meanings in the same Framework. Therefore, the staff does not support this approach.*

- (B) The same as Approach (A), but mention SAC 1 only in the Foreword to the revised AASB Framework. That is, the Foreword would indicate SAC 1 remains part of the AASB’s Conceptual Framework, even though it is not part of the document issued as the revised AASB Framework

*Staff thinks this approach would be likely to cause confusion about what the revised AASB Framework consists of. Therefore, the staff does not support this approach.*

- (C) Withdraw SAC 1 altogether and leave readers of AASB 1053 to apply the definition of ‘reporting entity’ in that Standard without the support of the guidance in SAC 1

*Staff observes that this approach should overcome the risk of confusion about the meaning of ‘reporting entity’ in the revised AASB Framework. However, ‘reporting entity’ would still have two meanings in the AASB’s literature. Also, this approach would seriously undermine the Board’s approach in AASB 1053 that, at least for the time being, the reporting entity concept should be retained as a basis for identifying which entities should be permitted to prepare special purpose financial statements. For these reasons, the staff does not support this approach.*

- (D) Withdraw SAC 1 altogether but transfer its guidance to Application Guidance accompanying AASB 1053

*Staff observes that this approach should overcome the risk of confusion about the meaning of ‘reporting entity’ in the revised AASB Framework. However, it would strengthen the emphasis on ‘reporting entity’ in AASB 1053 at the same time the Board is reviewing whether to retain the reporting entity concept in that Standard. Also, this approach would create a lop-sided AASB 1053 because of the extent of the additional guidance that would be included. For these reasons, the staff does not support this approach.*

- (E) Make no substantial changes to the draft revised AASB Framework (second pre-ballot draft)

*Staff observes that, under this approach, the risk of confusion about the meaning of ‘reporting entity’ in different contexts would remain. However, as long as ‘reporting entity’ has two meanings in the AASB’s literature, this risk of confusion seems unavoidable. Staff consider that this approach is preferable to the others noted above, in view of the problems associated with those approaches.*

9. For the reasons above, staff recommends adopting Approach (E). Staff also suggests editing the discussion of this issue in the revised AASB Framework, to reduce the risk of confusion where possible. Specifically, as reflected in Agenda Paper 11.5, staff proposes:
- (a) referring to the differing meaning of ‘reporting entity’ (from that in the revised AASB Framework) only in respect of AASB 1053—not in respect of SAC 1 (see marked-up amendment in the first paragraph under heading ‘This version of the AASB Conceptual Framework’ on page 1 of Agenda Paper 11.5);
  - (b) adding paragraph Aus1.4 to explicitly indicate that SAC 1 is being superseded;
  - (c) omitting the second footnote from paragraph OB2;
  - (d) omitting the reference to SAC 1 from the footnote on page 8 of Agenda Paper 11.5;  
and
  - (e) making corresponding amendments in paragraphs 2, 7 and 8 of the draft AASB Basis for Conclusions.
10. The attached mark-up of an extract from the second pre-ballot draft of a revised AASB Conceptual Framework (Agenda Paper 11.5: the third pre-ballot draft) reflects Approach E, including the suggestions above for clarifying edits.

**Question for Board members**

- Q1** Do you agree that the approach to discussing ‘reporting entity’ and SAC 1 in the second pre-ballot draft of the revised AASB Framework should be retained?