

Statement of Accounting Concepts

SAC 1
(8/90)

Definition of the Reporting Entity

Prepared by the **Public Sector Accounting Standards Board** of
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STATEMENT OF ACCOUNTING CONCEPTS
SAC 1 "DEFINITION OF THE REPORTING ENTITY"

Citation

- 1 This Statement may be cited as Statement of Accounting Concepts SAC 1 "Definition of the Reporting Entity".

Application and Operative Date

- 2 This Statement applies to each reporting entity in relation to its first reporting period that ends on or after 31 August 1990, and in relation to subsequent reporting periods.

INTRODUCTION

- 3 The purpose of this Statement is to define and explain the concept of a reporting entity and to establish a benchmark for the minimum required quality of financial reporting for such an entity. ¹ This Statement outlines the circumstances in which an entity or economic entity should be identified as a reporting entity. It also outlines the criterion for determining, for financial reporting purposes, the boundaries of a reporting entity.
- 4 In relation to the benchmark for the minimum required quality of financial reporting, this Statement specifies that reporting entities shall prepare general purpose financial reports and that these are reports which comply with Statements of Accounting Concepts and Accounting Standards.
- 5 This Statement does not consider techniques of accounting for and the method of presentation of financial information about a reporting entity. Such considerations are included in Accounting Standards.

DEFINITIONS

- 6 For the purposes of this Statement:
- "control"** means the capacity of an entity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of another entity so as to enable that other entity

¹ In the Discussion section of this Statement, the term "entity" should be read as referring also to an economic entity, except where the narrower meaning of the term is specified.

to operate with it in achieving the objectives of the controlling entity;

"economic entity" means a group of entities comprising a controlling entity and one or more controlled entities operating together to achieve objectives consistent with those of the controlling entity;

"entity" means any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives; and

"general purpose financial report" means a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs.

DISCUSSION

General Purpose Financial Reporting

- 7 Statement of Accounting Concepts SAC 2 "Objective of General Purpose Financial Reporting" states that general purpose financial reports are prepared to provide users with information about the reporting entity which is useful for making and evaluating decisions about the allocation of scarce resources (hereinafter "resources"). When general purpose financial reports meet this objective they will also be a means by which managements and governing bodies discharge their accountability to those users. If Statements of Accounting Concepts and Accounting Standards are to be effective in ensuring adequate disclosure of information to users of general purpose financial reports, it is necessary that all those entities which should report, do report. In addition, if the regulation of general purpose financial reporting is to be developed on a rational and efficient basis, it is equally important that those entities for which there is no justification to report are not required to report.
- 8 Financial reports which meet the objective of general purpose financial reporting are general purpose financial reports. General purpose financial reports should be prepared when there exists, in relation to an entity, users whose information needs have common elements, and those users cannot command the preparation of information to satisfy their individual information needs. Such reports will provide users with appropriate information for making decisions relating to the efficient allocation of resources.

- 9 Efficient allocation of resources is facilitated by ensuring that general purpose financial reports contain information of at least the minimum required quality. Accordingly, general purpose financial reports should be prepared in accordance with Statements of Accounting Concepts and Accounting Standards.

The Reporting Entity Concept

- 10 A number of alternative concepts of the reporting entity are implicit in existing legislation and regulations which specify the entities which should prepare general purpose financial reports. These concepts include the legal entity concept, which has been employed in legislation in the private sector, and a broad concept based on accountability of elected representatives and appointed officials, which has been employed in the public sector. In the private sector it has been common for entities to be required to report whenever they have had legal status (for example, companies have been so obliged). In the public sector the accent on accountability has seen widespread application of the fund concept of reporting, which implies a concern with reporting the results of individual funds. In other cases, the concept based on accountability of elected representatives and appointed officials has led to entities which have such representatives and/or officials preparing general purpose financial reports.
- 11 The concepts referred to in paragraph 10 do not give adequate consideration to user needs in identifying the reporting entity. In the private sector it is possible that users exist in respect of reporting entities which are not legal entities and for which legislation requiring the preparation of general purpose financial reports does not exist, for example, partnerships, most trusts, and associations. Similarly, in the public sector it is possible that users exist in respect of entities other than the fund or the electoral entity, for example, in respect of individual statutory authorities, departments and governments. If accounting concepts, developed within a framework which identifies users' information needs as primary, are to satisfy the objective of general purpose financial reporting, those concepts must be related to users' information needs.
- 12 This Statement adopts a concept of the reporting entity which is tied to the information needs of users and the nature of general purpose financial reports. The concept requires that individual reporting entities be identified by reference to the existence of users who are dependent on general purpose financial reports for information for making and evaluating resource allocation decisions. This means that a class of entity defined under another concept, such as the legal or fund concepts (for example, proprietary companies or special and

general purpose funds), may include some entities which should be identified as reporting entities, by virtue of the existence of users dependent on general purpose financial reports prepared by the entity, and other entities which should not be so identified.

- 13 It should therefore be noted that the concept of the reporting entity adopted by this Statement is not dependent on the sector - public or private - within which the entity operates, the purpose for which the entity was created - business or non-business/profit or not-for-profit - or the manner in which the entity is constituted - legal or other. It is a concept which is tied to the objective of general purpose financial reporting and, as noted in paragraph 12, is a concept which requires all entities with users dependent on general purpose financial reports for information to prepare such reports.
- 14 The concept of the reporting entity and the identification of the boundaries of a reporting entity are related. For example:
- (a) if the concept of the reporting entity adopted was based on a class of legal entity (such as a company), this would imply identification of the boundaries of the entity by reference to legal considerations, which would mean that only entities of that legal class could be aggregated to form a reporting entity; and
 - (b) if the fund concept of the reporting entity was adopted, this would imply identification of the boundaries of the reporting entity by reference to the functional uses for which resources were designated and deployed. This would (unless more than one concept of the reporting entity was adopted) render illogical and inoperative the concept of aggregating separate funds to recognise the existence of a reporting entity.
- 15 However, the concept of the reporting entity established by this Statement is one linked to the information needs of users of general purpose financial reports in making and evaluating resource allocation decisions. The provision of information for these purposes is the criterion used to determine the boundaries of a particular reporting entity.
- 16 The disclosure of the resources that an entity has the capacity to deploy, and the results of their deployment, will assist users to determine the performance and financial position of the entity. Such information will assist users in making resource allocation decisions and is necessary for the evaluation of past decisions. For these purposes, information about all resources able to be deployed by a

reporting entity is relevant, whatever the legal or administrative structure established to manage those resources. Thus, where an entity controls other entities, there should be disclosed information regarding the resources of controlled entities as well as the resources of the controlling entity because all of these resources may be deployed by the controlling entity for its own advantage.

- 17 Accordingly, while in some instances a reporting entity will comprise an individual entity, in other instances a reporting entity will comprise a group of entities, some of which individually may be reporting entities. One of the entities within the group will control the other entities so that they operate together to achieve objectives consistent with those of the controlling entity. The group, which may be termed an economic entity, will be a reporting entity where there exist users dependent on general purpose financial reports for making and evaluating resource allocation decisions regarding the collective operation of the group of entities. Whether one entity has the capacity to control other entities, and therefore whether an economic entity exists, will depend on an evaluation of the circumstances of the particular entities. In determining whether control exists, the factors to be considered include the following: extent and implications of financial dependence, capacity to appoint or remove managements or governing bodies, and power to direct operations.
- 18 For the purposes of this Statement, an individual would normally constitute an entity as defined in paragraph 6. However, it should be noted that individuals with the capacity to deploy resources, but not in order to achieve their own objectives, will not meet the definition of an economic entity, for example: a trustee whose relationship with a trust does not extend beyond the normal responsibilities of a trustee, and a liquidator of an entity.

Identification of Whether Dependent Users Exist

- 19 For the purposes of this Statement, the identification of an entity as a reporting entity is linked to the information needs of users of general purpose financial reports. In many instances, it will be readily apparent whether, in relation to an entity, there exist users who are dependent on general purpose financial reports as a basis for making and evaluating resource allocation decisions. For those entities in respect of which it is not readily apparent whether such dependent users exist, the factors outlined in paragraphs 20 to 22 are identified as the primary factors to be considered in determining whether a reporting entity exists. These factors are indicative only, and are not the only factors that will be relevant in determining whether, in a particular circumstance, an entity is a reporting entity.

Separation of management from economic interest

- 20 The greater the spread of ownership/membership and the greater the extent of the separation between management and owners/members or others with an economic interest in the entity, the more likely it is that there will exist users dependent on general purpose financial reports as a basis for making and evaluating resource allocation decisions.

Economic or political importance/influence

- 21 Economic or political importance/influence refers to the ability of an entity to make a significant impact on the welfare of external parties. The greater the economic or political importance of an entity, the more likely it is that there will exist users dependent on general purpose financial reports as a basis for making and evaluating resource allocation decisions. Reporting entities identified on the basis of this factor are likely to include organisations which enjoy dominant positions in markets and those which are concerned with balancing the interests of significant groups, for example, employer/employee associations and public sector entities which have regulatory powers.

Financial characteristics

- 22 Financial characteristics that should be considered include the size (for example, value of sales or assets, or number of employees or customers) or indebtedness of an entity. In the case of non-business entities in particular, the amount of resources provided or allocated by governments or other parties to the activities conducted by the entities should be considered. The larger the size or the greater the indebtedness or resources allocated, the more likely it is that there will exist users dependent on general purpose financial reports as a basis for making and evaluating resource allocation decisions.

Implications of Application of the Reporting Entity Concept

Implications of the criterion for identification of a reporting entity

- 23 As the concept of the reporting entity reflected in this Statement is related to the information needs of users, it is evident that the creation of a company, statutory authority or other organisational structure does not of itself mean that the entity or organisation will qualify as a reporting entity. Judgement will be required in determining whether an entity satisfies the criterion for being so classified.

- 24 For entities which operate in the public sector, the implications of the factors listed in paragraphs 20 to 22 are that most government departments and statutory authorities will be reporting entities. This arises by virtue of the separation between the parties with an economic interest in the activities undertaken in the sector and the parties responsible for the management of those activities. (Management is elected by the parties which have an economic interest in the activities, that is, members of the public, or is appointed by others who have been so elected.) It is fundamental that those who manage resources on behalf of others should account for their performance to those who have provided the resources. Thus, in the public sector, the practical use of the factors listed in paragraphs 20 to 22 will be to identify entities which are not reporting entities. For example, medical centres established and controlled by a hospital may not be considered to be reporting entities where, individually, the amount of resources allocated to each is very low relative to the total resource allocation to the hospital and, because of that and other factors, there do not exist users dependent on general purpose financial reports relating to each centre. In such circumstances, information about the medical centres controlled by the hospital would be incorporated into the general purpose financial report of the hospital. This does not mean that the hospital will not require financial information from each of the centres for making resource allocation decisions. Rather, the implication is that financial reports prepared for this purpose by the centres would not be in the nature of general purpose financial reports, but instead would be in the nature of special purpose financial reports.
- 25 An implication of applying the reporting entity concept in the public sector is that a government as a whole, whether at the Federal, State, Territorial or local government level, would be identified as a reporting entity because it is reasonable to expect that users will require general purpose financial reports to facilitate their decision-making in relation to the resource allocations made by, and the accountability of, those governments. At a lower level of reporting, a number of individual statutory authorities and departments (and the entities they control) may also be defined as individual reporting entities because of their economic or political significance and/or their financial characteristics (for example, resources controlled and level of indebtedness). In some cases, these factors may also identify a ministerial portfolio as a reporting entity.
- 26 In the private sector, the factors listed in paragraphs 20 to 22 will identify as reporting entities all entities in which there is significant separation of ownership/membership and management, for example public companies and listed trusts. In contrast, entities in which the

members and management are an identical group, as would be the case for most sole traders, partnerships and exempt proprietary companies, would usually not be identified as reporting entities on the basis of this factor. However, there will exist circumstances in which entities such as these ought to be regarded as reporting entities. For example, an entity which undertakes the raising of debt or equity funds from the public will become a reporting entity because there will exist potential resource providers who require general purpose financial reports as a basis for making resource allocation decisions. For similar reasons, undertaking to sell an entity may result in the identification of the entity as a reporting entity. Also, the size and/or economic significance of some entities to their suppliers, clients or employees or to the public may dictate that those entities are reporting entities even though the members manage the entity. Examples of this would be professional partnerships which service a very large number of customers or clients and which enjoy a special status in the community, and exempt proprietary companies which attract a special public interest because of their financial characteristics.

- 27 There will exist some entities which will not be regarded as reporting entities, but which form part of an economic entity which is a reporting entity. This would be the case, for example, where a company is a wholly-owned subsidiary of another entity in the economic entity, and the size and other economic characteristics of the company are such that there do not exist users dependent on general purpose financial reports as a source of information for making and evaluating resource allocation decisions about the wholly-owned company. Instead, users are interested in information about the collective operation of the company and the other entities comprising the economic entity. Similarly, a segment of an economic entity is unlikely to be regarded as a reporting entity because information about a segment is usually directed at improving the knowledge of users of the general purpose financial reports for the whole reporting entity, rather than catering for the needs of those users interested only in information about that segment.
- 28 Classification as a reporting entity may not be constant from one reporting period to the next. For example, a partnership or company established for the conduct of a family business may not, under normal circumstances, qualify as a reporting entity. However, where one or more partners or owners become distanced from the business or are in dispute with other participants, or where new non-family shareholders are admitted to the company, users dependent on general purpose financial reports may exist in respect of the financial reports for the periods during which disputations or non-

family shareholdings occur. As such, the partnership or company would meet the conditions for classification as a reporting entity in respect of one or more reporting periods.

Groups of entities as reporting entities

- 29 The concept of control as the basis for identifying an economic entity has important implications. In the public sector, the entities making up the budget sector (that is, those entities which are heavily reliant on the budget for resources) may individually be identified as reporting entities. Because they are controlled by a government, those entities together with that government and the other entities that the government controls would, as an economic entity, meet the definition of a reporting entity. In preparing a general purpose financial report for this reporting entity, that is, for the government as a whole, it may be desirable to report detailed information regarding the operation of particular segments of the government as a whole, for example, the budget sector. This Statement does not, however, require the preparation of a separate general purpose financial report relating to the group of entities comprising the budget sector because, without their controlling entity (the government as a whole), they do not form an economic entity.
- 30 In the private sector, it has been common practice for groups of entities to be recognised as an economic entity only where the entities making up the group are established in the same legal form (for example, all are companies). An implication of the concept of control is that an economic entity may comprise entities which are established in a form different from that of the controlling entity, and such entities may be parts of, or a combination of, entities recognised for other purposes.
- 31 Because an economic entity, as defined in this Statement, comprises only the controlling entity and controlled entities, those entities which are significantly influenced, but not controlled, by a member of the economic entity do not form part of the economic entity. (Entities which are significantly influenced are termed associated entities.) This means that in preparing the general purpose financial report for the economic entity, additional information about an investment in an associated entity may be reported, possibly in a supplementary form, but it would not be reported on the basis of the associated entity forming part of the economic entity.
- 32 The focus on user needs as the basis for determining the existence of a reporting entity implies that the fact that an economic entity (for example, a corporate group or a government) may be a reporting

entity does not affect whether the controlling entity or any of the controlled entities are reporting entities in their own right.

Implications of the reporting entity concept for current practice

- 33 It is likely that application of this Statement will result in substantial changes to current practice. For example, it will result in some partnerships, trusts, government departments, statutory authorities and other organisations that currently do not prepare general purpose financial reports being identified as reporting entities which therefore ought to prepare such reports in accordance with Statements of Accounting Concepts and Accounting Standards. Similarly, it will result in a government as a whole being identified as a reporting entity which therefore ought to prepare general purpose financial reports. Other entities, for example some private companies, which currently prepare general purpose financial reports may not meet the criterion for identification as reporting entities. This Statement would not, therefore, require such entities to prepare general purpose financial reports. In this regard, however, it should be noted that the fact that this Statement may not require a particular entity to prepare general purpose financial reports does not preclude other parties, for example, regulatory authorities and financial institutions, from imposing a requirement on that entity to prepare general purpose financial reports.

Implications of the Reporting Entity Concept for Differential Reporting

- 34 Statements of Accounting Concepts and Accounting Standards are applicable to all entities which prepare general purpose financial reports. It is sometimes proposed that certain entities should be permitted to depart from all or certain of these Statements and Standards in the preparation of their financial reports. This notion is referred to as differential applicability of Statements of Accounting Concepts and Accounting Standards, or differential reporting.
- 35 Bases that have been proposed for identifying the entities which should be permitted to depart from these Statements and Standards are:
- (a) the size of the entity - that is, entities classed as small in relation to certain size benchmarks, based on any combination of turnover, assets and number of employees, would be permitted to depart;

- (b) ownership characteristics - for example, privately-owned entities would be permitted to depart, whereas publicly-owned entities would not be permitted to depart; and
- (c) a combination of size and ownership characteristics - for example, privately-owned entities which are classed as small would be permitted to depart from the Statements and Standards.

36 In this Statement the need to prepare general purpose financial reports is linked to the existence of users dependent on those reports as a basis for making and evaluating resource allocation decisions. The existence of users dependent on general purpose financial reports is not determined by either the size or the ownership characteristics of an entity. Accordingly, the bases outlined in paragraph 35 are not supported by this Statement. However, the reporting entity concept enunciated herein embodies a concept of differential reporting in that certain entities will not be identified as reporting entities and thus would not be required to prepare general purpose financial reports or comply with Statements of Accounting Concepts and Accounting Standards in the preparation of other financial reports. The entities which need not prepare general purpose financial reports are those in respect of which it is reasonable to expect that users dependent upon information contained in general purpose financial reports for making and evaluating resource allocation decisions do not exist.

37 As paragraphs 24 to 28 outline, it is likely that some types of entities will be identified as reporting entities by this Statement, while others will not. Accordingly, in most instances the following private sector entities are unlikely to be required by this Statement to prepare general purpose financial reports: sole traders, partnerships, privately-owned companies and trusts other than those where funds are subscribed by the public. There may be some instances when it is considered necessary or desirable that a general purpose financial report about an entity in these categories be prepared, for example when a privately-owned company intends to raise funds from the public. In these circumstances the report is required to comply with all Statements of Accounting Concepts and Accounting Standards. In the public sector, although most government departments and statutory authorities are likely to be required to prepare general purpose financial reports, the financial characteristics of some authorities and government agencies will mean that they will not be required by this Statement to prepare such reports. Types of entities which always would be identified as reporting entities and types of entities that are or are not likely to be identified as reporting entities are indicated in Professional Statement APS 1 "Conformity with

Statements of Accounting Concepts and Accounting Standards", issued by the Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia.

ACCOUNTING CONCEPTS

Discussion and Definitions

- 38 **The following concepts shall be interpreted in the context of paragraphs 1 to 37 of this Statement.**
- 39 **Paragraph 6 (definitions) shall be read as forming part of the accounting concepts set out in this Statement.**

Concept of the Reporting Entity

- 40 **Reporting entities are all entities (including economic entities) in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources.**

Preparation of general purpose financial reports

- 41 **Reporting entities shall prepare general purpose financial reports. Such reports shall be prepared in accordance with Statements of Accounting Concepts and Accounting Standards.**