Invitation to Comment

ITC 17
June 2008

Request for Comment on IASB Discussion Paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity*

Prepared by the
Australian Accounting Standards Board

Australian Government

Australian Accounting Standards Board

Commenting on this Invitation to Comment

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 25 August 2008. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 29 September 2008. Comments should be addressed to:

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Sent electronically through the 'Open for Comment' page on the IASB website (www.iasb.org)

A copy of all non-confidential submissions to the AASB will be placed on public record on the AASB website: www.aasb.com.au and forwarded to the IASB.

Obtaining a Copy of this Invitation to Comment

This Invitation to Comment is available on the AASB website: www.aasb.com.au. Alternatively, printed copies of this Invitation to Comment are available by contacting:

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PREFACE

Background

Australian Accounting Standards

The Australian Accounting Standards Board (AASB) makes Australian Accounting Standards to be applied by:

(a) entities required by the *Corporations Act 2001* to prepare financial reports;

(b) governments in preparing financial statements for the whole of government and the General Government Sector (GGS); and

(c) entities in the private or public for-profit or not-for-profit sectors that are reporting entities or that prepare general purpose financial statements.

Australian Accounting Standards incorporate International Financial Reporting Standards (IFRSs), as issued by the International Accounting Standards Board (IASB), with the addition of paragraphs on the applicability of the Standard in the Australian environment.

Australian Accounting Standards also include requirements that are specific to Australian entities. These requirements may be located in Australian Accounting Standards that incorporate IFRSs or in other Australian Accounting Standards. These requirements are generally restricted to the not-for-profit or public sectors or include additional disclosures that address domestic, regulatory or other issues.

Invitation to Comment

Invitations to Comment (ITCs) are generally issued during the formative stages of an accounting standard setting project to present a comprehensive overview of an issue, possible approaches to addressing that issue as well as to invite feedback from constituents. This may help with the early identification of any significant flaws or implementation problems.

The AASB's ITCs often include an IASB or International Public Sector Accounting Standards Board Discussion Paper seeking feedback on specific issues raised in the Discussion Paper that are pertinent to Australian constituents.

Introduction

The IASB has published a Discussion Paper on the topic of the reporting entity, which is a significant aspect of a Conceptual Framework for Financial Reporting. The Discussion Paper has been published for comment as part of a joint project, undertaken by the IASB and the Financial Accounting Standards Board (FASB), to develop a common framework that will replace the respective existing frameworks of the two Boards. The title of the IASB Discussion Paper is *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity* and the Discussion Paper was issued in May 2008.

Reasons for Issuing this Invitation to Comment

The AASB has published this Invitation to Comment to:

- facilitate Australian constituents providing comments on the IASB Discussion Paper;
- assist the AASB in formulating its response to the IASB; and
- assist the AASB in determining how to incorporate the proposed concepts, once finalised, into the AASB *Framework.*

The proposals in the Discussion Paper, if included in the IASB's revised *Framework*, would be reflected in the AASB's *Framework for the Preparation and Presentation of Financial Statements* (AASB *Framework*) and has the potential to profoundly affect the future direction of financial reporting in Australia.

If these proposals result in amendments to the AASB *Framework*, they are expected to be applicable to for-profit entities from the time that the IASB makes the amendments to the IASB *Framework for the Preparation and Presentation of Financial Statements* (IASB *Framework*) applicable. The implications for not-for-profit entities are considered later in this Preface.

Structure of this Invitation to Comment

This Invitation to Comment:

(a) reproduces the IASB Discussion Paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity* without amendment; and

(b) seeks constituents' views on the proposals.

To assist constituents in their assessment of the proposed concepts, this Preface initially provides some background information to the conceptual framework project and other explanations.

Background to the IASB-FASB Conceptual Framework Project

As part of their commitment to achieving harmonisation of financial reporting standards, in October 2004, the IASB and FASB embarked on a joint project to develop an improved, common conceptual framework that, once finalised, is expected to replace the existing frameworks currently used by the two Boards. The Boards' objective is to produce principle-based financial reporting standards, and a common conceptual framework that is sound, comprehensive and internally consistent will help in this endeavour. Rather than undertake a fundamental re-think of the existing concepts, the project's aim is to build on the existing IASB and FASB frameworks by refining, updating, completing and converging them into a common framework.

The project is being conducted in eight phases. Initially, the Boards are focusing on developing concepts applying to business entities in the private sector. In a later phase of the project, the Boards will consider the applicability of those concepts to other types of entities, in particular, not-for-profit entities in the private sector.

This Discussion Paper is the result of work undertaken so far in Phase D of the project, on the reporting entity.

The following table shows the phases of the IASB-FASB conceptual framework project and those Boards' plan for the release of near-term due process documents, extracted from the IASB Work Plan as at 30 June 2008 (further information about each phase is available on the IASB website):

Phase	**Last document issued**	**Estimated publication date**					**Estimated issuance of final document**
		2008 Q3	**2008 Q4**	**2009 H1**	**2009 H2**	**2010**	
Phase A: Objectives and qualitative characteristics	ED*			Final chapter			
Phase B: Elements and recognition					DP	ED	2011
Phase C: Measurement				DP		ED	2011
Phase D: Reporting entity	DP				ED		To be determined
Phase E: Presentation and disclosure							
Phase F: Purpose and status							
Phase G: Application to not-for-profit entities							
Phase H: Remaining Issues							

Key to abbreviations:

DP – Discussion Paper
ED – Exposure Draft

* See AASB Exposure Draft ED 164 *An improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information* (June 2008).

The Boards also have decided that each Board, within the context of its respective current GAAP hierarchy, will finalise the common framework as parts (chapters) are completed. However, later phases of the project may include consequential amendments to parts of the framework that were completed in earlier phases.

The Current AASB Framework

The current AASB *Framework* consists of the IASB *Framework* and the Australian Statements of Accounting Concepts SAC 1 *Definition of the Reporting Entity* and SAC 2 *Objective of General Purpose Financial Reporting.* SAC 3 *Qualitative Characteristics of Financial Information* and SAC 4 *Definition and Recognition of the Elements of Financial Statements* in the previous Australian conceptual framework were replaced when the AASB adopted the IASB *Framework.*

SAC 1 and SAC 2 have been retained as part of the new AASB *Framework* because the IASB *Framework* did not specifically address these topics, and guidance provided in SAC 1 and SAC 2 continue to be useful in identifying reporting entities and distinguishing between general purpose and special purpose financial reports. The AASB will review the role of SAC 1 and SAC 2 as concept statements in the Australian reporting environment once the revised IASB *Framework* is further progressed. The role of SAC 2 may also change as a result of the AASB's differential reporting project.

The Reporting Entity Concept under SAC 1

Under the current AASB *Framework*, the definition of the reporting entity is that provided in SAC 1:

> **"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."**

SAC 1 (paragraph 3) notes that its purpose 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 (including an economic entity). It outlines:

(a) the circumstances in which an entity or economic entity should be identified as a reporting entity; and

(b) the criterion for determining, for financial reporting purposes, the boundaries of a reporting entity.

SAC 1 also notes that the reporting entity concept 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 (paragraph 36). The current differential reporting regime in Australia is based on this usage of the concept of reporting entity. The concept is used in the Application paragraphs of Australian Accounting Standards to identify entities to which the Standards apply.

Discussion Paper's Significant Difference from SAC 1

The IASB Discussion Paper is not concerned with the use of the reporting entity concept for differential reporting purposes. This is the main difference between SAC 1, as an integral element of the current AASB *Framework*, and the IASB Discussion Paper.

Accordingly, in commenting on the IASB Discussion Paper on the reporting entity, constituents need to distinguish between the role of the reporting entity as a 'concept' guiding the determination of the boundaries of the entity to be reported on, and its role as 'the basis for differential reporting'. The purpose of this ITC is to solicit constituents' comments on the role of reporting entity as a concept. Constituents' views on the use of reporting entity for differential reporting purposes are only relevant in the context of the AASB's differential reporting project.

Future Use of Reporting Entity for Differential Reporting Purposes in Australia

The AASB initiated a project in 2006 to review its differential reporting regime. ITC 12 'Request for Comment on a Proposed Revised Differential Reporting Regime for Australia and IASB *Exposure Draft of A Proposed IFRS for Small and Medium-sized Entities*' was published in May 2007 which contained proposals for a revised differential reporting regime.

The AASB received considerable feedback on its proposals from its constituents and is redeliberating its proposals in the light of comments received. The AASB has tentatively decided to change the focus of the application of Australian Accounting Standards from 'reporting entity' to 'general purpose financial statements'.

Implications for Not-for-profit Entities

The AASB *Framework* applies to all Australian entities that prepare general purpose financial reports. As noted above, the IASB has decided to consider the applicability to not-for-profit entities of the various amendments it makes to the IASB *Framework* as a later phase of its project to review and amend that *Framework*. Therefore, there are implications for the AASB *Framework* arising from the IASB's plan to finalise parts of its new framework before it has considered the applicability of any new or revised concepts to other types of entities.

The AASB, in conjunction with standard setting boards in Canada, NZ, and the UK, has been monitoring the development of the IASB-FASB joint conceptual framework project from the perspective of private and public sector not-for-profit entities. The monitoring group consists of the Chairs and senior staff members of the above standard setters. A consultant was engaged by the group to monitor the IASB-FASB conceptual framework project. The group plans to issue a report highlighting the implications of applying the concepts proposed in the Discussion Paper to private sector and public sector not-for-profit entities.

The AASB plans to consider how to incorporate any amendments to the existing IASB *Framework* into the AASB *Framework*. The AASB's preliminary view is that, until such time as the IASB considers the applicability of any new or revised concepts to other types of entities, it may be necessary to limit the applicability of those new or revised concepts to for-profit entities only. In other words, if the IASB proceeds with replacing the relevant parts of the existing *Framework* when work on Phase D is completed, then the AASB will consider whether those amendments should apply only to Australian for-profit entities, with the existing AASB *Framework* retained for not-for-profit entities, as an interim measure. Any decision on this issue will be made by the AASB when the IASB finalises the chapter on reporting entity, and will be affected by:

- whether the IASB proceeds with its plan to replace parts of its existing *Framework* before considering the applicability of any new or revised concepts to other types of entities; and

- whether the revised parts of the IASB *Framework* are substantially different from the relevant parts of its existing *Framework*, upon which the AASB *Framework* is based.

IPSASB Framework

In March 2006, the IPSASB agreed to develop a public sector conceptual framework as a collaborative project with national standard setters and other authoritative bodies in various jurisdictions. The AASB has contributed to developing the draft IPSASB *Framework*. Later this year, the IPSASB intends to issue an omnibus Consultation Paper on the objectives and scope of financial reporting, the qualitative characteristics of financial information, and the concept of a reporting entity.

The AASB considers that it is important to engage in both the IASB-FASB and IPSASB conceptual framework projects.

Request for Comments

Comments are invited on any of the proposals in the ITC, including the questions on the proposals as listed in the IASB Discussion Paper.

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 25 August 2008. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 29 September 2008. The AASB would prefer that respondents supplement their opinions with detailed comments, whether supportive or critical, on the major issues. The

AASB regards both critical and supportive comments as essential to a balanced review and will consider all submissions, whether they address all specific matters, additional issues or only one issue.

Specific Matters for Comment

In addition, the AASB would value comments on the following:

(a) as indicated above, because the IASB-FASB joint conceptual framework project has an initial focus on for-profit entities in the private sector, the AASB plans to undertake additional consultation with constituents in relation to not-for-profit issues. In the meantime, in relation to the topic of 'reporting entity' covered by the Discussion Paper, the AASB would welcome comments on the issues that would need to be considered if the proposed concepts were also to be applied in Australia to not-for-profit entities in the private and public sectors and for-profit entities in the public sector;

(b) whether the proposals would result in financial reports that are useful to users; and

(c) whether the proposals in the Discussion Paper are in the best interests of the Australian economy.

May 2008

DISCUSSION PAPER

Preliminary Views on an improved Conceptual Framework for Financial Reporting

The Reporting Entity

Comments to be submitted by 29 September 2008

International
Accounting Standards
Board®

Discussion Paper

Preliminary Views on an improved Conceptual Framework for Financial Reporting:

The Reporting Entity

Comments to be received by 29 September 2008

This discussion paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity* is published by the International Accounting Standards Board (IASB) for comment only.

The discussion paper has been prepared as part of a joint project by the IASB and the US Financial Accounting Standards Board and it sets out the boards' preliminary views on a topic to be catered for in their proposed common framework. Those views may be modified in the light of comments received before being published as an exposure draft of a proposed chapter.

Comments on the contents of the discussion paper should be submitted in writing so as to be received by **29 September 2008**. Respondents are asked to send their comments electronically to the IASB Website (www.iasb.org), using the 'Open to Comment' page.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

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International Accounting Standards Board®

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Preface

P1 This discussion paper is one of a series of publications being developed jointly by the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) as part of a joint project to develop a common conceptual framework for financial reporting.

P2 The boards' exposure draft *The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information* explains why the boards are reconsidering their existing frameworks. It also explains the process for developing the common conceptual framework. For convenience, some aspects of this process are also explained below.

Developing the common conceptual framework

P3 The boards concluded that a comprehensive reconsideration of all concepts would not be an efficient use of their resources. Many aspects of their frameworks are consistent with each other and do not seem to need fundamental revision. Instead, the boards adopted an approach that focuses mainly on the improvement and convergence of their existing frameworks, giving priority to issues that are likely to yield standard-setting benefits in the near term. When completed, the common framework will be a single document (like the IASB's *Framework*) rather than a series of Concepts Statements (like the FASB's conceptual framework).

P4 The boards decided to focus initially on concepts applicable to business entities in the private sector. Once concepts for those entities are developed, the boards will consider the applicability of those concepts to financial reporting by other entities, such as not-for-profit entities in the private sector and, in some jurisdictions, business entities in the public (governmental) sector.

P5 Four phases of the conceptual framework project are active. In this phase the boards are considering conceptual matters relating to the reporting entity. Other active phases are considering many conceptual matters such as:

(a) the objective of financial reporting,

(b) the qualitative characteristics of financial reporting information,

(c) the definitions of elements of financial statements,

(d) the unit of account,

(e) recognition and derecognition of elements of financial statements, and

(f) initial and subsequent measurement of elements in financial statements.

P6 The boards will consider, in later phases, matters of presentation and disclosure and, as discussed above, the applicability of the concepts in earlier phases to other types of entities.

Due process

P7 As part of their due process, the boards plan to consult interested parties by publishing common discussion papers and exposure drafts on each of the proposed chapters of the common and improved framework. The boards may also consult by publishing other due process documents to seek views on particular issues before developing preliminary views on those issues. The boards also expect to continue to consult in other ways, such as through discussions with the IASB's Standards Advisory Council and the FASB's Financial Accounting Standards Advisory Council, and in round-table and other meetings with interested parties.

Authoritative status of the framework

P8 At present, an entity preparing financial statements in accordance with International Financial Reporting Standards (IFRSs) is required to consider the IASB's *Framework for the Preparation and Presentation of Financial Statements* when there is no standard or interpretation that specifically applies to a transaction, other event or condition or that deals with a similar and related issue.[*] There is no similar requirement for entities preparing financial statements in accordance with US generally accepted accounting principles (GAAP). The FASB's Concepts Statements have the same authoritative status as accounting textbooks, handbooks and articles, and a lower authoritative status than practices that are widely recognised and prevalent either generally or in the industry.[†]

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* IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, paragraphs 10 and 11.

† FASB Statement No. 162 *The Hierachy of Generally Accepted Accounting Principles*, paragraphs 4 and 5. Statement 162 is not yet effective as of publication of this discussion paper but is expected to be effective before the final version of this Conceptual Framework for Financial Reporting.

P9 The boards have not yet reached a common conclusion on the authoritative status of the common conceptual framework; however, both have decided that the common conceptual framework will not have the same status as financial reporting standards. In particular, the common framework will not override those standards. Some existing standards may be inconsistent with the common framework. The boards will reconsider those standards to the extent that the discrepancies meet the criteria for adding a project to their agendas.

P10 The boards have also decided that each board, within the context of its respective current hierarchy, will finalise the common framework as parts (chapters) are completed. However, later phases of the project may include consequential amendments to parts of the framework that were completed in earlier phases. Furthermore, the boards note that their decision on how to finalise the common conceptual framework may need to be readdressed when they discuss the placement of the framework within their respective hierarchies.

P11 The FASB has decided that the authoritative status of the framework within the US GAAP hierarchy should be considered once the framework is closer to being substantially complete. However, for the purposes of providing comments on this discussion paper, and on other discussion papers and exposure drafts published by the boards during their joint conceptual framework project, respondents should assume that the framework's authoritative status will be elevated in the US GAAP hierarchy to be comparable to the status of the *Framework* in IFRSs.

Invitation to comment

The International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) invite comments on all matters in this discussion paper. Comments are most helpful if they:

(a) indicate the specific paragraph or paragraphs to which the comments relate

(b) contain a clear rationale

(c) include any alternative the boards should consider.

Respondents should submit one comment letter to either the IASB or the FASB. The boards will share and consider jointly all comment letters received.

Respondents must submit comments in writing by 29 September 2008.

The discussion paper includes some specific questions for respondents, which are set out throughout the paper and are listed at the end.

Summary

S1 This discussion paper considers issues for the purposes of developing a reporting entity concept for inclusion in the boards' common conceptual framework.

S2 Section 1 considers some general issues relating to the reporting entity concept. For example, it considers whether a precise definition of a *reporting entity* is necessary and whether a reporting entity must be a legal entity. In the boards' preliminary view, the conceptual framework should broadly describe (rather than precisely define) a *reporting entity* as a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers. Also, a *reporting entity* should not be limited to business activities that are structured as legal entities. Examples of reporting entities include a sole proprietorship, corporation, trust, partnership, association and a group of entities.

S3 Section 2 considers how to circumscribe the area of business activity of interest to equity investors, lenders and other capital providers in the context of a group of entities. The section discusses when the relationship between one entity and another is such that the boundary between the two entities should be disregarded, and the two entities instead presented as a single unit.

S4 To do so, Section 2 first considers the meaning of control in the context of one entity having control over another. The boards' preliminary views are that:

(a) if control is used to determine the composition of a group reporting entity, then control should be defined at the conceptual level.

(b) control over another entity entails both power over that entity and the ability to obtain benefits.

(c) determining whether one entity has control over another involves an assessment of all the existing facts and circumstances.

S5 Section 2 then considers three approaches to determining the composition of a group reporting entity:

(a) the controlling entity model

(b) the common control model

(c) the risks and rewards model.

S6 The boards' preliminary view is that the composition of a group entity should be based on control, and that the controlling entity model should be used as the primary basis for determining the composition of a group reporting entity. In addition, there are some circumstances in which the common control model may provide useful information to equity investors, lenders and other capital providers. It would be determined at the standards level when the common control model should (or may) be applied.

S7 Section 3 considers two issues relating to the general purpose financial reports of a parent entity:

(a) the parent company approach to consolidated financial statements.

(b) parent-only financial statements and consolidated financial statements—determining which set of financial statements meets the objective of financial reporting and whether both sets are needed for that purpose.

S8 On the first issue, consistently with the boards' decision in the first phase of the conceptual framework project to adopt the entity perspective, the boards' preliminary view is that consolidated financial statements should be presented from the perspective of the group reporting entity—not from the perspective of the parent company's shareholders, as occurs under the parent company approach. However, that does not mean that the information needs of the parent company's shareholders are ignored. Adopting the entity perspective does not preclude including in financial reports information that is primarily directed to the needs of a particular group of capital providers.

S9 On the second issue, the boards' preliminary view is that consolidated financial statements meet the objective of financial reporting, by providing useful information to equity investors, lenders and other capital providers. There are differing views about the usefulness of parent-only financial statements; however, in the boards' preliminary view, the conceptual framework should not preclude the presentation of parent-only financial statements, provided that they are included in the same financial report as consolidated financial statements.

S10 Section 4 considers further issues relating to control, such as latent control and the treatment of options over voting rights.

Introduction

1 The boards' existing conceptual frameworks do not include a reporting entity concept. The IASB's *Framework for the Preparation and Presentation of Financial Statements* defines the reporting entity in one sentence with no further explanation.* The FASB's *Statements of Financial Accounting Concepts* do not contain a definition of a reporting entity or discussion of how to identify one. As a result, neither framework specifically addresses the reporting entity concept. The objective of this phase of the project is to develop a reporting entity concept for inclusion in the boards' common conceptual framework.

2 Despite this lack of an explicit reporting entity concept, an implicit reporting entity concept exists. In particular, there are accounting standards and practices relating to the composition of, and financial reporting by, a group reporting entity. (The term *group reporting entity* is used in this discussion paper to refer to an entity that comprises two or more entities, such as two or more corporations, that are presented as a single unit.) Existing accounting standards and practices serve as a starting point for considering and developing a reporting entity concept because they were developed as a means of providing useful information to equity investors, lenders and other capital providers. However, they are not precedents or constraints for the boards' common conceptual framework.

3 Furthermore, this phase of the project does not seek to resolve the many accounting issues relating to the reporting entity, in particular, issues that arise in standards-level projects or in accounting practices about consolidated financial statements. The conceptual framework provides a foundation upon which accounting standards are based—it does not negate the need for those accounting standards. Therefore, once a reporting entity concept is developed, many issues will remain to be addressed at the standards level. This is true of all parts of the conceptual framework. However, because the boards are seeking to fill a gap in their frameworks, there is no existing content that indicates the extent of guidance that ought to be provided at the conceptual level. This may create an expectation that filling the gap at the conceptual level will resolve the many complex issues that exist at the standards level and in practice. However, that is not the objective of this phase. Rather, the objective is to develop a conceptual foundation to serve as the basis for resolving those issues.

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* IASB *Framework*, paragraph 8: '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.'

4 In addition, like other phases of the conceptual framework project, the reporting entity phase focuses on developing a reporting entity concept in the context of general purpose financial reporting. Throughout this discussion paper, the terms *financial reports* and *financial reporting* refer to *general purpose financial reports* or *reporting*.

5 In developing this discussion paper, the boards considered various literature sources in addition to their existing frameworks, such as the conceptual frameworks of other accounting standard-setters that include discussion of the reporting entity concept, existing accounting standards (eg consolidation standards that define *control*) and academic literature.

Section 1: The reporting entity concept

Introduction

6 General purpose financial reports provide information about a particular *reporting entity*. Those reports provide information about the entity's economic resources (ie its assets), claims on those resources (ie its liabilities and equity), and the effects of transactions and other events and circumstances that change an entity's resources and the claims on them. It is the entity itself that is the subject of financial reporting, not its owners or others having an interest in the entity. Thus, there is a distinction between the *subject* of general purpose financial reports and the *users* of those reports (such as equity investors and lenders).

7 In its most general sense, the term *reporting entity* refers to the entity that is the subject of a particular set of financial reports. However, merely describing or defining a *reporting entity* as being an entity that reports would not be helpful. Hence, something more is required if the boards are to develop a reporting entity concept that assists them in their standard-setting activities.

8 Because there is no reporting entity concept in the boards' existing conceptual frameworks, there is no clearly established starting point. Hence, the first task is to establish more clearly the objective of this phase of the project.

Whether a definition of the term *reporting entity* is necessary

9 Some might argue that the project should aim to develop a precise definition of a *reporting entity*, to establish which particular 'things' qualify as appropriate subjects of general purpose financial reports. That definition could then be applied in the boards' financial reporting standards, so that the subject of a particular set of financial reports must meet the definition of a reporting entity before those financial reports can be described as being general purpose financial reports prepared in compliance with IFRSs or US GAAP.

10 Such an approach would be similar, for example, to defining *assets*. The term *asset* is defined in the boards' existing conceptual frameworks. That definition is then applied in financial reporting standards so that, in general, something has to meet the definition of an asset before it qualifies as a potential candidate for recognition in a set of general purpose financial reports.

11 Some may support this approach because it would place limits on what is permitted to be the subject of general purpose financial reports. They argue that, without those limits, preparers of financial reports would have a free hand to select the subject of what are purported to be general purpose financial reports. That could result in financial reports that do not meet the boards' objective of financial reporting. For example, suppose a corporation prepared a financial report on its profitable operations, but excluded information about its loss-making operations. Even if the 'reporting entity' were clearly described, the boards would regard such a report as incomplete and potentially misleading to users of that report.

12 However, others would regard such concerns as unfounded. For example, the boards' financial reporting standards do not specify which 'things' may be the subject of financial reports prepared in compliance with those standards. However, in general, that lack of such a specification has not resulted in situations similar to that described above.

13 Moreover, being too prescriptive—as opposed to not being prescriptive enough—could result in a failure to meet the objective of financial reporting. For example, the boards considered whether, for something to be a reporting entity, it should have 'the capacity to deploy resources'[*] or some similar notion, such as the capacity to engage in transactions with other parties. However, the boards were concerned that defining a reporting entity in this manner might result in some types of business activities failing to satisfy that definition. For example, a special purpose entity, with a narrowly defined purpose and predetermined financing and operating policies, might have a limited capacity to deploy resources or engage in transactions with other parties. Yet there could be equity investors, lenders or other capital providers who require information about that entity but lack the ability to prescribe the information they need.

14 The boards' preliminary view is that developing a precise definition of a reporting entity is unnecessary. However, the question remains whether the conceptual framework should provide a general description of, or some explanation about, what constitutes a reporting entity in the context of general purpose financial reporting. In particular, an important issue is the relevance of legal structure to determining what constitutes a reporting entity and to establishing its boundary. Conceptually, this matter could be divided into two types of issues:

(a) disaggregation issues, in particular, determining whether a component of a legal entity, such as an unincorporated branch, is an appropriate subject of general purpose financial reports; and

[*] Australian Accounting Standards Board, SAC 1 *Definition of the Reporting Entity*, paragraph 6.

(b) aggregation issues, in particular, determining when the boundary between two or more entities should be disregarded, so that they are presented as a single unit.

15 The remainder of this section focuses on disaggregation and Section 2 focuses on aggregation.

Whether a reporting entity must be a legal entity

16 Many businesses are conducted using some form of legal structure, such as a corporation, trust, partnership or incorporated society. These types of legal structures help to identify the 'thing' that is the subject of financial reports, and distinguish it from the equity investors, lenders and other creditors who are the capital providers to that 'thing'. In other words, legal structure helps to distinguish between the *subject* of general purpose financial reports and the *users* of those reports.

17 Legal structure also helps to establish the boundaries of the reporting entity. In particular, it helps to determine which resources, claims on those resources, and changes in those resources or claims should be included in the entity's financial reports. For example, a small business that is owned and operated by a person could be structured as a sole proprietorship or as a corporation (or some other form of legal entity). Structuring the business as a legal entity often assists in distinguishing between the person's business and non-business assets, liabilities and activities. Thus, typically it would be easier to determine which assets, liabilities and activities should be included in—or excluded from—the financial reports prepared for that business.

18 However, not all businesses are operated through legal entities. As discussed above, a small business might be operated as a sole proprietorship that is not a legal entity and may present general purpose financial reports, for example, when seeking funding from a bank or when providing financial information to prospective purchasers of the business.

19 Similarly, in some jurisdictions, an unincorporated branch of an overseas corporation might be required, or might choose, to prepare general purpose financial reports, for example, to provide financial information to existing and potential creditors of the branch.

20 Some argue that any business activity that does not have a separate legal existence, such as a sole proprietorship or an unincorporated branch, could present special purpose financial reports, but should not be regarded as a reporting entity for the purposes of general purpose financial reporting, for the following reasons:

(a) *Practical difficulties of establishing the entity's boundary.* There may be practical difficulties in distinguishing between the resources, claims on those resources, and changes in those resources and claims of the unincorporated branch or sole proprietorship and those of the larger entity of which it is a component. Because of those practical difficulties, it may be difficult to ensure that the financial report provides a complete and faithful representation of all the resources, claims on those resources, and changes in those resources and claims of the unincorporated branch or sole proprietorship.

(b) *Legal structure is necessary to establish that the 'entity' exists in its own right.* For example, creditors of a sole proprietorship typically have recourse not only to the business assets of the proprietor but also to the proprietor's personal assets; the creditors of an unincorporated branch typically have recourse not only to assets of the branch but also to the assets of the larger entity of which that branch is a component. This suggests that the sole proprietorship or an unincorporated branch is not an 'entity' in its own right. Also, the financial reports of a sole proprietorship or an unincorporated branch could be regarded as incomplete because they do not include all of the assets against which the creditors have claims.

21 However, the boards did not agree with the above arguments. They noted that:

(a) *Practical difficulties could also arise with legal entities.* Practical difficulties in establishing the reporting entity's boundary could occur even when a legal entity exists. For example, practical difficulties could occur when one legal entity is controlled by another legal entity—in this situation, the degree of integration between the two legal entities may make it difficult to distinguish between the resources of the controlled entity and those of the controlling entity. Hence, the existence of a legal entity does not necessarily mean that the boundaries of the reporting entity are clearly identifiable.

(b) *Practical difficulties should be dealt with at the standards level.* The fact that there could be *practical* difficulties establishing the boundary of a particular area of business activity that does not have its own legal existence is not sufficient to conclude that, *in concept*, it is not an appropriate subject for general purpose financial reports. Rather, those practical difficulties may indicate the need for guidance at the standards level. For example, a standard may require disclosures about the identity of the reporting entity and the wider entity of which it is a component. A standard may also require disclosure of information about transactions with related parties, including perhaps information about transactions that were not recognised in the financial statements (eg goods and services received from a related party for no consideration, which may not have been recognised in the financial statements).

(c) *Concepts should reflect economic phenomena.* If the existence of a reporting entity is dependent upon whether an area of business activity is structured as a legal entity, this would imply that legal form is more important than the economic phenomena (ie the existence of an area of business activity). Thus, whether economically similar types of business activities are reporting entities for the purposes of general purpose financial reporting would depend on their legal form, which could differ across jurisdictions.

(d) *Creditor recourse is not determinative.* The fact that creditors may have recourse to assets other than the assets of the reporting entity does not mean that the reporting entity does not exist or that its financial reports are incomplete because those other assets are not included. For example, the creditors of a partnership typically have recourse to the personal assets of the partners. The creditors of a corporation may have recourse to the personal assets of the corporation's shareholders because of a personal guarantee. But that does not mean that the partnership or corporation does not exist or that its financial reports are incomplete because the personal assets of the partners or shareholders are excluded. Rather, it may be necessary for the reporting entity's financial reports to provide information about the other assets that provide security for creditors' claims. In some cases, it may be appropriate to recognise a capital contribution from owners, for example, if a shareholder's personal guarantee results in a corporation paying a lower interest rate. However, these are issues to be addressed at the standards level.

(e) *Users' information needs would not be met.* A reporting entity concept that is limited to legal entities would serve no useful purpose—it would simply create problems for the boards and their constituents, including the users of general purpose financial reports. For example, a sole proprietorship might not be a legal entity, but there is no reason why it should not be the subject of general purpose financial reports. Those reports would provide useful information to users, such as lenders, other creditors and prospective purchasers of the business.

22 The boards' preliminary view is that a *reporting entity* should not be limited to business activities that are structured as legal entities. Rather, a reporting entity should be broadly described as being a circumscribed area of business activity. That description would apply to, for example, a sole proprietorship, branch, corporation, trust, partnership and group of entities (as discussed further in Section 2).

The link with the objective of financial reporting

23 Broadly describing a reporting entity as a *circumscribed area of business activity* may be too vague to be of use when developing financial reporting standards because it does not provide a clear link to the objective of financial reporting. Given that the conceptual framework establishes concepts for general purpose financial reports, any discussion of the reporting entity in the framework should be clearly linked to that objective.

24 The boards are considering the objective of financial reporting in the first phase of the conceptual framework project. Their tentative conclusion, as set out in the exposure draft *An improved Conceptual Framework for Financial Reporting: Chapter 1: The Objective of Financial Reporting and Chapter 2: Qualitative Characteristics and Constraints of Decision-useful Information*, is that the objective of financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders and other creditors in making decisions in their capacity as capital providers. Thus, to provide a link to this objective, a reporting entity could be described as a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers. That description could be used, for example, when determining when the boundary between two or more entities should be disregarded and the entities presented as a single unit, as discussed in Section 2.

25 Describing a reporting entity in this manner may also be useful for purposes other than the boards' standard-setting activities. Many jurisdictions have legislative or regulatory requirements that establish which entities must prepare general purpose financial reports in accordance with the boards' financial reporting standards. Those legislative or regulatory requirements are often established to ensure that financial reporting information is provided to present and potential equity investors, lenders and other capital providers that do not have the ability to demand the information they need from the entities concerned. It is not within the boards' authority to specify which entities should apply their standards. However, describing a *reporting entity* in their common conceptual framework that links to the objective of general purpose financial reporting may assist regulators and legislators in deciding which entities should be required to prepare such reports.

26 Some might have conceptual concerns about specifically referring to equity investors, lenders or other capital providers in the description of a reporting entity. In particular, they might be concerned that doing so implies that the existence of a 'circumscribed area of business activity' depends upon the existence of external capital providers that are interested in that business. However, the business exists, irrespective of whether there are external capital providers interested in it or whether it presents general purpose financial reports.

27 By linking the description of a reporting entity to the objective of financial reporting, the boards' intention is to convey that the conceptual framework is *focused* on those circumscribed areas of business activity that are of interest to present and potential equity investors, lenders and other capital providers. Having such a focus is consistent with the framework's focus on general purpose financial reporting, rather than all types of financial reporting. Focusing on a particular type of financial reporting—or a particular area of business activity—does not imply that the concepts in the framework cannot be applied more broadly. For example, suppose a family-owned business had no external capital providers and its owner/managers had no intentions of seeking external funding in the future. Although the framework is not focused on this type of business activity, the entity could prepare financial reports by applying the concepts in the framework if it wished to do so.

28 Furthermore, focusing on the objective of financial reporting is likely to assist the boards when considering boundary issues relating to the reporting entity, in particular, determining when the relationship between one entity and another is such that the boundary between the two should be disregarded. When an entity prepares general purpose

financial reports, it is necessary to determine which resources, claims on those resources, and changes in those resources or claims should be included in its financial reports. For example, when an entity has an interest in, or relationship with, another entity that is legally separate from the first entity, guidance is needed to determine when presenting information about those entities as a single unit would meet the objective of financial reporting. That issue is addressed in Section 2 of this paper.

Questions for respondents

Question 1

Do you agree that what constitutes a reporting entity should not be limited to business activities that are structured as legal entities? If not, why?

Question 2

Do you agree that the conceptual framework should broadly describe (rather than precisely define) a reporting entity as a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers? If not, why? For example, do you believe that the conceptual framework should establish a precise definition of a reporting entity? If so, how would you define the term? Do you disagree with including reference to equity investors, lenders and other capital providers in the description (or definition) of a reporting entity? If so, why?

Section 2: Group reporting entity

Introduction

29 This section considers issues relating to a group reporting entity. The term *group reporting entity* is used in this discussion paper to refer to a reporting entity that comprises two or more entities that are presented as a single unit. The term *group financial statements* is used here to refer to the financial statements of a group reporting entity. Both *consolidated* financial statements and *combined* financial statements, as prepared in practice today and discussed further in this section, are types of group financial statements.

30 This section focuses on group reporting entities that comprise two or more legal entities that are presented as a single unit, such as two or more corporations, because it is common for business activities to be conducted through legal entities. When there is legal separation between one entity and another, issues arising at the standards level and in practice often relate to the question of when that legal separation should be disregarded and the two entities presented as a single unit. Therefore, it seems helpful to focus on groups of legal entities. However, that focus does not imply that the concept of a *group reporting entity* is limited to groups of legal entities.

31 In accounting practice, it has long been common for group or consolidated financial statements to be prepared, in which the results and activities of two or more legal entities (such as two or more corporations) are consolidated or combined, and presented as a single unit.

32 For example, consolidated financial statements, rather than parent-only financial statements, have been used in the US since the early 1900s. (The term *parent-only financial statements* is used in this paper to refer to financial statements prepared for a parent entity in which information is presented about the parent's net investment in its subsidiaries, and returns on that investment, rather than the underlying assets, liabilities and activities of those subsidiaries.) In the UK, consolidated financial statements were introduced in the 1920s, as a supplement to parent-only financial statements.[*] In continental Europe, consolidated financial

[*] R G Walker, *An Evaluation of the Information Conveyed by Consolidated Statements*, Abacus, December 1976, page 77.

statements were commonly presented by the 1980s. (The Seventh Directive, issued in 1983 by the Council of the European Communities, sets out various requirements relating to the presentation of consolidated financial statements.[*])

33 In general, the concept of control has been used as the basis for determining which entities should be included in group financial statements, with a group comprising a controlling entity and other entities under its control.

34 Even though there is a long-established practice of preparing consolidated financial statements, questions continue to arise about that practice, including questions that are relevant to the conceptual framework project. One such question is whether control is the most appropriate basis for determining the composition of a group reporting entity, or whether another basis should be adopted.

35 Section 1 of this discussion paper explains the boards' preliminary view that a reporting entity should be broadly described as a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers. Given that an entity may have a variety of interests in, or relationships with, other entities, there are likely to be various approaches to circumscribing that area of business activity. However, it would not be an efficient or effective use of the boards' resources to explore every conceivable approach. Therefore, the boards focused on three approaches that seem reasonable candidates, either because they are similar to the approach in use today (such as the controlling entity model) or because they have been suggested as a replacement for that approach (such as the risks and rewards model).

36 When considering alternatives to the approach in use today, the boards focused on whether those alternatives were likely to be an improvement on the current approach. An improved approach would be one that better meets the objective of general purpose financial reporting by providing more useful information to present and potential equity investors, lenders and other capital providers. This assessment would help determine whether developing an alternative approach, which may take considerable time and effort, would be a worthwhile use of the boards' resources.

37 The following approaches are discussed in this paper:

(a) the controlling entity model

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[*] The Seventh Directive is available on the Website *www.eur-lex.europa.eu*. Refer to Celex document number 31983L0349.

(b) the common control model

(c) the risks and rewards model.

38 Because two of these approaches involve control, two issues are first considered:

(a) the meaning of control, in the context of one entity having control over another entity

(b) the relationship between control in this context and control in the context of the definition of assets in the boards' existing conceptual frameworks.

Control over an entity—what does control mean?

39 The following paragraphs discuss the meaning of control in the context of one entity having control over another entity. Because control has been used in this context for financial reporting purposes in many jurisdictions, the discussion draws upon definitions of control found in financial reporting standards, conceptual frameworks and relevant financial reporting legislation. The term control is also used in the definition of assets in the boards' existing conceptual frameworks. The relationship between control in this context and in the context of control over another entity is discussed in paragraphs 51–62.

40 In its ordinary sense, control is defined as follows:

> The fact of controlling, or of checking and directing action; the function or power of directing and regulating; domination, command, sway. [Oxford English Dictionary, Second Edition, 1989.]

41 Therefore, control may be viewed as a synonym of power, in particular, the power to direct something. Indeed, some accounting definitions define control as a synonym of power. For example, the handbook of the Canadian Institute of Chartered Accountants defines control of another entity as '... the continuing power to determine its strategic operating, investing and financing policies without the co-operation of others.'[*] Similarly, in Belgian accounting legislation, control is defined as '... power de jure or de facto to exercise a decisive influence on the appointment of the majority of the board of directors or general management or the orientation of an enterprise.'[†]

* CICA Handbook, Section 1590, *Subsidiaries*, paragraph .03.

† Belgian Accounting Legislation 1990, Article 2, paragraph 1.

42 However, most accounting definitions of control refer not only to power over another entity, but also to benefits obtained from that entity (as does the explanatory material accompanying the Canadian definition). For example:

> *Control* is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.*
>
> The term "control" means the ability to affect the course of financial or management policies of an entity, or businesses constituting an entity, so as to benefit from the activities of such entity or businesses.†
>
> "Control" by one entity over another entity exists in circumstances where the following parts (a) and (b) are both satisfied:
>
> (a) the first entity has the capacity to determine the financing and operating policies that guide the activities of the second entity ...
>
> (b) the first entity has an entitlement to a significant level of current or future ownership benefits, including the reduction of ownership losses, which arise from the activities of the second entity.§

43 The UK Accounting Standards Board's *Statement of Principles for Financial Reporting* (SoP) explains the meaning of control, both in general and in the context of control of another entity. In both cases, the ability to benefit is a necessary component of control:

> Control has two aspects: the ability to deploy the economic resources involved and the ability to benefit (or to suffer) from their deployment. To have control, an entity must have both these abilities.
>
> An entity will have control of a second entity if it has the ability to direct that entity's operating and financial policies with a view to gaining economic benefit from its activities.ø

44 The reason for including the ability to benefit, rather than simply defining control as a synonym for power, is to exclude situations in which an entity might have power over another entity but only as a trustee or agent. For example, the SoP, after defining control as requiring both the

* IAS 27 *Consolidated and Separate Financial Statements*, paragraph 4; Ministry of Finance, People's Republic of China, Accounting Standard for Business Enterprises No. 33 *Consolidated Financial Statements* (CAS 33), Article 6.

† Business Accounting Council, Japan, *Accounting Standards for Business Combinations*, Section II, paragraph 2.

§ Financial Reporting Standards Board, New Zealand Institute of Chartered Accountants, FRS-37 *Consolidating Investments in Subsidiaries* (NZ FRS-37), paragraph 4.13.

ø SoP, paragraphs 2.8 and 2.11.

ability to deploy economic resources and the ability to benefit from their deployment, explains:

> This can be contrasted with the position in a trusteeship or agency arrangement, where the abilities are held by different parties. For example, in a trusteeship, the trustee ... has the power to deploy the trust's resources whilst the beneficiaries benefit from their deployment.[*]

45 Of course, a trustee or an agent might have the ability to obtain some benefits, such as a commission or fee. However, the primary responsibility of a trustee or an agent is to use its power over another entity not to benefit the trustee or agent, but to benefit the trust's *beneficiaries* or agent's *principal*. Hence, most definitions of control link power with benefits, so that control entails an entity using its power for its *own* benefit.

46 In addition, most accounting definitions of control refer to *benefits*[†] or to *economic benefits*[§] rather than to specific types of benefits. Similarly, any accompanying explanatory material does not limit benefits or economic benefits to particular types of benefits. For example, the Canadian definition refers to economic benefits and provides examples comprising dividends, interest, fees, royalties, and profits on inter-company sales.[ø]

47 Furthermore, existing definitions of control typically do not specify any minimum level of economic benefits that is required to satisfy the benefits element of the control definition.[‡] A possible exception is control in the context of special purpose entities, because some accounting standards refer to the majority of benefits in such situations. This issue is considered in paragraphs 71–79.

48 The boards' preliminary view is that existing accounting literature provides a reasonable basis for a definition of control. In particular, the boards' preliminary view is that control should not be based upon power alone, but also should include the ability to benefit from that power (or to reduce the incidence of losses). The boards' preliminary view is based on the objective of general purpose financial reporting. If one entity has power over another entity, but not the ability to benefit from that power, it would be unlikely that the two entities represent a circumscribed area of business activity of interest to equity investors, lenders and other capital providers. Without the ability to benefit, the first entity's interests in, or

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* SoP, paragraph 2.9.

† Examples include IAS 27 and accounting standards in China and Japan.

§ Examples include accounting standards in Canada and the UK.

ø CICA Handbook, Section 1590, paragraph .04.

‡ Examples include the SoP, IAS 27 and accounting standards in Canada, China, Japan and the UK.

relationships with, the other entity are unlikely to have a significant effect on the first entity's resources, claims on those resources, and the transactions and other events and circumstances that change those resources and claims.

49 The boards also noted that if control is used as the basis for determining the composition of a group reporting entity, control would be a key component of the reporting entity concept. Therefore, the boards' preliminary view is that control should be defined at the conceptual level. A working definition of control is set out below:

> Control of an entity is the ability to direct the financing and operating policies of an entity, so as to access benefits from that entity (or to reduce the incidence of losses) and increase, maintain or protect the amount of those benefits (or reduce the amount of those losses).

50 The boards also considered other issues relating to the control concept, which are discussed in Section 4.

Relationship between the control concept in the context of control over another entity and in the context of the asset definition

51 The concept of control is used both in the definitions of assets in existing conceptual frameworks and in accounting standards for determining the composition of a group reporting entity.

52 Assets are defined in terms of 'things' the entity controls, variously described as resources, economic resources, future economic benefits, or rights to future economic benefits. Control (in some form) is also used to determine the composition of a group reporting entity; a group reporting entity comprises the controlling entity and other entities under its control.

53 The fact that the control concept is used in two contexts raises questions about the relationship between the two. For example, if control is used in the asset definition, does that imply that control must also be used as the basis for consolidation? This question raises another question—is the asset definition relevant to determining the composition of a group entity?

54 Some argue that the boundary of a reporting entity should be determined by the extent of its control over assets—both assets under its direct control and assets under its indirect control, through its control of other entities. Under this view, it seems that the control concept must be used to determine the composition of a group entity—otherwise, recognising a

second entity's assets in the first entity's financial statements would result in the first entity reporting items that are not under its control and, therefore, do not meet the definition of an asset.

55 Furthermore, under this view, it seems that any change to the asset definition might also change the composition of a group entity. Thus, under this view, the boards would need first to define assets. Then, it would be a matter of considering when the assets of one entity are also the assets of another entity. For example, if one entity has an investment or interest in another entity, it would be a matter of considering whether the rights arising from holding that investment or interest, together with any other relevant facts or circumstances, result in the first entity having control over the second entity's assets.

56 Indeed, under this view, it *appears* there may be no need to determine when two or more *entities* should be presented as a single unit. Rather, all that is required is guidance on how to apply the asset definition.

57 However, the asset definition in existing conceptual frameworks (and in the work to date in the elements phase of the boards' conceptual framework project) refers to an 'entity'. Thus, it would be circular to use the asset definition to determine what constitutes the 'entity'. The same reasoning also applies to the definition of liabilities and other elements.

58 Also, for something to meet the definition of an asset, it must be associated with a particular entity. Hence, each particular 'asset' is an asset of a particular entity. It follows that, in concept, the only way for two entities to report the *same* items as assets is for one entity to be part of the other entity. In other words, one *entity* is subsumed within the other entity.

59 In turn, for it to be reasonable to regard one entity as being part of another entity when the second entity has its own legal existence (as is commonly the case), there must be some basis for disregarding the legal boundary between the two entities. (Disregarding the legal boundary is also important in the context of liabilities. For example, typically, a parent entity is not obliged to transfer cash or other assets to creditors of a subsidiary entity. However, when the legal boundary between the two entities is disregarded, the subsidiary's creditors are part of the liabilities of the group reporting entity.)

60 At present, control over another entity provides the basis for disregarding the legal boundary between the entities concerned. For example, before being able to conclude that one entity has control over another entity's assets, one must first conclude that the first entity has control over the

second *entity* and therefore it is appropriate to disregard the legal boundary between the two entities. In the absence of such a conclusion, it would be conceptually inconsistent for two entities each to report the same assets.

61 Therefore, although it might appear that the control concept in the asset definition is driving the determination of the composition of a group reporting entity, in fact it is the relationship between the two *entities* that is the determining factor.

62 Accordingly, the boards' preliminary view is that the reporting entity concept should first determine what constitutes the 'entity' that is reporting, and only then should the asset definition (and other element definitions) be applied to *that* entity. Hence, it is not necessary for the basis for determining the composition of a group reporting entity to be aligned with the asset definition—it would be possible to do so, but it is not necessary.

Determining the composition of a group reporting entity

63 The following paragraphs discuss three potential approaches to determining the composition of group reporting entity for financial reporting purposes:

(a) the controlling entity model

(b) the common control model

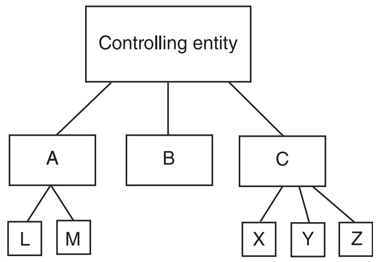
(c) the risks and rewards model.

Controlling entity model

Overview and general discussion

64 In this model, the area of business activity is circumscribed by the extent of an entity's control over other entities, with control defined as set out in paragraph 49 above. Hence, a group reporting entity comprises the controlling entity (ie the parent) and other entities under its control (ie its subsidiaries).

65 For example, consider the following group of entities:



66 The following combinations of entities would be possible group reporting entities under the controlling entity model:

(a) The group comprising the ultimate controlling entity and all the other entities (ie A, B, C, L, M, X, Y and Z)

(b) A + L + M

(c) C + X + Y + Z

67 Thus, one group reporting entity might be a part of another group reporting entity. This is because, as discussed in Section 1, the boards' preliminary view is that a reporting entity could be a component of another, larger entity.

68 In the boards' preliminary view, the controlling entity model is consistent with the objective of financial reporting. That objective is to provide information that is useful to present and potential equity investors, lenders and others creditors in making decisions in their capacity as capital providers (based upon the boards' tentative conclusions in the first phase of the conceptual framework project, as set out in the exposure draft *An improved Conceptual Framework for Financial Reporting: Chapter 1: The Objective of Financial Reporting and Chapter 2: Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information*). To help achieve that objective, financial reporting should provide information about the entity's resources, claims on those resources, and the effects of transactions and other events and circumstances that change resources and claims on them. When one entity has control over another, the first entity has the ability to direct the other entity's financing and operating policies, so as to access benefits flowing from that entity (or to reduce the incidence of losses), and to increase, maintain or protect the amount of those benefits. The cash flows and other benefits flowing from the subsidiary to the parent, and ultimately to the parent's capital providers, depend significantly on the subsidiary's activities and the parent's actions in directing those activities.

69 Therefore, in this situation, group financial statements would provide useful information to equity investors, lenders and other capital providers of the controlling entity.

70 However, some question whether the controlling entity model works well in the context of what are commonly referred to as 'special purpose entities' (SPEs), being entities that have a narrow and well-defined purpose.[*]

Application of the controlling entity model to SPEs

71 It could be argued that when accounting for SPEs, current accounting standards seem more consistent with a risks and rewards model than a controlling entity model. This is because current accounting standards focus on who benefits and who bears risks, rather than who has power over the entity. It could be argued that this indicates that the controlling entity model is flawed, because it has to be supplemented by another model when accounting for SPEs. (The relationship between the controlling entity model and the risks and rewards model, including the overlap between the two, is discussed in paragraphs 102 and 103.)

72 However, the boards noted that there is another way of looking at this issue. As explained earlier, having control over another entity involves not only power over that other entity, but also the ability to obtain benefits.

73 In the case of special purpose entities, the SPE may have predetermined financing and operating policies. In this situation, it may seem that no one—including the entity that established the SPE or the SPE's own 'management' (or administrators)—has the ability to direct the financing and operating policies of the SPE, except perhaps to a very limited extent.

74 This differs from the situation in which power and benefits are clearly separated because they are held by different parties. For example, the trustees of a trust may have the ability to direct the financing and operating policies of the trust, whereas the ability to benefit from the activities of the trust lies with the beneficiaries. In contrast, for an SPE with predetermined financing and operating policies, the issue is not the separation of power and benefits but rather determining whether power exists and with whom power lies.

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* For a discussion of special purpose entities, refer to SIC Interpretation 12 *Consolidation—Special Purpose Entities*.

75 When there is little observable evidence for ascertaining whether power exists or with whom power lies, accounting standards may look to or emphasise the ability to obtain benefits (or exposure to risk) to determine whether the SPE is controlled by another entity.

76 For example, SIC-12 *Consolidation—Special Purpose Entities* lists circumstances that may indicate a relationship in which an entity controls an SPE:

(a) in substance, the activities of the SPE are being conducted on behalf of the entity according to its specified business needs so that the entity obtains benefits from the SPE's operation;

(b) in substance, the entity has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an 'autopilot' mechanism, has delegated these decision-making powers;

(c) in substance, the entity has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incident to the activities of the SPE; or

(d) in substance, the entity retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.*

77 In these circumstances, the focus is on benefits or risks rather than power, and on the majority of benefits or risks. A similar notion is applied in FASB Interpretation No. 46R *Consolidation of Variable Interest Entities*. This Interpretation requires consolidation of a variable interest entity (VIE) in specified circumstances, including when the parent lacks the ability (through voting rights or similar rights) to make decisions about the VIE's activities that have a significant effect on the success of the VIE, but is the primary beneficiary of the VIE.

78 One reason why accounting standards focus on the majority of benefits (or risks) in the case of SPEs is that there is an underlying assumption that whichever entity is entitled to the majority of benefits (or exposed to the majority of risks) is likely to be the one in control. It is unusual to have a majority stake in another entity without some capacity to protect that stake. Hence, although it might otherwise not be apparent that the major beneficiary has the ability to direct the financing and operating policies of the second entity, the holding of such a stake may indicate that the major beneficiary has that ability.

* SIC-12, paragraph 10.

79 On balance, the boards' preliminary view is that the difficulties encountered in practice when applying the controlling entity model to SPEs do not necessarily indicate that the *concept* is flawed. However, before drawing any conclusions on the merits or otherwise of the controlling entity model, the boards considered some alternative approaches to determining the composition of a group reporting entity.

Common control model

Introduction

80 In some circumstances, *combined* financial statements are prepared, which combine the results and activities of two or more commonly controlled entities. In contrast to consolidated financial statements, combined financial statements do not include the controlling party (ie the parent) as part of the group reporting entity. For example, ARB No. 51 *Consolidated Financial Statements* discusses when combined financial statements of commonly controlled entities could be presented, such as when two or more entities are controlled by an individual or under common management.[*] Also, the IASB's exposure draft of a proposed *IFRS for Small and Medium-sized Entities* proposes that the presentation of combined financial statements should be permitted, but not required, for two or more entities controlled by a single investor.[†]

81 These references to combined financial statements in existing or proposed financial reporting standards raise the question whether a common control model should be developed, whereby a group reporting entity—a circumscribed area of business activity of interest to equity investors, lenders and other capital providers—would comprise entities under the control of the same controlling entity or body.

Entities controlled by an individual investor or family

82 Some argue that a common control model should be developed because it would allow for the possibility of preparing group general purpose financial reports, even though the controlling entity might not be required (or choose) to prepare such reports. For example, suppose that there are five corporations, all controlled by an individual investor. That individual investor might not be required (or choose) to prepare general purpose financial reports. A similar situation might arise when the corporations are controlled by a group of people, such as a family, with no single family member holding a controlling interest in the corporations.

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* ARB 51, paragraph 17.

† IASB exposure draft, paragraph 9.21.

83 In these situations, some argue that the presentation of group financial statements, which combine the assets, liabilities and activities of all the entities under the common control of an individual investor or family, would provide useful information to capital providers. Such financial statements, for example, would provide useful information to lenders that have advanced funds to the corporations concerned, especially if the same lender has advanced funds to several or all of the corporations. Even when that is not the case, being a part of a commonly controlled group may significantly affect the resources and claims on those resources of a particular entity's creditors and other capital providers. An example is when there is a significant degree of interaction or integration between the commonly controlled entities. Therefore, in the absence of consolidated financial statements, the presentation of combined financial statements may provide useful information to capital providers, in addition to that provided in a particular corporation's individual financial statements.

84 Furthermore, some argue that, in these situations, the combined financial statements of the commonly controlled corporations would provide *more useful* information than the consolidated financial statements of the individual investor or family. They argue that the consolidated financial statements would include the investor's or family's personal assets, liabilities and activities, in addition to the business assets, liabilities and activities of the commonly controlled corporations. Thus, those financial statements may not provide useful information to capital providers. For example, family members not involved in the management of the corporations would probably want information about the corporations' combined financial performance and financial position, as distinct from information about their and other family members' personal income, financial position, and other, unrelated business interests. This would help them to assess, for example, the amounts, timing and uncertainty of cash flows from the corporations, such as dividends. (However, others argue that the boundary of the reporting entity should be drawn by distinguishing between the family's common business interests and the other business and non-business interests of family members. This would be similar to the financial statements for a partnership, which distinguish between the common business interests of the partners and their other business and non-business interests.)

85 The above discussion focuses on situations in which there are entities under the common control of an individual investor or family. In the context of general purpose financial reporting, some would permit the presentation of combined financial statements for a group of entities

under common control in this type of situation only. In particular, they would permit the combination of all entities under the control of an individual investor, family, or other controlling entity, whose only business assets comprise their investments in the controlled entities. However, they would rule out the presentation of combined financial statements for entities that are under the common control of an entity that has business assets, liabilities or activities other than its investments in its subsidiaries, for the reasons explained below.

86 If the investor's only business assets were the investments in the controlled entities, there would be no difference between the business assets, liabilities and activities presented in:

(a) the combined financial statements of the entities under common control; and

(b) the consolidated financial statements of the controlling entity.

87 This is because, in the consolidated financial statements of an individual investor, the individual's investments in the subsidiary entities would be eliminated upon consolidation. Hence, if that individual has no other business assets, liabilities and activities, then there would be no difference between the business assets, liabilities and activities included in the two types of financial statements.

88 In contrast, if the individual investor had other business assets, liabilities and activities, the exclusion of the controlling entity from the group reporting entity would result in there being a difference between the business assets, liabilities and activities included in the consolidated financial statements of the individual investor and in the combined financial statements of the entities under common control.

89 In essence, those who support the use of the common control model in only these limited circumstances (ie when the investor's only business assets consist of investments in controlled entities) regard the common control model as an *exception* to the controlling entity model, rather than as the primary basis for determining the composition of a group entity. Moreover, that exception is regarded as being appropriate only when the combined financial statements for entities under common control would provide information about the same business assets, liabilities and activities as would be included in the consolidated financial statements of the controlling entity. Thus, the common control model would be used as a substitute for the controlling entity model in these limited circumstances.

Applying the common control model in other circumstances

90 In contrast to the discussion above, some support a more broadly applicable common control model. In particular, they argue that combined financial statements for two or more entities under common control would provide useful information to equity investors, lenders and other capital providers when those entities are managed together as a single unit. For example, suppose a parent entity has two subsidiaries that operate in the same industry and have the same management, and that the net assets of the two subsidiaries are managed together in a highly integrated and synergistic manner. Suppose also that there are external equity investors, lenders or other capital providers with a financial interest in one or both subsidiaries. In this situation, it is argued that combined financial statements would provide useful information to those capital providers. This conclusion holds, even though some—perhaps many—of the equity investors, lenders and other capital providers have claims against only one of the subsidiaries. The degree of integration and interaction between the two subsidiaries means that the returns to each subsidiary's capital providers are generated by the two subsidiaries' combined business operations. Thus, information in the combined financial statements would help these capital providers assess the amounts, timing and uncertainty of cash flows to them, such as dividends and interest.

91 In essence, the above argument is based upon an extension of the rationale underlying the controlling entity model. Under the controlling entity model, when one entity has control over another entity, the boundary between the two entities is disregarded. Instead, the two entities are regarded as a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers. Similarly, when two entities under the control of the same parent entity are managed together in the manner described above, the combined operations of the two entities are a circumscribed area of business activity of interest to existing and potential equity investors, lenders and other capital providers.

The boards' preliminary views on the controlling entity model and common control model

92 The boards' preliminary view is that, overall, the controlling entity model is *more* consistent with the objective of financial reporting than is the common control model. They noted that when one entity has control over another entity, the first entity has the ability to direct the other entity's

financing and operating policies, so as to access benefits flowing from that entity (or to reduce the incidence of losses), and to increase, maintain or protect the amount of those benefits. The cash flows and other benefits flowing from the subsidiary to the parent, and ultimately to the parent's equity investors, lenders and other capital providers, depend on the subsidiary's activities and the parent's actions in directing those activities. Thus, disregarding the legal boundary between the parent and subsidiary, and presenting information about them as a single unit—a circumscribed area of business activity—provides useful information to present and potential equity investors, lenders and other capital providers of the controlling entity.

93 However, the boards also think that there are occasions when combined financial statements of commonly controlled entities would provide useful information to equity investors, lenders and other capital providers of the controlled entities, such as the situations described above in the discussion of the common control model. In these situations, the boards noted that two factors are present:

(a) the entities are controlled by the same parent entity; *and*

(b) other circumstances exist that support the conclusion that the commonly controlled entities should be regarded as a circumscribed area of business activity of interest to equity investors, lenders and other capital providers (such as the circumstances discussed in paragraphs 82–91).

94 Hence, under the common control model, the existence of a controlling entity is a necessary, but not sufficient, factor in determining whether the commonly controlled entities represent a circumscribed area of business activity of interest to equity investors, lenders and other capital providers. Other circumstances must also exist. This contrasts with the controlling entity model, for which the boards' preliminary view is that the existence of the controlling entity is both necessary and sufficient for that entity and other entities under its control to be regarded as a circumscribed area of business activity of interest to equity investors, lenders and other capital providers.

95 Overall, because the controlling entity model is more consistent with the objective of financial reporting than is the common control model, the boards' preliminary view is that the controlling entity model should be used as the *primary* basis for determining the composition of a group reporting entity. However, because there are occasions when application of the common control model would provide useful information to equity investors, lenders and other capital providers, the conceptual

framework chapter on the reporting entity should also include discussion of the common control model. It would be determined at the standards level when the common control model should (or may) be applied. For example, it would be necessary to determine if the common control model should be applied in limited circumstances only, such as those discussed in paragraph 85, or should be more broadly applicable, as discussed in paragraphs 90 and 91.

Risks and rewards model

96 When reaching the preliminary views described above, the boards also considered another approach, referred to here as the risks and rewards model.

Factors to consider in developing a risks and rewards model

97 The boards noted that some have suggested that two entities should be combined into a group reporting entity when the activities of the second entity affect the wealth of the residual shareholders (or residual claimants) of the first entity.

98 However, the boards noted that, without refinement, such a broad and undefined notion is unlikely to be workable. The nature of a residual interest is such that the activities of virtually every other entity with which an entity conducts business have the potential to affect that entity and the wealth of its residual shareholders. For example, the activities of an entity's major customers could have a significant effect on it and hence its residual shareholders if, say, the customers withdrew their business or became bankrupt. Similarly, a major supplier with pricing power can affect the entity. This notion would seemingly lead to some suppliers including major customers in their financial statements and perhaps the same major customers including those suppliers in their financial statements.

99 Therefore, if this idea were pursued, it would be necessary to narrow the notion or define it more precisely, perhaps by identifying some relevant factors. Consistency with the objective of financial reporting suggests looking for a relationship in which the activities of one entity affect the amounts, timing and uncertainty of the net cash inflows of another entity. This occurs, for example, when one entity has provided capital to another entity. It would then be necessary to define capital and perhaps

narrow the notion further to particular types of capital with specific characteristics. Otherwise, for example, a bank would be required to prepare group financial statements that included every entity to which it had lent funds.

100 For example, the following factors could be considered:

(a) The nature of the financial interest, in particular, whether it exposes the first entity to risks and rewards, such as a 'residual' or an 'ownership' interest. One way of doing this would be to link it to the distinction between liabilities and equity, whereby the relevant types of capital would be those that give the first entity an equity interest in the second entity. (This is simply a suggestion—distinguishing between liabilities and equity is itself a difficult and complex topic.)

(b) The extent of exposure to risks and rewards. Considering this factor gives rise to a series of questions that would need to be addressed. For example, does the first entity need to be the 'major beneficiary' of the second entity? What if there is no single major beneficiary, but the first entity's interest in the second entity is a significant investment from the perspective of the first entity? Depending on the relative size of the entities involved, owning 5 per cent of the shares in the second entity could be a major investment of the first entity. Should the focus instead be on when the first entity is entitled to a 'significant' amount of benefits (or exposed to a 'significant' level of risk) and, if so, should 'significance' be assessed from the perspective of the first entity or the second entity, or perhaps both?

101 The boards did not attempt to answer these questions. Rather, they noted that these questions are examples of issues that would need to be addressed if the idea of adopting a risks and rewards model were pursued. Addressing these issues would be worth while only if the boards concluded that the risks and rewards model seems a viable approach to determining the composition of a group entity.

Relationship with the controlling entity model

102 The earlier discussion of the controlling entity model noted that the notion of risks and rewards is relevant to that model. In the context of SPEs, whenever it is difficult to determine who has power over an entity, accounting standards focus on risks and benefits (ie rewards) to determine whether the first entity controls the second entity.

103 Hence, there is some overlap between the controlling entity model and the risks and rewards model, in that the two models have some aspects in common. However, the risks and rewards model has the potential to be both broader and narrower than the controlling entity model for the following reasons:

(a) It is broader because it does not require that the first entity have power over the second entity. Hence, it could result in entities being combined when the first entity does not have that power, not only when it is unclear with whom power lies (as might be the case with SPEs), but also when another entity clearly has that power.

(b) It could be narrower because it may require a focus on particular types of risks and rewards, such as risks and rewards arising from a residual or ownership interest, rather than risks and rewards generally, and may require a minimum level of risks and/or rewards to be specified, such as when the first entity has an entitlement to a majority or 'significant' amount of those rewards or exposure to the majority of risk.

The boards' preliminary views on the risks and rewards model

104 The boards' preliminary view is that the risks and rewards model does not provide a conceptually robust basis for determining the composition of a group reporting entity. The basic idea is so broad that, in order to place what seem like reasonable and necessary limits on which entities should be included in the group, it would be necessary to develop criteria that would involve drawing some bright lines, such as the minimum level of exposure to risks or entitlement to rewards. It might also be necessary to develop criteria for determining whether exposure to risks is more or less important than entitlement to rewards, if there are differences between the extent of an entity's exposure to risks and entitlement to rewards. Although *applying* the controlling entity model might require bright lines to be drawn at the standards level, conceptually it is much more definitive—a control relationship either exists or it does not. The fact that there can be difficulties in practice determining whether power exists does not negate this conclusion at the conceptual level. In the boards' preliminary view, difficulties in determining whether power exists are similar to difficulties in determining whether an asset or a liability exists. In contrast, the risks and rewards model would require bright lines to be drawn at the conceptual level, which the boards found undesirable.

105 Moreover, the lack of a well-defined concept under the risks and rewards model would make it even more difficult to develop principle-based accounting standards to apply that model.

Questions for respondents

Question 3

Do you agree that the risks and rewards model does not provide a conceptually robust basis for determining the composition of a group reporting entity and that, except to the extent that it overlaps with the controlling entity model (as discussed in paragraphs 102 and 103), the risks and rewards model should not be considered further in the reporting entity phase of the conceptual framework project? If not, why?

Question 4

Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that:

(a) control should be defined at the conceptual level?

(b) the definition of control should refer to both power and benefits?

If not, why? For example, do you have an alternative proposed definition of control?

Question 5

Do you agree that the composition of a group reporting entity should be based on control? If not, why? For example, if you consider that another basis should be used, which basis do you propose and why?

Question 6

Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that the controlling entity model should be used as the primary basis for determining the composition of a group entity? If not, why?

Question 7

Do you agree that the common control model should be used in some circumstances only? If not, why? For example, would you limit the composition of a group reporting entity to the controlling entity model only? Or would you widen the use of the common control model? If you support the use of the common control model, at least in some circumstances, do you regard it as an exception to (or substitute for) the controlling entity model in those circumstances, or is it a distinct approach in its own right? Please provide reasons for your responses.

Section 3: Parent entity financial reporting

106 This section considers two issues relating to the general purpose financial reports of a parent entity:

(a) the parent company approach to consolidated financial statements.

(b) parent-only financial statements and consolidated financial statements—determining which set of financial statements meets the objective of general purpose financial reporting, and whether both sets are needed for that purpose.

The parent company approach to consolidated financial statements

107 In the first phase of the boards' conceptual framework project (phase A), on the objective of financial reporting and the qualitative characteristics of financial reporting information, the boards considered two perspectives from which information in general purpose financial reports might be presented, referred to as the entity perspective and the proprietary perspective. The boards decided that general purpose financial reports should reflect the entity's perspective rather than the owners' (ie proprietors') perspective. The reasons for that decision are explained in the Basis for Conclusions in the exposure draft for phase A. In discussions about the parent company approach to consolidated financial statements, some compare the approach with the proprietary perspective and the entity perspective. These two perspectives are briefly outlined below, followed by a comparison with the parent company approach.

108 Under the proprietary perspective, no distinction is drawn between the entity and its owners—the entity does not exist separately from the owners. The resources of owners remain their resources and do not become resources of an entity because the entity does not exist separately from its owners. Lenders and other creditors provide economic resources to the owners of an entity in exchange for a claim against the resources that would otherwise accrue to the benefit of the owners. In other words, the claims of lenders and other creditors reduce the owners' equity in the resources associated with the reporting entity. Thus, the proprietary perspective places the owners in the central position of financial reporting. Assets represent resources of the owners, liabilities are debts or obligations of the owners, and revenues and expenses represent changes in the net residual of owners' equity.

109 In contrast, under the entity perspective the entity exists separately from its owners. This separate existence is supported by legislation in the case of corporations. However, the entity perspective is not only applicable to corporations. Under the entity perspective, economic resources provided by owners or other capital providers become resources of the entity and cease to be resources of the owners or other capital providers. In exchange for the resources provided, capital providers are granted claims on the economic resources of the reporting entity. Thus, the entity is the focus of financial reporting, rather than its owners or others who have an interest in it. For example, the financial statements focus on information about the entity's economic resources (ie *its* assets), claims on those resources (eg *its* liabilities and equity interests), and the effects of transactions and other events and circumstances that change the entity's resources and claims on them (eg *its* revenues and expenses).

110 As noted by Baxter and Spinney (1975), the parent company approach falls somewhere between these two perspectives; it evolved from accounting practice, as a means of explaining and codifying existing consolidation practices.[*] For example, under the proprietary perspective, a proportionate consolidation method is applied if the parent company does not own 100 per cent of the subsidiary. The consolidated financial statements include only the investor's proportionate share of the investee's assets and liabilities, including goodwill. In contrast, under the entity perspective, a full consolidation method is applied. The consolidated financial statements included 100 per cent of the investee's assets and liabilities, including goodwill. Traditionally, the parent company approach applied a combination of full and proportionate consolidation. For example, traditionally, the consolidated financial statements included 100 per cent of the investee's assets other than goodwill, but only the investor's proportionate share of goodwill.

111 Similarly, the treatment of non-controlling interests under the parent company approach is somewhere between its treatment under the proprietary and entity perspectives. Under the proprietary perspective, non-controlling interests are excluded from the consolidated financial statements, because only the investor's proportionate share of the investee's assets, liabilities and activities is included. Under the entity perspective, non-controlling interests are included in the consolidated financial statements, and no fundamental distinction is drawn between controlling and non-controlling interests. Under the parent company

* G C Baxter and J C Spinney, *A Closer Look at Consolidated Financial Statement Theory*, CA Magazine (Canada), January 1975, page 32.

approach, non-controlling interests are included in the financial statements, but are distinguished from controlling interests. (For example, traditionally, non-controlling interests were presented outside equity, either as a liability or between liabilities and equity.)

112 The above discussion of the parent company approach and the proprietary and entity perspectives relates to the presentation of consolidated financial statements. For example, the parent company approach provides guidance on the presentation of information about the assets, liabilities, equity, revenue and expenses of the consolidated group, such as how to measure goodwill and other assets and liabilities, and how to present information about non-controlling interests.

113 In some respects, it may seem that the parent company approach is relevant to standards-level issues relating to the presentation of consolidated financial statements rather than to the conceptual issues addressed in the conceptual framework project. For instance, Section 2 of this discussion paper considers the conceptual issue of selecting the appropriate basis for determining the composition of a group reporting entity. The parent company approach does not seem relevant to that issue. For example, the parent company approach does not assist with deciding whether the composition of a group reporting entity should be based on control or on some other basis. Admittedly, some may argue that the parent company approach has *some* relevance, because they argue that consolidation should occur only when the parent has a majority ownership interest in the other entity. However, it is possible to use control to determine which entities should be included in the group, and then apply the parent company approach to consolidation when presenting the financial statements for that group.

114 Although the parent company approach may not assist with determining the composition of a group reporting entity, it has some relevance to the reporting entity phase, because it affects the perspective from which information about a group reporting entity is presented. Under the parent company approach, the presentation of information about the assets, liabilities, revenues and expenses of the consolidated group is intended to reflect the perspective of the parent company's shareholders. For example, traditionally, non-controlling interests were presented outside of equity because non-controlling interests are not shareholders of the parent company and thus were not regarded as having an ownership interest. Similarly, gains and losses were recognised from transactions between the parent company and non-controlling interests because they were regarded as transactions with parties other than owners.

115 As noted in paragraph 107, in the first phase of the boards' conceptual framework project (phase A), the boards decided that financial reports should be presented from the entity's perspective, not from the perspective of one particular group of capital providers. Hence, in the context of a group reporting entity, financial statements are prepared from the perspective of that group, not from the perspective of the parent company's shareholders.

116 Also, legal form is disregarded when presenting information about a group reporting entity under the entity perspective. Instead, the two or more legal entities that make up the group are presented as a single unit. In accounting literature, this treatment of two or more legal entities as a single reporting entity is sometimes referred to as the economic unit concept and is consistent with the entity perspective. In Section 2 of this discussion paper, the controlling entity model, the common control model and the risks and rewards model were considered in the context of determining when two or more entities should be presented as a single unit.

117 Furthermore, the presentation of different types of claims on the group reporting entity's assets, such as controlling and non-controlling interests, depends upon the nature of those claims from the perspective of the group reporting entity. Whether different types of claims should be divided into two (or more) categories, and the basis for distinguishing between those categories, depends upon the outcome of the boards' deliberations on the definitions of elements in another phase of the conceptual framework project (phase B), which is currently under way.

118 Given that the boards have decided to adopt the entity perspective, this may imply that they have rejected the parent company approach in its entirety. However, that is not so. The parent company approach developed as a means of providing useful information to one particular group of capital providers, namely the parent company's shareholders. The entity perspective has a broader focus than the parent company approach because the objective of financial reporting under the entity perspective is to provide useful information to all capital providers, not only one particular group of capital providers. However, that does not mean the information needs of the parent company's shareholders are ignored under the entity perspective. As noted in the exposure draft for phase A and its accompanying Basis for Conclusions, adopting the entity perspective does not preclude including in financial reports information that is primarily directed to the needs of a particular group of capital providers. For example, in the standards recently issued by the boards for their joint project on business combinations, the boards have specified

disclosure requirements relating to non-controlling interests, including requirements to disclose the amount of non-controlling interests separately from controlling interests, and the amount of profit or loss attributable to non-controlling interests.

Question for respondents

Question 8

Do you agree that consolidated financial statements should be presented from the perspective of the group reporting entity, not from the perspective of the parent company's shareholders? If not, why?

Parent-only financial statements and consolidated financial statements

119 In some jurisdictions, when an entity has one or more subsidiaries, it is common for both parent-only financial statements and consolidated financial statements to be presented. In parent-only financial statements, information is presented about the parent's investment in its subsidiaries, and returns on that investment, rather than the underlying assets, liabilities and activities of those subsidiaries. There may be a legal requirement to prepare both parent-only financial statements and consolidated financial statements. Furthermore, there may be a legal requirement for both sets of financial statements to be prepared in accordance with the particular jurisdiction's financial reporting standards.

120 As discussed in Section 2, the boards' preliminary view is that when one entity has control over another entity, the boundary between the two entities should be disregarded, and the two entities regarded as a circumscribed area of business activity of interest to existing and potential equity investors, lenders and other capital providers.

121 Once that area of business activity has been circumscribed, the question becomes how best to meet the information needs of the external users of the group reporting entity's general purpose financial reports. Hence, the boards discussed whether parent-only financial statements or consolidated financial statements should be presented to meet the objective of financial reporting, and whether both sets are needed for that purpose.

122 When considering this issue, two points should be borne in mind. First, it should be noted that the issue concerns the general purpose financial reports of the group reporting entity, not the *subsidiary* entity. As discussed in Section 1, a reporting entity may be a component of another entity. Hence, the subsidiary could be the subject of its own general purpose financial reports. For example, suppose the subsidiary entity has external equity investors (eg non-controlling ordinary shareholders or preference shareholders), lenders or other capital providers that require, but do not have the ability to demand, information about that subsidiary for making decisions as capital providers. Those information needs would be served by preparation of individual financial statements for the subsidiary.

123 Second, the boards noted that some might be concerned about reaching a conclusion that would be inconsistent with legal requirements in particular jurisdictions. However, in the boards' preliminary view, their deliberations should not be bound by current legislative requirements that apply in particular countries. (This is particularly relevant in the case of the IASB, which as an international standard-setting body cannot base its decisions on the legal requirements of particular jurisdictions.) The objective of the project is to develop an improved conceptual framework that provides a sound foundation for the development of high quality financial reporting standards, irrespective of legislative or regulatory barriers to the implementation of those concepts or standards. Therefore, the boards concluded that they should focus on considering the issues at the conceptual level.

124 Considering the issues at the conceptual level involves considering the objective of *general purpose* financial reporting. If financial statements are prepared for a *specific* purpose, then those financial statements may not satisfy the objective of general purpose financial reporting. This might occur, for example, if parent-only financial statements are prepared solely for taxation purposes.

125 However, in some cases, both parent-only financial statements and consolidated financial statements might be made available to a wide range of users, for example, by inclusion in an annual report. In these circumstances, the question is whether one set of financial statements or the other, or both, serve the information needs of present and potential equity investors, lenders and other capital providers. This issue is discussed in paragraphs 126–140.

126 As discussed in Section 2, when one entity has control over another entity, the boundary between the two entities should be disregarded. Instead, the two entities are regarded as a circumscribed area of business activity of interest to equity investors, lenders and other capital

providers. Consolidated financial statements would provide useful information to capital providers because those financial statements present information about all the resources and activities within the boundary of the reporting entity.

127 Furthermore, when one entity has control over another entity, the cash flows and other benefits flowing from the parent to its capital providers often depend significantly on the cash flows and other benefits obtained from its subsidiaries, which in turn depend on the subsidiary's activities and the parent's actions in directing those subsidiaries. Thus, consolidated financial statements, in which the assets, liabilities and activities of the parent and its subsidiaries are presented as a single unit, provide useful information to equity investors, lenders and other capital providers.

128 Some argue that parent-only financial statements also provide useful information. They note that the legal separation between a parent and its subsidiaries can significantly affect the cash flows available to equity investors, lenders and other capital providers of the parent entity. For example, in many jurisdictions, the amount available for distribution as dividends is based upon the parent's distributable profits, including dividends from its subsidiaries, but excluding undistributed profits of the subsidiaries and profits distributed to non-controlling interests. Hence, parent-only financial statements, which distinguish the profits generated by the parent from the profits generated by its subsidiaries, provide information to help equity investors assess the parent's ability to pay dividends. (This point assumes that there is a close relationship between the parent's profits for financial reporting purposes and those for dividend distribution purposes.)

129 Furthermore, lenders and other creditors of the parent typically have a claim against the assets of the parent, not the subsidiaries. Even though the parent has control over the assets of its subsidiaries, typically there are restrictions on the parent's ability to utilise the subsidiaries' assets or access the economic benefits flowing from those assets. These restrictions arise because of legal protections for creditors, non-controlling shareholders, and others with a financial interest in the subsidiaries. Hence, distinguishing assets held directly by the parent from those held indirectly (ie the assets of its subsidiaries) provides information to creditors of the parent about the assets available to settle their claims in the normal course of business. Also, because the subsidiaries' creditors typically do not have claims against the assets of the parent, parent-only financial statements provide useful information about assets that are protected from claims of the subsidiaries' creditors.

130 Thus, some argue that consolidated financial statements and parent-only financial statements *both* provide useful information. Each set of financial statements provides a different perspective on the resources, claims and activities of the parent, and complements the other. Hence, consolidated financial statements and parent-only financial statements together give equity investors, lenders and other capital providers a more complete picture of the resources, claims and activities of the parent.

131 Furthermore, some argue that the usefulness of the information in parent-only financial statements would be enhanced if the parent's investments in its subsidiaries are measured at fair value rather than at cost (or a cost-based measure). For example, for a venture capital parent entity, which holds investments in other entities for capital appreciation purposes, information about that capital appreciation is relevant when assessing the parent entity's financial position and financial performance.

132 In contrast, others argue that parent-only financial statements are potentially misleading, which significantly impairs their capacity to provide useful information to equity investors, lenders and other capital providers of the parent. They argue that parent-only financial statements are incomplete and do not faithfully represent the parent's assets, liabilities and activities. The parent's financial statements should include information about *all* of the assets, liabilities and activities under its control, including those assets, liabilities and activities that it controls through its control of its subsidiaries. That information is contained only in consolidated financial statements. Parent-only financial statements present information about the parent's investment in its subsidiaries, not the underlying assets, liabilities and activities. Some argue that parent-only financial statements therefore *omit* assets, liabilities and activities of the parent. Some others argue that, even though all the parent's assets, liabilities and activities are included in the parent-only financial statements, some of those assets, liabilities and activities are highly aggregated and offset. In both cases, it is argued that the information presented in parent-only financial statements is not a relevant or faithful representation of the parent's assets, liabilities and activities.

133 Furthermore, parent-only financial statements are based on legal form; they reflect the legal boundary between the parent and its subsidiaries. As discussed in Section 2, when one entity has control over another entity, the boundary between the two entities should be disregarded, as occurs when presenting consolidated financial statements.

134 Some also argue that a parent entity has only one set of general purpose financial statements, which are its consolidated financial statements. They argue that only the consolidated financial statements serve the information needs of all capital providers by providing information about all the assets, liabilities and activities under the parent entity's control. In contrast, parent-only financial statements are special purpose financial statements because they serve the information needs of a subset of capital providers.

135 To the extent that parent-only financial statements might provide useful information to capital providers, some argue that information could be provided instead as additional note disclosures in the consolidated financial statements or in other forms of supplementary *information*, rather than in parent-only financial *statements*. For example, if there are restrictions on the flow of dividends from subsidiaries to the parent, that information should be provided in the notes to the consolidated financial statements.

The boards' preliminary views

136 The boards' preliminary view is that consolidated financial statements provide information that is useful to equity investors, lenders and other creditors in making decisions as capital providers. Thus, the boards agreed with the arguments set out in paragraphs 126 and 127 that support the conclusion that when one entity has control over another entity consolidated financial statements are consistent with the objective of general purpose financial reporting.

137 Therefore, the preliminary view of the boards is that a parent entity should always present consolidated financial statements. Those consolidated financial statements include information about the parent's economic resources, claims on resources, and the effects of transactions and other events and circumstances that change those resources and claims on them. How that information should be presented raises issues that relate to other phases of the conceptual framework project. For example, one issue is how to present information about particular components of the reporting entity, such as discontinued operations. In the boards' preliminary view, that issue should be addressed at the standards level and involves applying concepts from other phases of the conceptual framework project, such as the definitions of elements (including the unit of account), measurement, presentation and disclosure, and the qualitative characteristics of financial reporting information.

138 The boards noted that there are differing views about the usefulness of parent-only financial statements, as discussed in paragraphs 128–135. Although some argue that parent-only financial statements provide useful information in addition to that provided in consolidated financial statements, others argue that parent-only financial statements are incomplete and, therefore, potentially misleading.

139 However, the boards also noted that, in practice, parent-only financial statements are often presented in the same general purpose financial report as the consolidated financial statements. If that occurs, concerns about the incompleteness of parent-only financial statements should be allayed. In some respects, parent-only financial statements could be viewed as a form of segment reporting, albeit based on the legal boundary of the parent entity rather than the way in which the entity's activities are managed. However, the boards noted that some regard information presented on the basis of legal boundaries as decision-useful. If that is so, provided that parent-only financial statements are included in the same financial report as the consolidated financial statements, there seems no reason to object to their presentation.

140 Therefore, the boards' preliminary view is that the conceptual framework should not preclude the presentation of parent-only financial statements, provided that they are included in the same financial report as the consolidated financial statements.

Questions for respondents

Question 9

Do you agree that consolidated financial statements provide useful information to equity investors, lenders and other capital providers? If not, why?

Question 10

Do you agree that the conceptual framework should not preclude the presentation of parent-only financial statements, provided that they are included in the same financial report as consolidated financial statements? If not, why?

Section 4: Control issues

141 Section 2 discusses the meaning of control in the context of one entity having control over another. This section discusses other issues relating to the control concept:

(a) determining when one entity has control over another;

(b) control other than by legal rights;

(c) latent control and the treatment of options;

(d) power is not shared with others; and

(e) control, joint control and significant influence.

Determining when one entity has control over another

142 Both the Australian Accounting Standards Board's *Statement of Accounting Concepts 1: Definition of the Reporting Entity* (SAC 1) and the UK Accounting Standards Board's *Statement of Principles for Financial Reporting* (SoP) note that determining when one entity controls another involves an assessment of all the facts and circumstances; there are no single facts or circumstances that demonstrate that an entity has control over another in all cases.[*]

143 Similarly, accounting standards that define control contain discussion of various factors to consider when assessing whether one entity controls another.[†]

144 One exception is ARB No. 51 *Consolidated Financial Statements*, which does not define control or discuss factors to consider when assessing control. Rather, it states:

> The usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one company, directly or indirectly, of over fifty percent of the outstanding voting shares of another company is a condition pointing toward consolidation.[§]

* SAC 1, paragraph 17; SoP, paragraphs 2.12–2.15.

† Examples include IAS 27 and accounting standards in Australia, Canada, China, Japan, New Zealand and the UK.

§ ARB No. 51, paragraph 2.

145 Ownership of a majority of the voting interest is expressed as being the *usual* condition for a controlling financial interest. However, in accounting practice it has often been interpreted as being a *necessary* condition. That is not, however, the view acknowledged by the FASB in 1987 when it said that 'ownership of a majority voting interest … is the most common but not the only means of controlling a subsidiary.'[*]

146 Under other accounting standards, ownership of a majority of the voting interest is not a necessary condition because control can exist through other means. For example, IAS 27 *Consolidated and Separate Financial Statements* lists other situations in which control exists even though the parent owns half or less of the voting power of another entity.[†] Similarly, the SoP notes:

> Although control of another entity has traditionally involved share ownership and voting rights, that need not be the case.[§]

147 The boards observed that different facts and circumstances may be relevant to determining whether one entity has control over another entity at a point in time. Also, because circumstances may change, an assessment of whether control exists should be based on facts and circumstances existing at the time of that assessment. In summary, in the boards' preliminary view, whether one entity has control over another entity involves an assessment of *all* the *existing* facts and circumstances. Furthermore:

(a) there are no single facts or circumstances that evidence that one entity has control over another entity in all cases, nor should any particular fact or circumstances—such as ownership of a majority voting interest—be regarded as a necessary condition for control to exist.

(b) the concept of control does not exclude situations in which control exists but it might be temporary; in other words, the possibility that circumstances might change in the future, and that such a change in circumstances might result in the loss of control, does not affect whether control exists at present.

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* FASB Statement No. 94 *Consolidation of All Majority-Owned Subsidiaries*, paragraph 20.

† IAS 27, paragraph 13.

§ SoP, paragraph 2.12.

Control other than by legal rights

148 The working definition of control in paragraph 49 refers to *the ability* to direct the financing and operating policies of the other entity. There might be situations in which the entity has that ability because of particular circumstances, rather than because of (or solely because of) legal rights held by the entity. (This is sometimes referred to as de facto control or effective control.)

149 As noted in paragraph 147, the boards' preliminary view is that an assessment of whether control exists should be based upon an assessment of all the existing facts and circumstances. Therefore, the boards' preliminary view is that the control concept in the conceptual framework should not be limited to circumstances in which the entity has sufficient voting rights or other legal rights to direct the financing and operating policies of another entity, but rather should be a broad concept that encompasses economically similar circumstances.

150 The boards noted that such a concept may give rise to difficulties when applied in practice. However, any such difficulties, and what might be done to resolve them, are issues to be addressed at the standards level. The existence of practical difficulties does not negate the conclusion that, *in concept*, control should be sufficiently broad to encompass economically similar circumstances, regardless of whether the ability to control is through legal rights or other means.

Latent control and the treatment of options

151 The UK SoP refers to *latent control*, noting that if the entity has the ability to control another entity, the first entity is usually presumed to be exercising control, even if such control is not apparent.[*]

152 Some argue that latent control exists if unilateral action by one entity will place it in control of another, provided that the economic cost of that action is not so high that it would be irrational to take the action. Similarly, accounting standards typically require potential voting rights to be considered when assessing whether control exists.[†]

153 For example, suppose Company A holds options over 100 per cent of the ordinary shares in Company X, which are currently held by Company B. Does this give the option holder the ability to control the entity now?

* SoP, paragraph 2.18.

† For example, IAS 27, CAS 33, Canadian Handbook (Section 1590) and NZ FRS-37.

154 The boards' preliminary view is that, in the absence of other facts and circumstances, Company A does not currently control Company X or the shares in Company X—Company A may have the ability to take control of Company X, but does not have control at present. Moreover, Company B currently controls Company X.

155 In essence, the argument that holding an option, in and of itself, gives the option holder control of the underlying resource over which the option is held is to treat the exercise of the option as inconsequential—it treats the holding of an option and the holding of the underlying resource as the same. However, this misrepresents the relationship between the option holder and the underlying resource. The basic purpose of holding an option is to give the holder choice—whether to acquire the underlying. In the absence of other circumstances, until the option is exercised the option holder does not have control of the underlying resource. Similarly, an option to acquire voting rights in the future does not give the option holder control over those voting rights now.

156 However, the general conclusion that holding an option does not, in itself, give the option holder control of another entity (or the underlying asset, in the case of options over assets), does not rule out the possibility that there could be situations in which the holding of options, taken in conjunction with other facts and circumstances, might result in the option holder controlling the other entity. This is because an assessment of whether one entity has control over another entity should be based on an assessment of all the facts and circumstances.

Power is not shared with others

157 Some accounting standards make it clear that to satisfy the power element of the definition of control, power cannot be shared with others. For example:

> The decision-making capacity that satisfies the power element of control must be unilateral. The capacity cannot be shared or divided such that it enables power to be exercised jointly by two or more partners or co-owners. The ability to participate with others in making decisions that guide the activities of another entity usually characterises joint venture relationships, which are covered under a separate financial reporting standard.*

* NZ FRS-37, paragraph 4.21. For another example, see the Canadian Handbook (Section 1590).

158 The boards found this a helpful clarification of the concept of control. For power to exist, it must be held by one entity only—an entity does not have power over another if it must obtain the agreement of others to direct the financing and operating policies of that other entity. This does not imply that power must be *absolute*—an entity is not required to have total, unrestricted power over another entity's financing and operating policies for power to exist. There are often limits on power that are imposed by law, regulations, fiduciary responsibilities and contractual rights. Those limits or restrictions are usually protective in nature, and do not usually deprive the controlling entity of the ability to direct the operating and financing policies of the controlled entity.[*] Rather, to have the ability to direct another entity's financing and operating policies, the first entity must have that ability itself, rather than in conjunction with others.

Control, joint control and significant influence

159 The boards' preliminary view set out in paragraph 158 contrasts with *joint control*, which includes some notion of shared control, for example:

> Joint control is the contractually agreed sharing of control over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).[†]

160 In joint ventures, in which financing and operating policy decisions require the unanimous consent of the venturers, it might be said that, *as a group*, the venturers control the joint venture. However, none of the individual venturers has control over the joint venture. Therefore, the boards concluded that the relationship between an individual venturer and the joint venture is not a control relationship.

161 Similarly, the boards' preliminary view is that the relationship referred to as 'significant influence' is not a control relationship. In the absence of other facts and circumstances, the fact that an entity might have some influence over the financing and operating policy decisions of another entity does not mean it has control over that entity.

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* See NZ FRS-37, paragraph 4.22; Canadian Handbook, Section 1590, paragraph .14; EITF Issue No. 96-16 *Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*.

† IAS 31 *Interests in Joint Ventures*, paragraph 3.

Questions for respondents

Question 11

With regard to the concept of control, in the context of one entity having control over another, do you agree that:

(a) establishing whether control exists involves assessing all the existing facts and circumstances and, therefore, that there are no single facts or circumstances that evidence that one entity has control over another entity in all cases, nor should any particular fact or circumstances—such as ownership of a majority voting interest—be a necessary condition for control to exist? If not, why?

(b) the concept of control should include situations in which control exists but might be temporary? If not, why?

(c) the control concept should not be limited to circumstances in which the entity has sufficient voting rights or other legal rights to direct the financing and operating policies of another entity, but rather should be a broad concept that encompasses economically similar circumstances? If not, why?

(d) in the absence of other facts and circumstances, the fact that an entity holds enough options over voting rights that, if and when exercised, would place it in control over another entity is not sufficient, in itself, to establish that the entity currently controls that other entity? If not, why?

(e) to satisfy the power element of the definition of control, power must be held by one entity only? In other words, do you agree that the power element is not satisfied if an entity must obtain the agreement of others to direct the financing and operating policies of another entity? If not, why?

(f) that having 'significant influence' over another entity's financing and operating policy decisions is not sufficient to establish the existence of control of that other entity? If not, why?

Question 12

Should any of the above control issues be addressed at the standards level rather than at the concepts level? If so, which issues and why?

Question 13

Are there any other conceptual issues, relating either to the control concept or to some other aspect of the reporting entity concept, that are not addressed in this discussion paper and should be addressed at the concepts level? If so, which issues and why?

List of questions for respondents

Section 1: The reporting entity concept

Question 1

Do you agree that what constitutes a reporting entity should not be limited to business activities that are structured as legal entities? If not, why?

Question 2

Do you agree that the conceptual framework should broadly describe (rather than precisely define) a reporting entity as a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers? If not, why? For example, do you believe that the conceptual framework should establish a precise definition of a reporting entity? If so, how would you define the term? Do you disagree with including reference to equity investors, lenders and other capital providers in the description (or definition) of a reporting entity? If so, why?

Section 2: Group reporting entity

Question 3

Do you agree that the risks and rewards model does not provide a conceptually robust basis for determining the composition of a group reporting entity and that, except to the extent that it overlaps with the controlling entity model (as discussed in paragraphs 102 and 103), the risks and rewards model should not be considered further in the reporting entity phase of the conceptual framework project? If not, why?

Question 4

Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that:

(a) control should be defined at the conceptual level?

(b) the definition of control should refer to both power and benefits?

If not, why? For example, do you have an alternative proposed definition of control?

Question 5

Do you agree that the composition of a group reporting entity should be based on control? If not, why? For example, if you consider that another basis should be used, which basis do you propose and why?

Question 6

Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that the controlling entity model should be used as the primary basis for determining the composition of a group entity? If not, why?

Question 7

Do you agree that the common control model should be used in some circumstances only? If not, why? For example, would you limit the composition of a group reporting entity to the controlling entity model only? Or would you widen the use of the common control model? If you support the use of the common control model, at least in some circumstances, do you regard it as an exception to (or substitute for) the controlling entity model in those circumstances, or is it a distinct approach in its own right?
Please provide reasons for your responses.

Section 3: Parent entity financial reporting

Question 8

Do you agree that consolidated financial statements should be presented from the perspective of the group reporting entity, not from the perspective of the parent company's shareholders? If not, why?

Question 9

Do you agree that consolidated financial statements provide useful information to equity investors, lenders and other capital providers? If not, why?

Question 10

Do you agree that the conceptual framework should not preclude the presentation of parent-only financial statements, provided that they are included in the same financial report as consolidated financial statements? If not, why?

Section 4: Control issues

Question 11

With regard to the concept of control, in the context of one entity having control over another, do you agree that:

(a) establishing whether control exists involves assessing all the existing facts and circumstances and, therefore, that there are no single facts or circumstances that evidence that one entity has control over another entity in all cases, nor should any particular fact or circumstances—such as ownership of a majority voting interest—be a necessary condition for control to exist? If not, why?

(b) the concept of control should include situations in which control exists but might be temporary? If not, why?

(c) the control concept should not be limited to circumstances in which the entity has sufficient voting rights or other legal rights to direct the financing and operating policies of another entity, but rather should be a broad concept that encompasses economically similar circumstances? If not, why?

(d) in the absence of other facts and circumstances, the fact that an entity holds enough options over voting rights that, if and when exercised, would place it in control over another entity is not sufficient, in itself, to establish that the entity currently controls that other entity? If not, why?

(e) to satisfy the power element of the definition of control, power must be held by one entity only? In other words, do you agree that the power element is not satisfied if an entity must obtain the agreement of others to direct the financing and operating policies of another entity? If not, why?

(f) having 'significant influence' over another entity's financing and operating policy decisions is not sufficient to establish the existence of control of that other entity? If not, why?

Question 12

Should any of the above control issues be addressed at the standards-level rather than at the concepts level? If so, which issues and why?

Question 13

Are there any other conceptual issues, relating either to the control concept or to some other aspect of the reporting entity concept, that are not addressed in this discussion paper and should be addressed at the concepts level? If so, which issues and why?