

Statement of Financial Accounting Concepts No. 8
June 2023

Conceptual Framework for Financial Reporting
Chapter 2, *The Reporting Entity*

Copyright © 2023 by Financial Accounting Foundation. All rights reserved. Content copyrighted by Financial Accounting Foundation may not be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of the Financial Accounting Foundation.



Statement of Financial Accounting
Concepts No. 8

June 2023

Conceptual Framework for Financial Reporting

Chapter 2, *The Reporting Entity*

Financial Accounting Standards Board

801 MAIN AVENUE, PO BOX 5116, NORWALK, CONNECTICUT 06856-5116

Statement of Financial Accounting Concepts No. 8

Conceptual Framework for Financial Reporting

Chapter 2, *The Reporting Entity*

June 2023

CONTENTS

	Paragraph Numbers
Chapter 2: The Reporting Entity	RE1–RE14
Introduction	RE1–RE3
Description of a Reporting Entity.....	RE4–RE7
Consolidated Financial Statements.....	RE8–RE9
Parent-Only Financial Statements	RE10
Portion of an Entity.....	RE11–RE13
Combined Financial Statements	RE14
Appendix: Basis for Conclusions.....	BC1–BC12
Introduction	BC1–BC4
Description of a Reporting Entity.....	BC5–BC7
Consolidated Financial Statements.....	BC8
Parent-Only Financial Statements	BC9
Portion of an Entity.....	BC10–BC11
Combined Financial Statements	BC12

Conceptual Framework for Financial Reporting

CHAPTER 2: THE REPORTING ENTITY

Introduction

RE1. The objective¹ of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other resource providers in making decisions about providing resources to the entity. Those decisions involve buying, selling, or holding equity and debt instruments and providing or settling loans and other forms of credit.²

RE2. The concept of the reporting entity was developed in the context of general purpose financial reporting. General purpose financial reporting, which is defined in Chapter 7, *Presentation*, of this Concepts Statement, provides useful financial information about a reporting entity that assists existing and potential resource providers in making resource allocation decisions. In making resource allocation decisions, resource providers form expectations about the reporting entity by evaluating (a) the entity's resources, (b) claims to the entity's resources, and (c) changes in those resources and claims during the period. A full set of financial statements, which is a component of general purpose financial reporting, is the principal way in which a reporting entity provides financial information that accomplishes the objective of general purpose financial reporting.³

RE3. Entities often report information, including financial information, in a variety of forms. Each of those entities could be thought of as a reporting entity. However, in the Conceptual Framework, reference to the reporting entity is in the context of an entity that produces general purpose financial reports.

¹The objective of general purpose financial reporting is described in paragraph OB2 of Chapter 1, *The Objective of General Purpose Financial Reporting*, of this Concepts Statement.

²Paragraphs OB22–OB28 of Chapter 1 of this Concepts Statement provide context for the application of the objective to not-for-profit entities.

³A full set of financial statements, as defined in paragraph PR20 of Chapter 7, *Presentation*, of this Concepts Statement, presents the elements of financial statements and the recognition and measurement related to those elements, including the information presented in paragraph PR18 of Chapter 7.

Description of a Reporting Entity

RE4. A reporting entity is a circumscribed area of economic activities that can be represented by general purpose financial reports that are useful to existing and potential investors, lenders, and other resource providers in making decisions about providing resources to the entity.

RE5. A reporting entity has three features:

- a. Economic activities have been conducted.
- b. Those economic activities can be distinguished from those of other entities.
- c. The financial information in general purpose financial reporting faithfully represents the economic activities conducted within the circumscribed area and is useful in making decisions about providing resources to the reporting entity.

RE6. Identifying the boundaries of the economic activities is necessary to faithfully present the reporting entity's financial information in general purpose financial reporting. General purpose financial reports, including a full set of financial statements, that faithfully represent the economic activities of a circumscribed area enable the reporting entity to achieve the objective of general purpose financial reporting.

RE7. Identifying the reporting entity in a specific situation requires considering the boundary of the economic activities that have been conducted. The existence of a legal entity is not necessary to identify the reporting entity. The reporting entity can include more than one entity, or it can be a portion of an entity.

Consolidated Financial Statements

RE8. If a circumscribed area of economic activities includes a parent-subsidiary relationship, a full set of consolidated financial statements that faithfully represents the circumscribed area's economic activities is necessary to meet the objective of general purpose financial reporting.

RE9. The net cash flows and other benefits to resource providers are dependent on the economic activities of both the parent entity and its subsidiaries. In assessing the prospects of net cash inflows from an investment in a parent entity, resource providers are interested in evaluating the parent entity and its subsidiaries as a single economic unit. A full set of consolidated financial statements, which includes the subsidiaries' (a) resources, (b) claims to those resources, and (c) changes in those resources and claims during the period, completely depicts the economic activities of the parent and its subsidiaries. Consequently, a full set of consolidated financial statements provides a faithful

representation of the circumscribed area's economic activities. Principles of consolidation, including any exception to consolidation in circumstances in which a parent-subsidiary relationship exists, would be made at the standards level.

Parent-Only Financial Statements

RE10. Parent-only financial statements, which in certain situations may be useful or required, do not completely depict the economic activities of a reporting entity that includes a parent-subsidiary relationship and, therefore, are not sufficient to meet the objective of general purpose financial reporting. Parent-only financial statements present subsidiaries as investments and do not depict the subsidiaries' (a) resources, (b) claims to those resources, and (c) changes in those resources and claims during the period. Consequently, parent-only financial statements do not faithfully represent the operating results, financial position, and capital structure of the parent and its subsidiaries as a single economic unit.

Portion of an Entity

RE11. A portion of a larger entity, such as a subsidiary, branch, or division, can represent a circumscribed area of economic activities and, consequently, meet the description and features of a reporting entity in paragraphs RE4 and RE5. A portion of a larger entity would still need to consolidate any of its own subsidiary relationships to meet the objective of general purpose financial reporting, consistent with paragraph RE8.

RE12. For a portion of a larger entity to prepare general purpose financial reports, including a full set of financial statements, it must identify the economic activities of its circumscribed area. Decisions on which economic activities should be attributable to the portion of a larger entity should result in general purpose financial reports that provide a faithful representation of the portion of the larger entity's financial position and performance.

RE13. Based on the needs of intended users, the portion of an entity may prepare financial reports that do not include a full set of financial statements. In those circumstances, the financial reports are special purpose. Because those special-purpose financial reports do not completely depict the portion of an entity's circumscribed area of economic activities, the financial reports would not be considered general purpose financial reporting.

Combined Financial Statements

RE14. Combined financial statements can appropriately depict two or more entities that are under common control or common management, including circumstances in which a parent-subsidiary relationship does not exist. If two or more commonly

controlled or commonly managed entities are combined to represent a circumscribed area of economic activities, the circumscribed area can represent a reporting entity if it can prepare general purpose financial reports. A full set of combined financial statements is consistent with the objective of general purpose financial reporting.

This chapter of Concepts Statement 8 was adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Richard R. Jones, *Chair*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Gary R. Buesser
Frederick L. Cannon
Susan M. Cospers
Marsha L. Hunt

Appendix: Basis for Conclusions

Introduction

BC1. The following basis for conclusions summarizes the Board's considerations in reaching the conclusions in this chapter. It includes reasons for accepting some alternatives and rejecting others. Individual Board members gave greater weight to some factors than others.

BC2. In January 2014, the FASB reactivated its Conceptual Framework project. The following are key historical documents issued on the reporting entity concept:

- a. May 2008—FASB and IASB Discussion Paper, *Preliminary Views—Conceptual Framework for Financial Reporting: The Reporting Entity*
- b. March 2010—FASB and IASB proposed Concepts Statement, *Conceptual Framework for Financial Reporting: The Reporting Entity*
- c. October 2022—FASB proposed Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 2, The Reporting Entity*.

BC3. The term *reporting entity* is used multiple times in existing Concepts Statements, and paragraph OB1 in Chapter 1 of this Concepts Statement explicitly references a concept of the reporting entity. Because the Conceptual Framework is intended to be a coherent system of interrelated objectives and fundamental concepts, there is a need to develop a concept of the reporting entity.

BC4. To be consistent with the objective of general purpose financial reporting, the Board concluded that it was essential for the description of a reporting entity to focus on the notion of a circumscribed area of economic activities. In making resource allocation decisions, resource providers identify a circumscribed area of economic activities that they wish to evaluate for expected returns. To satisfy the informational needs of resource providers and achieve the objective of general purpose financial reporting, the circumscribed area, as a reporting entity, must provide general purpose financial reports, including a full set of financial statements, to resource providers.

Description of a Reporting Entity

BC5. The objective of the reporting entity concept is to describe a reporting entity. The description of a reporting entity is consistent with the objective of general purpose financial reporting. The Board concluded that a concept of the reporting entity should focus on (a) identifying a circumscribed area of economic activities and (b) faithfully representing the economic activities of that circumscribed area in general purpose financial reporting. To faithfully represent the financial information of the reporting entity, that reporting entity must identify the economic activities of

its circumscribed area. To meet the objective of general purpose financial reporting, the reporting entity must faithfully represent the economic activities of its circumscribed area in general purpose financial reporting.

BC6. As stated in paragraph RE5(a), a reporting entity must have conducted economic activities. The Board observed that, in the absence of economic activities, there would be no financial information to report. However, the Board notes that economic activities would include initial contributions to an entity, which would consequently be financial information indicating that the feature in paragraph RE5(a) would be met.

BC7. The Board concluded that while a legal entity is a circumscribed area of economic activities that could represent a reporting entity, the legal form or structure of an entity should not exclusively dictate whether a circumscribed area of economic activities represents a reporting entity. For example, a sole proprietorship is not legally separate from its owner; however, a sole proprietorship may prepare general purpose financial reports for its circumscribed area of economic activities.

Consolidated Financial Statements

BC8. The Board decided not to define the term *control* in this chapter. The Board reasoned that the term *control* is defined at the standards level. In concepts, if a circumscribed area of economic activities represents a parent-subsidiary relationship, a full set of consolidated financial statements that faithfully represents the circumscribed area's economic activities is necessary to meet the objective of general purpose financial reporting. As noted in paragraph RE9, any exception to consolidation in circumstances in which a parent-subsidiary relationship exists would be made at the standards level.

Parent-Only Financial Statements

BC9. As noted in paragraph RE10, the Board concluded that parent-only financial statements do not completely depict the economic activities of a circumscribed area representing a parent-subsidiary relationship and, therefore, are not sufficient to meet the objective of general purpose financial reporting. Despite that conclusion, parent-only financial statements may provide useful information to resource providers as special-purpose financial reports. For example, parent-only financial statements may help resource providers assess the level of dividends that the controlling entity is legally able to pay without depending on transferred funds from its subsidiaries or perhaps reflecting the fair value of subsidiaries that are held as an investment if an entity elects to provide such fair value information for the investments.

Portion of an Entity

BC10. The Board concluded that a portion of a larger entity can qualify as a reporting entity if the portion of the entity represents a circumscribed area of economic activities whose financial information can be faithfully represented in general purpose financial reporting.

BC11. The Board acknowledges that in some cases there are practical complexities in identifying the assets, liabilities, and operations of a portion of an entity, specifically for items that are allocated to the portion of the entity. To achieve the objective of general purpose financial reporting, the portion of a larger entity must prepare general purpose financial reports, including a full set of financial statements, that faithfully represent the economic activities of its circumscribed area, including activities that have to be allocated to the portion of the entity, such as corporate overhead activities.

Combined Financial Statements

BC12. The Board concluded that combined financial statements may appropriately depict two or more entities that are under common control or common management, including circumstances in which a parent-subsidiary relationship does not exist. The Board decided to include the notion of common management to reflect structures used by various entities (for example, not-for-profit entities). The Board reasoned that two or more commonly controlled or commonly managed entities that are combined can represent a circumscribed area of economic activities and, therefore, meet the description of a reporting entity. Accordingly, general purpose financial reports, including a full set of combined financial statements, that faithfully represent the circumscribed area's economic activities achieve the objective of general purpose financial reporting.