

Proposed Statement of Financial Accounting Concepts on The Reporting Entity issued March 11, 2010

I am afraid that I could not help but think of Mr. Schuetze's famous empty box as I read the Proposed Statement of Financial Accounting Concepts on The Reporting Entity issued March 11, 2010. There is nothing in the proposed statement to which one could take particular offense but, at the same time, one was left wondering how this very, very broad definition would resolve issues related to determining the appropriate reporting entity. There can be little disagreement with the assertion that *accounting* entities are not coincident with *legal* entities but how then does this definition enable one to distinguish a division of a company from a company? It could be argued that “existing and potential” investors would find complete financial reports of a division of a company extremely useful in assessing whether “the management and the governing board” of that division had “made efficient and effective use of the resources provided.” In fact, texts on management control are replete with examples of measuring the performance of divisions. What, therefore, is there in this definition, that enables one to make the common-sense distinction that a division is not the same as a company?

I found myself wondering whether the FASB might not be able to appropriate suitable language from its sister GASB who grappled with the same issue in *GASB Statement 14* “The Financial Reporting Entity.” They use the term *accountability*, which harkens back to the estimable insights of Professor Ijiri of Carnegie University.¹ Is it the case that what distinguishes the company from the divisions of that company is a sense that the “governing board” is accountable to external users in a way that a divisional manager is not? Would the following addition resolve this problem?

A reporting entity is a circumscribed area of economic activities under the management of a governing body accountable to existing equity investors whose financial information has the potential to be useful to existing and potential equity investors, lenders, and other creditors who cannot directly obtain the information they need in making decisions about providing resources to the entity and in assessing whether the management and the governing board of that entity have made efficient and effective use of the resources provided.²

The use of the concept of *accountability* leaves the term *control* as a separate issue and perhaps circumvents the problem of special purpose entities, which were deemed by management to not be under its control and, therefore, not part of the reporting entity. Instead, one could argue that management was accountable even if not in control.

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¹ “On the Accountability-Based Conceptual Framework of Accounting,” *Journal of Accounting and Public Policy*, Summer 1983, p. 75.

² Or more simply: just add “under the management of an accountable body” or even simpler “under accountable management.” Alternatively, include the concept in the features.