

**30 Cannon Street, London EC4M 6XH, England**  
**Phone: +44 (0)20 7246 6410, Fax: +44 (0)20 7246 6411**  
**Email: [iasb@iasb.org](mailto:iasb@iasb.org) Website: <http://www.iasb.org>**



*This document is provided as a convenience to observers at Standards Advisory Council meetings, to assist them in following the Council's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.*

*Note: These notes are based on the staff paper prepared for the Council. Paragraph numbers correspond to paragraph numbers used in the Council paper.*

## **INFORMATION FOR OBSERVERS**

**SAC Meeting: February 2006, London**  
**Project: Conceptual Framework – Update on Progress to Date**  
**(Agenda Paper 4)**

---

## **INTRODUCTION**

### **The Conceptual Framework Project**

1. The Conceptual Framework project is a joint project between the International Accounting Standards Board and Financial Accounting Standards Board (the Boards) to develop an improved and common conceptual framework. Such a framework would provide a sound foundation for developing future accounting standards and is essential to fulfilling the Boards' goal of developing standards that are principles-based, internally consistent, internationally converged, and that lead to financial reporting that provides the information needed for investment, credit, and similar decisions.

### **The Purpose of this Paper**

2. This paper is intended to provide you with an update on the Conceptual Framework project as a whole, including, in particular, the work undertaken to date on the Objectives and

Qualitative Characteristics of financial reporting. The Boards are currently preparing an exposure draft of proposals on these topics, for release in the next month or so.

3. A separate paper explores aspects of the proposed Definition of an Asset that the Boards are currently considering. In the second part of the session, we will solicit your input on these proposals through break-out discussions.

### **Structure of the Paper**

4. The remainder of this paper is structured as follows:
  - (a) Overview of the project plan
  - (b) Summary of the tentative decisions on the Objective and Qualitative Characteristics
  - (c) Other parts of the project in process
5. Also provided in Agenda Paper 4A is the staff authored article *Revisiting the Concepts* which describes the goals of the joint project, the need for a conceptual framework, how the existing FASB and IASB frameworks fill part but not all of that need, and the areas that the Boards are aiming to improve.

### **OVERVIEW OF THE PROJECT PLAN<sup>1</sup>**

6. At their joint meeting in October 2004, the Boards decided to add to their agendas a joint project to develop an improved and common conceptual framework that is based on and builds on their existing frameworks, (i.e., the IASB's *Framework for the Preparation and Presentation of Financial Statements* and the FASB's *Statements of Financial Accounting Concepts*). The process will include considering the frameworks of other standard setters.

### **Project Objective**

7. The objective of this joint project of the Boards is to develop a common conceptual framework that is both complete and internally consistent. Such a framework would provide a sound foundation for developing future accounting standards and is essential to fulfilling

---

<sup>1</sup> Excerpts from the Joint Conceptual Framework Web Page as of January 23, 2006.

the Boards' goal of developing standards that are principles-based, internally consistent, internationally converged, and that lead to financial reporting that provides the information needed for investment, credit, and similar decisions. That framework, which will deal with a wide range of issues, will build on the existing IASB and FASB frameworks and consider developments since they issued their original frameworks.

## **Conduct and status**

8. The Boards plan to conduct the joint project in eight phases. The project will:
  - (a) Focus on changes in the environment since the original frameworks were issued, as well as omissions in the original frameworks, in order to efficiently and effectively improve, complete and converge the existing frameworks.
  - (b) Give priority to addressing and deliberating those issues within each phase that are likely to yield benefits to the Boards in the short term; that is, cross-cutting issues that affect a number of their projects for new or revised standards. Thus, work on several phases of the project will be conducted simultaneously and the Boards expect to benefit from work being conducted on other projects.
  - (c) Initially consider concepts applicable to private sector business entities. Later, the Boards will jointly consider the applicability of those concepts to private sector not-for-profit organizations. Representatives of public sector (governmental) standard-setting Boards are monitoring the project and, in some cases, are considering what the consequences of private sector deliberations might be for public sector entities.
9. Each of the first seven phases (A through G) are expected to involve *planning, research, and initial Boards deliberations* on major aspects of the Boards' frameworks and to result in an *initial document* that will seek comments on the Boards' tentative decisions for that phase. This will be followed by a period of redeliberations—the Boards' consideration of constituents' comments and redeliberations of the tentative decisions. While the Boards may seek comments on each phase separately they have not precluded seeking comments on several phases concurrently. An eighth phase will be used to address any remaining issues. That final phase is expected to lead to an Exposure Draft of the final proposed improvements for the entire converged framework that, perhaps concurrently with Phases F, G, or H, will

seek public comments and redeliberations leading to the issuance of the completed framework. Those phases and their current status, including plans for release of near-term initial documents, are as follows:

Project Phases, Status, and Timing			Next Document	
Phase	Topic	Current Status	2006	2007 and beyond
A	Objectives and qualitative characteristics	Board deliberations	Q2	
B	Elements, recognition, and measurement attributes	Board deliberations		Q1-2 2007 (estimated)
C	Initial and subsequent measurement	Planning and staff research		TBD
D	Reporting entity	Board deliberations		Q1-2 2007 (estimated)
E	Presentation and disclosure, including financial reporting boundaries	Research by others underway		TBD
F	Framework purpose and status in GAAP hierarchy	–		TBD
G	Applicability to the not-for-profit sector	–		TBD
H	Entire framework	–		TBD

10. The Boards will consult with their advisory councils for advice on broad strategic issues in the project. The Boards also directed the staff to identify subject matter experts who can be called on to provide IASB and FASB members and staff with advice informally as needed.

### **Relationship to other projects**

11. In conducting the conceptual framework project, the Boards decided to give priority to addressing those conceptual issues that are likely to yield benefits to the Boards in the short term, that is, cross-cutting issues that affect a number of their projects for new or revised standards. The Boards also expect that their joint conceptual framework project will benefit

from those standard-setting projects and by research being conducted by others on behalf of the Boards. These related activities and the phase to which they relate include:

- (a) Revenue Recognition, Phase B—The joint FASB and IASB revenue recognition project is developing guidance for revenue recognition. For more information, visit: FASB Revenue Recognition Project and IASB – Liabilities and Revenue Recognition.
- (b) Financial Instruments: Liabilities and Equity, Phase B—The financial instruments: liabilities and equity project is considering improvements to the defining characteristics of liabilities, equity, and perhaps assets. The IASB and FASB are using a "modified joint approach" in which the FASB is the lead Board until both Boards issue a document for comment simultaneously, at which time the project will become a joint project. For more information, visit FASB Liabilities and Equity Project.
- (c) Fair Value Measurements, Phase C—The FASB fair value measurements project is to define fair value and establish a framework for applying the fair value measurement objective in GAAP. For more information, visit FASB Fair Value Measurements Project. At the September IASB meeting, the IASB added a project on fair value measurement to its agenda. The aim of the project is to provide guidance on how to measure the fair value of assets and liabilities.
- (d) Initial and Subsequent Measurement, Phase C—The Canadian Accounting Standards Board, on behalf of the IASB, prepared a Discussion Paper, *Measurement Bases for Financial Reporting—Measurement on Initial Recognition*, which was published on November 17, 2005. The comment deadline is May 19, 2006.
- (e) Financial Performance Reporting, Phase E—The joint IASB and FASB Financial Performance Reporting project is developing guidance for the presentation of information in the financial statements to enhance the usefulness of that information. For more information, visit: FASB Financial Performance Reporting by Business Enterprises and IASB Performance Reporting Project.
- (f) Management Commentary and Disclosure Framework, Phase E— The IASB published a Discussion Paper, *Management Commentary* that addresses the role the IASB could play in improving the quality of management commentary that accompanies the financial

statements. The Canadian Accounting Standards Board has a project that is intended to provide guidance on determining disclosure requirements for accounting standards. For more information, visit [http://www.acsbcanada.org/index.cfm/ci\\_id/20570/la\\_id/1.htm](http://www.acsbcanada.org/index.cfm/ci_id/20570/la_id/1.htm).

## **SUMMARY OF TENTATIVE DECISIONS**

### **OBJECTIVE AND QUALITATIVE CHARACTERISTICS**

12. Phase A involves consideration of the objective of financial reporting and the qualitative characteristics of accounting information, which include relevance, reliability (faithful representation), understandability, and comparability, and trade-offs between qualitative characteristics and how they relate to the concepts of materiality and cost-benefit relationships. The Boards tentative conclusions are discussed in the following paragraphs.

#### **Objective of Financial Reporting**

13. As with the existing frameworks, the Boards' converged framework should be concerned with *general purpose* financial reports that focus on the common information needs of external users. The framework should identify the primary users as present and potential investors and creditors (and their advisors), rather than focus only on the information needs of existing common shareholders. Later in the project, the Boards will consider whether financial reporting also should provide information to meet the information needs of particular types of users, such as different kinds of equity participants.

#### *Users*

14. General purpose financial reporting should provide information about the entity to the *external* users who lack the power to prescribe the information they require and therefore must rely on the information provided by an entity's management. The entity's management also will be interested in that information. However, because management has the power to obtain the information it requires, any additional information needs of management are beyond the scope of the framework. Similarly, additional information needs of particular users (for example, a credit rating agency or a principal lender) that may have the power to prescribe the information they require are beyond the scope of the framework. As with the

existing frameworks, the Boards' converged framework should be concerned with *general purpose* financial reports, which focus on the common information needs of users. That does not preclude the Boards from concluding, in a standards-level project, that additional information should be provided to meet the information needs of particular types of users.

#### *Liquidity and Solvency*

15. General purpose financial statements should provide information that is helpful to users in assessing an entity's liquidity and solvency, which is consistent with the overall objective of providing decision-useful information to a wide range of external users. This does not mean, however, that the information provided in the financial statements should focus on meeting the information needs of particular types of users that use the financial statements primarily or only to help them assess an entity's liquidity and solvency.

#### *Stewardship and Accountability*

16. Stewardship or accountability should not be a separate objective of financial reporting by business entities. The Boards agreed that the converged framework should clearly describe its meaning of *stewardship*, which encompasses management's responsibility not only for the custody and safekeeping of assets entrusted to it but also for their efficient and profitable use. As a consequence, the Boards agreed that the converged framework should clarify that financial information useful for making investment, credit, and similar resource allocation decisions—the primary objective—would include financial information useful for assessing management's stewardship.

### **Qualitative Characteristics of Decision-Useful Financial Information**

#### *Relevance*

17. Relevance is an essential qualitative characteristic. To be relevant, information must be capable of making a difference in the economic decisions of users by helping them evaluate the effect of past and present events on future net cash inflows (predictive value) or confirm or correct previous evaluations (confirmatory value), even if it is not now being used. Being “capable of making a difference”, rather than “now being used”, is a change from the present

IASB *Framework*; confirmatory rather than feedback value is a change from the present FASB Concepts Statements. Also, the information must be available when the users need it (timeliness).

- (a) *Predictive value* is a characteristic of accounting information that is used, or could be used, to make predictions. Accounting information is not intended in itself as a prediction, nor as synonymous with statistical predictability or persistence.
- (b) *Confirmatory value* rather than feedback value is a change in terminology from the present FASB framework.
- (c) *Timeliness* is a third aspect of relevance; information must be available when the users need it.

#### *Faithful representation*

18. Faithful representation of real-world economic phenomena is an essential qualitative characteristic, which includes capturing the substance of those economic phenomena. Representations are faithful—there is correspondence or agreement between the accounting measures or descriptions in financial reports and the economic phenomena they purport to represent—when the measures and descriptions are verifiable and neutral. Therefore, faithful representation requires verifiability, neutrality, and not subordinating substance to form. Consequently, the common framework should drop the widely misinterpreted term *reliability* from the qualitative characteristics, replacing it with *faithful representation*. That replacement is a change from the current IASB and FASB frameworks. The common conceptual framework will need to discuss thoroughly what faithful representation means, and what it does not mean.

- (a) *Verifiability* of financial information provides assurance to users that such information faithfully represents what it purports to represent and that the information is free from material error, complete, and neutral. Descriptions and measures that can be directly verified through consensus among observers are preferable to descriptions or measures that can only be indirectly verified.
- (b) *Neutrality* means that financial information must be free from bias intended to influence a decision or outcome. To that end, the common conceptual framework should not include

conservatism or prudence among the desirable qualitative characteristics of accounting information. However, the framework should note the continuing need to be careful in the face of uncertainty.

- (c) Although empirical research may provide evidence useful in standard-setting decisions, for example, in assessing trade-offs between desirable qualities, the conceptual framework project should not seek to develop empirical measures of faithful representation or its component qualities.

### *Understandability*

- 19. Understandability also is an essential characteristic of decision-useful financial information and should be included in the converged conceptual framework. Understandability is the quality of information that enables users, who have a reasonable knowledge of business and economic activities and accounting and study the information with reasonable diligence, to comprehend the meaning of the information. Information is made more understandable by aggregating, classifying, characterizing, and presenting it in a clear and concise manner. Relevant information should not be excluded because it is too complex or difficult for certain users to understand.
- 20. The converged framework should include presumptions not only about the responsibilities and capabilities of financial statement users but also about the responsibilities and capabilities of financial statement preparers and auditors.

### *Comparability*

- 21. Comparability is an important characteristic of decision-useful financial information and should be included in the converged conceptual framework. Comparability, which enables users to identify similarities in and differences between economic phenomena, should be distinguished from consistency (the consistent use of accounting methods). Concerns about comparability or consistency should not preclude reporting information that is of greater relevance, or that more faithfully represents the economic phenomena it purports to represent. If such concerns arise, disclosures can help to compensate for lessened comparability or consistency.

### *Other Characteristics*

22. Other possible characteristics considered, including transparency, credibility, high quality, and internal consistency, do not describe attributes of decision-useful financial information that are clearly defined or distinct from other qualitative characteristics. For example, transparency often is cited by others as a desirable characteristic of financial information, but it cannot be clearly defined and in current usage, it appears to encompass some of the qualitative characteristics already included in the framework. Thus, those other characteristics will not be added as separate qualitative characteristics in the converged framework.

### *Materiality*

23. Materiality relates not only to relevance, but also to faithful representation. Materiality should be included in the converged framework as a screen or filter to determine whether information is sufficiently significant to influence the decisions of users in the context of the entity, rather than as a qualitative characteristic of decision-useful financial information.

24. Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the nature and amount of the item judged in the particular circumstances of its omission or misstatement. Given the pervasive nature of materiality, it is difficult to consider the concept except as it relates to the qualitative characteristics of relevance and faithful representation. Thus, materiality is a screen or filter used to determine whether information is sufficiently significant to influence the decisions of users in the context of the entity, rather than as a qualitative characteristic of decision-useful financial information.

### *Cost-benefit considerations*

25. The concept that the benefits of an accounting standard should justify the costs involved is a pervasive constraint, rather than a qualitative characteristic of accounting information. Cost-benefit considerations may limit the information provided by financial reports. The framework should indicate that, while information from preparers, users, and other

constituents about their expectations concerning the nature and quantity of benefits, in particular, and costs is likely to be incomplete, standard setters should consider in their deliberations the information they can obtain. The framework should describe what is included, and not included, in the benefits and costs to be considered, as well as criteria to help standard setters decide how to take particular types of costs into account.

26. There is no need to modify the cost-benefit constraint for application to smaller entities or any other particular type of entity. However, the results of considering whether benefits justify costs may differ for different types of entities.

*Relationships between Qualitative Characteristics*

27. Board members observed that the different qualitative characteristics and their sub-qualities sometimes suggest different answers to standard setting and financial reporting issues. Previously, discussion of such differences has focused on hierarchy (that is, which characteristics prevail over others because they are ranked higher) or bargaining (that is, how much of one quality the Board is willing to "trade-off" to get more of another quality). The Boards agreed that they should consider the characteristics of financial reporting information as steps in a process that results in decision-useful financial reporting. Board members suggested several improvements to the description and illustration of the process proposed by the staff and the staff has refined that process. The Boards decided that the process should be described as a process to be used by standard setters.

*Do the Objectives and Qualitative Characteristics Need to Differ for Particular Types of Entities?*

28. The Boards concluded that there is no need to modify the objectives of financial reporting or qualitative characteristics of decision-useful financial reporting for any types of private-sector entities. The Boards acknowledged that there might be differences in how certain qualitative characteristics are applied, for example, when cost-benefit constraints are considered in setting standards.

## **OTHER PARTS OF THE PROJECT IN PROGRESS**

### **Reporting Entity — Phase D**

29. Work has commenced on this phase of the project, with the following tentative conclusions being reached in December 2005:
- (a) The reporting entity concept should focus on determining the boundaries of the reporting entity, for both an individual reporting entity and a group reporting entity.
  - (b) The reporting entity concept should not be limited to those entities that have external users who are unable to demand the information they require and therefore must rely on information provided by the entity.
  - (c) The staff should conduct further research into whether a parent-only entity is a reporting entity.
  - (d) The staff should investigate whether the boundaries of a group reporting entity should be based on a broader concept of control, for example, a concept that might encompass entities under common control.

### **Elements — Phase B**

30. Work has also commenced on Phase B. The Boards commenced discussion of the definition of an asset in December 2005 (see separate Agenda Paper 4B for the SAC meeting) and will continue that discussion, together with initial discussion of the definition of a liability, in February 2006.