



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

**International
Accounting Standards
Board**

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These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IASB Meeting: 20 July 2005, London

**Project: Conceptual Framework - Objectives of Financial Reporting:
Stewardship and Accountability (Agenda Paper 7)**

Introduction

1. At the April joint IASB/FASB meeting, the Boards considered the staff recommendation that “the roles of stewardship and decision-usefulness in the two Boards’ existing frameworks remain unchanged” (paragraph 35 of Agenda Paper 4, FASB Memorandum 3). They did not reach a decision; rather, the Boards asked the staff to investigate the meaning of the terms *stewardship* and *accountability*, and the implications of having such objectives in the framework. This paper addresses that request.
2. At the July meeting, the staff will ask the Boards to continue their discussions about the meaning and roles of stewardship and accountability and the implications of those responsibilities for financial reporting. The staff will also ask the Boards to decide whether information for purposes of assessing stewardship and accountability responsibilities should be:
 - (a) Included as a *financial reporting objective* in the converged framework,
 - (b) Retained as part of a discussion that acknowledges that financial information directed at the primary objective of providing information useful for making investment, credit, and similar resource allocation decisions also may be useful for other purposes such as assessing management’s stewardship responsibilities and accountability, or
 - (c) Eliminated from any discussion in the body of the converged framework (with an explanation for that change in the basis for conclusions).

3. To facilitate discussing that issue, this paper begins by discussing the meaning of stewardship and accountability. It then divides the issue into two questions:
 - Should providing information needed to assess stewardship and accountability be added as an explicit objective of financial reporting by business entities?
 - Should a discussion of stewardship and accountability be retained in the converged framework?

The Meaning of Stewardship and Accountability

Stewardship

4. *Stewardship* is derived from the base word *steward*. Following are four definitions of steward:
 - One who manages the affairs of an estate on behalf of his employer Compact Oxford English Dictionary
 - One who manages another's property, finances, or other affairs Webster's II New College Dictionary
 - A person who manages another's property or financial affairs; one who administers anything as an agent of another or others Random House Webster's Unabridged (1987)
 - A person appointed in the place of another Black's Law Dictionary
5. Accounting literature uses the term *stewardship* many times with related but differing meanings. Sometimes stewardship is used to distinguish or separate the performance of a reporting entity's management from the performance of the entity itself. Sometimes stewardship is used narrowly to refer to the custodianship or safekeeping of assets. Other references to stewardship go beyond that narrow meaning. For example, in its May 1997 Comparative Study on Conceptual Frameworks in Europe, the Federation Des Experts Comptables Europeens (FEE) described stewardship as "how the manager/owner has used the resources put into a business."¹ Similarly, the 1973 Report of the AICPA Study Group on Objectives of Financial Statements ("Trueblood Report") notes:

Stewardship refers to the efficient administration of resources and the execution of plans for conserving and consuming them. [page 25]

6. Similarly, paragraph 105 of FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, states:

The Board rejected using historical cost because prices in past exchanges do not provide the most relevant information about the present ability of the plan's assets to provide participants' benefits. Further, the

¹ Federation Des Experts Comptables Europeens, *Comparative Study on Conceptual Accounting Frameworks in Europe*, May 1997, page 19.

Board does not believe that historical cost is the most appropriate measure for use in assessing how the stewardship responsibility for plan assets has been discharged. *Plan administrators or other fiduciaries who manage plan assets are accountable not only for the custody and safekeeping of those assets but also for their efficient and profitable use in producing additional assets for use in paying benefits.* Investment performance is an essential element of stewardship responsibility. Measuring changes in fair value provides information necessary for assessing annual investment performance and stewardship responsibility. Historical cost provides that information only when investments are sold. [Emphasis added]

7. In addition, paragraph 50 of FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprise*, discusses management's discharge of its stewardship responsibility as:

...not only for the custody and safekeeping of enterprise resources but also for their efficient and profitable use and for protecting them to the extent possible from unfavourable economic impacts of factors in the economy such as inflation or deflation and technological and social changes.

8. Both, the FASB and IASB frameworks mention stewardship. Additionally, references to stewardship were found in 9 FASB statements, which include at least 28 references, and two International Accounting Standards (IASs) and one International Financial Reporting Standard (IFRS).² Most of those references use stewardship to describe a type of responsibility or discuss information that can be used as a factor in assessing management's performance.
9. [Not included in Observer Notes]

Accountability

10. *Accountability* is derived from the word *accountable*. Webster's II New College Dictionary defines accountable as: (a) "required to render account: answerable" and (b) "capable of being explained." Black's Law Dictionary defines accountable as "responsible, answerable, explainable, justifiable, or liable."
11. Accounting literature uses the term *accountability* many times with similar meanings. Paul Rosenfield noted that "accountability denotes the responsibility to others that one or more persons have for their behaviour."³ The Trueblood Report notes that accountability "deals with management's responsibility for taking or not taking actions and for the outcome of those actions."⁴

² To see a list of the paragraphs, see Appendix A of this paper.

³ Rosenfield, Paul, "Stewardship," *Objectives of Financial Statements, Volume 2 Selected Papers*, AICPA May 1974, page 125.

⁴ American Institute of Certified Public Accountants, October 1973, page 26.

12. The Australian framework defines accountability as the “responsibility to provide information to enable users to make informed judgments about the performance, financial position, financing and investing, and compliance of the reporting entity.”⁵
13. GASB Concepts Statement No. 1, *Objectives of Financial Reporting*, uses that term extensively. Paragraph 56 of that Statement says:

Accountability is the cornerstone of all financial reporting in government, and the term *accountability* is used throughout this Statement. The dictionary defines *accountable* as "being obliged to explain one's actions, to justify what one does." Accountability requires governments to answer to the citizenry—to justify the raising of public resources and the purposes for which they are used. Governmental accountability is based on the belief that the citizenry has a "right to know," a right to receive openly declared facts that may lead to public debate by the citizens and their elected representatives. Financial reporting plays a major role in fulfilling government's duty to be publicly accountable in a democratic society.

14. Paragraphs 57 and 58 of GASB Concepts Statement 1 add a caution about extending the notion of accountability too broadly. Specifically they say:

57. The Board is aware that applying the broad concept of public accountability to financial reporting by state and local governments creates the potential to extend reporting beyond current practice. If being accountable means being obliged to explain one's actions, what are the limits of disclosure? How does one balance the cost of providing information against the value of the public's "right to know"? The need to be accountable for resources provided involuntarily by taxpayers makes cost-benefit analysis particularly difficult in setting standards. In addition, the benefits of financial information are usually difficult or impossible to measure objectively, particularly in a governmental environment.

58. The Board believes that, at a minimum, demonstrating accountability through financial reporting includes providing information to assist in evaluating whether the government was operated within the legal constraints imposed by the citizenry. The structure of government, the nature of the resource providers, and the political process are characteristics of the environment that underscore the need for accountability.

15. FASB Concepts Statement No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations*, also discusses management stewardship and accountability together with assessing management's performance. Paragraphs 40–42 of Concepts Statement 4 state:

Financial reporting should provide information that is useful to present and potential resource providers and other users in assessing how managers of a nonbusiness organization have discharged their stewardship responsibilities and about other aspects of their performance. Managers of

⁵ AASB SAC2, paragraph 5.

an organization are accountable to resource providers and others, not only for the custody and safekeeping of organization resources, but also for their efficient and effective use. Those who provide resources to nonbusiness organizations do not have a profit indicator to guide their resource allocation decisions and may not have an immediate choice about the amounts of their contributions. They must look to managers to represent their interests and to make operating cost/benefit judgments that achieve the objectives of the organizations with minimum use of resources. Managers also are accountable for compliance with statutory, contractual, or other limitations.

Information about an organization's performance (paragraphs 47–53) should be the focus for assessing the stewardship or accountability of managers of a nonbusiness organization. Users also need assurance that managers have exercised their special responsibilities to ensure that an organization uses resources in the manner specifically designated by resource providers. General purpose external financial reporting can best meet that need by disclosing failures to comply with spending mandates that may impinge on an organization's financial performance or on its ability to continue to provide a satisfactory level of services.

Financial reporting is limited in its ability to distinguish the performance of managers from that of the organization itself. Nonbusiness organizations are often highly complex institutions, and the processes by which they acquire resources and render services often are long and intricate. Organizational successes and failures are the result of numerous factors. The ability and performance of managers are contributing factors, as are events and circumstances that often are beyond the control of managers. It is usually not possible to determine the degree to which managers, or any other specific factors, have affected the result. Actions of past managers affect current periods' performance, and actions of present managers affect future periods' performance.

16. [Not included in Observer Notes]

Should Providing Information Needed to Assess Stewardship or Accountability be Added as an Explicit Objective of Financial Reporting by Business Entities?

17. Business entities take on a number of different organizational forms, such as corporations, partnerships, trusts, and proprietorships. Stewards generally manage them. For example, the members of an elected board of directors of a publicly-traded company are stewards who are “appointed” by the present shareholders to manage the affairs of their business entity. Similarly, a sole proprietor who owns a lawn care business may hire an individual to manager multiple work crews. That individual is a steward who has been appointed/hired by the owner to manage a part of the owner’s business affairs. And the partners of a general partnership often elect or appoint certain partners (an executive committee) to function as the stewards/managers for the affairs of the partnership.
18. Stewardship or stewardship responsibilities for a business entity requires the existence of a steward or stewards who are responsible for the performance of a number of

actions. For example, West's Business Law⁶ identifies *some* of the responsibilities of the board of directors of a corporation:

Authorization for major corporate policy decisions – for example, the initiation of proceedings for the sale or lease of corporate assets outside the regular course of business, the determination of new product lines, and the overseeing of major contract negotiations and major management-labour negotiations

Appointment, supervision, and removal of corporate officers and other managerial employees and determination of their compensation.

Financial decisions, such as the declaration and payment of dividends to shareholders and the issuance of authorized shares and bonds.

19. Similarly, the Model Business Corporation Act identifies a number of duties that directors and officers of corporations are to perform as stewards. Those duties are generally thought of to include: the duty of care, the duty to make informed and reasonable decisions, the duty to exercise reasonable supervision, and the duty of loyalty to the corporation.
20. Because managers of business entities are stewards who are responsible for the performance of a number of actions in conjunction with duties, they can be held accountable for the performance of those actions. Said another way, *managers perform a stewardship function and as a result, they can be held accountable for their actions.* Whether a manager will be held accountable depends on who needs and demands the explanation and for what purpose they need explaining.
21. The Boards identified the primary objective of financial reporting as providing useful information to a wide range of external users who lack the power to prescribe information they require so they can make informed economic decisions. Although the Boards identified present and potential investors and creditors (and their advisers) as the primary users of financial reporting information, others are not excluded from using such information. The economic decisions that users of financial reporting information make include investment, credit, and similar resource allocation decisions. These decisions involve assessing the business entity's ability to generate cash.
22. In order to assess a business entity's ability to generate cash, decision makers need a variety of information, including information about how the entity has performed. Paragraph 42 of FASB Concepts Statement 1 states:

Financial reporting should provide information about an enterprise's financial performance during a period. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise.

23. Accounting literature associates the entity's performance with accountability. Paragraph 51 of FASB Concepts Statement 1 states:

⁶ Clarkson, K., Miller, R., Jentz, G, and Cross, F., "West's Business Law Text Cases, Seventh Edition, page 735.

Earnings information is commonly the focus for assessing management's stewardship or accountability. Management, owners, and others emphasize enterprise performance or profitability in describing how management has discharged its stewardship accountability.

[rest of paragraph not included in Observer Notes]

24. However, the performance of an entity generally cannot be separated from the performance of those who manage it. Paragraph 53 of FASB Concepts Statement 1 elaborates on this point:⁷

Financial reporting, and especially financial statements, usually cannot and does not separate management performance from enterprise performance. Business enterprises are highly complex institutions, and their production and marketing processes are often long and intricate. Enterprise successes and failures are the result of the interaction of numerous factors. Management ability and performance are contributing factors, but so are events and circumstances that are often beyond the control of management, such as general economic conditions, supply and demand characteristics of enterprise inputs and outputs, price changes, and fortuitous events and circumstances. What happens to a business enterprise is usually so much a joint result of a complex interaction of many factors that neither accounting nor other statistical analysis can discern with reasonable accuracy the degree to which management, or any other factor affected the joint result. Actions of past managements affect current periods' earnings, and actions of current management affect future periods' earnings. *Financial reporting provides information about an enterprise during a period when it was under the direction of a particular management but does not directly provide information about that management's performance. The information is therefore limited for purposes of assessing management performance apart from enterprise performance.* [Emphasis added.]

25. In the staff's view, that discussion in the FASB framework remains appropriate. [rest of paragraph not included in Observer Notes]
26. [First sentence not included in Observer Notes]. Paragraph 14 (of the IASB Framework) says:

Financial statements also show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. Those users who wish to assess the stewardship or accountability of management do so in order that they may make economic decisions; these decisions may include, for example, whether to hold or sell their investment in the entity or whether to reappoint or replace the management. [Emphasis added.]

27. [First two sentences not reproduced in Observer Notes]. Paragraph 13 (of the IASB Framework) states:

⁷ Paragraph 42 of FASB Concepts Statement 4 parallels this discussion.

Financial statements prepared for this purpose [information useful in making economic decisions] meet the common needs of most users. However, financial statements do not provide all the information that users may need to make economic decisions since they largely portray the financial effects of past events and do not necessarily provide non-financial information.

28. [Not included in Observer Notes]
29. On June 22, 2005, the FASB met with its Small Business Advisory Committee (SBAC) and discussed whether the Board should elevate stewardship, either in the traditional sense or the more recent sense, to be an objective of financial reporting on a par with providing information that is useful in making investment and credit decisions or should it be a subordinate objective. SBAC members expressed mixed views. [Rest of paragraph not included in Observer Notes].

Staff Recommendation

30. In the staff view, providing the information needed to assess stewardship or accountability should *not* be added as an explicit objective of financial reporting by business entities.

Should a Discussion of Stewardship and Accountability Be Retained in the Converged Framework?

31. An entity and its managers may provide financial and nonfinancial information voluntarily or involuntarily—that is, because they feel *compelled* by strong market forces or are compelled by laws, regulations, or others who can demand the information they require. Yuji Ijiri⁸ illustrates this point.

Either you want to do this (provide information) voluntarily in order to impress, appeal to, and solicit certain actions by others, or you do so involuntarily under force. Why force? Because there is an underlying accountability relation between you and someone else. Based on that relation, you are expected to account for your activities and their consequences to a certain person

32. For example, most entities are required (accountable) to provide information to a taxing authority, generally by filing a tax return that prescribes specific financial information in a prescribed form, with prescribed inclusions and exclusions and prescribed computations. Such information is predominately financial in nature, but taxing authorities may require certain nonfinancial information. Examples include headcounts, new hires, and measures of emission quality that may be used as a basis for granting certain tax subsidies.
33. Sometimes entities are compelled to provide information to regulators in order to maintain their license (franchise) to operate in a particular industry or jurisdiction. For example, insurance companies must explain the results of their operations and their

⁸ Yuji Ijiri, "On the Accountability-Based Conceptual Framework of Accounting," *Journal of Accounting and Public Policy*, 2, 75-81 (1983)

financial position via reporting prescribed by the National Association of Insurance Commissioners.

34. Certain broker-dealers in United States are required to provide information prescribed by the Securities Exchange Act of 1934 to the Securities and Exchange Commission (SEC) and any related exchanges with which the broker-dealer is registered. One such rule, SEC Rule 15c3-3, requires that the broker-dealer explain how it protected customers' assets. If the broker-dealer does not provide such information in the prescribed format, it can be fined and may be precluded from performing services in the securities trading industry.
35. The characteristic that differentiates the users of information in these examples from the primary users of general-purpose financial reporting is the authority with which the user can compel the entity to provide financial and nonfinancial information. All of the users in the examples can compel the entity to provide whatever information is deemed necessary for their purposes. That is, entities and their managers often are held accountable by various parties for various types of specific information. On the other hand, the primary users of general-purpose financial reporting do not have such authority. Financial reporting is a source of information about the business entity that otherwise may have only been provided voluntarily. However, as noted in paragraph 13 of IAS 1, financial statements, and paragraph 22 of FASB Concepts Statement 1, financial reporting by a particular business entity is not intended or expected to provide *all* information necessary to make an informed economic decision.
36. Financial reporting has its limits and boundaries. Paragraph 22 of FASB Concepts Statement 1 states:

Financial reporting is but one source of information needed by those who make economic decisions about business enterprises. Business enterprises and those who have economic interests in them are affected by numerous factors that interact with each other in complex ways. Those who use financial information for business and economic decisions need to combine information provided by financial reporting with pertinent information from other sources, for example, information about general economic conditions or expectations, political events and political climate, or industry outlook.

37. At present, neither of the Boards' frameworks call for the provision of nonfinancial information as an objective of financial reporting. Paragraph 18 of FASB Concepts Statement 1 notes that "the information provided by financial reporting is primarily financial in nature—it is generally quantified and expressed in units of money." As noted previously, the boundaries of financial reporting are scheduled to be addressed during a later phase (Phase E) of the project. [Rest of paragraph not included in Observer Notes].

Staff Recommendation

38. In conclusion, financial information directed at the primary objective of providing information useful for making investment, credit, and similar resource allocation decisions also is useful in assessing management's stewardship responsibilities and accountability. Therefore, the staff recommends retaining a discussion in the

converged framework that acknowledges that financial information is useful for other purposes, which include assessing management's stewardship and compliance with laws, regulations, and contractual provisions. Specifically, the staff recommends that the text of the converged framework include the following points:

- Information about the economic resources of an entity, the claims to those resources, and the changes in them also is useful for purposes other than making investment, credit, or similar resource allocation decisions.
- Financial reporting information may be useful in assessing how management of an entity has discharged its stewardship responsibility to owners (stockholders) for the use of resources entrusted to it.
- Financial reporting information may be useful in assessing management's performance. However, financial reporting usually cannot and does not separate management performance from entity performance.
- Financial reporting information may be useful in assessing an entity's compliance with laws, regulations, and contractual provisions.

Questions for the Boards

39. Do the Boards agree that providing the information needed to assess stewardship and accountability should not be added as an explicit objective of financial reporting by business entities?
40. Do the Boards agree that a discussion that acknowledges that financial information directed at the primary objective of providing information useful for making investment, credit, and similar resource allocation decisions also may be useful in assessing management's stewardship responsibilities and accountability and should be retained in the converged framework?