



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

**International
Accounting Standards
Board**

This document is provided as a convenience to observers at the World Standard Setters meeting, to assist them in following the 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 papers prepared for the World Standard Setters meeting. Paragraph numbers correspond to the paragraph numbers in the staff papers.

INFORMATION FOR OBSERVERS

Meeting: World Standard Setters meeting, September 2005, London

Agenda Paper 3

Conceptual Framework

BACKGROUND

1. At their joint meeting in April 2004, the IASB and FASB discussed plans for coordinating their future activities, which included a staff proposal to undertake a joint project to develop a common conceptual framework for use by both Boards. The Boards decided not to make an agenda decision at that time, but instead directed the staff to develop a plan for conducting such a project for discussion at their joint meeting in October 2004.
2. At their joint meeting in October 2004, the Boards discussed the staff plan and they 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*). That framework will consider developments since the Boards issued their original frameworks, including considering the frameworks of other standard setters.

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3. The Boards are conducting the joint project as follows:
 - (a) With the objective that the converged framework will be in the form of a single document that will include a summary and a basis for conclusions.
 - (b) By initially considering concepts applicable to private sector business entities. Later, the Boards will consider the applicability of those concepts to private sector not-for-profit organizations. The IASB also may consider their applicability to public sector (governmental) entities.
 - (c) By focusing on changes in the environment since the original frameworks were issued, as well as omissions and errors in the original frameworks, in order to efficiently and effectively converge the existing frameworks. This means that the Boards will initially focus on improving particular aspects of the frameworks dealing with objectives, qualitative characteristics, elements, recognition, and measurement.
 - (d) By dividing and deliberating the issues in phases and giving priority to addressing 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. In addition, the Boards expect to utilize the research activities being conducted by their related standard-setting projects and by other standard setters that are conducting research on related projects.

4. The project is divided into eight phases. Each of the first seven phases (A through G) are expected to result in an initial document that will seek comments on the Boards’ tentative decisions for that phase. This will be followed by consideration of constituents’ comments and re-deliberations of the tentative decisions. A final eighth phase will be used to address any remaining issues and develop a single comprehensive Exposure Draft of the intended improved and converged framework that will seek additional comments. (At this time, the Boards have not decided whether any of the initial documents being used to develop the single comprehensive Exposure Draft also might be issued in the form of an Exposure Draft of proposed amendments to the Boards’ existing frameworks.) Those phases and

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their current status, including estimates for release of near-term initial documents, are as follows:

Phase	Topic	Current Status	Initial Document	
			2006	2007 and beyond
A	Objectives and qualitative characteristics	Board deliberations in progress	Q1	
B	Elements, recognition/derecognition and measurement attributes	Planning and staff research underway	Q4	
C	Initial and subsequent measurement	Planning and staff research underway ¹		TBD
D	Reporting entity	Planning and staff research underway		TBD
E	Presentation and disclosure, including financial reporting boundaries	Research by others underway ²		TBD
F	Framework purpose and status in GAAP hierarchy	-		TBD
G	Applicability to the not-for-profit sector	-		TBD
H	Entire framework	-		TBD

Project Status

5. In recent months the Boards have been deliberating the objectives of financial reporting and qualitative characteristics of accounting information (Phase A). In October, the Boards plan to hold a joint meeting, at which they plan to discuss any remaining issues for Phase A and their plan to issue in the first quarter of 2006 an initial discussion document inviting comments on the decisions reached on the objectives of financial reporting and qualitative characteristics of accounting information.
6. In September 2005, the Boards will consider a plan for deliberating issues relating to the reporting entity (Phase D)³. Work is also expected to commence on the elements of financial statements during the latter part of 2005 (Phase B).

¹ Includes Canadian AcSB work on Measurement Objectives – IASB expected to publish Discussion Paper in October 2005.

² Includes Canadian AcSB work on a Disclosure Framework and New Zealand-led research on Management Commentary – IASB expected to publish Discussion Paper on Management Commentary in October 2005.

*Conceptual Framework***Matters for discussion by World Standard Setters**

7. As initial deliberations on Phase A of the Conceptual Framework project are coming close to the time when the Boards will be requested to approve the issue of an initial document for comment, we propose to focus on those issues to help you become more familiar with the decisions made to date and to provide an opportunity for you to explore and provide input on some of the issues being considered.
8. The Appendix to this Agenda Paper provides a summary of tentative decisions made by the IASB and FASB in meetings prior to September 2005. These relate to both the objectives of financial reporting and to qualitative characteristics. We will provide a brief update on the decisions relating to the objectives of financial reporting at the World Standard Setters meeting in September, but would like to focus attention on the qualitative characteristics.
9. This is, in part, because we are developing a process for considering the qualitative characteristics that differs somewhat from the manner in which they have been thought about in the past and the manner in which they are considered in current conceptual frameworks. The process is outlined in Agenda Paper 3A for this meeting. We request that delegates review Agenda Paper 3A, which is based on an Agenda Paper for consideration by the IASB and FASB in September 2005, before participating in the World Standard Setters' discussions in September. Delegates should also review the decisions related to qualitative characteristics in the Appendix to this paper, so as to be familiar with the manner in which terminology is used in Agenda Paper 3A.
10. As we have developed the process for using qualitative characteristics, we have been requested by some Board members to consider how it might apply to particular fact situations – not necessarily to see if it provides the “right” answer (indeed, the “right” answer, in some cases, may not be the one in existing standards) but to test whether the process helps in using the qualitative characteristics to build decision-useful financial reports. We would like you to help us in this endeavour.

³ After development of the initial plan the Boards requested that consideration of issues in Phase D be accelerated so as to assist with resolving issues in other active standard-setting projects.

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11. Accordingly, we will request that you consider four case studies during the breakout sessions, each of which considers how the process for using qualitative characteristics might apply to particular situations. These case studies are set out in Agenda Paper 3B. We emphasize that the objective is not to see whether a particular answer is supportable, but rather is to consider the usefulness of the process.
12. We hope that the discussion of these cases studies will achieve at least two objectives:
 - (a) To further familiarize you with the Boards' tentative thinking on these issues, so that you will be better placed to follow the Boards' deliberations and provide input; and
 - (b) To provide input that will be useful to the Boards' in their further deliberations of this topic.
13. In order that we ensure that we cover all of the case studies, we will ask each breakout group to consider the case studies in a different order – although we hope that each group will have time to consider as many of the cases as possible. We will then ask each of the breakout groups to report back on how they used the process in evaluating one of the cases, followed by alternative considerations on that case from the other groups. We will also ask the groups to comment on any common themes or areas of difficulty that they found in applying the process to each of the cases.
14. A small note – the first eight questions in each of cases are the same. However, case 4 contains an additional question. In the first three cases the focus is on the first row of the Illustration in Agenda Paper 3A, since in each of these cases only a single financial reporting item is being considered. Only in case 4 do we introduce a number of items, with the ability to also consider the second row of the Illustration which is concerned with aggregation of items into financial reports.

Group assignments

Breakout Group	Order of Cases
Breakout Group 1	1, 2, 3, 4

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Breakout Group 2	2, 3, 4, 1
Breakout Group 3	3, 4, 1, 2
Breakout Group 4	1, 4, 2, 3

*Conceptual Framework***APPENDIX****CONCEPTUAL FRAMEWORK
OBJECTIVES AND QUALITATIVE CHARACTERISTICS****Summary of tentative decisions made in meetings to July 2005****Sources: FASB Action Alert, IASB Update****OBJECTIVES****Objective of Financial Reporting**

In the two Boards' existing frameworks, the overriding objective of financial reporting is to provide information to assist users in making economic decisions, such as making investment, credit, and similar resource allocation decisions.

Liquidity and Solvency

Also, as discussed in the two Boards' existing frameworks, the financial statements should provide information to help users assess an entity's liquidity and solvency. However, that objective should be consistent with the overall objective of providing information to a wide range of users. Therefore, the information provided in the financial statements should not be focused upon meeting the information needs of particular types of users that primarily use the financial statements to help them assess an entity's liquidity and solvency.

Stewardship and Accountability

The Board agreed that stewardship or accountability should not be a separate objective of financial reporting by business entities in the converged framework. The Board 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 Board 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.

Financial reports

The objective is to provide information about the entity to *external* users, i.e. 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 will also 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.

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.

*Conceptual Framework***Users**

Financial reports should be prepared from the entity's perspective and should aim to provide information to a wide range of users, rather than focusing on the information needs of existing common shareholders only. The framework should identify the primary users as present and potential investors and creditors (and their advisors).

Later in the project, the Boards will consider whether financial reporting should also provide information to meet the information needs of particular types of users, such as different types of equity participants.

QUALITATIVE CHARACTERISTICS

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 framework. Also, the information must be available when the users need it (timeliness).

Accounting information has *predictive value* if users use it, or could use it, to make predictions. Accounting information is not intended in itself as a prediction, nor as synonymous with statistical predictability or persistence.

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 the measuring or describing is done in a neutral manner. Therefore, faithful representation requires completeness, not subordinating substance to form, verifiability, and neutrality. 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.

Financial information needs to be *verifiable* to provide assurance to users that the 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.

Financial information needs to be *neutral* - free from bias intended to influence a decision or outcome. To that end, the common conceptual framework should not include conservatism or

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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.

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 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 who study the information with reasonable diligence, to comprehend the meaning of the information⁴. 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.

The converged framework should include presumptions not only about the capabilities of financial statement users but also about the capabilities of financial statement preparers and auditors.

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

Transparency, often cited recently as a desirable characteristic of financial information, seems to be difficult to define. In current usage, it appears to encompass some of the qualitative characteristics already included in the frameworks. Because it would be redundant, transparency should not be added to the converged framework as a separate qualitative characteristic of decision useful financial information.

Other possible characteristics considered, including credibility, high quality and internal consistency, do not describe attributes of decision useful financial information that are distinct from other qualitative characteristics. Thus, they should not be added as separate qualitative characteristics in the converged framework.

⁴ Staff have revised the wording of the proposed definition of understandability based on the recommendations made by Board Members during the July 2005 meetings.

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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.

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. (Source: Approved Minutes)

Relationships between qualitative characteristics of financial reporting

The Board agreed that staff should further develop a description of how qualitative characteristics of financial reporting information are used to build decision-useful financial reports. Board members observed that the different qualitative characteristics, which include relevance, faithful representation, comparability, understandability, 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 Board agreed that it would be better to view consideration of the qualitative 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.

Issues remaining to be addressed

Cost/benefit - do the qualitative characteristics, especially the cost/benefit balance, differ for different entities, e.g., large/small, listed/unlisted, widely dispersed ownership vs. closely held? [scheduled for October 2005]

The converged framework should include information about the types of costs that should be considered in deciding what financial information to provide, as well as criteria to help standard setters decide how to take particular types of costs into account. [scheduled for October 2005]