

## STAFF PAPER

October 2017

## IASB Meeting

<b>Project</b>	<b>Conceptual Framework</b>		
Paper topic	Sweep issue: a flowchart for Chapter 1		
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**Purpose of paper**

1. This paper considers comments received on the discussion of the objective of general purpose financial reporting in Chapter 1—*The objective of general purpose financial reporting* and proposes a way to address those comments. It also provides relevant background information.

**Staff recommendation**

2. The staff recommend that Chapter 1 of the revised *Conceptual Framework for Financial Reporting (Conceptual Framework)* includes a flowchart that illustrates the link between the objective of general purpose financial reporting and the information needed to meet that objective.
3. Appendix A provides an illustration of such a flowchart. It is provided for information only. The staff do not plan to discuss detailed drafting points at the meeting.

**Existing *Conceptual Framework***

4. The existing *Conceptual Framework* states that the objective 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 creditors in making decisions about providing resources to the entity. Those decisions depend on the returns that those investors, lenders and other creditors expect from investing in the entity's debt and equity instruments or from providing credit to the entity. Their expectations about returns depend on their assessment of the prospects for future net cash inflows to the entity. To make that assessment, investors, lenders and other creditors of the entity need information about:

- (a) the resources of the entity and claims against the entity; and
  - (b) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources.
5. The existing *Conceptual Framework* further discusses when that information is useful and provides examples of management's responsibilities towards the entity.
  6. Paragraph BC1.27 of the Basis for Conclusions of existing *Conceptual Framework* explains that the discussion of the objective of general purpose financial reporting is intended to capture the idea that users of financial statements need information to help them assess management's stewardship of the entity's resources. However, the existing *Conceptual Framework* does not use the term stewardship. The Basis for Conclusions states that this is because this term can be difficult to translate into other languages.

### **Pre-ballot draft of the revised *Conceptual Framework***

7. In developing the revised *Conceptual Framework*, the Board received feedback from stakeholders who argued that the notion of stewardship does not have enough prominence in the existing *Conceptual Framework* and can easily be overlooked. They requested the Board to provide more clarity about the role of stewardship in financial reporting.
8. The Board acknowledged those concerns and decided to make more prominent, within the discussion of the objective of general purpose financial reporting, the importance of providing information needed to assess management's stewardship of the entity's resources.

9. Accordingly, the pre-ballot draft clarifies that expectations about returns by the entity's investors, lenders and other creditors depend on both:
  - (a) their assessment of the prospects for future net cash inflows to the entity; and
  - (b) their assessment of management's stewardship of the entity's resources.
10. It further states that both those assessments rely on information about:
  - (a) the resources of the entity and claims against the entity and changes in those resources and claims; and
  - (b) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources.
11. Appendix B provides relevant extracts from Chapter 1 of the pre-ballot draft.

### **Feedback on the pre-ballot draft**

12. Some reviewers of the pre-ballot draft raised questions and concerns about the discussion of the objective of general purpose financial reporting in Chapter 1. Some of those comments seem to suggest that the revised discussion may not be clear, in particular, the link between the single objective of general purpose financial reporting and the information needed to achieve that objective, which includes information about how effectively and efficiently management has discharged their responsibilities. For example, one reviewer stated:

These paragraphs were amended to make stewardship more prominent, consistent with the Board decision. However, we believe it has gone further than just increased prominence. It now seems to reflect a dual objective, which we do not believe is consistent with the Board's decision. BC1.35 explains that there is a single objective, and information on stewardship supplements information on financial performance in helping users make allocation decisions. This is not clear throughout the Framework and Basis.

13. Two other reviewers expressed similar concerns. One suggested that the revised discussion fundamentally changes the objective of general purpose financial reporting, and that this was not the Board’s intention. Another reviewer read Chapter 1 of the pre-ballot draft as suggesting that expectations about returns help in assessing stewardship instead of assessment of stewardship being a factor in forming expectations about returns.
14. A few other reviewers raised questions and made editorial suggestions on the existing text in Chapter 1.

**Staff analysis and recommendation**

15. The staff think that the discussion in Chapter 1 of the pre-ballot draft appropriately reflects the Board’s decision to make more prominent, within the discussion of the objective of general purpose financial reporting, the importance of providing information needed to assess management’s stewardship of the entity’s resources. However, the staff is mindful of the confusion that the revised discussion has created. The staff think that such confusion may be largely attributable to the fact that Chapter 1 does not establish a direct link between the objective of general purpose financial reporting and the information needed to meet that objective. Instead, Chapter 1 establishes separate links:
  - (a) between the objective of general purpose financial reporting and expectations about returns;
  - (b) between expectations about returns and the assessments (of prospects for cash flows, and of stewardship) that those expectations depend on; and
  - (c) between those assessments (of prospects for cash flows, and of stewardship) and the information needed to make those assessments.
16. This logic is already present in the existing Chapter 1. However, the comments received on the pre-ballot draft suggest that the revisions to Chapter 1 made that logic more difficult to follow.
17. It might be possible to clarify the flow of logic in Chapter 1 by making further revisions to that chapter. However, the staff do not recommend making further

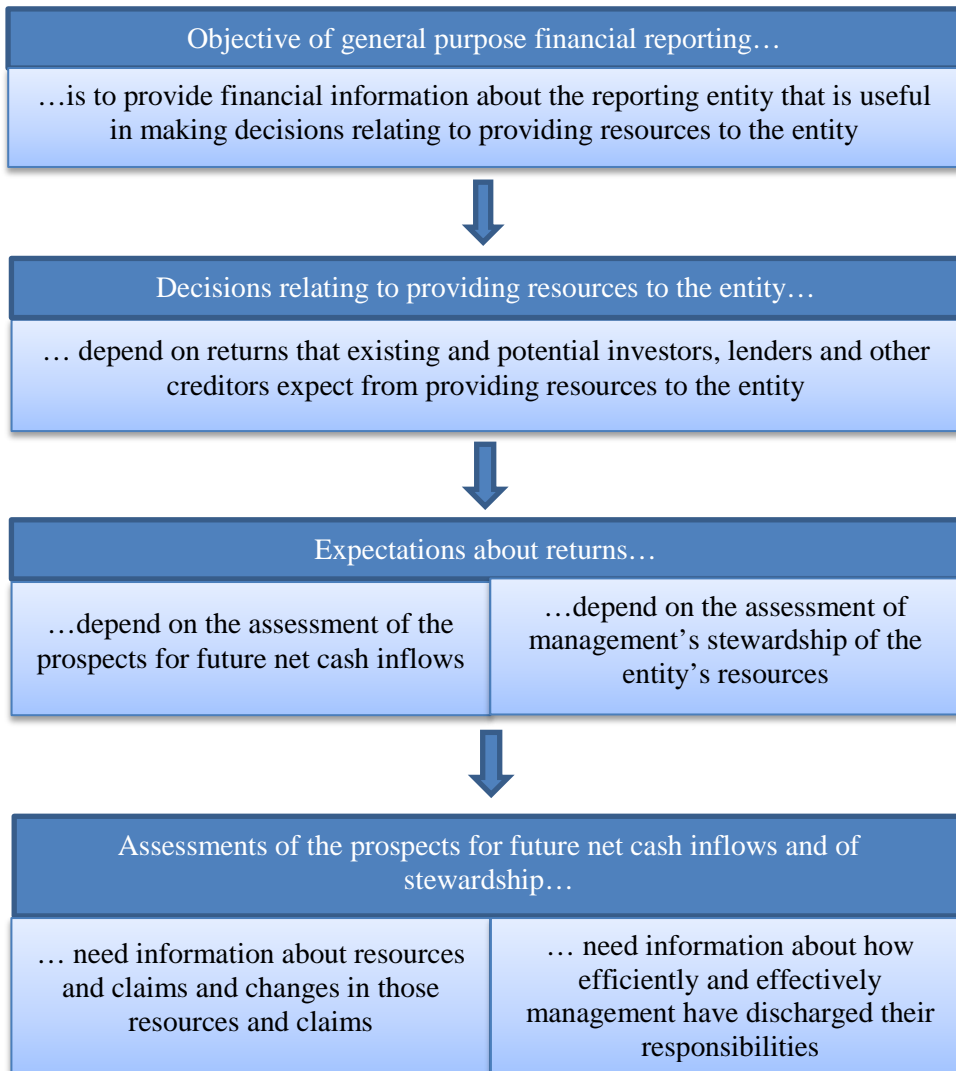
revisions to the discussion in Chapter 1, beyond those revisions that the Board has already tentatively decided to make. This is because Chapter 1 was issued in 2010 following extensive due process and the Board has tentatively decided to only make limited clarifications to that Chapter.

18. However, the staff think it would be helpful to provide clarification to assist interested parties in understanding the discussion in Chapter 1. Accordingly, the staff recommend that Chapter 1 of the revised *Conceptual Framework* includes a flowchart that illustrates the link between the objective of general purpose financial reporting and the information needed to meet that objective. An illustration of such a flowchart is provided in Appendix A. However, as noted in paragraph 3, the staff do not plan to discuss detailed drafting points at the meeting.

**Question for the Board**

Does the Board agree with the staff recommendation to include in Chapter 1 of the revised *Conceptual Framework* a flowchart that illustrates the link between the objective of general purpose financial reporting and the information needed to meet that objective?

**Appendix A—An illustrative flowchart for Chapter 1**



## Appendix B—Extracts from Chapter 1 of the pre-ballot draft

Note: Chapter 1 will be carried forward from the existing *Conceptual Framework* with only limited changes. For this appendix, paragraph numbers are based on the pre-ballot draft, new text is underlined and deleted text is struck through.

### Objective, usefulness and limitations of general purpose financial reporting

- 1.2 The objective of general purpose financial reporting<sup>1</sup> is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions ~~about~~ relating to providing resources to the entity.<sup>2</sup> Those decisions involve decisions about:
- (a) buying, selling or holding equity and debt instruments;~~;~~ ~~and~~
  - (b) providing or settling loans and other forms of credit;~~;~~ or
  - (c) exercising any rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.
- 1.3 The decisions described in paragraph 1.2 depend on returns that existing and potential investors, lenders and other creditors expect, for example, dividends, principal and interest payments or market price increases. ~~Decisions by existing and potential investors about buying, selling or holding equity and debt instruments depend on the returns that they expect from an investment in those instruments, for example dividends, principal and interest payments or market price increases. Similarly, decisions by existing and potential lenders and other creditors about providing or settling loans and other forms of credit depend on the principal and interest payments or other returns that they expect.~~ Investors', lenders' and other creditors' expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity and on their assessment of

<sup>1</sup> Throughout ~~this~~ *Conceptual Framework*, the terms 'financial reports' and 'financial reporting' refer to general purpose financial reports and general purpose financial reporting unless specifically indicated otherwise.

<sup>2</sup> Throughout the *Conceptual Framework*, the term 'entity' refers to the reporting entity unless specifically indicated otherwise.

management's stewardship of the entity's economic resources. Consequently, existing and potential investors, lenders and other creditors need information to help them assess the prospects for future net cash inflows to an entity make those assessments.

1.4 To make the assessments described in paragraph 1.3, assess an entity's prospects for future net cash inflows, existing and potential investors, lenders and other creditors need information about:

- (a) the resources of the entity, claims against the entity, and changes in those resources and claims (see paragraphs 1.12–1.21); and
- (b) how efficiently and effectively the entity's management and governing board<sup>3</sup> have discharged their responsibilities to use the entity's resources (see paragraphs 1.22–1.23). Examples of such responsibilities include protecting the entity's resources from unfavourable effects of economic factors such as price and technological changes and ensuring that the entity complies with applicable laws, regulations and contractual provisions. Information about management's discharge of its responsibilities is also useful for decisions by existing investors, lenders and other creditors who have the right to vote on or otherwise influence management's actions.

[...]

### **Information about use of the entity's economic resources**

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1.22 Information about how efficiently and effectively the entity's management has discharged its responsibilities to use the entity's economic resources helps users assess management's stewardship of those resources. Such information is also useful for predicting how efficiently and effectively management will use the entity's economic resources in future periods. Hence, it is useful for assessing the entity's prospects for future net cash inflows.

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<sup>3</sup> Throughout this *Conceptual Framework*, the term 'management' refers to management and the governing board of an entity unless specifically indicated otherwise.



- 1.23 Examples of management’s responsibilities to use the entity’s economic resources include protecting those resources from unfavourable effects of economic factors, such as price and technological changes, and ensuring that the entity complies with applicable laws, regulations and contractual provisions.