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International
Accounting Standards
Board

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

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

Board Meeting: 18 April 2007, London

Project: Conceptual Framework

Subject: Phase A Redeliberations: Issues Related to the Conceptual Framework Project in General (Agenda Paper 5A)

INTRODUCTION

1. At the Boards' February meetings, the staff presented an analysis of comments received related to the Discussion Paper (DP), *Preliminary Views on an Improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting Information*. The Boards received some comments that were not specific to Phase A, but rather addressed issues related to the conceptual framework project in general. This paper discusses those comments and the staff's plans for addressing them.
2. In cases where the staff directly quotes a comment letter received, the staff chose not to directly identify the respondent and letter number. Rather, endnotes are provided for quotes that identify the quoted respondents.

REDELIBERATIONS RELATED TO GENERAL COMMENTS

3. After analyzing the comments received on the DP, the staff identified two issues related to the general conceptual framework project for the Boards' consideration. Those issues are (a) the applicability of the framework to not-for-profit entities and (b) the authoritative status of the framework (which is an issue pertinent only to the FASB).

Applicability of the Framework to Not-For-Profit Entities

Issues Raised

4. When the Boards developed their plan for the conceptual framework project at the October 2004 joint IASB/FASB meeting, they decided to address not-for-profit considerations subsequent to developing a framework applicable to for-profit businesses. According to the minutes of the October 2004 joint meeting, Board members unanimously supported consideration of the private/business sector first, followed by consideration of the not-for-profit sector. Included in that decision was a stipulation that the IASB will need to question whether any differences need to be highlighted for the public/business sector (government business entities). Reasons cited by Board members for developing a framework for the private/business sector first included (a) the majority of constituent concerns relate to the private/business sector and (b) it will be more time efficient to focus on one sector and adjust for differences between that sector and other sectors later.
5. Some respondents commented unfavorably on the Boards' plan to address not-for-profit entities toward the end of the conceptual framework project. A letter from a public sector group states¹:

We note that the Conceptual Framework project will initially focus on business entities in the private sector, and only subsequently consider the applicability of the Conceptual Framework to other entities. While most elements of the conceptual framework may be equally valid to both private and public sectors, this will not always be the case. By considering the needs of not for profit and public sector bodies after establishing the framework for profit making entities, there is an increased risk that adequate consideration of public sector issues will not be provided; or that amendments to the framework established for profit making entities necessary to fully

reflect the needs of the public sector may be more difficult to accommodate.

6. The letter gives examples of phrasing in the DP that may need to be reconsidered in Phase G, such as the primary user group and the role of financial reporting. Specifically, the primary user group of not-for-profit entities is not present and potential investors and creditors, and resource allocation decisions are often less important to capital providers of not-for-profit entities than stewardship concerns might be.

Staff Analysis

7. The staff analyzed the comments received from respondents regarding the Boards' decision to defer consideration of not-for-profit and public entity issues until later in the project and found no issues raised that the Boards did not adequately consider at the time that the initial decision was made. Respondents indicated concerns that the Boards' preferred approach may be less efficient than considering not-for-profit and public entity issues concurrently with business entity issues, resulting in a longer project time frame. Respondents also expressed concerns that the Boards' preferred approach might be less effective, resulting in not-for-profit and public entity issues getting less focus and priority than they deserve and lowering the quality of the framework as it relates to those entities. Based on a review of the Board memo and minutes of the Board meetings at which the issue was originally decided, the staff thinks that the Boards were aware of those concerns when the decision was made to focus first on business entities. An important reason that the Boards decided to focus first on business entities was to be able to better deal with some of the difficult and perplexing issues associated with them. The Boards decided that those issues should be accorded a higher priority, and that dealing with not-for-profit entities concurrently would be a distraction.

Staff Recommendation

8. The staff recommends that the Board affirm its decision to defer consideration of not-for-profit and public entity issues and continue to focus currently available resources on the first four phases of the project. However, we note that care can be taken in drafting due process documents related to those phases

so that, where feasible, the terms used in those documents are compatible with the broad range of entities that make up the Boards' constituencies. The staff thinks such an approach will minimize the need for revising framework documents at a later stage in the project and therefore be more efficient.

Authoritative Status of the Framework

Issues Raised

9. The IASB and FASB currently place their respective conceptual frameworks at different levels of their GAAP hierarchies. International Accounting Standard (IAS) 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, states:
 10. In the absence of a Standard or an Interpretation that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:
 - (a) relevant to the economic decision-making needs of users; and
 - (b) reliable, in that the financial statements:
 - (i) represent faithfully the financial position, financial performance and cash flows of the entity;
 - (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;
 - (iii) are neutral, i.e. free from bias;
 - (iv) are prudent; and
 - (v) are complete in all material respects.
 11. In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:
 - (a) the requirements and guidance in Standards and Interpretations dealing with similar and related issues; and
 - (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.
 12. In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11.

10. The U.S. GAAP hierarchy, found in AICPA Statement on Auditing Standards No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*, states:

.11 In the absence of a pronouncement covered by rule 203 or another source of established accounting principles¹, the auditor of financial statements of entities other than governmental entities may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes, for example, FASB Statements of Financial Accounting Concepts; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; Governmental Accounting Standards Board (GASB) Statements, Interpretations, and Technical Bulletins; Federal Accounting Standards Advisory Board (FASAB) Statements, Interpretations, and Technical Bulletins; pronouncements of other professional associations or regulatory agencies; Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, FASB Statements of Financial Accounting Concepts would normally be more influential than other sources in this category. [Footnote added.]

11. As the U.S. GAAP hierarchy currently places the Concepts Statements at a lower level than IFRS places the IASB Conceptual Framework, the Boards

¹ SAS 69, paragraph .05 explains the sources of established accounting principles and Rule 203: The sources of established accounting principles that are generally accepted in the United States of America are—

- a. Accounting principles promulgated by a body designated by the AICPA Council to establish such principles, pursuant to rule 203 of the AICPA Code of Professional Conduct. Rule 203 provides that an auditor should not express an unqualified opinion if the financial statements contain a material departure from such pronouncements unless, due to unusual circumstances, adherence to the pronouncements would make the statements misleading. Rule 203 implies that application of officially established accounting principles almost always results in the fair presentation of financial position, results of operations, and cash flows, in conformity with generally accepted accounting principles. Nevertheless, rule 203 provides for the possibility that literal application of such a pronouncement might, in unusual circumstances, result in misleading financial statements.
- b. Pronouncements of bodies, composed of expert accountants, that deliberate accounting issues in public forums for the purpose of establishing accounting principles or describing existing accounting practices that are generally accepted, provided those pronouncements have been exposed for public comment and have been cleared by a body referred to in category (a).
- c. Pronouncements of bodies, organized by a body referred to in category (a) and composed of expert accountants, that deliberate accounting issues in public forums for the purpose of interpreting or establishing accounting principles or describing existing accounting practices that are generally accepted, or pronouncements referred to in category (b) that have been cleared by a body referred to in category (a) but have not been exposed for public comment.
- d. Practices or pronouncements that are widely recognized as being generally accepted because they represent prevalent practice in a particular industry, or the knowledgeable application to specific circumstances of pronouncements that are generally accepted.

included a phase to the conceptual framework project (Phase F) during which the FASB will consider elevating its framework to mirror the level of the IASB conceptual framework in IFRS. The Boards' discussions of the original plan did not indicate any compelling need to accelerate the timing for that phase or otherwise give it high priority.

12. However, a substantial number of respondents to the Phase A DP expressed concerns about the Boards' decision to deliberate the authoritative status of the framework in a later phase of the conceptual framework project. Many stated that it is difficult to comment constructively on the objectives and qualitative characteristics without a complete understanding of the purpose and authoritative status of the framework. Those respondents recommended that the Boards consider accelerating Phase F to make the authoritative status of the framework clear as the Boards deliberate its content. Questions raised included:
 - a. Where will the framework reside in the hierarchy of generally accepted accounting principles (GAAP)? Many who raised this issue expressed concern that the two Boards currently have differing views on the authoritative status of the framework. Many respondents, especially IASB constituents, proposed that both Boards should establish the same authoritative status, with most suggesting that the FASB adopt the same authoritative status that is currently included in IAS 8.
 - b. Will the framework be mandatory for standard setters, or will it merely serve as guidance for them?² Most respondents who expressed an opinion indicated that they would like the Boards to be required to comply with the framework when issuing new pronouncements. Some indicated that an act of the trustees that oversee each Board would be required to make the framework binding on the Boards.

²The IASCF *Constitution*, paragraph 23, states, "Each full-time and part-time member of the IASB shall agree contractually to act in the public interest and to have regard to the IASB *Framework* (as amended from time to time) in deciding on and revising standards."

The FASB *Rules of Procedure* state, "Statements of Financial Accounting Concepts are intended to establish the objectives and concepts that the FASB will use in developing standards of financial accounting and reporting."

Staff Analysis

13. At the FASB's February 28, 2007 meeting concerning the Phase A comment letter analysis, some FASB members indicated that there is no compelling reason to decide the authoritative status of the proposed conceptual framework until the framework is closer to being substantially finished. Since the February IASB and FASB meetings, the staff has conducted some research to gain a better understanding of the potential effects of elevating the status of the FASB conceptual framework in the GAAP hierarchy in a way similar to IAS 8. The staff interviewed regulators, public accountants, and representatives from professional accounting organizations in France, the Netherlands, the United Kingdom, and the European Union to learn, among other things:
 - a. To what extent is the conceptual framework being applied as a result of an absence of IFRS standards-level guidance?
 - b. Are there particular types of assets, liabilities, or transactions for which preparers must rely on the conceptual framework regularly?
 - c. Has there been confusion among preparers, auditors, and regulators in instances in which the conceptual framework must be applied?
 - d. What are common problems in implementing IAS 8? For example, are preparers and auditors using analogies to other standards (perhaps even National standards) before defaulting to the Framework and, if so, are those practices and judgments reasonably consistent?
 - e. Are they familiar with any studies concerning application of the IASB framework by preparers?
14. [Paragraph omitted from Observer Notes.]
15. Based on comments received from constituents related to the authoritative status of the conceptual framework during the Phase A comment period, the staff plans to ask the FASB how it wants to proceed with the decision of whether to elevate the conceptual framework in the GAAP hierarchy. The staff has identified two

options for FASB members³ to consider regarding elevating the status of the framework:

Option 1: Affirm the timing of the original plan that is to consider elevating the status of the framework when the framework is closer to being substantially complete.

Option 1(A): In future exposure documents, include a notice to recipients that FASB constituents should comment on the exposure document with the understanding that the FASB may elevate specific parts of the framework (for example, the definitions, recognition criteria, and measurement concepts for assets, liabilities, income, and expenses) to parallel the authority of the IASB conceptual framework in IFRS.

Option 2: Revise the timeline for FASB to address the authoritative status of the framework sooner (for example, to solicit input at the time of issuing the first document that is in the form of an Exposure Draft). That is, solicit input well before the framework is essentially completed.

Staff Recommendation

16. The staff recommends that the FASB choose Option 1(A). The staff appreciates the difficulties of deciding now whether and how the yet-to-be-revised and completed conceptual framework or its specific parts will be used by the Board, its constituents, or both. Once the conceptual framework is close to essentially complete, it will be important for both Boards to consider the status of the framework for use in standard-setting as well as for FASB members to consider the status of the framework for its constituents. The staff thinks it is important to inform FASB constituents of the possibility that the framework will be elevated within the GAAP hierarchy. Excluding multinational companies, only

³ Presumably the issue is primarily an FASB issue—that is, whether to elevate the status of the framework in U.S. GAAP and there is no need for the IASB to change its status. However, as previously discussed, as each Chapter is finalized the IASB will consider whether the IAS 8 references to specific parts of the framework require any modification.

four U.S. preparers commented on the Phase A Discussion Paper. That small number of responses may be due to a presumption by preparers that the conceptual framework project does not affect them because of the current status of the Concepts Statements in the GAAP hierarchy. Option 1(A) would provide more explicit notification earlier and could help diffuse last minute arguments of insufficient notice or calls for further due process.

SUMMARY OF QUESTIONS FOR THE BOARDS

17. The staff seeks decisions from the Boards at this meeting on the following questions. Do the Boards agree with the staff's recommendations to:
 1. Affirm the Boards' decision to focus initially on business entities and defer consideration of issues related to not-for-profit and public entities?
 2. Affirm the Boards' decision to defer consideration of the authoritative status of the framework in the U.S. GAAP hierarchy until the framework is substantially complete? [FASB only]

ⁱ Letter 155 from the Auditor General for Wales