30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: www.iasb.org

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:	**20 February 2007, London**
Project:	**Conceptual Framework**
Subject:	**Phase A: Objective of Financial Reporting and Qualitative Characteristics—Comment Letter Summary (Agenda paper 3A)**

INTRODUCTION

1. The comment period on 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* ended on 3 November 2006.

2. The IASB and FASB received 179 comment letters, grouped by constituent type in the following table.

Constituent Type	**Number**	**%**
Investor/Analyst	33	18%
Preparer	29	16%
Professional organization	27	15%
Standard-setter	22	12%
Individual	20	11%
Academic	18	10%
Not-for-profit	12	7%

Constituent Type	Number	%
Regulator	10	6%
Accounting firm	8	5%
Total	**179**	**100%**

3. Responses received, classified by geographical region can be summarized as follows:

Region	Number	%
Europe	88	49%
North America	43	24%
Asia-Pacific	21	12%
Africa	3	2%
Multi-regional[1]	24	13%
Total	**179**	**100%**

4. This paper summarizes the comments received. The analysis begins by summarizing significant general comments received on the DP, including comments relating to the conceptual framework project but not specifically addressed in Phase A of the project. That analysis is followed by comments specific to Chapter 1 of the DP and then comments specific to Chapter 2. The final section of the paper summarizes the staff's plan for deliberation of the issues raised by constituents and drafting and issuance of an exposure draft.

5. The staff has used a combination of techniques to present the comments received from constituents in this paper. In some cases, we summarized comments that were made frequently by using our own words to describe the general theme. In other cases, we paraphrased comments made by particular respondents without attribution. Also, when we found a comment to be particularly useful in illustrating a salient point, we quoted that comment directly. In those cases, while we made it clear that the comment is a direct quote from a respondent, we did not identify the respondent. We did, however, identify the type of respondent (accounting firm, academic, standard-setter, etc.) that made each comment that we quoted to enable Board

[1] Multi-regional comprises those respondents representing multiple regions, such as the joint international responses from each of the Big 4 Accounting Firms, and other international organizations.

members to understand the perspective of the respondent and anticipate potential biases.

6. [Paragraph omitted from Observer Notes].

7. [Paragraph omitted from Observer Notes].

GENERAL COMMENTS ON THE DP

8. The DP contains a short preface that discusses the authoritative status of the existing frameworks of each Board, the objectives of the conceptual framework project, and some process issues in the project. Many respondents commented on one or more of the issues discussed in the preface. This section summarizes those comments.

Objectives of the Project

9. The DP explains that the IASB and the FASB are reconsidering their frameworks:

   a. To update and refine existing concepts to reflect changes in markets, business practices, and the economic environment in the two or more decades since the concepts were developed.

   b. To improve and fill some of the gaps in the framework.

   c. To develop a common conceptual framework so that the Boards are able to develop consistent standards based on a single set of principles.

   The preface also notes that a comprehensive reconsideration of the frameworks is unnecessary and would not be an efficient use of Board and staff resources.

10. Most respondents who expressed an opinion supported the project generally, recognizing its important role in quality financial reporting. Many also commented favorably about the Boards' decision to issue a DP covering the objectives and qualitative characteristics phase, so as to engage constituents at an early stage.

11. Generally, respondents supported the Boards' plans to update and converge the frameworks without a comprehensive reconsideration. However, a minority indicated that the Boards should complete a more comprehensive reconsideration of the framework. Those respondents questioned the assumption made by both Boards that the existing frameworks were a good starting point for the revised, converged framework. Several respondents, especially in the academic community, submitted alternate frameworks (in various levels of detail) as part of their responses. For the most part, the alternative frameworks proposed by respondents were sufficiently different from the existing frameworks so as to require a more fundamental reconsideration rather than an update of the existing frameworks.

Authoritative Status of the Framework

12. A substantial number of respondents were concerned about the Boards' decision to deliberate the authoritative status of the framework in Phase F 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

[2]The 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."

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.

Other General DP Comments

13. Phase G, *Not-for-profit and other business entities in the public sector*: A number of respondents from the not-for-profit sector expressed disappointment that the DP is limited to business entities and does not address not-for-profit entities and other business entities in the public sector.

14. Length of the Document: Some respondents criticised the length of the DP. Most of these comments were from the IASB's constituents. Some noted that the length of the entire IASB *Framework* is 27 pages long, while Chapters 1 and 2 and the accompanying basis for conclusions contained in the DP cover 84 pages. Those respondents noted that the Boards may lose their audience by being too theoretical. Some also suggested that the DP should focus only on the main principles, and the remaining supporting material in the DP should be moved to the basis for conclusions.

15. Finalization: About 5% of respondents indicated that they would prefer that the Boards publish a single exposure draft after all phases of the project are deliberated so that constituents can review and comment on the revised framework as a whole, rather than finalizing portions of the framework before others are developed[3].

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."

[3] At the October 2006 meeting, the Boards agreed that each Board, within the context of its current GAAP hierarchy, will finalize the common framework as parts (chapters) are completed and noted that later parts may include consequential amendments to earlier parts.

ANALYSIS OF COMMENTS: THE OBJECTIVE OF FINANCIAL REPORTING

The objective of general purpose financial external financial reporting is to provide information that is useful to present and potential investors and creditors and others in making investment, credits, and similar resource allocation decisions. (Paragraph OB2)

General Issues

16. Respondents who commented on specific aspects of Chapter 1 generally had concerns that can be categorised in the following three themes: (a) scope of the objective, (b) primary users of financial reports, and (c) completeness of the identified objective.

Theme A – Scope

Should the scope of the objective be financial reporting or financial statements? What is included within financial reporting? (OB16-17, BC1.3-1.7)

17. About 16% of respondents expressed support for the Boards' decision to address the objective of financial reporting broadly. Many of these constituents also agreed with the DP that financial statements are still central to the financial reporting process and should remain the focus of the Boards' standard-setting activities. The majority of those who commented specifically on general purpose external financial reporting agree that it should be the focus of the framework.

18. 16% of respondents, most of whom were constituents of the IASB, objected to the fact that the Boards have proposed an objective of financial **reporting** rather than a more limited objective of financial **statements**.

19. Most of those who objected to the expansion of the scope were concerned that the Boards had not yet determined the boundaries of financial reporting. Some respondents were concerned about the inclusion of forecasts and descriptions of an entity's social or environmental impact reports within the boundaries of financial reporting. Some respondents indicated that the qualitative characteristics identified in Chapter 2 of the DP may not apply as well to financial reporting outside of the financial statements. Other respondents

expressed concerns about including information that may not be auditable with the boundaries addressed by the objective. Some expressed concern that the Board may be expanding the scope of information subject to audits, thereby increasing the cost of compliance with audit requirements.

20. Some respondents questioned whether an objective that is primarily focused on assessing an entity's ability to generate net cash inflows can provide an adequate basis for other types of reporting, especially reporting of nonfinancial information. Some questioned whether the Boards had the expertise and/or the authority to prescribe an objective for financial reporting other than financial statements. Those respondents noted that, in many jurisdictions, there were other bodies charged with responsibility for regulating the many types of reports included in paragraph OB 16. Finally, some respondents noted that the Boards have not yet dealt effectively with certain issues within the scope of financial statements, and that expanding the scope of the Boards' responsibility to include other types of financial reporting is inappropriate.

21. Several respondents proposed that the Boards limit their consideration of the proposed framework to financial statements until the Boards have determined the boundaries of financial reporting. Some of those respondents indicated that they limited their comments on the objective proposed in the DP to financial statements rather than to financial reporting as a whole. In contrast, other respondents noted that they did not comment on the objective at all because they were unable to form an opinion on the proposed objective of financial reporting until the Board determines what constitutes financial reporting.

22. Some respondents also suggested that the Boards define what constitutes certain types of financial reporting, such as business reporting, corporate governance reporting, and financial statements. Some also requested that the Board define a separate objective for each of the primary financial statements.

23. One respondent indicated a potential conflict between paragraph BC1.38 in the DP, which notes that information to assess corporate governance may be beyond that provided in financial reporting, and paragraph OB28, which

implies a broad objective of financial reporting that encompasses corporate governance aspects.

Entity vs. proprietary approach (OB10, BC1.8 – BC1.13)

24. Nearly all respondents who commented on the entity perspective proposed in the DP stated that this issue should not be prejudged until it has been deliberated fully. Many said that the issue of entity vs. propriety approach should be considered as part of Phase D of the project, *Reporting Entity*, which concerns the definition and boundaries of reporting entity. Those respondents noted that a thorough consideration is necessary given that the perspective selected will have an impact on how transactions are recognised and recorded. For example, the perspective selected will impact how to present consolidated financial statements, including goodwill and minority interest accounting, as well as accounting for and disclosure of related party transactions. One respondent suggested that the Boards should clearly explain the differences between the entity and proprietary perspectives, the implications of using one rather than the other, and how the views expressed in the framework are consistent with the perspective selected.

25. Of those who commented on this issue, many disagreed with the Boards' decision to adopt the entity perspective as the basic perspective underlying financial reports (BC1.12). Some respondents indicated that they preferred the proprietary approach. They disagreed with the Boards' reason for choosing the entity perspective, as the entity perspective is consistent with the focus on a wide range of users and a proprietary approach would be more consistent with the Boards chosen focus on a primary user group (current and potential investors and creditors). Many noted that they echoed their disagreement with the Boards in the recently published ED on Business Combinations, which also adopted the entity perspective over the proprietary perspective.

26. Two respondents indicated that the Boards contradicted themselves when they decided on an entity perspective but also identified current and potential investors and creditors as the primary user group, which they view as more consistent with a proprietary view.

27. One respondent from the user community recommended that the Boards focus on reporting from the perspective of the existing common shareholder. That respondent holds that financial reporting that meets the needs of the common shareholder will meet the needs of all stakeholders because the common shareholder is last residual claimant. That respondent thinks that a common shareholder perspective also will meet the information the needs of those who want to evaluate management performance in a comprehensive way.

Theme B – Users

Potential users and their needs (OB6)

28. Most respondents agreed that the Boards have identified the relevant potential users of financial reporting in OB6. However, a minority of respondents proposed that management should be included as one of the potential users listed in OB6.

29. One respondent, a national standard setter, noted that, "From our discussions and research activities, many internal users – those who have the ability to prescribe financial information – do not, in fact, do so. These internal users often do not request additional financial information beyond GPFR because they do not know what information they need or because the costs of developing specialized financial information are likely to exceed the benefits. They, therefore, rely also on GPFR. We think the framework should observe that some internal users find GPFR adequate for their purposes as well."

30. Three respondents did not think that governments and regulatory bodies should be identified as potential user groups. They noted that government and regulatory bodies can require the information and presentation of that information that best suits their needs, and therefore do not have to rely on general purpose financial reporting.

31. Some respondents noted that the Boards seem to focus heavily on analysts and other sophisticated financial statement users rather than on investors, creditors, and potential investors and creditors. Those respondents indicated that the Boards should focus on the information needs and the knowledge level of primary users rather than on sophisticated advisors.

32. Some respondents commented that the DP did not adequately address the potential differences between users of the financial reporting of different types of entities. Those respondents questioned whether the Boards had considered whether users of the financial reporting of non-publicly listed, small, and medium-sized entities had the same information needs as users of the financial reporting of large public entities. Two respondents noted that when the Boards identified primary users as investors and creditors and concentrated the objective of financial reporting on resource allocation, they reflected a bias toward publicly listed entities. Some respondents noted that employees of privately held companies may not have access to GPFR.

Should there be a focus on current and potential investors and creditors? (OB10-OB13)

33. A majority of respondents who discussed this issue agreed that the Boards should focus on a primary user group. However, there was considerable diversity among the respondents as to how to define the primary user group. In general, the responses ranged from existing shareholders only at the narrow end to existing and potential investors and creditors at the other end of the spectrum. A significant minority of respondents commented that the Boards should not focus on a group of primary users because they feared that standard-setters might not adequately address the concerns of other users.

34. Among those who disagreed with the Boards' identified primary user group, the majority preferred a focus only on existing ordinary common shareholders. Respondents in this group included many user groups. Those respondents noted that a focus on existing common shareholders does not mean that other types of users are unimportant, but rather that their needs are best served by a common shareholder perspective. Those respondents cited the following points in arguing for a current common shareholder perspective:

a. Existing shareholders bear the highest risks in the entity when an investment is made and receive a return only when all other investors have been compensated for their risks.

b. Other stakeholders (for example, creditors) are protected by contractual and other legal rights. Financial reporting should focus on shareholders who do not share the same protection.

c. A common shareholder perspective is consistent with the reality that audit reports are currently directed to existing shareholders rather than potential investors and current and potential creditors.

d. Potential investors do not have different needs in financial reporting from current investors; thus, including potential investors as a separate class of primary users is misleading. It appears to imply apparent additional obligations for directors and auditors to potential investors which may not be appropriate in all legal jurisdictions.

35. The UK Accounting Standards Board noted that its *Statement of Principles for Financial Reporting* which focuses only on present and potential investors, has been criticized as having too wide a primary user group, and should be narrowed to focus on existing ordinary shareholders only.

36. Two respondents who agreed with the Boards' identified primary user group disagreed with including investors' and creditors' advisors in primary users because that could be interpreted as requiring investors and creditors to use specialist advisors to understand financial reports and might cause standard setters to place too little emphasis on understandability in developing their standards.

37. Three respondents suggested the Boards should have a hierarchy of users and their needs rather than focus merely on primary users. Those respondents cited the report prepared by the CFA Centre for Financial Market Integrity, *A Comprehensive Business Reporting Model: Financial Reporting for Investors*.

38. Some respondents from the not-for-profit or public benefit entities sector (NFP) noted that the set of primary users was too narrow. Some suggested that the term *investor* be clarified to encompass the main class of users of the accounts of NFPs – commonly defined as "funders and financial supporters".

39. A few respondents noted that *creditor,* as defined in the DP, may be confusing in certain jurisdictions, and suggested that term be replaced by *lenders* or *financiers*. Another respondent noted that the Boards should not use *investors* as a synonym for *shareholders,* noting that creditors are often investors, and suggested replacing *investors* with *shareholders*.

Theme C – The Objective

Should decision-usefulness be the objective of financial reporting?

40. Only 14% of respondents who commented specifically on the issue agreed that decision-usefulness should be the single, overriding objective of financial reporting. For these respondents, the objective of providing information to help users assess the stewardship or accountability of management is encompassed within the decision-usefulness objective, rather than treated as a separate objective.

41. Those who agreed with the objective proposed in the DP made the following points:

   a. The objectives of financial reporting should not be confused with corporate governance issues. The requirements of corporate governance should point in directions different from decision making, and perhaps towards something like the traditional accounts, reflecting what the entity has done.

   b. Making a distinction between the stewardship[4] and decision-usefulness objective would risk separating the company's performance from that of the company's managers when they are inseparable. Elevating stewardship to a secondary objective could de-emphasize information regarding the entity's performance.

42. Two respondents, while agreeing that the overarching objective is to provide decision-useful information, did not think that the objective was sufficiently focused to help determine what information should be included in *financial*

[4] This respondent, a user, defines stewardship as "How agents (or a company's executives) manage the company's resources on behalf of their principals (or a company's shareowners) to maximize the principals' return subject to a given level of risk."

reporting to meet this objective. For example, one respondent (a standard-setter) said:

"The objective of financial reporting should focus on *what* constitutes decision-useful information and *why* that information should be provided. This could be achieved by including the following ideas:

(a) Focus on providing *financial information*;

(b) Include the *entity's economic purpose*.

(c) Refer to *cash flows*, including past, present and future net cash flows.

(d) Communicate the *type of information* to be provided."

43. The remaining 86% of those who specifically responded on this issue disagreed with the Boards' assertion that the proposed objective (OB2) should be the only objective of financial reporting and that stewardship was subsumed within the decision-usefulness objective. The group of respondents who expressed disagreement with the DP on this issue included user groups, a regulator, standard-setters, accounting firms, and preparers. A small percentage of respondents noted that they prefer that the objective of financial reporting be focused on stewardship with a focus on cash flows as a secondary objective. The majority of respondents from this group commented that to satisfy the information needs of the entity's users, the objectives of financial reporting should include **both** stewardship/accountability and decision-usefulness. Those respondents tended to reject the Boards' view of stewardship expressed in paragraphs OB27-OB28 of the DP and support the IASB alternative views expressed in the DP.

44. Respondents who disagreed that information useful to assess cash flow prospects will encompass a stewardship/accountability objective noted that:

a. The proposed objective was defined in narrower terms than in either of the present frameworks. That is because the present frameworks permit a broader view of what constitutes useful information about how management of an entity has discharged its stewardship responsibility than is the case when that information is provided only insofar as it is relevant to “resource allocation decisions”.

b. The focus on cash flows does not reflect the fact that users want sufficient information to enable them to assess the entity’s management, the returns generated on the capital invested, and the likely future returns. Whilst forward-looking information on cash flows is useful, it should not replace historic information.

c. The objective of financial reporting should not be limited to buy/sell/hold types of decisions. One respondent, an association of insurance regulators, noted that, “Certain users may not be in a position to alter their current choice of applying their scarce resources to the entity – for example, where they are locked in by contract terms. In such cases their focus will be more on the entity’s ability to deliver on its promises.”

d. This focus on cash flows would not adequately cover the needs of a wide range of stakeholders. For example, the DP seems to rely on an overly passive view of investors and ignores other types of information that they would require (for example, historic performance of management against its targets, business risks, and business drivers.)

e. The focus will not deal with some issues arising from principal-agency relationship (for example, certain disclosures on related party transactions).

f. The U.S. Security and Exchange Commission’s increased focus on compensation disclosure and stock options is further evidence that stewardship and corporate governance is an important part of financial reporting.

45. Not-for-profit respondents tended to view stewardship as the key objective of financial reporting. Many public sector bodies produce publicly available budgets and they are assessed against these budgets. Furthermore, the focus on resource allocation is not as important to users of not-for-profit financial

statements as an assessment of whether the entity's assets are being deployed in accordance with the wishes of the users.

Have the Boards appropriately described stewardship/accountability?

46. In addition to objecting to the omission of stewardship/accountability as a primary objective of financial reporting, some respondents disagreed with how stewardship is described in the DP. Many respondents commented on their view of what stewardship is and why it should be an important objective of financial reporting (although their views varied). Some of the points made are as follows:

    a. Financial reporting should include the provision of information that provides a foundation for a constructive dialogue between management and shareholders. One of the purposes of financial reporting is to provide shareholders with the information they need to make decisions as owners of the business. This will include their rights, as owners, to change the direction of the business, or change the management. One respondent, a standard-setter, notes, "In some cases … because those resource allocation decisions have already been made, and the resources cannot be easily withdrawn, for example, an investor in an unlisted entity whose shares cannot be easily sold …the users are more interested in information to help monitor the entity's activities, and to take actions to protect their investments, such as by exercising their votes at shareholders' meetings."

    b. Stewardship is more than just historical information. It is about assessing the management (including directors) performance and integrity during the year. Transactions that would be important under the management accountability notion would include management remuneration in the form of stock options or small loans to management during the year.

    c. Stewardship includes an emphasis on historic performance and transactions which underpin the financial performance of the business, which helps balance the forward looking intent in OB3-OB5.

d. Stewardship arose from agency theory. The stewardship objective provides for disaggregation of information to highlight management related party transactions that are immaterial to the business as a whole, but still detrimental to the business. It also requires information on how agents (or a company's executives) manage the company's resources on behalf of their principals (or a company's shareowners) to maximize the principals' return subject to a given level of risk. A respondent highlighted some recently published academic research that noted that for publicly listed companies, accounting earnings are associated with changes in executive compensation (stewardship objective) and changes in share prices (valuation objective).

Information useful in assessing cash flow prospects (OB3-OB5, OB13)

47. Some respondents, while agreeing with the objective of financial reporting and the relevance of information about future cash flows to that objective, were concerned that the DP did not examine other types of information that may be useful to investors. One respondent, a standard-setter, noted that, "This focus (on assessing future cash flow prospects) causes concern as to whether the decision-usefulness objective has been inappropriately narrowed to focus on information useful to buy/sell/hold decisions, which might result in the exclusion of information that is useful for stewardship-type decisions."

48. Two respondents noted that if the purpose of financial reporting is to help assess future cash flows, the Boards should consider requiring other types of financial information be reported that they do not currently require. For example, information on general economic conditions in the industry is also useful for assessing value of the entity and presumably assessing future cash flows.

49. In addition, two respondents noted that if the Boards believe that an assessment of future cash flow prospects is crucial to the objective of financial reporting, then the Boards should consider establishing a framework for prospective financial information rather than rely on historical financial information to meet these needs.

50. One respondent proposed that the framework should focus on transaction driven changes in value (historical transactions and cash flows) because that is the best indicator of future performance when adjusted by users to take into account changing economic conditions and specific business developments.

51. The majority of respondents who want management stewardship/accountability as a separate objective disagreed that the objective of financial reporting should focus solely on cash flows. One respondent, a standard-setter, stated, "… paragraphs OB3, OB5, OB12, OB13, BC1.16 and QC8 together with an absence of discussion of other information relevant to resource allocation decisions imply this purpose [to focus on cash flows] is synonymous with the proposed objective of financial reporting. … for example, some related party transactions (such as management's cash compensation) may be immaterial for assessing the entity's future cash flows, but nonetheless would warrant disclosure in discharging management's accountability."

52. Those responding from not-for-profit/public benefit entities acknowledged that information on cash flows is as relevant for their entities as it is for the private sector. However, factors such as 1) how well the organization meets its objectives and 2) effectiveness and efficiency of goods and service delivery will generally be more significant for them. Therefore, they suggested a broader definition of the primary focus of financial reporting to ensure universal application.

Other Issues Raised From Chapter 1

Focus on particular financial statements (OB18-OB26, BC1.26—BC1.31)

53. As the DP did not specifically deal with the objective of each financial statement, some respondents thought that the Boards prejudged the objective of the statement of financial performance in this DP. Some respondents thought that the Boards view the statement of financial performance/income statement as secondary to the statement of financial position. They disagreed and stated that many users focus primarily on the information in the income statement rather than the statement of financial position. They also noted that

the DP seems to imply that the statement of financial performance is measured only by changes in assets and liabilities, which they disagree with.

Underlying assumptions

54. Three respondents urged the Board to consider including a more robust explanation of the objectives of accrual accounting. Other respondents questioned why the Boards did not discuss the going concern assumption, noting that IAS 1, *Presentation of Financial Statements,* requires entities to prepare financial statements on a going concern assumption.

ANALYSIS OF COMMENTS: QUALITATIVE CHARACTERISTICS

52. The DP includes qualitative characteristics of relevance, faithful representation, comparability, and understandability, and constraints of materiality and cost-benefit considerations. Respondents most frequently commented about faithful representation and its components of verifiability, neutrality, and completeness. 78% of the letters received included comments regarding faithful representation and/or its components.

53. Many respondents objected that the DP contains references to measurement attributes such as fair value and historical cost. The DP compares these measurement attributes in the context of examples throughout chapter 2 and implies that fair value is more relevant or representationally faithful than historical cost. Some constituents argued that the qualitative characteristics section of the conceptual framework should not imply that one measurement attribute is more favorable than another, and that discussions of measurement should be reserved for the measurement phase of the project.

Relevance (Including Predictive Value, Confirmatory Value, and Timeliness)

54. 20% of respondents commented favorably on the Boards' inclusion of relevance (including predictive value, confirmatory value, and timeliness) as a qualitative characteristic; 16% commented unfavorably. Among those who commented unfavorably, some acknowledged that the IASB's current definition of relevance may be interpreted as requiring demonstration that information influences decisions. However, those respondents stated that the proposed phrase "capable

of making a difference" is vague and may inappropriately broaden the definition of relevance to include information that "may possibly" make a difference. Respondents suggested changing the phrase to "actually making a difference" or "would make a difference if provided," instead of "capable of making a difference." One respondent, a standard-setter, stated:

> We are concerned that the proposed phrase "capable of making a difference" unduly broadens the definition of relevance. Our concerns especially pertain to the further explanations in the last sentence of QC 9, "standard-setters cannot rely entirely on users to request." Therefore, we prefer a wording that refers to an influence on the decisions of users that can be reasonably expected.

Timeliness

55. Some respondents wrote that timeliness should not be a component of relevance, but rather should be included in the chapter as a constraint. For example, a comment from a standard-setter states, "Timeliness is just like materiality—it affects several qualitative characteristics, including faithful representation and reliability." Constituents explained that materiality and timeliness affect many of the qualitative characteristics in the same manner, and as such, both materiality and timeliness should be either components of relevance or constraints.

Faithful Representation (Including Verifiability, Neutrality, and Completeness)

56. 5% of respondents commented favorably on the Boards' inclusion of faithful representation (including verifiability, neutrality, and completeness) as a qualitative characteristic; 73% commented unfavorably. 23% of respondents stated that faithful representation is not equivalent to reliability. Some respondents suggested that reliability should be maintained as a qualitative characteristic and appropriately clarified rather than be replaced with faithful representation. Letter No. 179 from the European Financial Reporting Advisory Group states:

> EFRAG believes that IASB is wrong to describe replacing *reliability* with *faithful representation* as not being a change of substance. *Faithful representation* is a narrower notion than reliability…Bearing in mind that under existing Framework *faithful representation* is just one sub-characteristic of *reliability*, it follows that *reliability* must be a

> broader notion than *faithful representation*. It therefore must follow that, in replacing *reliability* with *faithful representation*, there is either a change of substance or a change in the meaning of the term *faithful representation*.

57. Other respondents stated that replacing reliability with faithful representation results in a loss of understandability. Those respondents argue that if reliability is currently misunderstood, it would be better to clarify its meaning rather than to replace it with another term that is less clearly understood. A letter from a Big Four accounting firm states:

> While we understand the Boards' intent, we believe that the proposed solution creates more confusion than it resolves. It has been our experience that the term *reliability* is generally well understood in practice. We suggest that those who have differing views would benefit from clarification and not elimination of the term. The definition of *faithful representation* is not intuitive and perhaps more likely to be misapplied resulting in additional confusion.

58. Some respondents accepted the inclusion of faithful representation as a qualitative characteristic but suggested that the description of faithful representation could be improved. Some stated that reliability should be included as a component of faithful representation. However, those who described reliability in this context did not necessarily use a description that mirrored the use of the term in the current frameworks. For example, a Big Four accounting firm wrote:

> Reliability is an important component of faithful representation and consequently the Boards should include the role of reliability in the discussion of faithful representation. Reliability of measurement represents the extent to which measurement yields the same results when performed by different qualified parties and is closely associated with verifiability.

59. Some constituents noted that the terms *faithful representation* and *real-world economic phenomena* are confusing and imprecise. Others noted that those terms may not convey the Boards' intended meaning when translated into a language other than English. Those constituents suggested that the terms be clarified or replaced by more precise and understandable terms.

Verifiability

60. Many respondents noted that verifiability should include the notion of judgment and the need for reliable evidence. They wrote that verifiability, along with faithful representation, does not encompass the full meaning of reliability. A letter from an investor/analyst association states:

> The inclusion of the need for information to be verifiable could be viewed to be different from the need for information to be reliable. In the preparation of financial statements there are many situations where a preparer will need to exercise professional judgement to determine the initial and ongoing measurement of a transaction or event. In our view, the term verifiable would imply that information would need to be substantiated or validated for it to faithfully represent the transaction whereas financial statements have historically included estimates where these are considered to be reliable.

61. Several constituents agreed with the Alternative View, as described in the DP, that indirect verification should not only require that the chosen recognition or measurement method is applied without material error or bias but also that the chosen method be one that knowledgeable and independent observers would agree is reasonable and appropriate in the circumstances. A Big Four accounting firm wrote:

> While we agree that *verifiability* is a very important component of faithful representation, we do not agree that information should be considered to be verified simply because knowledgeable and independent observers would reach general consensus that the chosen recognition or measurement *method* has been applied without material error or bias. The Boards' definition of *verifiability* could actually result in information that, using the normally understood meaning of the term, is unverified or even unverifiable. It requires only that the information has been arrived at by a method that has been applied correctly, not that the method itself is appropriate or reliable or that it has been applied to reliable data…Information should be considered to be verified when knowledgeable and independent observers would reach general consensus that the information both represents the economic phenomena that it purports to represent *and* that the chosen recognition or measurement method has been applied without material error or bias.

62. Some respondents suggested that verifiability should not be a component of faithful representation. Those constituents argue that certain useful information presented in financial reports can faithfully represent what it purports to represent while nonetheless being unverifiable. Those respondents are

concerned that including verifiability as a component or faithful representation will result in excluding information from financial reporting that is useful and appropriate. A comment from a preparer states:

> Financial information is either verifiable or it is not; greater verifiability does not, in our view, equate with greater reliability/faithful representation, nor does it necessarily improve the usefulness of financial information…The emphasis on verifiability will result in future accounting standards that are rules-based rather than principles-based. This is because if the responsibility for the validity of financial reports is taken away from management who, instead of being tasked with the job of communicating the results and prospects of the entity, are required to ensure that financial reports can be substantiated by readers, those reports will inevitably contain information that is verifiable but not necessarily understandable.

63. Some respondents stated that the term "knowledgeable and independent observers" is ambiguous. Some commented that they do not understand what characteristics would be required of an observer to make that observer knowledgeable and/or independent.

64. Additionally, some respondents commented that the effects of uncertainty in the financial statements on the qualitative characteristics should be clarified. Those respondents commented that information may be very imprecise yet still be relevant and verifiable if the methodologies can be developed to produce an amount, even if the measurement is very uncertain.

Comparability and Consistency

65. 8% of constituents commented favorably on the Boards' inclusion of comparability (including consistency) as a qualitative characteristic; 10% commented unfavorably. Some of those who commented unfavorably noted that it is important to reflect reality, and that the effort to enforce consistency can lead to a lack of faithful representation. Other respondents noted that it is inconsistent to count comparability as a qualitative characteristic while the Boards allow alternative acceptable accounting treatments in standards. Still other respondents noted that consistency should not be subsumed within comparability, but rather should have the equal prominence as a qualitative characteristic. An association of insurance industry professionals wrote:

> Comparability results when similar economic events are accounted for in a similar manner by different enterprises. Consistency results when an enterprise applies the same accounting policies between periods. By adding consistency to the list, we believe the Framework would be clear that information between entities and between periods is equally important.

Understandability

66. 15% of respondents commented favorably on the Boards' inclusion of understandability as a qualitative characteristic; 10% commented unfavorably. Among those who commented unfavorably, some argued that the discussion on understandability must place more emphasis on the need for making financial reports as a whole as clear as possible. Those constituents stated that understandability should require making financial statements understandable for the common user, and accordingly the Boards should place less emphasis on sophisticated users when assessing understandability. A letter from a professional organization states:

> The discussion of understandability seems to be tilted towards the inclusion of information that is complex and difficult to understand; it should place more emphasis on the need for understandability. The complexity of business activities and of the transactions dealt with by financial reporting often makes complexity in reporting inevitable. But even where this is the case, standard-setters should be under a duty to endeavour to ensure that the reporting is as clear as possible.

How the Qualitative Characteristics Relate to the Objective of Financial Reporting and to Each Other

67. 4% of respondents commented favorably on the sequential order of the qualitative characteristics; 21% commented unfavorably. Notwithstanding a clear statement in the DP that faithful representation is not secondary to relevance, many respondents noted that the sequential ordering appears to make relevance the most important qualitative characteristic. Those constituents suggested that the Boards further clarify that the sequential ordering does not imply that there is a hierarchy of characteristics. Other respondents argued that it is not possible for a financial report to contain something that is relevant unless it is also faithfully represented; thus these two characteristics should be considered concurrently and not in succession. A regulator explains:

> The fact that the concept of relevance is the first step in the assessment process could be seen as implying a hierarchical order among the qualitative characteristics and could send a negative signal to companies and auditors indicating that accurate, dependable measurements are of diminished importance within the new conceptual framework…The Committee recommends further emphasizing that equal importance is given to the concepts of relevance and reliability in the framework.

Constraints on Financial Reporting

Materiality

68. 9% of respondents commented favorably on the Boards' inclusion of materiality as a constraint on financial reporting; 16% commented unfavorably. Of those who commented unfavorably, some argued that materiality should be a qualitative characteristic rather than a constraint. A letter from a preparer states:

> While we agree that materiality as a concept applies equally to relevance and reliability, we believe that its application actually enhances the quality of financial reporting information rather than limits it, because:
>
> a. *Completeness* in the context of financial reporting does not mean "all information about every single transaction or event";
>
> b. Immaterial information has no impact on economic decisions and should therefore be excluded from financial reporting information that aims to provide relevant information;
>
> c. The aggregation of immaterial items…enhances financial reporting information because it makes it more understandable…Conversely, the inclusion of immaterial information reduces understandability.

69. Other respondents suggested that the Boards clarify the application of the concept of materiality to financial reporting. For example, some respondents suggested that the Boards state that the assessment of materiality should be made relative to matters considered individually and in the aggregate. These constituents supported the Chapter 1 Alternative View position that the materiality of related party transactions and compensation for management should be based on the materiality of the issue to the individual manager rather than to the company. Thus, the threshold for materiality depends on the nature of the item in question, as much as its specific amount.

Should Additional Qualitative Characteristics Be Added?

70. Many respondents suggested that the concept of a true and fair view should be included as an overriding characteristic. Those constituents stated that faithful representation does not fully encompass the notion of a true and fair view. Rather, faithful representation has a more narrow scope which does not suggest the need for judgment, as does a true and fair view.

71. 12% of respondents argued that the notion of substance over form should be explicitly included as a component of faithful representation. Constituents noted that inclusion of substance over form will help communicate an essential component of faithful representation. As faithful representation may be less readily understood internationally than reliability, it is important to include substance over form as a component of the characteristic. A letter from a professional organization rejects the argument that substance over form should be excluded as a component because it is implicitly included in faithful representation:

> Substance over form…should be identified as a component of faithful representation—in fact as the primary component, as it is in our view more important than verifiability, neutrality or completeness…The discussion paper states that "the quality of faithful representation is incompatible with representations that subordinate substance to form. Accordingly, the proposed framework does not identify *substance over form* as a component of faithful representation because to do so would be redundant" (BC2.18)…According to the discussion paper, the quality of faithful representation is also incompatible with the absence of the qualities of verifiability, neutrality and completeness. But this has not prevented the two Boards identifying them as components of faithful representation.

72. Many constituents argued that prudence, or conservatism, should be included as a characteristic or component of a characteristic. Some respondents noted that the tensions similar to that between conservatism and neutrality also exist between other characteristics. Thus, the fact that a tension exists is not a compelling argument for excluding conservatism. Other constituents raised concerns that conservatism should be retained as a component of faithful representation. For example, it will be difficult to apply the concept of neutrality to determine the appropriate fair value measurement for a security that does not have a readily determinable fair value. Constituents suggested that it would be

appropriate to use the concept of conservatism in such a circumstance to determine the appropriate fair value that should be recorded. A letter from a professional body states:

> The Board's treatment [of prudence] seems to stem from a misunderstanding of the concept of prudence; this concept does not allow for deliberate understatement of assets or income or overstatement of liabilities or expenses. Prudence is a concept providing for the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty.

73. The Management Commentary project team questioned whether the same qualitative characteristics should be applied to all components of financial reports. In developing its own discussion paper, the project team originally intended to use the same terms for the management commentary qualitative characteristics as are in the current IASB *Conceptual Framework*. At that time, the IASB questioned whether it was appropriate to apply qualitative characteristics for the conceptual framework to those for management commentary. The project team subsequently adopted modified qualitative characteristics:

> We believe that *understandability* and *relevance* should be applicable in the preparation of MC and accordingly should be reflected in the qualitative characteristics. Rather than using the *Framework* terms *reliability* and *comparability* we use *supportability, balance* and *comparability over time*.

Thus, the project team suggested the Boards consider whether the same qualitative characteristics may be applied to all financial reporting, or if there should be separate qualitative characteristics for financial statements and other portions of financial reporting.

PLAN FOR REDELIBERATIONS

74. [Paragraph omitted from Observer Notes].

Redeliberations Sequence

75. As noted in the comment letter analysis, respondent comments can be broadly grouped into three categories: (1) general comments on the conceptual framework project, (2) comments on Chapter 1, and (3) comments on Chapter 2.

76. The general comments and concerns about the project, including those on the project's objectives, process, and authoritative status of the framework, are outside the scope of the DP. We plan to bring those matters that need to be considered by the Boards to the April 2007 joint FASB/IASB meeting. Because the Boards have historically had different approaches to issues like the authoritative status of the framework, the staff believes that the Boards will benefit from hearing one another's perspectives at a joint meeting. For the sake of efficiency, we will address the remaining general comments at that joint meeting as well. While resolution of those issues is important, it is not expected to adversely affect plans for the exposure draft for Chapters 1 and 2.

77. Based on our analysis of the comment letters, we think that the issues that respondents raised in connection with Chapter 1 are considerably more substantive and more difficult to resolve than those raised in connection with Chapter 2. Accordingly, we think that the quality of the redeliberations of the Chapter 1 issues will be improved if the staff has more time to conduct additional research, including discussions with respondents as necessary to fully understand the comments received on Chapter 1. That suggests deliberating the less controversial Chapter 2 issues first while the staff engages in that research and those discussions.

Roundtable Considerations

78. Based on our analysis of the comment letters received, we do not think that it is necessary to schedule a roundtable or other formal public information-gathering meeting. The comments received are sufficiently straight-forward and understandable, and the Boards should be able to make informed decisions during redeliberations.

79. We did consider the possibility that a roundtable might provide additional insight on the general issue of stewardship. As noted in the foregoing analysis, there

were two broad categories of comments on stewardship. First, many respondents agreed with the Alternative View and rejected the Boards' view that stewardship is subsumed in the decision usefulness objective. Second, many respondents commented that the description of stewardship contained in the DP is not consistent with their particular notions of stewardship.

80. On this latter point, we considered recommending roundtable discussions to enable the Boards to hear the varied views of respondents in an environment where the respondents could interact with each other. However, we ultimately decided not to recommend such roundtable discussions for several reasons. First, the majority of respondents who commented on stewardship were European. Conducting roundtables in several jurisdictions (as is customary in joint projects) is not deemed to be a good use of the Boards' resources. Second, the staff is concerned that a roundtable might add additional delays to the process of finalizing an exposure draft that would likely exceed any additional benefit that would be gained from the exercise. Finally, we think that by scheduling the Chapter 1 redeliberations for the June Board meetings, we will have sufficient time to arrange for less formal meetings with individual respondents or small groups of respondents from whom obtaining further clarification of their comments may be helpful.

Drafting and Publication

81. [Paragraph omitted from Observer Notes].

82. [Paragraph omitted from Observer Notes].