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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: 19 February 2008, London

Project: Conceptual Framework

Subject: Issues Arising During Drafting of Phase A ED and Phase D DP/PV (Agenda Paper 3)

INTRODUCTION

1. This memo discusses issues raised by board members and external reviewers concerning the pre-ballot draft II ED that was circulated to the Boards in January.
2. Generally, board members and the external reviewers were supportive of the pre-ballot draft II. FASB members have also expressed support to proceed to a ballot draft of the ED. Most of the comments were editorial in nature, and the staff are addressing those comments in preparing a ballot draft. In addition to the editorial comments, the staff identified the following substantive comments for which board deliberation is requested:
 - (a) Some board members are concerned that the implications for the other chapters of the framework of adopting the entity perspective for financial reporting have not been clearly identified and presented in the ED.

- (b) The use of the term *accuracy* as a component of faithful representation may be misinterpreted by constituents. At least five board members prefer the phrase *free from error*.
- (c) At least three board members are concerned that the importance of comparability as a qualitative characteristic is not sufficiently captured in the ED.

ENTITY PERSPECTIVE

Invitation to Comment

3. In commenting on the ED, two board members expressed a concern that constituents have not been given a comprehensive explanation of the consequences of the adopting the entity perspective of financial reporting. They agree that the entity perspective is the appropriate perspective upon which to base general purpose financial reporting, but are concerned that constituents may not recognize how far-reaching the consequences of that decision might be. This issue is discussed at a high level in both the Phase A ED and the Phase D DP/PV, but the issue is not presented in depth in either document. In particular, the extent to which the adoption of the entity or proprietary perspectives of financial reporting might constrain the boards' options when deliberating later phases is not discussed in detail in either document.
4. The staff acknowledge that the issues surrounding the entity and proprietary perspectives have not been presented to our constituents in a comprehensive way in one document. The staff notes that there are differing views as to the implications on other phases of the project of adopting an entity perspective. For example, some think that the entity view provides a framework for developing the elements definition that naturally leads to an assets and claims approach. Others do not think that the entity view constrains the elements definitions in that way. Also, there are differing views about the extent to which the entity perspective constrains the definition of a reporting entity. The staff is concerned that

we may lose an opportunity to gain valuable insight into those issues if constituents are not provided with an appropriate forum in which to express their views on the perspectives and their possible implications for general purpose financial reporting and the remainder of the conceptual framework.

5. The staff developed several possible solutions to these concerns:
 - (a) Expand the discussion of the entity perspective and proprietary perspectives in the phase A ED to include the possible implications for later phases, and ask constituents to comment on those implications when responding to the ED.
 - (b) Expand the discussion of those issues in the phase D preliminary views document/discussion paper, and seek constituent comments through that document.
 - (c) Draft a third, stand-alone document to describe the two competing perspectives and the implications that adopting either of them might have for general purpose financial reporting.
6. The staff favours drafting a stand-alone invitation to comment (ITC) (for IASB: discussion paper) addressing the issues. Some staff thinks that the adoption of the entity perspective could conceivably have far-reaching implications on other phases of the conceptual framework, particular the definitions of the elements and the boundaries of the reporting entity. The staff thinks it is important to share the boards' thinking about the implications of the entity view as soon as practicable to give constituents an opportunity to affect the boards' thinking on those issues.
7. The staff does not recommend expanding the phase A document to discuss the implications of the entity perspective as opposed to the proprietary perspective because that document is an exposure draft. Given the wide range of views expressed and the preliminary stage of the staff's analysis, the staff believes that an ITC is the proper vehicle for soliciting feedback.

8. The staff does not recommend expanding the phase D document to discuss the implications because the implications are potentially broader than the scope of Phase D. The staff believes that the quality of the feedback that we receive from constituents will be improved if the implications of adopting either perspective on all future phases are laid out comprehensively in one place. The staff thinks the best way to do that is to draft a stand-alone ITC.
9. To give the boards an indication of what the ITC would cover, the staff prepared the following outline of an ITC (before drafting the ITC, the staff would incorporate any changes to the outline that results from board feedback on it):
 - (a) Describe and contrast the entity and proprietary perspectives of financial reporting as the boards use those terms.
 - (b) Explain the implications on the objective of financial reporting of adopting one or the other basic perspective.
 - (c) Explain how the selection of one basic perspective might influence or constrain work on other phases of the conceptual framework, such as the definitions in the elements phase.
 - (d) Explain how the selection of one basic perspective might influence or constrain work on the boundaries of the reporting entity. In this section we would introduce the parent company view of consolidation and describe how it relates to the two basic perspectives.

Timing of Related Documents

10. A related issue is whether the Phase A ED and/or the Phase D PV should be delayed pending the publication of the ITC. Some are concerned that the phase A ED contains an incomplete discussion of the implications of adopting the entity view. As a result, constituents may not be able to comment effectively on the phase A ED without a more complete understanding of the implications that some of the provisions of the ED

might have on later phases of the conceptual framework project. Some think that the Phase A ED should be delayed until the ITC is complete so that both documents can be issued simultaneously for comment. Others think that the implications of adopting the entity perspective are not significant enough to warrant delaying the issuance of the ED.

11. The staff thinks that it is too early to ascertain whether the treatment of the basic perspective of general purpose financial reporting in the Phase A ED is sufficient. The staff is in the preliminary stages of compiling its views on the implications of adopting the entity perspective. It is already clear, however, that there are very diverse views among the staff and board members about the implications. Whether the phase A ED can be adequately understood and analyzed by constituents in its present state may depend on the resolution of those diverse views about the implications of adopting the entity perspective. Accordingly, the staff recommends that any board decision about the publication of the Phase A ED be delayed at least until the staff is able to complete a draft of the ITC and share it with the boards. At that point, the staff will recommend whether the Phase A ED should be released independently or delayed until the ITC is issued.
12. The staff also recommends that any board decision about the publication of the Phase D DP/PV be delayed until the draft of the ITC is shared with the boards. Phase D builds upon the decisions in Phase A, including the adoption of the entity perspective. Also, up until now, the issue of the parent company approach to consolidated financial statements has been part of Phase D. Constituents, therefore, will be expecting the Phase D document to include discussion of it. However, as noted in paragraph 10, that issue may be covered in the ITC instead. Therefore, the Phase D document may not appear to be sufficient if it was published before the ITC.

Questions to the Boards:

13. Do you agree that a separate ITC should be drafted to invite comments on the entity and proprietary perspectives?
14. Do you agree with the staff proposals that publication for both the Phase A ED and Phase D DP should be delayed until we share a draft ITC with the boards?

ACCURACY VS. FREE FROM ERROR

15. When the staff initially circulated the November version of the pre-ballot draft for review, a Board member objected to using the term *accuracy* to describe *free from error*, a component of faithful representation. His concern was highlighted in an internal staff cover memo to the boards accompanying the pre-ballot draft II of the ED. Since then, several other board members have agreed with that board member's views. This view was also highlighted by an external reviewer.
16. Reasons expressed by board members why they prefer the term *free from error* rather than *accuracy* are:
 - (a) The term *accuracy* could be interpreted to imply a level of precision that may not be achievable under the conditions of uncertainty that often exist with accounting representations. Therefore, some constituents might argue a fair value measurement could not be a faithful representation because of its inherent uncertainty.
 - (b) The term *accuracy* is not easily translatable. For example, possible translations of *accuracy* into French convey the idea of an absolute precision, precluding any reasonable estimate, which is clearly not the intention of the draft and of the boards. The expression used in the pre-ballot draft that a faithful representation of an economic phenomenon requires "some minimum level of accuracy" is an oxymoron when translated into French.

- (c) The term *free from error* is not new in IASB’s literature. The *Framework* defines reliable information “when it is *free from material error* and bias and can be depended upon by users to represent faithfully that which it purports to represent or could reasonably be expected to represent”.

Staff Analysis and Recommendation

17. The genesis of using the term accuracy is from the DP/PV when describing how certainty, accuracy and precision relate to faithful representation. The DP/PV noted that “some minimum level of accuracy (precision) is necessary for an estimate to be a faithful representation of an economic phenomenon”. Therefore, when drafting pre-ballot draft I/staff draft, the staff used the term - accuracy – to describe the component *free from error*. (Respondents to the DP/PV did not comment adversely on this term.)
18. When updating the draft ED, the staff considered other terms such as “fairness”, “substance” or “precision” to replace *accuracy* and noted that both of these terms have particular meanings in accounting literature. We also hesitate to use *free from error* as suggested by board members because similar to *accuracy*, *free from error* can be deemed absolute, and therefore unattainable when dealing with uncertainty. Therefore, when the staff circulated the pre-ballot draft in January, it used the term *accuracy*. Furthermore, most of the other Board members were not adverse about the use and description of accuracy in the ED.
19. In reading the comments from board members during this stage, some of the staff are persuaded that we should replace the term *accuracy* with *free from error*. Others continue to think that accuracy can be adequately described in the ED to mitigate the board members’ concerns, but they are not opposed to using *free from error* if the majority of the boards prefer it.

Question to the Boards:

20. Which term do you prefer – free from error or accuracy? If you do not like either terms, can you please propose another term.

COMPARABLE FINANCIAL INFORMATION

21. Two board members noted that, while agreeing that comparability is an enhancing qualitative characteristic (QC), the discussion of the importance of having comparable information should be strengthened. Users' decision-making processes usually include researching and comparing financial information across different entities and/or time periods. Therefore, it is essential that general purpose financial reporting result in financial information that is comparable.
22. Issue a: But because comparability is an enhancing QC, some constituents may perceive that an enhancing QC is not necessary.
23. Issue b: The pre-ballot draft ED notes that "Permitting alternative accounting methods for the same economic phenomena may be undesirable, because to do so diminishes comparability." A board member recommended that the ED should expand upon that notion. That board member thinks that an accounting standard should not allow different entities to apply different accounting methods (or policies) for similar economic phenomena. He is particularly concerned when an accounting standard implicitly allows different accounting methods to account for a similar accounting phenomenon, and users may not be aware of the different types of way to account for that accounting phenomenon. Otherwise, standard-setters have failed the objective of financial reporting which is to provide financial information *for users to make decisions*.

Staff Analysis and Recommendation

24. In regards to issue a, the staff continues to think that comparability is an enhancing QC, as it enhances the usefulness of information that is

relevant and faithfully represented. The staff reminds the Boards that the distinction between fundamental and enhancing characteristics is not a commentary on the relative importance of the characteristics but rather a description of their relationship to each other. Relevance and faithful representation are fundamental, bedrock characteristics of useful information. To a great extent, achieving those bedrocks results in information that possesses the enhancing characteristics as well.

25. By definition, comparability is not so much a quality of information as it is a quality of the relationship between two or more separate pieces of information. The extent to which pieces of information about two or more economic things contain the other qualitative characteristics will bear on whether the information about those things taken collectively possesses the characteristic of comparability. The staff will make some changes to the explanatory text on comparability in the ED to emphasize the link between comparability and the fundamental QCs.
26. In regards to issue b, the staff agree with the board member's views on the importance of comparability and role that standard-setters play to ensure that financial information in GPFR is comparable.
27. The staff will work with the concerned board members to enhance the description of comparability in the ED.

Question to the Boards

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| 28. Do the boards agree with the staff's analysis and recommendations for issues a and b? |
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