STAFF PAPER

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REG IASB Meeting

Project	**Conceptual Framework**		
Paper topic	Stewardship		
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Purpose of paper

1. The purpose of this paper is to discuss whether Chapter 1 *The objective of general purpose financial reporting* of the *Conceptual Framework* should give more prominence to the idea that financial statements should provide information to help users assess the stewardship of management.

Summary of staff recommendation

2. The staff recommend that Chapter 1 of the *Conceptual Framework* should be amended to increase the prominence of stewardship within the overall objective of financial reporting by identifying the information needed to assess the stewardship of management as separate from the information needed to help users assess the prospects for future net cash inflows to the entity. However, providing information to help assess the stewardship of management would still be considered part of the information needed to meet the overall objective of financial reporting – that is to provide information that is useful for making resource allocation decisions.

Structure of paper

3. This paper is structured as follows:

   (a) background (paragraphs 4-9);

   (b) feedback (paragraphs 10-20);

   (c) stewardship or accountability? (paragraph 21)

   (d) approaches (paragraphs 22-30);

   (e) staff recommendation and question for the IASB (paragraph 31-39).

Background

4. In describing the objective of general purpose financial reporting, Chapter 1 does not use the word ‘stewardship’. However, Chapter 1 states that users of financial statements need information about how effectively and efficiently the entity’s management and governing body have discharged their responsibilities:

> To assess an entity’s prospects for future net cash inflows, existing and potential investors, lenders and other creditors need information about the resources of the entity, claims against the entity, and how efficiently and effectively the entity’s management and governing board have discharged their responsibilities to use the entity’s resources. Examples of such responsibilities include protecting the entity’s resources from unfavourable effects of economic factors such as price and technological changes and ensuring that the entity complies with applicable laws, regulations and contractual provisions. Information about management’s discharge of its responsibilities is also useful for decisions by existing investors, lenders and other creditors who have the right to vote on or otherwise influence management’s actions.[1]

[1] See paragraph OB4 of the existing *Conceptual Framework*.

5. Paragraph BC1.27 of Chapter 1 states that information that can be used to assess future cash flow prospects and information needed to assess stewardship are both important for making decisions about providing resources to an entity. In addition, information needed to assess stewardship is important for resource providers who have the ability to vote on, or otherwise influence, management's actions.

6. The Basis for Conclusions goes on to explain that the IASB decided to describe what is meant by the term 'stewardship' rather than using the term itself, because there would be difficulties translating the term 'stewardship' into other languages.

7. The discussion in the Basis for Conclusions makes it clear that the IASB views providing information to assess the stewardship of management as part of the overall objective of financial reporting. However, some have expressed the view that Chapter 1 does not give enough prominence to the idea of 'stewardship' and, consequently, Chapter 1 should be revised.

8. Stewardship was discussed in Section 9 of the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (the 'Discussion Paper').We did not ask an explicit question on the issue. Instead we asked whether respondents agreed with the IASB's proposal not to fundamentally reconsider Chapters 1 and 3.

9. The International Public Sector Accounting Standards Board's *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* issued in 2013, describes the objectives of financial reporting by public sector entities as to provide information that is useful for both accountability purposes and for decision-making purposes. However, the staff note that the users of public sector financial statements are different from the users of the financial statements of profit making entities and, in this context, it is understandable that accountability is given greater prominence.

Feedback

10. Although we did not ask an explicit question on stewardship, many respondents commented on the issue.

11. Some respondents expressed the view that it is unnecessary to change how Chapter 1 of the existing *Conceptual Framework* deals with stewardship. These respondents noted that, while Chapter 1 does not use the term ‘stewardship’, the wording of Chapter 1 and its Basis for Conclusions clearly indicate that information needed to assess stewardship is important to meet the objective of financial reporting.

12. A few respondents expressed the view that introducing stewardship as a competing primary objective of financial reporting could lead to ambiguity in standard-setting.

13. One user group stated that stewardship should not be given greater prominence in the *Conceptual Framework* because some would seek to use it as a justification to introduce management bias into recognition and measurement.

14. Some respondents believe that the IASB could deal with the issue of stewardship by making explicit reference to stewardship in Chapter 1 (ie use the word stewardship). They stated that additional changes would be unnecessary.

15. However, many of those who commented on stewardship stated that the IASB should change how Chapter 1 deals with stewardship. In particular, these respondents expressed the following views:

    (a) It is unclear in Chapter 1 that information needed to assess stewardship is necessary to meet the objective of financial reporting.

    (b) Some information needed to assess the stewardship of management (for example, information about related party transactions, compensation of key management personnel) is not needed to make resource allocation decisions.

    (c) Chapter 1 appears to imply that information used in assessing stewardship by management is also part of the information needed to assess prospects for future cash flows. However:

        (i) Providing information to help users assess stewardship by management is just as important as providing information needed to assess prospects for future cash flows.

        (ii) Information needed to assess the prospects for future cash flows is predictive in nature while information needed to assess stewardship by management is confirmatory in nature. This distinction could be important when deciding the measurement basis for an item (for example, cost or fair value).

(d) One of the purposes of financial reporting is to hold management to account. Providing information to help assess the stewardship of management helps to align management's behaviour with the objectives of investors, thereby reducing moral hazard. This role should be clearly stated in the *Conceptual Framework*.

(e) Information to help assess the stewardship of management is particularly important to long-term investors. If providing such information is not identified as an objective of financial reporting, there is a risk that Standards will focus more on the needs of short-term rather than long-term investors.

16. To address these concerns, some respondents suggested that the IASB should give greater prominence to stewardship as part of what is needed to meet the decision-usefulness objective of financial reporting. In particular, Chapter 1 should state that providing information to help assess stewardship by management is as important as providing information to assess the prospects for future cash flows.

17. Other respondents stated that stewardship should be included as an additional objective of financial reporting, separate from decision-usefulness.

> In our view, the provision of information that provides accountability is a primary objective of financial reporting. It should be reflected in the Conceptual Framework as a separate objective, equal in prominence to that of providing information that is useful for making decisions about the provision or resources to the entity. *UK Financial Reporting Council*

18. Few respondents agreed with the IASB's statement that the term 'stewardship' is difficult to translate or is not well understood. Moreover, some respondents stated that a problem with translating 'stewardship' was not a good reason for excluding the term from the *Conceptual Framework*. Some respondents suggested that if the

term 'stewardship' is unclear the IASB should consider using 'accountability' instead.

19. Stewardship was discussed at the December 2013 Accounting Standards Advisory Forum (ASAF) meeting:

    (a) Some ASAF members expressed the view that the IASB has adequately addressed the importance and the role of accountability or stewardship in the *Conceptual Framework*.

    (b) Some ASAF members expressed the view that the provision of information on accountability or stewardship is a primary objective of financial reporting, not merely a part of, or ancillary to the decision usefulness objective.

    (c) One ASAF member expressed the view that it is important not to confuse stewardship (management's responsibility for the resources entrusted to it) with accountability (management's responsibility to account for its stewardship of those resources).

20. In January 2014, the IASB held an education session on an academic literature review *The Use of Information by Capital Providers*, published by the European Financial Reporting Advisory Group (EFRAG) and the Institute of Chartered Accountants of Scotland (ICAS). That review concluded that, although there is disagreement over the relative importance of the stewardship and decision usefulness roles of financial information, there is a consensus that the two roles do not always coincide. In particular, some of the literature suggests that information needed to assess stewardship focuses on past transactions (and what management have done to influence those transactions) while the information needed to make investment decisions focuses on the potential for future cash flows.

Stewardship or accountability?

21. As noted in paragraph 6, the IASB decided not to use the word stewardship when it revised Chapter 1 because of concerns about how it would be translated into different languages. Although there are clearly problems with the translation of the word stewardship into some languages, there are also problems with the

alternative that has been suggested by some of accountability. We believe it should be possible to use the word stewardship without misunderstanding as long as we make it clear that providing information needed to assess stewardship is the same as providing the information needed to assess how effectively and efficiently management have discharged their responsibilities to use the entity's resources. Consequently, we have used the term 'stewardship' rather than 'accountability' throughout this paper.

Approaches

22. The staff have identified four approaches for you to consider:

    (a) **Approach 1** – Do nothing (paragraph 23).

    (b) **Approach 2** – Include an explicit reference to stewardship (paragraphs 24-25).

    (c) **Approach 3** – Increase the prominence of stewardship within the overall objective of financial reporting (paragraphs 26-28).

    (d) **Approach 4** – Treat stewardship as an additional objective of financial reporting, separate from decision-usefulness (paragraphs 29-30).

Approach 1 – Do nothing

23. As noted above, Chapter 1 treats providing information to assess the stewardship of management as part of the overall objective of providing decision useful information to users of financial statements. This is clear if Chapter 1 is read in conjunction with the Basis for Conclusions on Chapter 1. Therefore, the IASB could decide to do nothing and leave the treatment of stewardship in Chapter 1 unchanged.

Approach 2 – Include an explicit reference to stewardship

24. Under Approach 2, we would leave the text of Chapter 1 largely unchanged. However, we would explain in the text of the Chapter that when we refer to the information needed to assess how efficiently and effectively management have

discharged their responsibilities to use the entity's resources, we mean the information needed to help users assess the stewardship of management.

25. How this could be achieved is illustrated in the appendix to this paper.

Approach 3 – Increase the prominence of stewardship within the overall objective of financial reporting

26. Some respondents to the Discussion Paper expressed the view that the information needed to assess the stewardship of management is, in some cases, different from the information needed to help users assess the prospects for future net cash inflows to the entity. However, the wording of Chapter 1 appears to imply that information needed to assess the stewardship of management is a subset of the information needed to assess the prospects for future net cash inflows to the entity.

27. Approach 3 would address this concern by identifying the information needed to assess the stewardship of management as separate from the information needed to help users assess the prospects for future net cash inflows to the entity. However, providing information to help assess the stewardship of management would still be considered part of the information needed to meet the overall objective of financial reporting – that is to provide information that is useful for making resource allocation decisions. Providing information to help assess the stewardship of management would not be considered a separate objective of financial reporting.

28. The appendix illustrates the changes that would be needed to Chapter 1 if this approach was adopted.

Approach 4 – Treat stewardship as an additional objective of financial reporting

29. Approach 4 would identify providing information to help assess the stewardship of management as a primary objective of financial reporting, equal in prominence to the objective of providing information that is useful for making resource allocation decisions.

30. The appendix illustrates how Approach 4 could be achieved.

Staff recommendation and question for the IASB

31. Chapter 1 has been through extensive due process and, because it was developed together with the FASB, is converged with US GAAP. In addition, as noted in paragraphs 12 and 13, some constituents have raised concerns about giving stewardship greater prominence in the *Conceptual Framework*. There are therefore arguments against making changes to Chapter 1, particularly given that Chapter 1 treats providing information to help users assess the stewardship of management as part of the overall objective of financial reporting. Indeed the debate that has taken place during and after the publication of the Discussion Paper has helped to highlight the role of stewardship within the *Conceptual Framework*.

32. However, although Chapter 1 treats providing information to help users assess the stewardship of management as part of the overall objective of financial reporting, it is clear that many have not interpreted Chapter 1 in this way. Consequently, the staff believe that stewardship should be given greater prominence in the *Conceptual Framework* and, therefore, do not recommend Approach 1.

33. The main advantage of Approach 2 is that it makes it clear that providing information to help assess the stewardship of management is part of the overall objective of financial reporting without making significant changes to the text of Chapter 1 that could be misinterpreted.

34. However, this approach does not respond to the concerns of those who believe that information needed to help assess the stewardship of management does not coincide totally with:

    (a) the information needed to help users assess the prospects for future net cash inflows to the entity; or

    (b) the information needed to make resource allocation decisions.

35. The staff believe that in most cases the information needed to assess stewardship is the same as the information needed to assess the prospects for future net cash inflows to the entity. For example, information about the fair value of an entity’s investment property provides information about the prospects of future cash flows to the entity in the form of rentals or sales proceeds. Fair value information

(including fair value gains and losses) also indicates how successfully management has invested the resources entrusted it. However, we believe in some cases some information needed to assess the stewardship of management may not be needed to assess the prospects for future cash inflows (for example, some information about related party transactions or management remuneration). We therefore do not recommend Approach 2.

36. The staff reject Approach 4 because:

(a) we believe that, ultimately, information about stewardship is used to make decisions about whether to buy, sell or hold an investment (ie resource allocation decisions). A decision to change management, for example, is motivated by a desire to generate greater returns from the entity either in the form of dividends or market price increases.

(b) we disagree with the idea that a decision usefulness objective results in a focus on providing information about future net cash flows rather than information about past transactions. Information about past transactions is important for assessing both the stewardship of management and the prospects for future net cash inflows.

(c) we agree with those who believe it could be confusing to identify more than one objective of financial reporting.

37. Approach 3 acknowledges that the information needed to assess stewardship by management is sometimes different from the information needed to assess the prospects for future cash flows, but Approach 3 does not introduce an additional objective of financial reporting.

38. Approach 3 is, also, arguably consistent with the statement in BC1.27 of Chapter 1 that:

> The Board did not intend to imply that assessing prospects for future cash flow or assessing the quality of management's stewardship is more important than the other. Both are important for making decisions about providing resources to an entity, and information about stewardship is also important for resource providers who

have the ability to vote on, or otherwise influence, management's actions.

39. The staff therefore recommend Approach 3.

Question
The staff recommend that Chapter 1 of the *Conceptual Framework* should be amended to increase the prominence of stewardship within the overall objective of financial reporting as described in paragraphs 26-28 (Approach 3). Do you agree?

Appendix – Illustrating the approaches

Additions to the existing text of Chapter 1 are shown as underlined text; deletions are shown as struck through text.

Approach 2 – Include an explicit reference to stewardship

OB2 The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit.

OB3 Decisions by existing and potential investors about buying, selling or holding equity and debt instruments depend on the returns that they expect from an investment in those instruments, for example dividends, principal and interest payments or market price increases. Similarly, decisions by existing and potential lenders and other creditors about providing or settling loans and other forms of credit depend on the principal and interest payments or other returns that they expect. Investors', lenders' and other creditors' expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity. Consequently, existing and potential investors, lenders and other creditors need information to help them assess the prospects for future net cash inflows to an entity.

OB4 To assess an entity's prospects for future net cash inflows, existing and potential investors, lenders and other creditors need information about the resources of the entity, claims against the entity, and how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources. Examples of such responsibilities include protecting the entity's resources from unfavorable effects of economic factors such as price and technological changes and ensuring that the entity complies with applicable laws, regulations and contractual provisions. Information about management's discharge of its responsibilities <u>(sometimes referred to as management's stewardship)</u> is also useful for decisions by existing investors, lenders and other creditors who have the right to vote on or otherwise influence management's actions.

Approach 3 – Increase the prominence of stewardship within the overall objective of financial reporting

OB2 The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit.

OB3 Decisions by existing and potential investors about buying, selling or holding equity and debt instruments depend on the returns that they expect from an investment in those instruments, for example dividends, principal and interest payments or market price increases. Similarly, decisions by existing and potential lenders and other creditors about providing or settling loans and other forms of credit depend on the principal and interest payments or other returns that they expect. Investors', lenders' and other creditors' expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity <u>and their assessment of management's stewardship of the entity's resources</u>. Consequently, existing and potential investors, lenders and other creditors need information to help them assess the prospects for future net cash inflows to an entity <u>and information to help them assess management's stewardship of the entity's resources</u>.

OB4 To assess an entity's prospects for future net cash inflows <u>and to assess management's stewardship of the entity's resources</u>, existing and potential investors, lenders and other creditors need information about the resources of the entity, claims against the entity, and how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources. Examples of such responsibilities include protecting the entity's resources from unfavorable effects of economic factors such as price and technological changes and ensuring that the entity complies with applicable laws, regulations and contractual provisions. Information about management's discharge of its responsibilities is also useful for decisions by existing investors, lenders and other creditors who have the right to vote on or otherwise influence management's actions.

Approach 4 – Treat stewardship as an additional objective of financial reporting

OB2 The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in:

(a) making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit; and

(b) <u>assessing management's stewardship of the entity's resources.</u>

OB3 Decisions by existing and potential investors about buying, selling or holding equity and debt instruments depend on the returns that they expect from an investment in those instruments, for example dividends, principal and interest payments or market price increases. Similarly, decisions by existing and potential lenders and other creditors about providing or settling loans and other forms of credit depend on the principal and interest payments or other returns that they expect. Investors', lenders' and other creditors' expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity. Consequently, existing and potential investors, lenders and other creditors need information to help them assess the prospects for future net cash inflows to an entity.

OB4 To assess an entity's prospects for future net cash inflows, existing and potential investors, lenders and other creditors need information about the resources of the entity and claims against the entity~~, and how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources. Examples of such responsibilities include protecting the entity's resources from unfavorable effects of economic factors such as price and technological changes and ensuring that the entity complies with applicable laws, regulations and contractual provisions. Information about management's discharge of its responsibilities is also useful for decisions by existing investors, lenders and other creditors who have the right to vote on or otherwise influence management's actions~~.

<u>OB4A To assess management's stewardship of the entity's resources, existing and potential investors, lenders and other creditors need in addition to information about the resources of the entity and claims against the entity, information about how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources. Examples of such responsibilities include protecting the entity's resources from unfavorable effects of economic factors such as price and technological changes and ensuring that the entity complies with applicable laws, regulations and contractual provisions. Information about management's discharge of its responsibilities is also useful for decisions by existing investors, lenders and other creditors who have the right to vote on or otherwise influence management's actions.</u>