IFRS™

STAFF PAPER

March 2016

IASB Meeting

Project	**Conceptual Framework**		
Paper topic	Feedback summary—Chapter 2—*Qualitative characteristics of useful financial information*		
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Accounting Standards Advisory Forum, April 2016, Agenda paper 2C

Purpose of paper

1. This paper summarises the feedback received on the discussion of the qualitative characteristics of useful financial information in Chapter 2 of the Exposure Draft *Conceptual Framework for Financial Reporting* ('the Exposure Draft').

2. This paper provides a high-level summary of the comments received. Where appropriate, we will provide a more detailed breakdown of the comments for future meetings.

Summary of key messages

3. About three-quarters of respondents commented on the proposed reintroduction of an explicit reference to prudence and more than half on other questions on Chapter 2. Many of them supported the proposed changes. However, some argued that the *Conceptual Framework* should do one or more of the following:

   (a) with regard to prudence:

      (i) acknowledge, in the *Conceptual Framework* itself rather than only in the Basis for Conclusions, the possibility of selecting asymmetric accounting policies for gains and losses if such selection is intended to result in relevant information that faithfully represents what it purports to represent;

(ii) introduce asymmetric prudence rather than cautious prudence to Chapter 2; or

(iii) avoid reintroducing prudence in any form;

(b) explain measurement uncertainty as an aspect of:

(i) faithful representation;

(ii) relevance and faithful representation; or

(iii) reliability; or

(c) reintroduce reliability as a qualitative characteristic.

Structure of paper

4. This paper summarises the feedback on the following topics:

(a) reintroduction of prudence (paragraphs 5–25);

(b) substance over form (paragraphs 26–39);

(c) measurement uncertainty (paragraphs 40–58);

(d) keeping relevance and faithful representation as fundamental qualitative characteristics (paragraphs 59–73); and

(e) other comments on Chapter 2 (paragraphs 74–80).

Reintroduction of prudence

Exposure Draft proposals (paragraphs 2.18 and BC2.1–BC2.17)

5. In the Exposure Draft the Board proposed to reintroduce an explicit reference to the notion of prudence (described as caution when making judgements under conditions of uncertainty):

> 2.18. Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgements

> under conditions of uncertainty. The exercise of prudence means that assets and income are not overstated and liabilities and income are not understated. Equally, the exercise of prudence does not allow for the understatement of assets and income or the overstatement of liabilities and expenses, because such mis-statements can lead to the overstatements of income or the understatement of expenses in future periods.

6. In the Basis for Conclusions the Board distinguished between two types of prudence:

   (a) ‘cautious prudence’—a need to be cautious when making judgements under conditions of uncertainty, but without needing to be more cautious in judgements relating to gains and assets than those relating to losses and liabilities. It is in this sense that the Board proposes to reintroduce prudence in the *Conceptual Framework*.

   (b) ‘asymmetric prudence’—a need for systematic asymmetry: losses are recognised at an earlier stage than gains are. The Board thinks that the *Conceptual Framework* should not identify asymmetric prudence as a necessary characteristic of useful financial information. However, it explained that accounting policies that treat gains differently from losses could be selected in accordance with the proposals in the Exposure Draft if:

      (i) they are selected in a manner that is not intended to increase the probability that financial information will be received favourably or unfavourably by users of financial statements (ie neutral accounting policies are selected); and

      (ii) their selection is intended to result in relevant information that faithfully represents what it purports to represent.

Summary of feedback

7. Question 1(b) of the invitation to comment asked respondents whether they support the proposal to reintroduce an explicit reference to the notion of prudence (described as caution when making judgements under conditions of uncertainty) and to state that prudence is important for achieving neutrality. About three-quarters of respondents commented on the question.

8. Of those who responded:

   (a) many expressed support for the reintroduction of prudence, described as caution under conditions of uncertainty. Some support, however, was conditional on the *Conceptual Framework* also acknowledging in the body of the text rather than in the Basis for Conclusions the possibility of selecting accounting policies that treat gains and losses (assets and liabilities) asymmetrically if their selection is intended to result in relevant information that faithfully represents what it purports to represent (paragraphs 9–16);

   (b) some proposed to introduce into the *Conceptual Framework* ‘asymmetric prudence’ rather than ‘cautious prudence’(paragraphs 21–23); and

   (c) some disagreed with the reintroduction of the notion of prudence in any form (paragraphs 24–25).

Support for cautious prudence

9. Respondents who supported reintroduction of cautious prudence represent a broad cross-section of geographical regions and types of respondent.

10. They cited the following reasons:

    (a) it helps bring discipline into preparation of financial information and counteract the natural optimism of management;

    (b) application of cautious prudence does not allow hidden reserves and prohibits deliberate misstatements;

    (c) the notion of prudence is already built into IFRS Standards; and

    (d) application of prudence supports the assessment of stewardship (accountability) and corporate governance.

11. Some respondents, many from Europe, expressed conditional support for the reintroduction of cautious prudence. They agreed that cautious prudence is important for the application of neutral accounting policies; however, they thought that the Board should also explain how prudence should be applied in the selection of accounting policies. They noted the discussion on this topic in the Basis for

Conclusion and agreed with the statement in paragraph BC2.14 that 'accounting policies that treat gains and losses asymmetrically could be selected in accordance with the proposals in the Exposure Draft if their selection is intended to result in relevant information that faithfully represents what it purports to represent'. These respondents suggested that the *Conceptual Framework* should acknowledge such possible asymmetry in selecting accounting policies for gains and losses (assets and liabilities) and include some of the discussion that is currently included in the Basis for Conclusions.

12. Respondents' views on who could choose such asymmetric accounting policies differed:

    (a) most thought that only the Board, when developing a particular Standard, could select accounting policies that treat gains and losses (assets and liabilities) asymmetrically; while

    (b) a few respondents suggested that this should also be applicable to preparers, including those who select accounting policies based on the *Conceptual Framework* when no Standard or Interpretation specifically applies to a transaction.

13. A few respondents suggested that the possibility of selecting asymmetric accounting policies could be discussed in other relevant chapters of the *Conceptual Framework* (Chapter 5—Recognition and derecognition and Chapter 6—Measurement) instead of in Chapter 2.

14. A few respondents commented on how the *Conceptual Framework* could clarify the link between prudence, asymmetry and neutrality:

    (a) it could be helpful to separate the notions of prudence and asymmetry, for example by not describing asymmetry as asymmetric prudence;

    (b) using 'unbiased' instead of 'neutral' could avoid misunderstandings;[1]

[1] This suggestion was also made by a few supporters of introducing asymmetric prudence into the *Conceptual Framework*.

(c) the *Conceptual Framework* should explain that prudence is not necessarily inconsistent with neutrality, but should not state that prudence 'supports' neutrality;

(d) neutrality should be identified as a starting-point in standard-setting. If there is a valid reason for a Standard to incorporate asymmetry, the Board would have to explain its choice in the Basis for Conclusions.[2]

15. A few respondents expressed the view that acknowledgement and explanation of the possibility of selecting asymmetric accounting policies would contribute to a more consistent application of the concept. A standard-setter stated that it would also help auditors when assessing the application of prudence, and so would enhance the auditability of financial statements.

16. On the other hand, a few respondents found the discussion of asymmetric prudence and possible asymmetry in selecting accounting policies in the Basis for Conclusions to be confusing and thought that it could create potential uncertainty about the role of prudence in standard-setting.

Other concerns and suggestions expressed by the supporters of reintroduction

17. Some respondents argued that the description of prudence that is proposed in the Exposure Draft (cautious prudence) is not a traditional meaning of the term 'prudence'. To avoid misinterpretation by those who understand the term prudence to mean asymmetric prudence:

(a) some suggested that the Board should avoid using the term 'prudence' in the *Conceptual Framework* and should refer directly to 'caution'. Other suggestions to describe the term included 'care', 'objectivity', 'unbiased judgements', 'unbiased consideration' and 'careful consideration…in a balanced manner'.

(b) an accountancy body suggested that the Board should explain that the old notion of prudence would not be reintroduced, but a new notion would be introduced defined as 'caution under conditions of uncertainty'.

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[2] There was some inconsistency in the use of the term 'neutrality' in the comment letters. Some respondents, when talking about the selection of accounting policies, seemed to imply that neutral accounting policies should be the same for gains and losses, while the description of neutrality in the *Conceptual Framework* is different.

(c) an accounting firm suggested acknowledging that the notion in the *Conceptual Framework* is not the same as the meaning that some ascribe to the term.

18. A few respondents commented on the proposed description of prudence:

(a) the application of prudence should not be limited to conditions of uncertainty;

(b) the description of prudence should refer to both judgements and *estimates*;

(c) the pre-2010 drafting explains the notion of prudence more clearly.

19. Some respondents suggested that the *Conceptual Framework* should provide more guidance on:

(a) how prudence should be applied by preparers and standard-setters. A few respondents expressed concern that prudence as currently described in the Exposure Draft applies mostly to preparers and not the Board;

(b) the implications of reintroducing prudence for other sections of the *Conceptual Framework* (definitions, recognition, selection of measurement bases, and presentation and disclosure); and

(c) the interaction between prudence and neutrality. On this issue:

(i) a few respondents thought that prudence should not be described as supporting neutrality;

(ii) a standard-setter stated that although prudence is an important aspect of achieving neutrality, it also stands on its own as a key consideration when exercising judgements, eg in the discussion of measurement uncertainty.

20. Other comments made by respondents included the following:

(a) the *Conceptual Framework* should clarify that its notion of prudence is different from the regulatory concept of prudential reporting;

(b) a few respondents who suggested that reliability should be reintroduced as a qualitative characteristic of useful financial information (paragraphs 67–68) commented that prudence is a quality that supports reliability;

(c) one preparer was concerned that reintroduction of prudence could lead to more pessimistic judgements than IFRS Standards currently permit or require and suggested that preparers should disclose how they applied prudence.

Proposal by some respondents to introduce asymmetric prudence

21. Some respondents, predominantly from Europe, disagreed with the reintroduction of the notion of prudence explained as caution. Instead, they suggested including asymmetric prudence in the *Conceptual Framework*. They argued that:

(a) the treatment of cautious prudence in the *Conceptual Framework* serves no useful purpose that is not already served by the concept of neutrality;

(b) the *Conceptual Framework* should use the term 'prudence' in its traditional meaning which is, in their view, the asymmetric recognition of gains and losses;

(c) asymmetric prudence is inherent in many IFRS Standards and the *Conceptual Framework* should acknowledge this fact so that asymmetric prudence can be applied consistently when setting Standards; and

(d) in many jurisdictions where IFRS Standards are currently implemented, prudence (interpreted by the respondents as asymmetric prudence) is already a legal requirement for accounts presented by publicly-listed entities.

22. Some of these respondents commented on whether asymmetric prudence is consistent with neutrality:

(a) some thought that asymmetric prudence is not inconsistent with neutrality; while

(b) others expressed a view that prudence does not help achieve neutrality and the statement in the Exposure Draft that neutrality is supported by the exercise of prudence is misleading.

23. Respondents suggested different ways of introducing asymmetric prudence into the *Conceptual Framework*, which the staff will describe in a future paper.

Opponents of reintroduction of prudence

24. In contrast, some respondents, including many from Australia and New Zealand, objected to the reintroduction of any notion of prudence. They argued that the reintroduction is likely to be misinterpreted as leading to bias in recognition and/or measurement and could result in over-provisioning and profit-smoothing. A few respondents explicitly supported the Alternative view of Patrick Finnegan (see the Appendix).

25. Some of the opponents commented that if the notion of prudence is reintroduced, the *Conceptual Framework* should be clear that asymmetric prudence was rejected and why.

Substance over form

Exposure Draft proposals (paragraphs 2.14, 4.53–4.56, BC2.18–BC2.20 and BC4.11)

26. The existing *Conceptual Framework* does not include an explicit reference to substance over form. However, the Basis for Conclusions points out that accounting for something in accordance with its legal form, instead of its economic substance, would not result in a faithful representation.

27. The Exposure Draft proposed to state explicitly that a faithful representation represents the substance of an economic phenomenon instead of merely representing its legal form:

> 2.14. Financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the phenomena that it purports to represent. <u>A faithful representation provides information about the substance of an economic phenomenon instead of merely providing information about its legal form. Providing information only about a legal form that differs from the economic substance of the underlying economic phenomenon would not result in a faithful representation</u>.

28. In addition, the Exposure Draft discussed the application of the notion of substance over form in the guidance on definitions in Chapter 4. It explained that:

    (a) the terms of a contract create rights and obligations for an entity and sometimes a detailed analysis is required to identify the substance of the rights and obligations.

    (b) all terms of a contract—whether explicit or implicit—are taken into consideration unless they have no commercial substance.

    (c) a term has no commercial substance—and is disregarded—if it has no discernible effect on the economics of the contract.

    (d) sometimes it may be necessary to treat the group or series of contracts as a whole in order to report the substance of a transaction. Conversely, in some circumstances a contract may be accounted for as a set of contracts in order to faithfully represent the rights and obligations.

Summary of feedback

29. Question 1(c) in the invitation to comment asked respondents whether they support the proposal to state explicitly that a faithful representation represents the substance of an economic phenomenon instead of merely representing its legal form. More than half of respondents commented on the question.

30. Most of the respondents supported the proposal that the *Conceptual Framework* should make an explicit reference to substance over form. They cited the following reasons:

    (a) it helps prevent form-driven reporting and transaction structuring to achieve desired accounting outcomes ('creative accounting').

    (b) substance over form is already inherent in financial reporting and embedded in many Standards.

    (c) it is supported by the academic literature. For example, evidence suggests that market prices and more sophisticated investors incorporate off balance sheet liabilities into firms' debt-to-equity rations and/or firm value.

(d) an explicit statement of substance over form provides clarity to Islamic finance entities that are adopting IFRS Standards. Stakeholders in Islamic finance place high importance on the legal form used to achieve a particular phenomenon, because it determines whether a transaction is permissible (halal) or prohibited (haram).

31. However, some respondents commented on the drafting of the inserted text. They thought that it should not imply that substance and legal form are mutually exclusive concepts and suggested that the *Conceptual Framework* should clarify that assessment of an economic phenomenon requires a balanced consideration of both substance and legal form.

32. A representative body of financial institutions commented that it is particularly important to avoid the misinterpretation that legal form may be disregarded. They stated that the proposed focus, in the description of a present obligation, on ‘no practical ability to avoid’ rather than legal enforceability could lead to this misinterpretation.

33. A few respondents disagreed that the *Conceptual Framework* should include an explicit reference to substance over form because:

(a) its application requires substantial judgement and may reduce comparability, especially if applied by preparers at a transaction level in the absence of specific Standards; and

(b) the addition to paragraph 2.14 is not compatible with the statement in paragraph 4.8 that rights to an asset are established by contract, legislation or similar means.

34. Some respondents provided other suggestions for improving or expanding the discussion of substance over form, which the staff will consider in future papers.

Comments on reporting the substance of contractual rights and obligations in Chapter 4

35. Some respondents commented on the guidance on the substance of contractual rights and obligations in Chapter 4.

36. A few respondents suggested that this guidance should be pervasive and should be brought forward to Chapter 2. At a minimum, there should be a link between the description of the notion of substance over form in Chapter 2 and its application in paragraphs 4.53–4.56 of the Exposure Draft.

37. A few respondents commented on the possible inconsistency of the proposed guidance and the following Standards:

    (a) IFRS 9 *Financial Instruments*, in which the terms of the contract are particularly important in determining the appropriate accounting for a financial instrument, for example, instrument E in paragraph B4.1.13 of that Standard; and

    (b) IFRS 11 *Joint Arrangements*, which could be perceived as relying much more on legal form than on the economic substance and purpose of joint arrangements.

38. Other comments on the guidance included:

    (a) the analysis of rights and obligations should be explained more broadly, and should consider not only the impact on the balance sheet but also the impact on the income statement.

    (b) the Board should analyse how different IFRS Standards apply the concept of substance over form, in particular the use of the terms ‘remoteness’ and ‘not genuine’ in IFRS 9 and IAS 32 *Financial Instruments: Presentation*, before finalising the guidance on the topic in the *Conceptual Framework*.

39. A few respondents asked the Board to clarify the guidance in paragraph 4.55 of the Exposure Draft on terms that have no commercial substance. They suggested:

    (a) explaining the meaning of ‘practical ability’ in this paragraph and whether it is intended to be the same as in the context of a present obligation (paragraphs 4.32–4.35).

    (b) adding another example to this paragraph—terms that are not genuine (ie terms that only apply on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur) to mirror guidance that is included in paragraph 25(a) of IAS 32 and paragraph B4.1.18 of IFRS 9.

Measurement uncertainty

Exposure Draft proposals (paragraphs 2.12–2.13 and BC2.24(b)–(c))

40. The Exposure Draft proposed that measurement uncertainty is one factor that can make financial information less relevant, and that there is a trade-off between the level of measurement uncertainty and other factors that make information relevant.

41. These changes were made to address concerns raised by some respondents to the Discussion Paper that, since 2010, the *Conceptual Framework* has no longer identified reliability as a qualitative characteristic of useful financial information. Their main concern seemed to be that measurement uncertainty makes financial information less useful. In response, the IASB proposed to clarify that the level of measurement uncertainty affects the relevance of an estimate, and that there is a trade-off between the level of measurement uncertainty and other factors that make information relevant. That trade-off is similar to the trade-off previously described as existing between relevance and reliability. For example, one piece of information may be of high interest to users of financial statements but subject to high measurement uncertainty. Another piece of information about the same economic phenomenon may be of lower interest to users of financial information, but subject to lower measurement uncertainty. In such cases, judgement is needed to determine which piece of information is more relevant.

Summary of feedback

42. Question 1(d) in the invitation to comment asked respondents whether they support the proposal to clarify that measurement uncertainty is one factor that makes financial information less relevant, and that there is a trade-off between the level of measurement uncertainty and other factors that make information relevant.

43. More than half of the respondents commented on the question. A few respondents stated that it is important to discuss measurement uncertainty in the light of the removal of the probability criterion from recognition.

44. More than half of those who commented agreed with the proposal to clarify that measurement uncertainty is one factor that can make financial information less

relevant. A few of those respondents asked for a clearer explanation of why measurement uncertainty is discussed as a factor affecting relevance, because the link between measurement uncertainty and relevance may appear counterintuitive.

45. A few respondents expressed the view that measurement uncertainty does not necessarily make information less relevant (for example, in the insurance industry measurements can be highly uncertain, but nevertheless, relevant), and in many circumstances the presence of significant uncertainty can make information even more pertinent. They argued that disclosures that explain the inputs used in the measurement of an item can provide users with necessary information to assess its relevance.

46. Some respondents, many of them standard-setters, argued that measurement uncertainty is a factor that affects faithful representation and when discussed as a factor affecting recognition and measurement decisions in later chapters of the *Conceptual Framework* it should be discussed within the context of faithful representation, not relevance. These respondents cited the following reasons:

    (a) if measurement uncertainty is discussed within relevance, it may lead to an interpretation that relevance is more important than faithful representation and possibly to the conflation of relevance with usefulness. Just as the Exposure Draft argues that a high level of measurement uncertainty affects relevance, it could be argued that mistakes and incorrect application of procedures, incompleteness and lack of neutrality will all reduce the predictive or confirmatory value of information, ie its relevance. Similarly, it can be argued that information is not relevant if it does not represent faithfully what it purports to represent. As a result, relevance would come to be seen as the single fundamental characteristic.

    (b) information can be highly uncertain but still remain relevant. A high level of measurement uncertainty does not make a measure less relevant but does affect whether a faithful representation can be achieved. The information provided could even be misleading if a single figure is used to represent a wide range of possible outcomes.

(c) completeness, freedom from error, neutrality and prudence have important roles in assessing measurement uncertainty, and they are all discussed as aspects of faithful representation.

(d) measurement uncertainty relates to the degree of verifiability. The *Conceptual Framework* explains that verifiability helps assure users that information faithfully represents what it purports to represent, so measurement uncertainty should be considered as a factor that affects whether economic phenomena can be faithfully represented.

47. Some respondents argued that measurement uncertainty is a factor that affects both relevance and faithful representation. One preparer suggested moving the discussion of measurement uncertainty to paragraphs 2.20–2.21, which discuss the application of both fundamental qualitative characteristics.

48. Some respondents, who called for reinstatement of reliability as a qualitative characteristic of useful financial information (see paragraph 67), suggested that measurement uncertainty should be discussed as a factor affecting reliability.

Views on trade-off

49. Depending on their views on where measurement uncertainty should be discussed, the respondents' views on a possible trade-off differed. Some respondents explicitly supported the proposal in the Exposure Draft that there is a trade-off between measurement uncertainty and other factors affecting relevance. A few respondents asked for more guidance, including on other factors that affect relevance.

50. Other respondents suggested the *Conceptual Framework* should discuss a trade-off between:

(a) relevance and faithful representation; or

(b) relevance and reliability.

51. Another suggestion was to discuss how measurement uncertainty affects whether information is presented in the financial statements or disclosed in the notes to the financial statements, ie the trade-off is between presentation and disclosure.

52. A few respondents also suggested that the *Conceptual Framework* should further explain that it does not prevent the use of estimates with a high level of measurement

uncertainty if they are relevant, eg insurance liabilities and Level 3 fair values. In these cases uncertainty related to these items should be disclosed.

Suggestions for improving/expanding the discussion of measurement uncertainty

53. A few respondents suggested that further discussion about the interrelation between relevance and faithful representation would be helpful in determining which of these qualitative characteristics is affected by measurement uncertainty:

> To see this, I begin by raising the question whether the relevance of an item of information should be considered with or without reference to a particular representation. In 2.14, the ED seems to choose the line that relevance is a characteristic of the phenomena to be represented, and that therefore representation, including measurement, can and should be discussed separately from relevance, because a phenomenon can be represented in different ways. *Professor Kees Camfferman, Vrije Universiteit Amsterdam*

54. A few respondents commented on the fact that Chapter 2 discusses only measurement uncertainty and suggested that it should also discuss other types of uncertainty that affect financial reporting. Some of them suggested that it could be done by discussing uncertainty more broadly, possibly as a pervasive constraint (similar to the cost constraint), and then cross-referencing it in other relevant chapters of the *Conceptual Framework.*

55. A few respondents expressed a view that too much emphasis was put on measurement uncertainty in Chapter 2. They thought that other factors affecting relevance, for example low probability of a flow of economic benefits, should be addressed in Chapter 2, or that measurement uncertainty should be discussed in the relevant sections of Chapters 5 and 6.

57. A few respondents found the example in paragraph 2.20 confusing:

> EFRAG, however, disagrees with the idea that any number could qualify as a faithfully represented estimate, provided that the reporting entity has properly applied an appropriate process, properly described the estimate and explained any uncertainties that significantly affect the estimate as is stated in paragraph 2.20 of the ED. Faithful representation cannot be limited, in EFRAG's view, to strict compliance with a computation process and disclosures. An estimate will represent what it purports to represent, provided the link between the economic reality that is considered and the estimate that is provided can be identified. *European Financial Reporting Advisory Group (EFRAG)*

58. A few respondents suggested that the *Conceptual Framework* should also discuss:

(a) the boundary of an acceptable level of measurement uncertainty;

(b) not only the level of measurement uncertainty as a factor of relevance but also how pervasive or broad the measurement uncertainty is;

(c) the link between verifiability and measurement uncertainty;

(d) the link between measurement uncertainty and prudence;

(e) why measurement uncertainty affects recognition of different assets and liabilities differently, with possible factors including the availability of accepted valuation techniques or there being a binary outcome; and

(f) how measurement uncertainty affects predictive and confirmatory value of information.

Keeping relevance and faithful representation as fundamental qualitative characteristics

Exposure Draft proposals (paragraphs BC2.21–2.25)

59. In 2010, the label 'faithful representation' was applied to the qualitative characteristic previously labelled 'reliability'.

60. The Exposure Draft proposed to continue to identify relevance and faithful representation as the two fundamental qualitative characteristics of useful financial information.

61. The Basis for Conclusions explained why the Board proposed not to reinstate reliability as a qualitative characteristic and noted that there is much in common between the description of reliability in the pre-2010 Framework and the description of faithful representation proposed in the Exposure Draft.

Summary of feedback

62. Question 1(e) of the invitation to comment asked respondents whether they support the proposal to continue to identify relevance and faithful representation as the two fundamental qualitative characteristics of useful financial information. More than half of respondents commented on the question.

63. Many of those who commented on this question agreed that relevance and faithful representation should continue to be identified as the two fundamental qualitative characteristics of useful financial information.

64. A few respondents specifically supported the use of the term ‘faithful representation’ rather than ‘reliability’ because:

    (a) the term ‘reliability’ is often misunderstood and associated only with measurement;

    (b) faithful representation is a broader notion and seems to capture more of the ‘presents fairly’ or ‘true and fair’ concept; and

    (c) the Exposure Draft sufficiently and appropriately addresses measurement uncertainty and/or low probability of cash flows.

65. A few respondents emphasised that they support the use of the term ‘faithful representation’ rather than ‘reliability’, because the Exposure Draft proposed to reintroduce prudence and increase the prominence of substance over form.

66. In addition, a few respondents suggested that the *Conceptual Framework*:

(a) should include in the description of faithful representation a statement that users can depend on the information. This statement was included in the pre-2010 description of reliability.

(b) should explain how the relationship between relevance and faithful representation differs from the one between relevance and reliability and what the remaining differences are between the pre-2010 concept of reliability and the concept of faithful representation in the Exposure Draft.

(c) could include a discussion of reliability within the discussion of faithful representation.

67. However, some of those who responded suggested that the *Conceptual Framework* should reintroduce reliability as a fundamental qualitative characteristic. They cited the following reasons:

(a) reintroduction of reliability is important to restore the trade-off between relevance and reliability;

(b) reinstatement of reliability is necessary to maintain the credibility of financial statements, because reliability includes a notion that information can be depended upon by users;

(c) the notion of faithful representation differs from reliability; for example Level 3 fair value measurements can faithfully represent values, but their reliability can be questioned;

(d) if the term ‘reliability’ was not well understood, it would be more useful to provide additional clarification instead of replacing it with another term that is potentially not well understood either; and

(e) the removal of the reliability criterion for recognition coupled with other changes to recognition could potentially extend the range of recognised assets and liabilities.

68. These respondents suggested the following ways of reintroducing reliability:

(a) as a separate fundamental qualitative characteristic with measurement uncertainty discussed as a factor affecting reliability;

(b) as a separate characteristic or as an aspect of relevance or faithful representation;

(c) as an enhancing qualitative characteristic to augment the concept of faithful representation; or

(d) as a fundamental qualitative characteristic that would have prevalence over relevance.

69. A group of academics suggested adding measurement uncertainty as a third fundamental qualitative characteristic alongside relevance and faithful representation.

Other comments on the fundamental qualitative characteristics

70. A few respondents expressed an opinion that the *Conceptual Framework* seems to imply that information can be relevant for all purposes (decision-making, stewardship, predicting future cash flows and assessing performance) and so creates an expectations gap. The qualitative characteristic of relevance should be clarified in the light of the objective of financial reporting.

71. A few respondents expressed the view that the Exposure Draft relies more heavily than the existing *Conceptual Framework* on the qualitative characteristics of relevance and faithful representation, which are relatively subjective. The *Conceptual Framework* should further explain how they should be applied within different contexts, eg in recognition criteria. One prudential regulator suggested that over the longer term their explanation should be enhanced so that they can be interpreted and applied consistently by all.

72. An accountancy body suggested that transparency could be discussed as part of faithful representation.

73. A user representative body suggested that relevance should be identified as the primary qualitative characteristic, with ‘credibility’ introduced as a secondary characteristic, which would encapsulate substance over form, reliability and verifiability.

Other comments on Chapter 2

74. A few respondents, predominantly from Europe, expressed a view that the *Conceptual Framework* should explain the link between the qualitative characteristics of useful financial information, the notions of 'true and fair view' and 'fair presentation' and the notion 'present fairly' as described in paragraph 15 of IAS 1 *Presentation of Financial Statements*.

75. They argued that it was important to do so because:

    (a) the concept of true and fair view is used in many jurisdictions that have adopted IFRS Standards. It is a statutory requirement for the EU and one of the endorsement criteria used by EFRAG.

    (b) International Standards on Auditing require auditors to form a view as to whether general purpose financial statements are presented fairly (or present a true and fair view).

76. A few respondents suggested that after the work on materiality is completed as part of the Disclosure Initiative, the *Conceptual Framework* should be revised to reflect it.

77. One standard-setter expressed the view that the usefulness of financial statements to users depends largely on the perceived credibility of those financial statements, which is affected not only by the quality of financial reporting framework but also by other factors, including whether the financial statements have been audited. It suggested that explicit consideration by the Board of auditability and its overlap with verifiability could be helpful when drafting Standards that meet the overall objective of financial reporting. Furthermore, it encouraged the Board to recognise that auditability could be significantly enhanced if the Standards required management to document the basis for significant judgements and decisions made in applying the Standards.

78. One preparer from the financial sector expressed a view that the Exposure Draft overemphasises the predictive value of historical financial information, because resource allocation decisions are made daily, while financial reports are issued at best four times a year, and there is a time lag between the balance sheet date and the release of general purpose financial reports.

79. A few respondents commented on the cost constraint:

(a) it is difficult to apply because costs are borne and benefits are received by different parties. More guidance is needed on the notion to ensure consistent application and disclosures by preparers.

(b) it should only be used by the Board in standard-setting, not by preparers in applying the Standards, ie individual preparers should not use the cost constraint to justify non-compliance with an existing Standard.

80. Comments on the enhancing qualitative characteristics included:

(a) the description of completeness suggests that providing more detailed and extensive disclosure is preferable to providing more concise disclosure. However, provision of too much detailed information could obscure useful information and result in financial statements being less understandable. One standard-setter recommended that the discussion of completeness should draw on the work being done in the Disclosure Initiative. Another suggested that conciseness should be included as an enhancing qualitative characteristic in the *Conceptual Framework*.

(b) the existing *Conceptual Framework* explains verifiability in terms of different observers reaching consensus on whether a particular depiction is a faithful representation. One standard-setter suggested that verifiability should be explained in terms of 'based on objective evidence' rather than consensus.

(c) one accounting firm expressed a view that understandability, timeliness and comparability need to be elevated to fundamental qualitative characteristics.

Appendix—Extract from the Alternative view of Patrick Finnegan

Prudence

AV16 Mr Finnegan disagrees with the decision to reintroduce an explicit reference to the notion of prudence in the *Conceptual Framework* to support the meaning of neutrality, ie a lack of bias in the selection or presentation of financial information. He believes that financial information possessing the characteristic of neutrality is already free from bias. Mr Finnegan thinks that if prudence is included in the *Conceptual Framework* or any Standard, it would introduce bias and would create confusion in the minds of many preparers about whether or how it should be applied. Even though the Exposure Draft attempts to make it clear that prudence is consistent with neutrality, Mr Finnegan disagrees that prudence (the exercise of caution) is consistent with neutrality. He believes the use of that term within the *Conceptual Framework* could result in:

(a) Standards designed to produce weighted outcomes.

(b) preparers being cautious by understating assets and overstating liabilities or being cautious in communicating bad news and hence overstating assets and understating liabilities. Such actions have the potential to confuse investors and lower their confidence in financial reporting.