

## STAFF PAPER

May 2016

## IASB Meeting

Project	Conceptual Framework		
Paper topic	Chapters 1 and 2—Introduction		
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**Purpose of this paper**

1. This paper:
  - (a) provides background for the discussion about whether any amendments are needed to Chapter 1—*The objective of general purpose financial reporting* and Chapter 2—*Qualitative characteristics of useful financial information* in response to feedback received on the Exposure Draft *Conceptual Framework for Financial Reporting* (‘the Exposure Draft’);
  - (b) identifies the topics within Chapters 1 and 2 that have been analysed for this meeting; and
  - (c) asks the Board to confirm its Exposure Draft proposals on other topics discussed in Chapters 1 and 2.

**Background for the discussion**

2. At its April 2016 meeting the Board confirmed that redeliberations on the *Conceptual Framework for Financial Reporting* (‘the *Conceptual Framework*’) will focus on areas that have been controversial or those where new information has become available.

3. In addition, when preparing the analysis for this meeting, any comments received on Chapters 1 and 2 of the Exposure Draft were considered in the context of:
- (a) the Board’s intention, that has been communicated throughout the project, not to reconsider fundamentally these chapters because they were completed only recently and had been through extensive due process;
  - (b) the overall objective of the Conceptual Framework project, which is to improve financial reporting by providing a more complete, clear and updated set of concepts instead of fundamentally reconsidering all aspects of the *Conceptual Framework*;
  - (c) the fact that these chapters were developed jointly with the FASB. Any decisions to change them would lead to a non-converged result.

**Topics for further consideration**

4. Agenda Paper 10B for the April 2016 Board meeting proposed conditions for redeliberations on the Conceptual Framework project. Based on those conditions, the staff propose that in respect of Chapters 1 and 2 additional analysis is needed on the following topics :
- (a) stewardship—whether to confirm giving more prominence to stewardship as part of the objective of financial reporting as proposed in the Exposure Draft and whether to discuss ‘decision usefulness’ as a broader concept than just the decisions about buying, selling or holding the entity’s shares;
  - (b) prudence—whether to confirm the proposed reintroduction in the *Conceptual Framework* of the notion of prudence described as the exercise of caution under the conditions of uncertainty; and whether to acknowledge that asymmetry in recognition and/or measurement has a role to play in standard-setting; and
  - (c) measurement uncertainty—whether to confirm the discussion of measurement uncertainty as a factor that affects the qualitative characteristic of relevance, or discuss measurement uncertainty as a factor

that affects the qualitative characteristic of faithful representation; and whether to discuss other types of uncertainty.

5. Agenda Papers 10C–10E for this meeting provide further analysis and staff recommendations on the treatment of stewardship, prudence and measurement uncertainty in the *Conceptual Framework*.
6. In addition, at a future meeting the staff plan to present a paper which will consider whether the description of materiality in the *Conceptual Framework* should be modified in the view of developments on this topic in the Disclosure Initiative.

### Dealing with other topics

7. In addition to the topics identified in paragraph 4, the respondents commented on a number of other issues. The staff analysed the comments on the issues that received significant feedback and recommend:
  - (a) retaining the existing description of the primary user group—ie existing and potential investors, lenders and other creditors—in Chapter 1. Less than a quarter of the respondents commented on the primary user group, with some respondents suggesting that it should be expanded and some that it should be more narrowly defined (focusing on the needs of existing equity investors)<sup>1</sup>. Respondents to the Exposure Draft did not raise any new issues that were not considered by the Board when Chapter 1 was developed in 2010 and/or during development of the Exposure Draft.
  - (b) confirming that the *Conceptual Framework* should include an explicit statement that a faithful representation represents the substance of an economic phenomenon instead of merely representing its legal form. Most of those who commented on the issue supported the proposal. Some respondents commented on the drafting of the inserted text. In particular, 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

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<sup>1</sup> See the summary of feedback in paragraphs 30–33 of March 2016 Agenda Paper 10A.

balanced consideration of both substance and legal form<sup>2</sup>. The staff will address these comments when drafting the revised *Conceptual Framework*.

- (c) confirming that relevance and faithful representation should continue to be identified as the two fundamental qualitative characteristics of useful financial information. This proposal received strong support from the respondents to the Exposure Draft. While some respondents would prefer to reintroduce reliability as a fundamental qualitative characteristic instead of faithful representation, most respondents agreed that the term ‘faithful representation’ better explains the substance of this qualitative characteristic. Some of the previous concerns of supporters of reliability were also addressed by the reintroduction of prudence, inclusion of an explicit statement about substance over form and an explanation of measurement uncertainty<sup>3</sup>.

- 8. The staff also considered whether it is necessary to develop further any of the suggestions raised on Chapters 1 and 2 by only one or a few respondents to the Exposure Draft (see appendix). However, the staff do not recommend making any changes to the *Conceptual Framework* in respect of these suggestions for the reasons explained in paragraph 3.

**Question for the Board**

Do you agree to:

- (a) retain the existing description of the primary user group in Chapter 1;
- (b) confirm that an explicit statement that a faithful representation represents the substance of an economic phenomenon instead of merely representing its legal form should be included in the *Conceptual Framework*; and
- (c) confirm that relevance and faithful representation should continue to be identified as the two fundamental qualitative characteristics of useful financial information?

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<sup>2</sup> See the summary of feedback in paragraphs 29–39 of March 2016 Agenda Paper 10B.

<sup>3</sup> See the summary of feedback in paragraphs 62–73 of March 2016 Agenda Paper 10B.

## Appendix—Summary of other comments on Chapters 1 and 2 made by only one/ a few respondents

This appendix provides extracts from March 2016 Agenda Papers 10A Feedback summary—Chapter 1—*The objective of general purpose financial reporting* and Agenda Paper 10B Feedback summary—Chapter 2—*Qualitative characteristics of useful financial information*.

### Other comments on Chapter 1

35. A few respondents suggested that the existing *Conceptual Framework* should have a section dealing with the scope of financial reporting. Suggestions for such guidance included:
- (a) including in the *Conceptual Framework* a clarification that information in financial statements complements other forms of reporting, including Integrated Reporting;
  - (b) clarifying the relationship between information contained in general purpose financial reports and general purpose financial statements; and
  - (c) setting a broad scope for financial reporting and elaborating on the reference to meeting common information needs.
36. A few respondents also discussed the effect of the evolution of user information needs on the ability of financial reporting to provide a comprehensive view of an entity's performance, including stewardship. They suggested that the *Conceptual Framework* should include a section that discusses Integrated Reporting and similar developments and their role in meeting users' needs.
37. A suggestion for the medium term was to clarify that the concepts articulated in the *Conceptual Framework* are transaction-neutral, ie capable of being applied by all reporting entities, irrespective of their operating structure or the sector in which they operate—private or public. This respondent thought it was important to acknowledge the desirability of having a single conceptual framework that can be applied by all reporting entities around the world.
38. One user representative body thought that the Board should give greater prominence to paragraph 1.8 of the existing *Conceptual Framework* about including additional

information that is most useful to a particular subset of primary users. They thought that entities should be aware that they should seek to provide relevant information rather than merely focus on compliance with IFRS Standards.

## 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.