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Sir David Tweedie  
Chairman  
International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
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Dear Sir David,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, I appreciate the opportunity to comment on the *Exposure Draft of An improved Conceptual Framework for Financial Reporting – Chapters 1 and 2* (May 2008). Principal authors of this comment letter were Peter Geyer, Roland Nessmann, and Alfred Wagenhofer.

### **General comments**

We understand that this ED is the first part of a broader project to develop a conceptual framework that is sound, comprehensive and internally consistent (para P4). Chapter 1 is particularly important as it will serve as the basis for the development of the rest of the chapters (para OB1). Nevertheless, new insights may be gained in later stages of the deliberations, so that some of the text in the ED could be altered to be consistent with these insights (para P15). For example, para OB4 explains general purpose financial reporting but mentions that its boundaries will be considered in later stages. This sequential process makes it difficult to comment on the proposal at the current stage. There may arise unintended consequences in later stages that are not anticipated yet. Therefore, our comments to be preliminary and may be subject to change in the course of the development of the other phases of the framework.

The Board sees the framework as the “goal or ideal” (para OB 14) towards which standards are developed and notes that in reality deviations from that ideal may be necessary. The ED states qualitative characteristics in general form, which are hard to disagree with. But their applicability on certain accounting issues may vary due to a trade-off between the different characteristics and, consequently, lead to inconsistent resulting standards. Different weights may particularly be a result of different needs of certain types of entities. The ED states in para BC1.30-32 that the Board concluded that financial reporting should not be different for different types of entities. We do not fully agree with that because some user needs may be more pressing for certain kinds of users. For example, smaller closely held entities usually do not access capital markets, so that they may have less transparency requirements than listed entities. Since the Board develops its standards for all entities, such differences are likely not to be sufficiently taken into account – we just refer to the IFRS for Private Entities (formerly known as IFRS for SMEs). Entities may be required by law to prepare financial statements so they do not have the discretion that para BC1.31 appears to allude to. Finally, cost considerations may not be the only characteristic that is affected (see para BC1.32).

Similarly, in para OB13, the Board acknowledges that financial reporting is but one source of information to capital providers. It is not clear from that statement what the consequences of such other information are to financial reporting. It is possible that the availability of other information with certain characteristics alters the desirable qualitative characteristics of financial reporting. For example, if the market price of an entity is available, which presumably is “neutral”, financial information may not need to be neutral as well but focus on particular strengths of financial reporting relative to market prices, such as the inclusion of verifiable information.

The ED paints a picture as if accounting information is a natural thing, that is, it can be technically correct or wrong. It seems to ignore that accounting reports are prepared under uncertainty, with different objectives in mind, and by managers who have self-interest in the entity and do have superior private information. In other words, we believe that the ED takes the view of prescribing intended consequences, such as neutrality, that would arise if accounting were a technology. Regulation should consider potential reactions of decision-makers to enacted standards, so it is not the intention but the result that is eventually important. For example, how would faithful representation without a high degree of verifiability be ever achievable? How would we know if such information faithfully represents the underlying events?

We consider conservatism (prudence) to be a characteristic of accounting – it has always been so – and find it difficult to believe that there are no good reasons for this to be the case. Simply stating in the ED that conservatism conflicts with neutrality and neutrality being an essential component of faithful representation, falls short of potential tradeoffs between these characteristics. It may be that conservative information is still informative whereas intended neutral information is void of any decision relevance due to its potential management bias. Eliminating conservatism in the framework may also

be the argument to a future change in standards that require impairment of assets; impairment is certainly not a neutral measurement.

However, we see the need to limit the possibility for management to create hidden reserves by misuse of valuation techniques or using so-called conservative valuation. A suggestion would be by requiring management to disclose the fair values in the notes whenever not used for accounting purposes, with additional information why management could not or did not use the fair value for reporting purposes. Additionally, we want to point out that the determination of fair values is one of the most urgent needs for financial reporting.

The ED is silent on the planned authoritative status of the framework (see para P13-P16). We believe this is important to understand the implications of the provisions in the proposed framework. Many national financial reporting regimes, including IAS 1, include an overriding principle. We miss a statement about the overriding principle and think it is important that it should be mentioned in the framework, as it is clearly fundamental to understand the hierarchy of general principles and individual characteristics or rules. Alternatively, if IASB aims to abandon the overriding principle, it should explicitly discuss that.

## Specific comments

### Chapter 1

**Q1.** *The boards decided that an entity's financial reporting should be prepared from the perspective of the entity (entity perspective) rather than the perspective of its owners or a particular class of owners (proprietary perspective). (See paragraphs OB5–OB8 and paragraphs BC1.11–BC1.17.) Do you agree with the boards' conclusion and the basis for it? If not, why?*

We agree that the entity perspective is more appropriate than the proprietary perspective. In conjunction with the primary user group which includes both investors and creditors, the entity perspective appears to be consistent with the objectives of financial reporting. We do note, however, that current equity investors may have additional information requirements due to their legal and contractual status than, say, prospective future investors. Therefore, we suggest including part of the discussion in BC1.21 into the main text.

We note that the entity perspective may have implications on the boundaries of the reporting entity, which is dealt with in a separate Discussion Paper, and perhaps in other parts of the framework. Therefore, we cannot finally conclude that the entity perspective will remain the most appropriate approach.

**Q2.** *The boards decided to identify present and potential capital providers as the primary user group for general purpose financial reporting. (See paragraphs OB5–OB8 and paragraphs BC1.18–BC1.24.) Do you agree with the boards’ conclusion and the basis for it? If not, why?*

We note that investors and creditors have different claims against the entity and therefore their information needs are not necessarily equal. For example, creditors may be less interested in detailed information about future growth opportunities than investors, because their claims will normally be affected mainly by the downside risk of an entity. The ED appears to presume that the information is costless so that both groups of capital providers can be served by increasing the amount of information. However, information is costly, which is also acknowledged in para QC29-31. Therefore, it is costly to serve both groups with the same accounting standards. The ED does not discuss how the Board attempts to deal with this tradeoff, although it addresses this issue with respect to other users of financial reporting (para BC1.20).

Para OB4 defines general purpose financial reporting to serve the needs of a wide range of users. The other users are included in a broad definition of other creditors that comprise employees, suppliers, customers and so on. We find this an abuse of the term, since most readers of standards would not include employees and other groups in the primary capacity of a creditor. A suggestion might be to focus on contractual relationships. It is further unclear why long-term deferrals establish a credit-relationship, but executory contracts do not (see para OB6 (c)) – particularly in light of a full asset-liability approach. Para OB8 excludes management for the same reason.

In para OB6, the ED equates financial reporting with information about assets and liabilities (and equity). We find this is premature here, because it appears to implant the prevalence of the asset-liability approach before discussing the potential usefulness of other approaches.

**Q3.** *The boards decided that the objective should be broad enough to encompass all the decisions that equity investors, lenders and other creditors make in their capacity as capital providers, including resource allocation decisions as well as decisions made to protect and enhance their investments. (See paragraphs OB9–OB12 and paragraphs BC1.24–BC1.30.) Do you agree with that objective and the boards’ basis for it? If not, why? Please provide any alternative objective that you think the boards should consider.*

We are pleased that the Board has now included stewardship into the objectives of financial reporting in para OB12 (and implicitly in OB2) and support this move. We note that it does so under the heading of “decision-usefulness,” which is possible because all information is used for decision-making, but it is a departure from the terms decision-usefulness and stewardship that have been used for a long time.

## Chapter 2

**Q1.** *Do you agree that:*

*(a) relevance and faithful representation are fundamental qualitative characteristics? (See paragraphs QC2–QC15 and BC2.3–BC2.24.) If not, why?*

*(b) comparability, verifiability, timeliness and understandability are enhancing qualitative characteristics? (See paragraphs QC17–QC35 and BC2.25–BC2.35.) If not, why?*

*(c) materiality and cost are pervasive constraints? (See QC29–QC32 and BC2.60–2.66.) If not, why? Is the importance of the pervasive constraints relative to the qualitative characteristics appropriately represented in Chapter 2?*

We agree with the distinction into fundamental and enhancing characteristics and pervasive constraints. The two fundamental characteristics include the major attributes, but we also note that they are often negatively correlated.

The discussion in para QC13-14 appears to suggest that the two fundamental qualitative characteristics are binary, i.e., that information is either relevant or not or it is either faithful or not. We believe this is counterfactual and that both characteristics are on a continuum so that information can be more or less relevant and faithfully represented. For example, a degree of error in faithful representation is allowed. To consider degrees of these characteristics may help making trade-off decisions on certain accounting methods. This observation is independent of the enhancing characteristics. It appears that the Board does not consider the potential for tradeoffs within the fundamental characteristics. We believe there is a need for such a tradeoff and suggest including an explanation that this is indeed possible and sometimes necessary.

**Q2.** *The boards have identified two fundamental qualitative characteristics—relevance and faithful representation:*

*(a) Financial reporting information that has predictive value or confirmatory value is relevant.*

*(b) Financial reporting information that is complete, free from material error and neutral is said to be a faithful representation of an economic phenomenon.*

*(i) Are the fundamental qualitative characteristics appropriately identified and sufficiently defined for them to be consistently understood? If not, why?*

*(ii) Are the components of the fundamental qualitative characteristics appropriately identified and sufficiently defined for them to be consistently understood? If not, why?*

Information is relevant if it is capable of changing a decision. It is not clear how this definition deals with other sources of information. Should it be capable of changing a decision only if other sources of information are ignored, or should it be marginally informative? In para BC2.4 other sources appear to be important, so it would be marginal information content over and above other sources. In para

BC2.6 it seems to ignore other information. We suggest clarifying the concept behind relevance of information.

**Q3.** *Are the enhancing qualitative characteristics (comparability, verifiability, timeliness and understandability) appropriately identified and sufficiently defined for them to be consistently understood and useful? If not, why?*

We do not see a particular reason for the order in which these four characteristics are introduced.

We refer to our comments in the general part of this letter. In particular, it is unclear how information can be faithfully representative if it lacks (a degree of) verifiability (what is suggested in para BC2.28).

**Q4.** *Are the pervasive constraints (materiality and cost) appropriately identified and sufficiently defined for them to be consistently understood and useful? If not, why?*

We are not convinced of the way materiality is proposed to come into play. We do not see it as a constraint because what it states (para QC28) appears similar to what is captured in (ir-)relevance. That is, the question would be whether relevant information can be immaterial? We do not see materiality being related to faithful representation as is indicated in para QC32.

Please do not hesitate to contact us if you wish to discuss any aspect of our comment letter in more detail.

Kind regards,

Romuald Bertl  
Chairman