

Submitted via IASB webpage

International Accounting Standards Board
30 Cannon Street,
London EC4M 6XH,
United Kingdom

Brussels, 29 September 2008

Subject: *Response of the European Banking Federation¹ to the IASB ED of an improved conceptual framework for financial reporting – Chapters 1&2*

Dear Sirs,

Thank you very much for providing us with an opportunity to comment on the ED. We would like to express our continuing support to the IASB effort to improve the framework for financial reporting as well as harmonizing IFRS and US GAAP standards. We are pleased to see that compared to the DP the text of the ED improved to a considerable extent, taking into account some of the comments the constituents made back in 2006. As mentioned in our response to the DP, we consider the project very important for the whole standard setting process. The IASB should therefore finalize the Conceptual framework project before exposing any new significant changes to the standards. The impact of each chapter of the Conceptual Framework on subsequent chapters should be clear before any chapter is considered final. There should be a possibility for constituents to review the complete Conceptual framework before its implementation.

Please find below remarks, our members consider as most important:

Chapter 1 - The objective of Financial Reporting

Entity vs shareholders perspective

We are concerned that an entity perspective is being adopted rather than a shareholder one; therefore departing from the hybrid view taken in the past. We do not think the issue has been explored in sufficient detail. In particular, as mentioned above, we are concerned that adopting the entity perspective will have implications for aspects of the framework yet to be discussed and it would be inappropriate to draw definitive conclusions on the basis of a partial analysis. We would urge that a comprehensive debate be undertaken before any definitive conclusions are drawn.

¹ Set up in 1960, the European Banking Federation is the voice of the European banking sector, with over 30 000 billion EUR assets and 2.4 million employees in the 31 EU and EFTA countries. The EBF represents the interests of some 5000 European banks: large and small, wholesale and retail, local and cross-border financial institutions.

Status of the Framework

We note that Board has not reached a common conclusion on the authoritative status of the common conceptual framework. We however believe that the framework should be mandatory and the standard setters should follow the principles agreed in the Framework.

Users of the financial statements

We have been discussing the objectives of financial statements and users needs within the International Banking Federation in preparation of a document entitled “Accounting for financial instruments” published in April 2008.² The broad variety of financial institutions’ users with different needs identified demonstrate the necessity to provide general purpose financial statements addressing the common needs of the users rather than focusing to meet the needs of a certain group of users.

Stewardship

Management needs to be considered as users of financial information in the same way as investors and creditors. In our view, financial statements have both a decision-usefulness and a stewardship/ accountability objective. Although OB8 explains why managers are not primary users of financial reporting, we believe that financial reporting should not meet only the needs of the primary users. While management can produce any additional information they wish for their own purposes, financial reporting as a communication tool is aimed to address common information needs. It is not clear why any information that is not used by management would be relevant to investors or creditors. Basing a measurement on information that is used in managing the business is key to ensuring that the external reporting produced is relevant, reliable and understandable. Transparency requires that the information that is used by management should be provided to the market.

Management is accountable for the sound use of the resources that have been entrusted to them and have to explain how the business follows the management strategy. It is important that they can report to their shareholders on past transactions and events of the period and on what they have done, in order to fulfil their fiduciary duties and stewardship responsibilities to shareholders. Therefore, management and shareholders need a communication framework for financial reporting that is relevant, reliable and reflects the company’s business model in a way that both can understand. We welcome therefore that the stewardship has now been recognized by the ED and that the perspective of the management will be addressed later in the framework.

Financial reporting

We are concerned about the possible intention to extend the remit of the framework in financial reporting in general. It should not be assumed that users and their information needs are the same for financial reporting in general as for financial statements. We note that the boundaries of financial reporting and distinctions between financial statements and other parts of financial reporting should be deferred to a later phase of the Conceptual Framework project and we hope that the differences will be taken into account.

² <http://www.ebf-fbe.eu/content/Default.asp?PageID=232>

In our view, the objectives of financial reporting for all entities, including banks, are to create a communication framework that:

- is useful to present and potential equity investors, creditors and other users in making economic decisions.
- is useful to present and potential equity investors, creditors and other users in assessing the accountability of management for the resources entrusted and the entities ability to make distributions under the legal framework in which it operates.
- provides information about the entity's financial performance and financial position that is useful to present and potential equity investors, creditors and other users in evaluating the entity's ability to generate cash, including information about the timing and uncertainty of cash generation.

Financial reporting has been created by convention over time and cannot meet all the information needs of all users. Users will need to supplement the information in financial statements with information that is provided by the entity in the form of management commentary or from external sources. In addition, there are inherent limitations to financial statements, which are a conventionalized representation of the financial effect of transactions. They involve allocations of the effect of continuous operations to discrete reporting periods, as financial statements are prepared as at a particular date. The statements therefore do not reflect future events or transactions or potential changes in the economic environment.

Chapter 2 - Qualitative characteristics and constraints of decision-useful financial reporting information

Relevance, reliability and faithful representation

We support the introduction of hierarchy of qualitative characteristics and the division into fundamental and enhancing. We however remain concerned by the proposal to replace the concept of 'reliability' with that of 'faithful representation'. We do not think that faithful representation, which is a new term, can be better understood than the old term even with the attempts made in the ED to explain. We are also concerned that what appears to be lost by the change in terminology is any notion that numbers should only be included in the financial statements if they are worthy of use. This is what "can be depended upon by users" conveys in our view. It is no doubt possible for a calculation to be verifiable and for the financial statements to provide adequate disclosure about how the number has been determined and how and in what circumstances it could be different, but, at some point when the uncertainty becomes so great, the use of the number in the financial statements becomes at worst misleading and at best a waste of users' time in trying to understand the overall financial statements including the number.

This idea may be conveyed by the comment that "some minimum level of accuracy is also necessary for an estimate to be a faithful representation of an economic phenomenon" but the term 'reliability' better conveys the notion. If 'faithful representation' is to remain, it would

be useful to explore further the point at which the minimum level of accuracy is not achieved and the consequence if that is the case. We think that relevance and faithful presentation should have equal prominence as one is unlikely to exist without the other.

The text of the ED has improved by clarification of verifiability as and enhancing characteristic rather than a part of “faithful representation”, however the terms faithful representation, economic phenomena and substance used in the ED are still unclear and may be confusing when discussing later phases of the project.

Substance over form

BC2.19 gives convincing reasons why substance over form principle is part of faithful representation. However this well understood principle should be mentioned in the part dealing with faithful representation. It is already described in the last sentence of paragraph QC7. For clarification a short sentence should be added at the end of the paragraph: “This principle is often called substance over form.”

Yours sincerely,



Guido Ravoet