Accounting Standards Board

Aldwych House, 71-91 Aldwych, London WC2B 4HN
Telephone: 020 7492 2300 Fax: 020 7492 2301
www.frc.org.uk/asb

Jerome Chevy
Conseil National de la Comptabilite
3 Boulevard Diderot
75572 Paris
Cedex 12
France

06 March 2007

Dear Jerome

PAAinE Discussion Paper *'The Conceptual Framework Starting from the Right Place?'*

This letter sets out the ASB's comments on the PAAinE discussion paper '*The Conceptual Framework Starting from the Right Place*' (PDP).

Our comments on the PDP are based on our response to the IASB/ FASB discussion paper '*Preliminary Views on an Improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting Information*' (IASB DP). For ease of reference we attach a copy of our response as an appendix to this letter.

1. *Should the Framework be mandatory and, if so, for whom?*
   We fundamentally disagree with the conclusion in the PDP that to be effective a framework should be mandatory for standard-setters. We therefore agree with the comments made in the section 'Arguments against mandatory status' set out in paragraphs 2.2.7 to 2.2.10 of the PDP. New thinking in accounting often occurs when new problems or innovative transactions are being analysed. Such new thinking is often incorporated in new standards and it is only over time that the framework is revised to reflect such changes. To make the framework mandatory will mean that such changes will need to be reflected in the framework before any new standards may be issued, making the whole process extremely cumbersome. It is therefore not pragmatic to consider that all standards will be in line with the framework at all times.

2. *The role of the Framework in the preparation of financial reporting.*
   We agree with the conclusion in the PDP that in the absence of specific standards or interpretations the framework should be considered to have authoritative status. We are therefore in favour of retaining the hierarchy of authoritative sources set out in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.*

3. *Are general purpose financial statements for all stakeholders a valid concept?*
   We agree with the concern expressed in the PDP that the needs of investors and creditors might be assumed to cover most of the needs of reporting of other user groups. We agree that general purpose financial statements cannot, and should not, be all things to all users. To be fair to the IASB, in its DP (paragraph OB12), it states that "information that meets the needs of investors *is also likely* to be useful to members of other groups *who are interested in an entity's ability to generate net cash inflows*" (italics added). The ASB has, in its response to the IASB DP (Appendix A, paragraph 24) questioned the emphasis on cash flow generation, and we feel that our own 'Statement of Principles for Financial Reporting' better articulates what is being sought, which is that general purpose financial statements "that focus on the interest that investors have in the reporting entity's financial performance and financial position will, in effect also be focusing on the **common interest** (emphasis added) that all users have in that entity's financial performance and financial position".

   We agree with the concerns expressed in the PDP about the lack of discussion in the IASB DP of the entity and proprietary perspectives, which is also covered in the ASB's response to the IASB (Appendix A, paragraphs 17-25). In that response, the ASB flagged up the need for the IASB to conduct more research on users.

4. *Do investors and creditors represent a homogenous enough group to be chosen as primary users?*
   We agree with the conclusion in the PDP that "a clear definition of primary users of financial information, and their needs have to be provided before revising the framework". However, we do not believe that users of financial reporting have to be a "homogeneous group to be chosen as the primary users". This premise would appear to ignore the needs of users of some entities including public benefit entities, which we believe should be within the scope of a common framework. As noted in the ASB response to the IASB DP (Appendix A, paragraph 25), we have recommended that the IASB conducts further research before coming to a view on who should be the primary users.

5. *Do the users of financial reporting of different types of entity have similar needs? Do the users of financial reporting of profit-orientated and non-profit orientated entities have similar needs?*
   Although we agree that a focus on profit orientated entities would "avoid diluting the reporting requirements" however, we firmly believe that a framework should be sufficiently broad based to meet the general needs of not-for-profit entities as well. We acknowledge that in doing so some principles would need to be re-expressed and others would need a change of emphasis before they can be applied to that sector. As you are aware, the ASB is collaborating with a group of national standard setters in a project that considers the implications of the IASB/ FASB conceptual framework project for the not-for-profit and public sectors. This project has followed the IASB's

debate at each phase of the project and provides direct input to the IASB staff and Board on the potential implications for not-for-profit and public sectors. This issue is also covered in our response to the IASB (Appendix A, paragraphs 1 and 2).

6. *Do financial statements and other types of financial reporting have (a) similar objectives and (b) similar qualitative characteristics?*
7. *Can all kinds of financial reporting be dealt with by the same framework?*
   It is difficult to answer these questions without first knowing what the definition is of financial reporting. The IASB DP has neither defined the boundaries of what constitutes financial reporting nor has it satisfactorily dealt with the qualitative characteristics of financial reporting. While we would not agree with that apparent implication in the PDP that the same framework cannot be applied to both financial statements and **any** other financial reporting, we do accept that widening the boundary to encompass all financial reporting could lead to problems. These issues are covered in our response to the IASB DP (Appendix A, paragraphs 3-5).

We hope these comments are helpful. We are happy to provide further explanations and clarification if required. If you would like any further information on the comments made above then please contact Seema Jamil-O'Neill on 020 7492 2422, David Loweth on 020 7492 2420 or myself on 020 7492 2434.

Yours sincerely

Ian Mackintosh
Chairman
DDI: 020 7492 2434
Email: i.mackintosh@frc-asb.org.uk

Appendix A

ASB Response to IASB on IASB/ FASB discussion paper '*Preliminary Views on an Improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting Information*'

Accounting Standards Board
Aldwych House, 71-91 Aldwych, London WC2B 4HN
Telephone: 020 7492 2300 Fax: 020 7492 2301
www.frc.org.uk/asb

Li Li Lian
Assistant Project Manager
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

2 November 2006

Dear Li Li

IASB Preliminary Views Discussion Paper: 'The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information'

This letter sets out the Accounting Standard Board's comments on the above IASB Discussion Paper (DP).

The ASB welcomes the IASB's decision to issue this material in the form of a discussion paper. The Conceptual Framework is of fundamental importance to the future development of International Financial Reporting Standards and therefore it is pleasing to see that constituents are being given the opportunity to fully discuss its contents. We are also grateful to the members of the project team who participated at a public meeting on the DP that the ASB hosted on 21 September.

The ASB has some fundamental concerns with the proposals in the paper. These are summarised below and discussed in more detail in the appendix to this letter.

- Our first fundamental concern is with the proposal that the converged framework should specify only one objective of general purpose external financial reporting (paragraph OB2 of the DP), that of resource allocation decision-usefulness. The ASB supports the Alternative View set out in Chapter 1 of the DP that stewardship should be identified as a separate objective of financial reporting, or as part of the decision-usefulness objective. This issue is further discussed in paragraphs 6-16 of the appendix to this letter. As a useful contribution to the debate, I also attach a copy of Andrew Lennard's paper on stewardship which sets out a view of what stewardship is and why it is important.

- The DP identifies the primary users of general purpose external financial reporting as being "present and potential investors and creditors (and their advisers)". A number of problems arising from this have not been dealt with in any detail by the DP, including: the reasons for choosing the entity perspective at the expense of the shareholder perspective; whether users of the financial reports of listed, unlisted and small and medium-sized entities have the same information needs; and the contradiction between the entity perspective chosen and the primary user group identified. We discuss these issues further in paragraphs 17-25 of the appendix. We recommend that the IASB conduct more research in this area to address these issues prior to coming to a final view on who should be the primary user.

- The DP proposes replacing the qualitative characteristic of “reliability” in the current Framework with “faithful representation”. We believe that faithful representation is a softer notion which, when combined with a lack of specific identification of substance over form as a principle and reliance on the component of “verifiability”, could lead to a number of problems. In our view, the IASB should instead seek to clarify what is meant by “reliability” as a qualitative characteristic, rather than remove it. This is discussed in more detail in paragraphs 26-37 of the appendix.

- The DP notes that the Framework being developed will apply to general purpose external financial reporting, and not just the financial statements. However, what constitutes financial reporting has been deferred to a later phase of the project. We believe that users have very different expectations from financial statements and financial reporting, the latter may be more explicitly forward looking and accordingly users will recognise that there will be differences in the “reliability” of the content. In our view, the IASB and FASB should define financial reporting sooner, rather than later, as we are not yet convinced that the Framework can be widened to encompass all financial reporting. This issue is discussed in paragraphs 3-5 of the appendix.

We have a number of other concerns as follows:

- The limitation of the scope of the Framework to business entities in the private sector and the proposal to consider the impact on not-for-profit entities towards the end of the project. In our view, the implications for not-for-profit entities should be considered as the project progresses. This is discussed in paragraphs 1-2 of the appendix to this letter.

- Finally, we would like to make a general point that the current IASB Framework is used by standard setters, preparers and auditors alike. We are concerned that if the length and theoretical arguments contained in the DP were replicated in the final Framework it will alienate preparers and auditors. As such we will urge the IASB to make every effort to ensure that the final Framework is not so theoretical and long that it acts only as a reference manual for standard setters.

Given our fundamental concerns we do not consider that the proposals in the DP should proceed to an exposure draft (ED). If they do, we could not support the ED.

We hope these comments are helpful. We are happy to provide further explanations and clarification if required. If you would like any further information on the comments made above then please contact Seema Jamil-O'Neill on 020 7492 2422, David Loweth on 020 7492 2420 or myself on 020 7492 2434.

Yours sincerely

Ian Mackintosh
Chairman, Accounting Standards Board
DDL: 020 7 492 2434

Appendix

Scope of the Framework

Entities within the scope

1. We note that the scope of the Framework has been limited to "business entities in the private sector" (see, for example, paragraphs P8 and OB1 of the DP). We know that the IASB and the FASB are to consider the impact of the Framework on not-for-profit entities in the private sector and, in some jurisdictions, business entities in the public sector, at a later stage in the project (Phase G). However, as outlined in Ian Mackintosh's letter of 20 October 2005 to David Tweedie and Bob Herz, we feel that a more effective and efficient approach would be for the IASB and FASB to assess the applicability to not-for-profit entities as a step at each phase of the project, rather than as a separate phase towards the end of the project. That said, we acknowledge the pressures the IASB and FASB are working under and the need for the Boards to set priorities in the approach to the project as a whole.

2. As you know, the ASB is participating in a group of chairs and senior staff of the standard-setters of Australia, Canada, New Zealand and the UK (the 'Group of Four') that is monitoring the applicability of the conceptual framework project to the not-for-profit entities in the private and public sector. A report from this group on the key issues for such entities arising from the proposals in the DP is attached to this letter and, where appropriate, reference is made below to the issues raised in that report. You will also be aware that the International Public Sector Accounting Standards Board (IPSASB) has agreed to lead a collaborative project on the development of a conceptual framework for public sector financial reporting, in conjunction with national standard-setters and similar organizations. We hope that the three Boards will have close co-ordination and collaboration with each other during the development of their respective projects.

Financial Reporting or Financial Statements?

3. The DP notes at the outset that the proposed conceptual framework establishes the objective of general purpose external financial reporting. As the current IASB Framework only applies to financial statements this implies an expansion in the scope of the Framework. We note that consideration of specific issues concerning the boundaries of financial reporting and distinctions between financial reporting and other parts of financial reporting have been deferred to a later phase (Phase E) of the project. The DP (paragraph OB16) notes that the objective pertains to all financial reporting, not just financial statements, because some types of both financial and non-financial information may best be communicated by means other than the financial statements. This may include corporate annual reports, prospectuses, annual reports filed with government agencies, news releases, management forecasts or other descriptions of its plans and expectations, and descriptions of an entity's social or environmental impact.

4. In our view, there is a need for the IASB and FASB to first define what is covered by financial reporting before seeking to determine what the objective should be. We are concerned that widening the application of the Framework to encompass all financial reporting (however defined) will give rise to problems, in that it may be attempting to outline the concepts that underpin two fundamentally different things: financial statements and financial reporting. . In our view, users have very different expectations from financial statements and financial reporting, the latter may be more explicitly forward looking and accordingly users will recognise that there will be differences in the "reliability" of the content.

5. We note that an attempt to define the scope of financial reporting has been made by the project team that prepared the Discussion Paper 'Management Commentary', which was published by the IASB in October 2005. In that paper, the project team concluded that the qualitative characteristics of management commentary should be different in some respects to those that pertain to the financial statements. Given that the qualitative characteristics described in the latest DP predominantly apply to financial statements we expect that the IASB and FASB will have to revisit these at the time the Boards undertake to define the boundary of financial reporting.

The objective of general purpose external financial reporting

Stewardship

6. The objective of general purpose external financial reporting as set out in paragraph OB2 of the DP focuses solely on the provision of information that is useful in making investment, credit and similar resource allocation decisions. Paragraph OB3 goes on to place the emphasis on the provision of information that helps in assessing future cash flows. The DP does not identify, either as part of the overall or as a separate objective, the provision of information that enables users to assess the stewardship of management. Rather, as noted in paragraph OB28, the objective "encompasses" providing information useful in assessing management's stewardship.

7. We acknowledge that this has been portrayed as not representing a significant change from the current Framework, but we disagree with this treatment of stewardship. Instead, we support the Alternative View as set out in paragraphs AV1.1 to AV1.7. In our view, users are not only interested in stewardship because, as the DP states in paragraph OB27, it "significantly affects an entity's ability to generate net cash inflows" but goes much wider. While acknowledging that the importance of stewardship can depend on the particular legal framework in any jurisdiction, our view is that one of the purposes of financial reporting is to provide shareholders with the information they need to make decisions as owners of the business. These decisions are not merely whether to sell their shares, or buy more, but also include their rights, as owners, to change the direction of the business, or the management, in jurisdictions where they have those rights. In not having stewardship as an objective, there is a danger in the future that information useful for stewardship purposes, for example in an area such as related party

disclosures, may not be included in financial statements on the grounds that it is not thought to be 'decision-useful' for resource allocation purposes.

8. As Andrew Lennard's paper *Stewardship and the objectives of financial statements* makes clear, stewardship should not be characterised simply as information to assist an assessment of the competence and integrity of 'stewards' (ie the management and directors), but as the provision of information that provides a foundation for a constructive dialogue between management and shareholders.

9. Users look to financial reporting not only to identify risks inherent in the business but also to identify those risks that arise solely from the management's decisions. The later cannot be achieved simply by providing information that helps in assessing future cash flows; it requires some review of previous decisions taken and transactions entered into by management. We note that the IASB and FASB are keen to avoid the implication that they do not think that financial reports should provide information that is useful in assessing stewardship (paragraph BC1.36). But, in our view, the sole focus on decision-usefulness does run the risk of implying that investors, in particular, look to financial statements only to make decisions to buy, sell or hold securities – and that the quality of an accounting standard should be judged wholly by whether it provides information that informs such decisions.

10. Financial statements should not aspire to provide information that is sufficient for a valuation of the company to be made, nor should that be their exclusive focus. Whilst the information in financial statements should be useful, relevant, and helpful in decision-making, they will never provide all the information that is necessary to make informed investment decisions. This point is acknowledged in the ASB's *Statement of Principles for Financial Reporting* (at paragraph 1.8). Indeed, we think that the converged framework should be rather more open about the limitations of general purpose external financial reporting, along the lines of the discussion in the ASB document.

11. If the sole aim of financial statements were to be to influence decisions about buying, selling or holding the company's securities, it is arguable that the most useful form they could take is a summary of management's expectations for the future. While there is no question that forward-looking financial information would be useful, it is not expected to supplant the current form of financial statements.

12. An obvious fact about current financial statements is that they are historical—the information is nearly all about financial position at a past date and changes in that position over a past period. The Framework needs to articulate clearly why this information is useful. In particular, transactions are of central importance to economic activity, and so the summary which is provided by financial statements of past transactions and their economic impact on the entity is useful in assessing the extent to which similar transactions might recur in the future and how they might affect the entity. If, for example, sales have grown strongly but margins are squeezed, this is

important information for assessing both future sales and their profitability. Therefore, the Framework should clearly identify the reporting of information about past transactions as a central feature of financial statements.

13. In practice, not all investors are solely concerned with buy, sell or hold decisions. In the UK, for example, the vast majority of the companies are private companies of all sizes where the owners, and at times the creditors, have made the long term commitment to work with the management. In such cases, the primary users are not only looking for the potential cash inflows but also how this is being achieved. By ignoring stewardship, which is a key objective of financial reporting for the primary users of these profit-orientated companies, the IASB is at risk of not meeting their needs in the proposed Framework.

14. As one of the current IASB projects is to the development of an IFRS for ‘Small and Medium-sized Entities’, it is clearly right that the conceptual framework should cover these entities and their users’ needs. We feel that by not referring specifically to the stewardship objective the IASB could be placed in a position where it has to devise separate frameworks for these entities. Any separate frameworks issued could create further problems upon application when entities move up from SME to listed status.

15. This is also the case when considering the applicability to not-for-profit entities in the private and public sector of the concepts proposed in the DP. As highlighted in the report prepared by the ‘Group of Four’, in the case of not-for-profit entities, stewardship or the discharge of accountability is a significant aspect of the objective of financial reporting and should either be identified as a separate objective or recognised within a single objective /

16. In conclusion, we feel that stewardship as an objective forms the basis of a dialogue between the management and investors of a company through the medium of financial reporting. A simple solution would be to add to the text of paragraph OB 2 (after “decisions”) “and for assessing the stewardship of the entity’s management”. As such, adding stewardship to the objective, or alternatively as a separate objective in parallel to decision-usefulness, will help enhance the way the Framework proposes to meet the needs of the primary users. This approach also has the advantage of ensuring the applicability of the Framework to entities and their users that may otherwise be left outside its boundaries.

Primary users of general purpose external financial reporting

17. The DP notes in paragraphs OB2 and OB10 that the financial reports should be designed to meet the needs of a wide range of users and not just investors and creditors. Yet the remainder of the paper then concentrates on the needs of investors and creditors as “their uses of information needs have been studied and described to a greater extent, and thus are better understood, than those of other external groups” and that “information that meets the needs of investors and creditors is also likely to be useful to members of other

groups" (paragraph OB14). In our view, there is a lack of evidence in the DP on which to base the decision as to the primary users of financial reporting. In our view, further research is required before such a conclusion can be drawn.

18. In common with the existing IASB and FASB frameworks, the ASB's Statement of Principles identifies a wide range of users who use financial statements in order to satisfy some of their different needs for information. It then narrows that focus to a particular, defining class of user: in the ASB's case, present and potential investors.

19. The ASB's defining class of user is therefore narrower than that proposed for the converged framework. The ASB is aware of concerns expressed in the UK, but also elsewhere, that maybe the primary users as identified in the ASB's statement is too wide a class and that the defining class should be narrowed further to focus upon the existing common shareholders only. For example, the CFA Institute[1] has argued that the financial statements should be viewed from the position of an investor in the common shares of the company (ie an existing common shareholder). Any hierarchy of users of financial reports, it has been suggested, should start with the current shareholders, as the owners of the business, in order to give the framework more clarity and focus. This could affect the debate as to whether a proprietary view or an entity view is used to determine the boundary of a reporting entity.

20. The discussion paper however, notes that an entity view will be taken as the financial reporting is directed to the needs of a wide range of users which can only be satisfied by the use of the entity perspective. In our view, the reason why the discussion paper chooses the entity perspective, which focuses on the needs of stakeholders (investors, creditors, employees, suppliers, customers, etc), at the expense of the proprietary perspective, which focuses on the needs of the owners of the company (current shareholders) needs to be researched and debated further. The discussion is limited to a short section in the Basis for Conclusions (in particular, paragraphs BC1.11-BC1.13), which notes that the IASB, despite having adopted the entity perspective as the basis underlying financial reports, "does not preclude also deciding in future standards projects to include in financial statements more information that might be viewed as consistent with a proprietary perspective". We would have expected to see more discussion in the paper as to what the two perspectives imply in terms of financial reporting information.

21. In particular the entity perspective may lead to problems further down the line when dealing with issues such as goodwill and minority interests. We are aware of user groups who are concerned that the adoption of the entity perspective at the expense of the proprietary perspective will lead to International Financial Reporting Standards in the future ignoring the needs of proprietors, the only stakeholders to whom the entity is not bound by means of a contract.

[1] CFA Centre for Financial Market Integrity 'A Comprehensive Business Reporting Model: Financial Reporting for Investors' (CFA, October 2005)

22. Another area we feel has been inadequately addressed is the exploration of the needs of the different user groups e.g. users of listed, unlisted, small and medium sized entities and whether they have the same information needs. As identified above, for certain categories of entity, there are primary users whose needs will not be fully addressed by the proposed framework and its objective. In particular, by identifying the primary users as investors and creditors and then concentrating on decision-usefulness there is a fear that the scope of the Framework effectively becomes limited to listed entities only.

23. One further issue is that of the contradiction that arises from choosing the entity perspective and then concentrating on investors and creditors as primary user group. As mentioned above, the entity perspective focuses on the needs of a wide range of stakeholders in the company. However, trying to meet the divergent needs of investors, creditors, employees, suppliers, customers and other stakeholders through the vehicle of financial reporting is unrealistic. It would lead to long convoluted financial reports that, by the sheer volume of information contained within them, will be of little or no use to any one of those stakeholders. Although not specifying this as the reason, the IASB has acknowledged this by concentrating on the needs of investors and creditors and claiming that their needs, i.e. assessing the entity's ability to generate cash flows, is common to all other users as well.

24. We do not feel cash flow generation alone covers adequately the needs of such a wide range of stakeholders. A different approach may work better. Investors need to know all the information that other stakeholders need. For example, they need to be able to assess the capacity of the entity to take debt, or avoid costly disputes with its employees. As such, information that has, or may have, a financial impact on the entity needs to be included and these are also likely to be the areas that will be of interest to other user groups.

25. In conclusion we would recommend that the IASB conducts more research in this area to address the issues before coming to a firm view on who should be the primary users.

Qualitative characteristics

26. There are three main areas where we are concerned by the proposals in draft Chapter 2 of the DP:
    a. the replacement of reliability with faithful representation and the introduction of the notion of verifiability;
    b. the omission of any reference to 'substance over form'; and
    c. the placement of the discussion of the constraints on financial reporting.

Faithful representation or reliability

27. We note that the main change in the DP is to replace the qualitative characteristic of 'reliability' in the proposed Framework with 'faithful representation'. The DP defines the qualitative characteristic in context of information that is a 'faithful representation of the real-world economic

phenomena that it purports to represent' (paragraph QC16). The paper further defines sub-components of faithful representation as being verifiability, neutrality and completeness.

28. The IASB and FASB are proposing this change on the grounds that there have been "longstanding problems with the qualitative characteristic of reliability" and that because "further efforts to explain what reliability means did not seem likely to be productive, the Boards sought a term that would more clearly convey the message" ie faithful representation (paragraph BC2.27).

29. Information presented in financial reports and statements is stylised information which does not necessarily faithfully represent the underlying economic reality. An analogy may be the London Tube map which cannot be called a faithful representation of how the actual tube lines run in London, the distance between the stations or their actual location aboveground, in fact an aerial photograph may be more faithfully representative. However, the map can be relied on every time to find you the correct interchanges and the quickest route to your destination. So reliability may not always give the exact economic substance but it will present a picture that is accessible to the user of the financial reports.

30. The DP presents substitution of reliability with faithful representation as a change in terminology, rather than any change in substance. However, when the definition in paragraph BC2.15, as the quality of faithfully representing what information purports to represent, is combined with the fact that the reference to 'substance over form' is being dropped from the Framework (see below), it makes us concerned that 'faithful representation' might be interpreted in a legalistic way.

31. In some quarters reliability is equated with quality and faithful representation with agreement. A good example is that of the Enron special purpose entities (SPEs). It was agreed by a number of different parties that they should be left off-balance sheet and it could be argued that this was the faithful representation of their substance, at least in legal terms. However, placing them off balance sheet did not represent the economic substance of the transaction and so did not present the users of the financial statements with a reliable picture.

32. We are also concerned at the proposal to introduce verifiability as a component of faithful representation. Verifiability implies agreement between two parties of a calculation using the same assumptions rather than the testing of the underlying assumptions. So applying verifiability to Enron, as long as the auditors were able to verify the decision made by the management to place the SPEs off-balance sheet, using the same assumptions (indirect verification as identified in the DP), neither they nor the management will be culpable as they would be faithfully representing the economic substance at the time of the decision.

33. As such, we concur with the Alternative View on verifiability as set out in paragraphs AV2.1 and AV2.2 of the DP paper. On the basis of the above analysis we would further note that consensus that is not based on reliable evidence should not constitute verification.

34. Our fear is that the application of faithful representation and its component of verifiability, as currently described in the DP, would take away responsibility from management as they will be able to argue that they presented information that was the most faithful representation of the economics at the time without having to justify whether their conclusions were reliable or not. In practical terms, we have still to be convinced that faithful representation offers a sufficiently robust alternative to reliability, which can stand up to the rigour of audit in the current environment.

35. The removal of reliability also has implications for later phases of the project. The current IASB Framework, in paragraph 83, notes that one of the criteria of recognition of an element of financial statements is that it has a cost or value that can be measured with sufficient reliability. Reliability of measurement is discussed further in paragraphs 86-88 of the Framework. We would be concerned if this aspect of the recognition criteria was removed.

Substance over form

36. We note the view that the quality of faithful representation is “incompatible with representations that subordinate substance to form”. While this provides some reassurance, we do not agree with the proposal to omit any reference to substance over form as a component of faithful representation, on the grounds that any reference to it would be “redundant” (paragraph BC2.18). The notion of substance over form has in the past ensured that preparers account for the full economic substance of a transaction rather than the legal substance or form. When discussing the accounting for transactions it has generally been sufficient to rely on ‘substance over form’ to ensure that the economic substance of a transaction is reflected without the need for references to any other qualitative characteristics.

37. Given that it has been such a cornerstone principle we feel that if it is not specifically referred to in the Framework it will be forgotten in due course. We therefore feel that it is better to retain a clear reference to the principle in the Framework.

Constraints on financial reporting

38. The discussion on qualitative characteristics in draft Chapter 2 mentions two constraints on financial reporting: materiality and cost benefit concerns. Given that the Framework attempts to set out the ideal to which financial reporting should aspire (paragraph OB15), is it right that any discussion of the constraints on these ideals should be within the body of the Framework itself? We would recommend that the IASB combine the Purpose, Scope and Constraints of the Framework in an introductory section upfront so as not to detract from the main provisions of the Framework itself.

Other

39. We also have an observation that the current Framework includes references to the accruals and going concern principles in paragraphs 22 and 23. The DP omits any references to financial statements or reporting being produced on a going concern basis. We assume that the IASB continues to considers going concern an important notion and we would urge the Boards to include a specific reference to it in the converged framework.

40. If on the other hand, all references to going concern are to be deleted from the Framework, this should only be done after the rationale has been fully explained and exposed for discussion.