Grant Thornton International
Chicago Office

November 3, 2006

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856
director@fasb.org

File Reference No. 1260-001, *Conceptual Framework for Financial Reporting: Objective of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting Information*

Grant Thornton International and its U.S. member firm, Grant Thornton LLP, appreciate the opportunity to jointly comment on the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) Preliminary Views, *Conceptual Framework for Financial Reporting: Objective of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting Information* (the Preliminary Views document). We support the Boards' efforts to update and enhance the conceptual framework to provide a foundation for developing principles-based and converged standards.

Our primary concern is with the proposed changes to the objective of financial reporting. We are not convinced that a focus on information for resource allocation decisions and on investors and creditors as the primary users of financial statements would meet the needs of a wide range of users of financial reporting, including the users of the financial reports of smaller, privately held entities. We believe that the proposed objective would encourage calls for a separate financial reporting framework for non-publicly accountable entities. In our opinion, there should be a common objective of financial reporting that addresses the needs of all business entities regardless of size or public accountability.

These are our preliminary comments on the conceptual framework project. We look forward to the opportunity to update our comments as the project evolves.

175 W. Jackson
20th Floor
Chicago, IL 60604
P 312.856.0200
F 312.565.4719
W www.gti.com

The objective of financial reporting

Comment 1: The needs of a wide range of users

We believe that the objective of financial reporting should clearly state that financial reporting should meet the needs of a wide range of users. We are concerned that in the Preliminary Views document, the objective of financial reporting appears to focus on investors and creditors, with less emphasis on other users (OB7). The proposed definition of "creditors" would exclude customers, suppliers, and similar parties (OB8). Although some sections of the document state that financial reporting information is for a wide range of potential users (BC1.10), other sections state that investors and creditors are the primary users of financial reporting and that the primary focus of financial reporting is to meet the needs of investors and creditors (OB13).

In our view, a belief that it is appropriate to focus on investors and creditors as the primary users of financial reporting is not justification for excluding the needs of other users from the objective of financial reporting. The Boards justify the focus on investors and creditors as the primary users of financial reporting by asserting that financial reporting that meets *their* needs will also satisfy the needs of other users. In our view, the needs of other users have not been sufficiently studied to support that assertion. But even if there were supporting research, we do not believe that the assertion supports excluding other users from the objective of financial reporting. If the assertion is valid, it would imply that the needs of investors and creditors could serve as a reliable proxy for the needs of other users. It would not imply that the needs of other users are not part of the objective of financial reporting.

In any event, we do not believe that the needs of investors and creditors would always be a reliable proxy for the needs of other users because different users may have different priorities. Other users may perceive the costs and benefits of providing financial information differently from investors and creditors, leading to different decisions about the information to be included in financial reports. We believe that the needs of a wide range of users should be considered when assessing the costs and benefits of financial reporting and therefore should be included in the objective of financial reporting.

Comment 2: Resource allocation decisions

We believe that the term "resource allocation" should be defined and that the proposed change from "economic decisions" to "resource allocation decisions" should be justified in the document.

The current frameworks do not use the term "resource allocation" except in the context of not-for-profit organizations. Paragraph BC1.32 of the Preliminary Views document describes resource allocation as being "more specific" but provides no definition of the term. If more specific implies that some economic decisions could lie outside the scope of resource allocation decisions, the distinction should be clarified. It also would be useful to provide examples of the kinds of decisions that may be excluded by the change in terminology.

In our view, resource allocation could be defined narrowly or broadly. For example, some would include accountability within resource allocation decisions. If the intent is to define resource allocation narrowly, then we believe it would be preferable to retain the term "economic decisions" to ensure that the objective of financial reporting addresses the needs of a wide range of users.

Comment 3: The primacy of cash flows

The premise in paragraph OB13 that investors and creditors have a common interest in the ability of an entity to generate future cash flows does not support the conclusion that cash flows should be the primary focus of financial reporting. Investors and creditors may have many common interests, but commonality would not be sufficient to establish the primacy of those interests as the focus of financial reporting. We believe that it is more accurate to say that *one* of the purposes of financial reporting is to help users make assessments of an entity's future cash flows. That is not the same as stating that the focus of financial reporting is to provide information about an entity's ability to generate net cash inflows. We believe that financial statements also help to present the results of past transactions and the financial position of the reporting entity and therefore have an important accountability function. Information about accountability is also part of the needs of a wide range of users of financial reporting.

Comment 4: Stewardship and accountability

Stewardship should remain an objective of financial reporting and not a by-product of the resource allocation objective. The debate within the Preliminary Views document includes different approaches on including stewardship as an objective of accounting, ranging from (1) excluding stewardship as an objective of financial reporting (BC1.35), (2) including stewardship as a separate objective (BC1.34; AV1.1), and (3) encompassing stewardship within the objective of information for resource allocation decisions by investors and creditors, but not as a separate objective of financial reporting (OB28; BC1.37). In our opinion, stewardship has been an objective of financial reporting for longer than the objective of providing information for investment and credit decisions. Removing or reducing the status of stewardship is a decision not to be taken lightly. The "encompassing" position outlined in paragraph OB28 appears to be an extension of the argument that information meeting the needs of investors and creditors will also meet the needs of other users. We believe that, at best, information for resource allocation decisions by investors and creditors could be a proxy for information for stewardship decisions. However, we note that the proxy may not always be reliable when there are different assessments of the importance of certain information by different users. Therefore, we believe that stewardship should remain an objective of financial reporting, even if there are no substantive differences between the set of information useful for resource allocation decisions and the set of information useful for stewardship decisions.

We note that the term "stewardship," like reliability, has evolved to mean different things to different people. Designating a new term to capture a desired meaning could be useful here. In our view "accountability" expresses the desired concept better than stewardship and the concept of accountability should be retained within the objective of financial reporting.

Comment 5: A common objective for smaller, privately held companies

We agree with the Boards' determination that the objective of general purpose external financial reporting should be the same for all entities. However, overemphasis of the needs of investors and creditors is not consistent with that determination. We believe that the proposed objective would encourage calls for a separate financial reporting framework for nonpublicly accountable entities.

On balance, we believe that the proposed financial reporting objective is unsuitable for smaller, privately held entities. If the objective of financial reporting is to provide information for a wide range of users, then the language in paragraph 2.1 of the *Draft ED of the IFRS for Small and Medium Entities* could be a starting point for an objective of financial reporting that is both consistent with the definition of general purpose financial reporting in paragraph OB10 and with the needs of investors and creditors (we have substituted *accountability* for *stewardship* in the definition):

> The objective of financial statements is to provide information about the financial position, performance, and cash flows of that entity that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs. Financial statements also show the results of management's accountability for the resources entrusted to it.

The qualitative characteristics of financial reporting

Comment 6: Transparency

We agree with the Boards' assessment that transparency has different meanings, some of which may have been subsumed in other qualitative characteristics. Clarity of exposition, for example, would be included in the characteristic of understandability. However, we feel it would be useful to mention clarity of exposition within understandability, perhaps with reference to the desirability of plain language in financial reports. In addition, transparency has other meanings (discussed below) that may not have been addressed but perhaps should be considered in revising the framework.

We believe that a discussion of the interrelationships of relevance, confidentiality, and transparency is necessary in a conceptual document primarily intended for standards setters. While users may desire virtually all information about reporting entities for decision making purposes, we believe that there are limits to transparency. Business enterprises are permitted to keep certain business information confidential, such as production processes, plans for future acquisitions, and planned product lines, which some users would find relevant. The regulations and standards that govern financial reporting help define the boundaries of transparency. The boundaries are fluid and constantly changing. For example, the promulgation of FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes,* increased the level of transparency of reporting entities regarding disclosure about tax positions. The adoption of IFRS in Europe has increased transparency for many of the entities now using those standards.

Another meaning of transparency, implicit in the description of the benefits of financial reporting outlined in paragraph QC54, should be made explicit. Paragraph QC54 describes the benefits of transparency but the term itself is not used. We believe it would be useful to identify those benefits as the benefits of transparency, thereby forming a link to references to transparency in the Boards' mission statements and to the broader objective of serving a wide range of users. It also would be useful to discuss the *costs* of transparency as well as the *benefits* of transparency in that paragraph. Observations about the costs of transparency are a perennial feature of comment letters.

Comment 7: Relationships among qualitative characteristics

We believe that an explanation of the relationships among the qualitative characteristics would contribute to the clarity of the conceptual framework. We agree with the provision in paragraph QC47 that calls for flexibility in interpreting these characteristics in individual cases. However, we are concerned that the way the Preliminary Views document describes a logical order for considering the qualitative characteristics (QC42 – QC47) could potentially be misconstrued as retaining a hierarchical nature. Because the qualitative characteristics may address different aspects of financial reporting, an exact linear relationship may not always exist between them. For example, relevance and transparency refer to *what* financial information should be reported, while faithful representation and understandability refer to *how* financial information should be reported. Comparability/ consistency, on the other hand, contributes to the value of financial information but would not take preference over reliability, faithful representation, or understandability.

Comment 8: Features of understandability

Regulators in the United States have often commented that financial reporting should be viewed not solely as a compliance exercise but as a means of communicating with users. The intent to communicate should be considered part of the characteristic of understandability in financial reporting.

We believe that conceptual consistency is a component of understandability. The objective of the conceptual framework project is to provide the best foundation for developing converged, principles-based standards (P6). Principles-based standards, in turn, produce more understandable financial reporting than arbitrary standards or standards that contain multiple exceptions. Therefore, conceptual consistency should be viewed as a component of understandability and a characteristic of financial reporting. While this is currently expressed in the preface, we recommend that this viewpoint be retained in the final document.

Overall comments

Comment 9: Financial reporting and financial statements

Paragraph BC1.4 states that the issues of financial reporting boundaries and the distinction between financial statements and financial reporting are topics slated for discussion at one of the later project stages. We believe that it would be useful to define the boundaries and the related terms "financial reporting" and "financial statements" at this stage of the project instead of later. The qualitative characteristics relevant to other forms of financial reporting may differ from the characteristics relevant to financial statements.

The current IASB framework uses the term "financial statements." The FASB framework uses the term "financial reporting" but contains a discussion of the relationship of financial reporting and financial statements in Statement of Concepts 1, *Objectives of Financial Reporting*, paragraphs 5–8. We would like to see either that discussion carried forward or clarification of how the meanings of the terms have changed. If the definition of financial reporting has changed, it may affect our views on the adequacy of the objective and the qualitative characteristics of financial reporting.

If financial reporting cannot be defined at this time, we believe that focusing on the objectives of financial statements may be a reasonable alternative, even if the scope is later expanded to include other forms of financial reporting. As financial statements are similar from one jurisdiction to another, a discussion of the objectives of financial statements and the qualitative characteristics of information within financial statements would be understood by a wide audience.

Comment 10: The public interest

We believe that financial reporting and the accounting profession in general serve public interests as well as the private needs of investors and creditors and that it is necessary to discuss the public interest aspect of financial reporting in the Boards' introduction to the framework. The FASB existing framework defines "stewardship" in a broad manner that includes the public interest. The public interest is incorporated into the mission statements of both Boards, but the public interest is not mentioned explicitly in the Preliminary Views document.

Comment 11: Characteristics

We believe that some of the discussion of the reasoning behind the qualitative characteristics could be relegated to the basis for conclusions, which would allow for a more succinct final document. Succinctness will aid in applying the conceptual framework in practice, especially should it become part of the U.S. GAAP hierarchy and continue to be part of the IFRS hierarchy.

*****

We would be pleased to discuss our comments and recommendations with Board members or the staff. Please direct your questions or comments to Gary Illiano (Gary.Illiano@gt.com or +1 (212) 542-9830) on behalf of Grant Thornton LLP or Andrew Watchman (Andrew.Watchman@gtuk.com or +44 (0) 870 991 2721) on behalf of Grant Thornton International.

Sincerely,

Kenneth C. Sharp

Kenneth C. Sharp
Global Head of Assurance Services
On behalf of Grant Thornton International

John L. Archambault

John L. Archambault
Managing Partner of Professional Standards
On behalf of Grant Thornton LLP