The Corporate Reporting Users' Forum

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Dear Mr Chevy

EFRAG Discussion Paper on the Conceptual Framework

The Corporate Reporting Users' Forum welcomes the opportunity to comment on your consultation regarding the IASB's *Conceptual Framework*. Our response is set out below.

About the Corporate Reporting Users' Forum (CRUF)

The CRUF came together in 2005 as a discussion forum to help its participants in their approach to the debate on current and future corporate reporting requirements. In particular, participants are keen to have a fuller input into the deliberations of accounting standard setters such as the IASB. CRUF participants come from Europe – across the City of London and Frankfurt, including two members of EFRAG's User Group – and around the world, including individuals from both buy- and sell-side institutions, and from both equity and fixed income markets.

The CRUF is a discussion forum. The chairmanship of the CRUF rotates at each meeting and different individuals take leadership in discussions on different topics and in the initial drafting of representations. It does not seek to achieve consensus views, though at times some or all of its participants will agree to make joint representations to standard setters or to the media. It would not be correct to assume that those individuals who do not participate in a given initiative disagree with that initiative.

CRUF participants take part in discussions and joint representations as individuals, not as representatives of their employer organisations. The participants in the Forum that have specifically endorsed this response are listed at the end of this letter.

Conceptual Framework

We are responding to this consultation in the light of our own Guiding Principles, which are attached to this response. These articulate briefly what we believe are the key roles of financial reporting standards from the user's perspective. We developed these Principles some 18 months ago as our first action after coming together as a group. Our aim was to reach consensus among a diverse group of users on our overarching desires from accounts and therefore our views on the appropriate nature of accounting standards. These inform our view of the proposed conceptual framework.

Should the framework be mandatory and, if so, for whom?

The answer to this question depends on the nature of the framework. If what is on offer is a truly high level, principles-based framework, then we support the view that the framework should be mandatory. In particular, we would welcome both the IASB and FASB giving the document authoritative status, and are disappointed that it is not yet clear that the Framework will have such status in US GAAP. We regard this as a vital ingredient in developing shorter, more principles-based financial reporting standards, which we think would be in the interests of both preparers and users. Most important, we think it would lead to higher quality reporting. We believe that the framework's mandatory status should apply to the work of the standard setters but its high level principles also need to bind preparers and auditors, such that there is a clear principled basis for financial reporting.

As stated in our Guiding Principles, "Accounting standards ... should be principles-based and comprehensible to the financially literate", and they "should avoid unnecessarily detailed prescription". We welcome convergence towards short, principles-based standards and away from lengthy rules-based standards. We regard a Conceptual Framework with proper authoritative status as a vital mechanism to ensure that these key aims are fulfilled. However, it is only if the framework is indeed high level and principles based that we would support the framework being made mandatory. If what is on offer is detailed, prescriptive and impenetrable to the average reader of accounts, then we have strong reservations about mandatory status.

Our provisional view is therefore that the framework should be mandatory, provided that it is not detailed and over-prescriptive. If, however, the framework is indeed prescriptive then we reserve the right to oppose mandatory status since we are concerned that such prescription might lead to significantly lower quality reporting.

Role of framework

For us, the Conceptual Framework is key to ensuring higher quality financial reporting standards going forwards. Our own Guiding Principles articulate briefly what we believe are the key roles of financial reporting standards from the user's perspective and reflect a consensus among a diverse group of users on our overarching desires from accounts and therefore our views on the appropriate nature of accounting standards.

EFRAG concludes that the framework should only be used as guidance in the absence of relevant IFRSs. Where there is conflict between the framework and the standard, the standard should prevail. However, we believe that the framework should be used in the preparation of financial reporting to ensure that the accounts present the economic reality of the business rather than accounting or legal form. Both management and auditors need to be able to look to high-level principles in the conceptual framework to ensure that they can do so.

We do not share the concern that this may drive subjective interpretations. As users our concern is that company reporting should not become merely a compliance function but be one of communication. We welcome companies taking subjective decisions which ensure that their reporting more closely reflects the underlying economics of their business, rather than blindly reporting in accordance with detailed rules which may actually obscure the reality of their results.

We therefore disagree with EFRAG's tentative view: a properly constructed framework should be applied whether or not there is a detailed standard which is applicable, if doing so would reveal more about the economic reality of the business.

Are general purpose financial statements for all stakeholders a valid concept?

We favour the parent approach over the entity approach to financial reporting. In our response to the IASB Business Combinations consultation in October 2005, we stated that: "we cannot see sufficient flaws or problems with the current parent company approach to warrant this change" to the entity approach. We continue to be of the view that a switch to the entity approach would risk giving theory precedence over commercial reality and user needs.

We do not share the EFRAG view that a support for the parent approach rather than the entity approach means a favouring of shareholder interests over those of other stakeholders. Our concern is that an approach which uses only the entity perspective risks obscuring reality for all users of accounts, whether shareholders or stakeholders.

We believe that reporting which focuses on the needs of equity owners serves the needs of all stakeholders. Because groups such as creditors, employees, suppliers and so on enjoy other protections under contractual or other specific legal rights, reporting which serves the interests of the shareholders – which do not enjoy such additional protections and so are most economically exposed to all aspects of company performance – will also serve the needs of other stakeholders. Financial reporting which tries directly to address the needs of all stakeholders is liable to produce a lack of clarity; stakeholder interests will be better served by narrative reporting which more directly addresses their various concerns. We believe that reporting from an entity perspective can support and add value to reporting from a parent perspective, but we do not believe it would be a substitute for such reporting.

We believe that accounts designed to meet the needs of all stakeholders would tend to obscure more than they reveal and that the reporting needs of stakeholders will best be met in practice by reporting which focuses on the needs of equity owners. We favour the parent approach as the principal approach but we recognise that reporting from an entity perspective can provide additional insights.

Do investors and creditors represent a homogenous enough group to be chosen as primary users?

We share the EFRAG concern that there is the potential for confusion in having too large and diffuse a group of parties designated as primary users. As stated above, we believe that as shareholders are most economically exposed to the performance of the company, their reporting needs will also meet the reporting needs of creditors (as well as other stakeholders).

We would note also our view that *potential* investors and creditors do not need to be named separately as primary users. They will not have interests in reporting which differ significantly from current investors, and their inclusion in the definition of primary users risks adding apparent additional obligations for directors and auditors which are not appropriate in all legal jurisdictions.

We would welcome the clarity that would come to financial reporting from current shareholders alone being designated as primary users.

Do the users of financial reporting of different types of entity have similar needs?

We agree that the focus for the moment should be on listed entities although it may be helpful to consider whether lessons may be learned from other areas.

Do the users of financial reporting of small, large, listed and unlisted entities have similar needs?

The basic needs are the same in terms of wanting to have an understanding of the main activities of the company, how it has dealt with its responsibilities to shareholders and others, and the main opportunities and risks that it faces. However, the level of detail required should be different depending on the size and complexity of the company and of its ownership base.

On the issue of costs and benefits, it is important to us as users of accounts that the accounting standards should not be so costly and complex that companies are discouraged from listing on the world's capital markets. It is also useful for companies to be able to send out summary financial statements for those shareholders who do not wish to receive the full annual report and accounts, provided that they have access to the full information if they so wish. Summary statements may be of particular value to private shareholders who do not wish to read the full 300 pages.

Do financial statements and other types of financial reporting have similar objectives?

The discussion in the EFRAG consultation concentrates on the issue of stewardship. Our view on this is as follows: we strongly believe that the stewardship concept should be retained as a separate objective of financial reporting – we note that we included the term stewardship in our Guiding Principles.

For many of us, we share this view because of the problems which arise through agency theory. We therefore also strongly support the specific application of the Alternative View expressed in the IASB's Discussion Paper to dealings with management: that the threshold for disclosure must be determined by reference to the individual rather than the entity. This is not driven by a prurient interest in excessive remuneration, but because such an analysis will assist users in taking a view as to whether management is driving full value at the entity, or whether personal motivations may be hindering changes which might otherwise generate additional value.

Others of us support the retention of stewardship as a separate objective – while acknowledging the agency argument – more because stewardship appears to be a key anchor for the retention of historic data in reporting. We are concerned that unless stewardship is retained as a separate objective, financial reporting risks becoming excessively focussed on forward-looking predictions and estimates of future cashflows. Accurate reporting of the historic investment in the operational side of a business – highlighted in our Guiding Principles as the core role of the balance sheet – enables a more effective analysis of the dynamics of that business. History matters, because it allows users to gain a closer understanding of how a company generates returns, and therefore provides users with key tools in assessing what future returns from that business may be.

We fear that a good deal of information which is useful to users will not be required if the objective of financial reporting is restricted in the way currently proposed by the IASB. The overall objective should be, we believe, to provide information that helps decision-making by investors, rather than just that which helps in making investment decisions. We believe that this is most likely to be achieved if the concept of stewardship, or an equivalent, is retained as a separate objective of financial reporting.

The EFRAG consultation also discusses the IASB/FASB focus on assets and liabilities. We share the concern that this focus may tend to obscure the underlying reality of the operating performance of the business. We also share EFRAG's view that this focus may reduce the ability to forecast future performance and so limit the value of some reporting for users.

Do financial statements and other types of financial reporting have similar qualitative characteristics?

We find qualitative characteristics difficult to comment on in any detail. It is not clear to us as users of accounts what the various potential qualitative characteristics will mean in practical terms for the financial reporting standards which will be brought in under the Conceptual Framework or for accounts that we use. We similarly understand that the terminology is not clear to many preparers, and nor is it to auditors.

This appears to us a fundamental problem. The Conceptual Framework should be a framework of principles helping to minimise the need for detailed rule-making in financial reporting standards and providing a basis for preparers and auditors to reach judgements based on high-level principles. Where there is a lack of clarity in the meaning of the Conceptual Framework, it will fail to perform this function.

It should not be a surprise therefore that various parties, including preparers, auditors and users, are calling for the retention of terminology which is well understood by all parties, such as substance over form, because the use of such terms would ensure that the framework does provide a basis for judgements as intended.

If the Conceptual Framework uses qualitative characteristics which are high level enough, there is no philosophical reason why they cannot apply to all financial reporting. But in order for them to be effective and useful to preparers, auditors and users, those qualitative characteristics need to be understandable to, and indeed understood by, all.

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Can all kinds of financial reporting be dealt with by the same framework?

Given the wide variation in the characteristics of different kinds of financial reporting, it will only be appropriate to have a single framework for those different forms of financial reporting if it is high level and principles-based – and, we would argue, if it uses concepts which are already well understood.

We therefore agree with EFRAG that more work needs to be done to ensure that the framework employs appropriate qualitative characteristics which will add value to all financial reporting as opposed to confusing and obscuring disclosure.

We would be happy to discuss any of the points above.

Yours sincerely

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