The Hundred Group
of Finance Directors

Financial Reporting Committee

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Dear Jerome

Pro-active Accounting Activities in Europe: Elements of the Framework Debate
The Conceptual Framework – Starting from the right place?

I am pleased to submit The Hundred Group's response to the Discussion Paper. Our overall comments are set out below. A more detailed response is dealt with in Appendix A.

The Hundred Group of Finance Directors represents the views of the finance directors of the UK's largest companies drawn largely, but not entirely, from the constituents of the FTSE100 Index. Our members are the finance directors of companies whose market capitalisation collectively represents over 80% of companies listed on the London Stock Exchange.

Overall comments

We believe PAAinE has developed a very useful contribution to the conceptual framework debate. The Discussion Paper highlights a number of areas which are fundamental to the conceptual framework project and yet which do not appear to have been formally addressed in the conceptual framework project undertaken by the IASB and FASB. Whilst some may regard the Discussion Paper as being slightly late in publication relative to the IASB and FASB timetable, we feel it is important given the conceptual nature of the project that omitted subjects are raised in the public domain and answers sought from the Boards.

The Hundred Group supports a conceptual framework for financial reporting which is business driven and which ensures financial information reported to investors is closely aligned to the performance information used internally so that existing and potential investors are able to view the business through the eyes of management.

The conceptual framework should encompass information about the financial position, economic and financial performance and changes in financial position of a business.

The conceptual framework should be a clear concise statement of principles

We attach our response to the IASB with regards the Conceptual Framework Phase A Discussion Paper as Appendix B which is a useful summary of our views both on that phase and on the conceptual framework project as a whole.

Please feel free to contact me if you wish to discuss our comments.

Yours sincerely

Ken Lever

Ken Lever
Chairman
The Hundred Group - Financial Reporting Committee

APPENDIX A

What is the purpose of the framework?

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

The role of the framework in standard setting

We feel the question of whether the framework should be mandatory is dependent on its purpose. We believe the conceptual framework should be what it purports to be – that is, it should be the framework around which future accounting standards should be built.

The conceptual framework should be developed before new standards and not made to fit existing standards. Draft standards should take account of the developing conceptual framework and the Boards should increase the speed with which it develops the conceptual framework and treat it as one whole project. Ten years to develop a framework given there is a perfectly good starting position is excessive. Piecemeal development of a framework is inefficient and to a large extent does not allow meaningful debate (as there are too many unknowns in future phases of the framework).

Furthermore, we believe the framework should be a clear concise statement of principles which would allow far greater potential for flexible application of accounting standards and principles to new thinking and changes in the business environment which is likely to better address the changes at hand.

We would highlight we disagreed in our response with regards the deferral by the Boards of the status of the framework because we believe the authoritative status of the framework is fundamental to the project as a whole not least as the IASB and FASB current frameworks have a different authoritative status.

Accordingly, we do believe the purpose of the framework should be addressed at a much earlier stage in the project and that it should be a concise set of principles akin to an aspirational statement (as opposed to technical guidance) based around such values as setting standards to report a "true and fair view" and using the principle of "substance over form" to reflect the underlying activities

Arguments for mandatory status

We would support the arguments set out for the framework to have a mandatory status and have the following observations:

1. A high level set of principles may be more open to interpretation but is probably necessary to deal with the rainbow of different economic and accounting issues that will arise over time. We would note that even with a rules based conceptual framework, one may not end up with consistent application in standard setting as there may well be instances where for practical purposes the framework should not be followed.

2. Notwithstanding the fact we support the conceptual framework to be a mandatory document where it is based on high level principles, we recognise this is unlikely to be achieved in practice. Therefore, we would propose that in the (hopefully unlikely) event, standard setters depart from the conceptual guidance principles when finalised, that there should be a higher hurdle for the standard setters to evidence to its constituents the net benefit in improving financial reporting of adopting such a course of action.

Arguments against mandatory status

We do not support the conceptual framework status being seen as a blueprint for what standard setters believe accounting should be like in the future. Fundamentally, financial reporting is a practical exercise in communication which aims to reflect the needs of users. Any conceptual framework must be based on what would be beneficial for users and what is likely to be practicable for preparers, auditors and regulators.

Tentative view – the role of the framework in standard setting

We support the tentative view that a framework with a mandatory status is the most useful for standard setters in that it provides a stable conceptual basis for developing standards and ensures the coherence and consistency of financial reporting standards.

We also agree that in the unlikely event of exceptions between standards and a framework (based on high level principles) does arise, the basis of the inconsistency is explained and the framework revised.,

The role of the framework in financial reporting

We support the tentative view expressed that the framework in financial reporting should represent a set of concepts and principles and is not a standard.

In the absence of specific standards or interpretations the framework should be considered to have authoritative status for preparers.

We agree the framework should not be used to override IFRSs but support the idea that this may be necessary in exceptional cases (perhaps to show a true and fair view, provided adequate disclosures were made).

Who are the users of financial reporting and what are their information needs?

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

We would agree that the conceptual framework Discussion Paper issued by the Boards provides little evidence on whether either the proprietary or entity approach should be adopted.

We do not regard this as a philosophical debate as we have seen with Business Combinations Part II that whichever approach is taken, the approach can be used to justify in part the Boards' decisions.

It is fair to say at present there seems to be very little evidence that is available and given that current accounting seems aligned more closely with the proprietary approach which reflects the importance of the shareholder – management (or principal-agent) relationship and stewardship then we believe the proprietary should be retained until real (and not just academic) evidence is produced which suggests the entity approach is more appropriate.

In practical terms, a number of stakeholders can and do get financial information outside of the financial statements (eg debtholder, tax officials, government).

General purpose financial statements may develop over time as a valid concept but at present there is insufficient evidence that the current regime is not (for the most part) meeting users' needs.

Tentative view

We agree with the tentative view expressed by PAAinE that more research should be undertaken with respect to the conceptual rationale for the two perspectives. We would note that the current market driven approach based on the proprietary view should be retained until credible evidence exists to suggest it should be changed.

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

We believe the primary purpose of financial statements is to communicate and typically this will be with the primary user groups as defined (albeit most of the communication is with investors rather than creditors).

In principle, there is very limited information we can conceive which would be of interest to another user group but not investors. We do acknowledge that certain user groups (eg the tax authorities) may require far more detailed information (eg individual employee salary and tax deduction details) but this may be less relevant for investors. We would contend that there are very few areas where such information (where required) is not being provided – it is worth noting that the information provided to investors is often above and beyond standard setters requirements. A clear example would be the use of non-GAAP measures and disclosures to provide more meaningful information to investors.

Whilst different users may have different needs reducing the homogeneity of the group, the capital markets evolve to meet the needs of the different types of users and within reason, it would seem appropriate that financial reporting aims to serve those different needs.

We would note that certain types of reporting such as regulatory reporting (for instance, in the banking sector) cannot be satisfied by the same data that one would provide to shareholders and that there are appropriate alternative routes for such information to be provided. Furthermore, users other than investors and creditors, typically have either significant statutory or other rights to demand non-financial reporting information which the investor base may not.

Where differing information demands from users are received, preparers typically will satisfy those of the shareholder/investor base first and it seems logical in practice, that the investor base is considered to be the primary user base.

Tentative view

We do not believe that it will be practicable for standard setters to obtain evidence to arrive at a clear definition of primary users of financial information in a short time period.

The current emphasis on investors and creditors appears to reflect the way in which capital markets interact with regards financial information and therefore we believe that whilst the primary users may not be homogenous, they are sufficiently important to capital markets that the conceptual framework seeks to address the needs of the spectrum of investors and creditors. Accordingly, an emphasis on investors and creditors for the most part, we feel, will provide information which is relevant for other users and based on the evidence through the practicalities of running a business will meet a lot of these other user needs.

To which entities should the framework apply?

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

Tentative view – profit and non-profit making entities

We agree with the PAAinE tentative view that the conceptual framework should first address the IASCF constitution of helping participants in the world's capital markets in their decision making and the priority given to profit making entities in the IASB's standard setting activity.

At this stage, potentially including the needs of non-profit making entities could potentially lead to a sub-optimal conceptual framework for profit making entities or vice versa.

We believe that it would be more helpful to consider the individual entities separately and then determine whether there is sufficient consistency between the principles (that would be the basis for the resulting conceptual frameworks) to suggest that a single conceptual framework would be appropriate.

Tentative view – types of entity

We believe the conceptual framework should focus on public listed entities to begin with.

If the principles of the conceptual framework are suitably high level, we see no reason why the conceptual framework could not apply to all entities. We do not equate this to agreeing that all entities should be subject to the same standard requirements.

The arguments about different needs are often based on the relative emphasis of certain financial reporting topics to the entity concerned or the fact that certain aspects are not relevant.

The scope of each standard could be adjusted to reflect the entity involved if there is no benefit for certain entities to comply with a standard. For instance, the IASB's SME project is designed for entities that: 1) do not have public accountability and (2) publish general purpose financial statements for external users and aims to reduce a large number of requirements that really only apply to public entities.

Whilst one can easily distinguish between public and private companies, the basis on which one would otherwise distinguish separate conceptual frameworks is not immediately obvious. We do not believe it is feasible to work on the basis that one size fits all for the definition of "small", "medium" or "large". Any objective basis using quantitative limits is unlikely to be easily transferred across many different countries whilst any subjective basis is likely to lead to inconsistencies.

We would prefer to see more time spent reducing the burden of financial reporting for all companies through alleviation of some of the more excessive reporting requirements of individual standards. This would extend not only to a review of disclosure requirements as a whole but also exemptions that can be applied for small and medium size companies.

To which types of financial reporting should the framework apply?

Do financial statements and other types of financial reporting have (a) similar objectives and (b) similar qualitative characteristics?

Financial statements and other types of financial reporting may have similar objectives but we would question whether they share similar qualitative characteristics based on the evidence available.

As PAAinE point out, management commentary does not share the Boards' stated qualitative characteristics of the conceptual framework (existing or proposed). We would add that the current debate on Financial Statement Presentation, where the overriding characteristic being applied by the IASB Staff is cohesiveness, is also inconsistent with the conceptual framework.

We believe that the qualitative characteristics should be similar given the objectives of the financial statements and management commentary should be aligned. In other words, management commentary should reflect the story of the financial statements consistently.

The definition of financial reporting can as PAAinE rightly notes can extend to many other aspects (of which non-financial information including judgments on market trends is but one) and we would be reluctant at this stage, without a clear understanding of just how wide that definition is, to commit to saying all "financial reporting" should be covered by the same conceptual framework.

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

We believe that it is unlikely that all kinds of financial reporting can be dealt with by the same framework if financial reporting is very widely defined and believe the tentative views expressed by PAAinE including the need for further research on the objectives of other forms of financial reporting are valid.