

September 2010

Project Summary and Feedback Statement

Conceptual Framework for Financial Reporting

At a glance

We, the International Accounting Standards Board (IASB), completed the first phase of the conceptual framework project by publishing two new chapters of our updated conceptual framework in September 2010. These chapters discuss the objective of general purpose financial reporting and the qualitative characteristics of useful financial information.

The objective of financial reporting is the foundation of the conceptual framework. The qualitative characteristics are the qualities that financial information must have to meet the objective of financial reporting.

The conceptual framework project

Principle-based standards

Our goal—which we share with our constituents—is for our standards to be based on consistent and appropriate principles. To provide the best foundation for developing principle-based standards, we undertook this project to establish an improved conceptual framework.

We have set out to develop a conceptual framework that is rooted in fundamental economic concepts rather than one based on a collection of arbitrary conventions.

Our *Framework* needs updating

The framework we are replacing was published in 1989, by the predecessor body to the IASB. In many cases, the 1989 framework requires refinement, updating and completion. For example, it does not have a measurement concept—it has a list of measurements choices.

Also, our 1989 framework does not include a basis for conclusions to discuss and explain why some issues were accepted or rejected.

One set of standards

The project also seeks to eliminate differences between IFRSs and US GAAP. As part of this process, we have been undertaking projects jointly with the FASB.

It is more difficult to develop improved and common requirements if each board bases its decisions on a different framework.

Also, without such a framework, standard-setting would be based on the personal frameworks of individuals and we might reach different conclusions about similar or even identical issues depending on the mix of board membership.

Project process

The new *Conceptual Framework*, which will deal with a wide range of issues, will build on the existing IASB and FASB frameworks and on frameworks developed in other jurisdictions. It will also take into consideration developments since those frameworks were created.

This project is being conducted in eight phases. For each phase of the project, the initial consultative document will be a discussion paper (DP). This will enable interested parties to become involved in the project at an early stage.

The new *Conceptual Framework* will combine the new chapters as they are completed with the text carried forward from the 1989 framework.

Project phases

Topic	Status of phase
Objective and qualitative characteristics	Completed Chapters 1 and 3 of the new Conceptual Framework
Definitions of elements, recognition and derecognition	DP to be published in 2011
Measurement	DP to be published in 2011
Reporting entity concept	Exposure Draft published in March 2010

Phases not yet active, and to be considered in the future:

Boundaries of financial reporting, and Presentation and Disclosure

Purpose and status of the framework

Application of the framework to not-for-profit entities and government business entities

Remaining issues, if any

Next steps

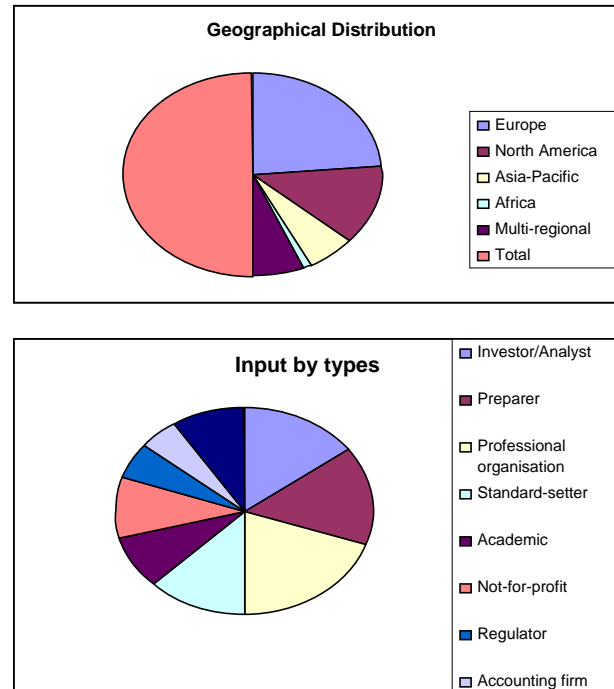
We are currently considering the draft chapter on the reporting entity.

When that chapter is completed the Board will update the *Conceptual Framework* to incorporate the new chapter.

We are also working to develop discussion papers for potential chapters addressing the elements and measurement.

Our consultation process

We published a discussion paper and an exposure draft jointly with the FASB on the objective and qualitative characteristics of financial reporting. We received 321 comment letters on our proposals. We also contacted some respondents to gain further insights into their comments. The accompanying chart shows the geographical distribution and the types of respondents who provided input to this framework.



The IFRS Advisory Council (previously called the Standards Advisory Council) and the FASB's Advisory Council also provided feedback on the issues that were raised in the discussion paper and exposure draft.

The global financial crisis brought a sharp focus on some of the fundamentals of financial reporting, such as who are the primary users of financial reports. We reviewed the recommendations from the Financial Crisis Advisory Group (the report is available on the IASB website) and noted that their recommendations were consistent with the respondents' comments.

Feedback Statement

We received broad support for the conceptual framework project and our project objectives.

When we published the discussion paper, some respondents disagreed with some of our preliminary views, particularly on how we articulated the objective of financial reporting. We considered the issues raised and published our proposed objective of financial reporting and qualitative characteristics of useful information. Most respondents commented favourably on how we had dealt with those issues.

In the pages that follow we outline the most significant matters raised with us and how we responded.

Summary of the main changes since the discussion paper

- The objective of financial reporting has been amended to clarify that its purpose is to help users to make decisions about providing resources to an entity, which includes decisions about the accountability of the entity's management.
- The chapters clarify that financial reports are directed to meet the common information needs of those who provide resources to an entity but cannot compel the entity to provide information to enable them make decisions about the entity.
- The qualitative characteristics are now categorised as either fundamental or enhancing characteristics. This clarifies how the qualitative characteristics relate to each other. There is one constraint upon providing useful information—cost.

The objective of financial reporting

The first chapter of the new *Conceptual Framework* deals with the objective of financial reporting.

The objective of general purpose financial reporting is:

To provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

General purpose financial reporting is directed at users who provide resources to an entity but lack the ability to compel the entity to provide them with the information they need to be able to make decisions.

Stewardship

The discussion paper stated that the objective of financial reporting should focus on resource allocation decisions.

Respondents' comments

Most respondents to the discussion paper agreed that providing useful information for decision-making was the appropriate objective. However, some respondents noted that investors, lenders and other creditors make decisions other than those related to resource allocation. For example, many shareholders make decisions related to the stewardship of an entity's resources, eg to vote on whether to retain directors or replace them, and on how members of management should be remunerated for their services.

Some respondents did not think that the exposure draft captured the concept of stewardship adequately.

Our response

We agreed with the respondents to the discussion paper. The revised wording that we used in the exposure draft was intended to capture the concept of stewardship.

The exposure draft also described the role that financial reports can play in supporting decisions related to the stewardship of an entity's resources.

However, in the light of the comments received, we have modified the wording so that the chapter now describes what stewardship encapsulates. We did not to use the term 'stewardship' because of ambiguities introduced when translating it into other languages.

The primary users

The exposure draft proposed that the primary users comprise existing and potential investors, lenders and other creditors—the users who:

- (a) are providing, or are considering providing, resources to the entity; and
- (b) do not have the power to compel the entity to provide information directly to them and must rely on general purpose financial reports.

Respondents' comments

A *primary user group*

Nearly every respondent agreed that there should be a primary user group. However, some stated that other users who have not provided, and are not considering providing, resources to the entity also use financial reports to monitor how developing economies transfer resources to their citizens.

Equity investors

Some respondents suggested that only equity investors should be the primary user group because they bear the highest risk in cases of liquidation.

Our response

We recognise that a wide range of parties may be interested in general purpose financial reports. However, we retained having a primary user group because it provides an important focus in setting standards. We think many other users will be well served by the financial reporting standards that are developed using this framework.

Many existing and potential investors, lenders and other creditors cannot compel reporting entities to provide information directly to them and must rely on general purpose financial reports.

Financial stability

Other potential users, such as regulators, were not identified as primary users because they often have the power to demand the information needed.

Respondents' comments

Some respondents suggested that regulators should be identified as a primary user group. Those respondents said that maintaining financial stability in capital markets (the stability of a country's or region's economy or financial systems) should be an objective of financial reporting. They stated that financial reporting should focus on the needs of regulators and fiscal policy decision-makers who are responsible for maintaining financial stability.

Our response

We fully accept that financial reporting standards have special importance for prudential regulators. We think that the objective reflected in the *Conceptual Framework* is not inconsistent with financial stability. Providing relevant and faithfully represented financial information can improve users' confidence in the information, and thus contribute to promoting financial stability. It is important that we protect the transparency and integrity of financial reporting.

We maintain an open dialogue with prudential regulators, that we think is very important. This dialogue helps us identify any areas where regulatory standards might differ from financial reporting standards.

The reporting entity

The exposure draft proposed that financial reports should focus on the activities of the entity. This means that the reporting entity is deemed to be separate from its owners.

Respondents' comments

Most respondents agreed that the entity is distinct from its owners or from a subset of them. However, some respondents to the exposure draft said that the reporting entity is not separate from its investors.

Our response

The view that the reporting entity is not separate from its equity investors has its roots in the days when most businesses were sole proprietorships and partnerships that were managed by their owners who had unlimited liability for the debts incurred in the course of the business. Over time, the separation between businesses and their owners has grown. The vast majority of today's businesses are separate from their owners by virtue of their legal form of organisation, by their numerous investors with limited legal liability and by their professional managers who are separate from the owners. Consequently, we retained our conclusion that financial reports should reflect that separation by accounting for the entity rather than for its primary users and their interests in the reporting entity.

Qualitative characteristics

The chapter of the new *Conceptual Framework* on qualitative characteristics deals with the attributes that make financial information useful. They are:

- relevance and faithful representation—the fundamental qualitative characteristics
- comparability, timeliness, verifiability and understandability—the enhancing qualitative characteristics that distinguish more useful information from less useful information.

Cost is a pervasive constraint on the reporting entity's ability to provide useful financial information.

The qualitative characteristics of useful financial information apply to financial information provided in financial statements, as well as to financial information provided in other ways.

Reliability and faithful representation

Reliability is a key quality of financial reporting. Unfortunately, the concept of reliability has grown to mean different things to different people. For example, some put more emphasis on *freedom from error* to the virtual exclusion of the *faithful representation* aspect of reliability, while others associate reliability with *precision*. This lack of a common understanding led us to consider how we could better convey what *reliability* means.

Accordingly, we proposed replacing the term *reliability* with the term *faithful representation* and clarifying that it encompasses all of the qualities that the framework we are replacing included as aspects of reliability—the depiction in financial reports of the economic phenomena that it purports to represent.

Respondents' comments

Many respondents did not support the change in terminology. Some stated that faithful representation is not equivalent to reliability and is a narrower term. These respondents suggested that reliability should be maintained as a qualitative characteristic. Others recommended the boards clarify *reliability* rather than replace the term with something new.

Our response

We acknowledge that the term *reliability* is more familiar than *faithful representation*. However, given the nature and extent of the long-standing problems with the meaning of reliability, and the failure of the previous efforts to address them, we reconfirmed our decision that *reliability* should be replaced with the term *faithful representation*.

Notes

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The IASB is the independent standard-setting body of the IFRS Foundation

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