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CANADA

9 February 2009

Dear Stephenie

Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities:

- **The Objectives of Financial Reporting**
- **The Scope of Financial Reporting**
- **The Qualitative Characteristics of Information Included in General Purpose Financial Reports**
- **The Reporting Entity**

Introduction

1 The ASB welcomes the publication by IPSASB of the Consultation Paper on the Conceptual Framework for Public Sector Entities. We believe this initiative is timely and can be expected to lead to significant improvements in the financial reporting of public sector entities. We agree with many of the conclusions in the paper.

2 As you are aware, the ASB has published an Interpretation of its Statement of Principles for Public Benefit Entities (the SOPBE). In developing the comments in this letter we have reconsidered the issues rather than merely repeating the position adopted in the SOPBE. It is, of course, important that the scope of the documents differ in that the IPSASB Framework will address reporting by public sector entities, whereas the SOPBE also includes private sector public benefit entities.

Scope

3 We welcome the statement that 'Information presented in financial statements and their notes remains at the core of financial reporting' (paragraph 3.22 of the Consultation Paper). However, we are concerned that the Consultation Paper takes a very broad view of the boundaries of financial reporting and the potential users of General Purpose Financial Reports (GPFRs). There is a risk that, by attempting to be too broad in scope, the Framework will not be as useful as it would be if its scope were more clearly defined. The wide scope of the Consultation Paper makes it difficult to appraise whether its proposals are appropriate for the wide range of information to which it applies.

4 We expand on this difficulty below under "Objectives" and "Qualitative Characteristics" and then suggest under "Developing the Framework" how the approach to the project might be refined to meet this concern.

Objectives

5 We agree that, particularly in the public sector, the notion of 'accountability' should form part of the objective of financial reporting. In our view, accountability emphasises the provision of information on the events that have occurred in the reporting period; that is, historical information. In contrast, decision-usefulness implies a focus on the future because rational decisions can only be made on the basis of future prospects. Despite this apparent divergence, there is a very significant overlap between accountability and decision-usefulness as:

- Information prepared for accountability purposes necessarily includes information on the financial position at the end of the period: that information will be heavily influenced by projections of the future.
- Information on future events is usually incomplete and the most relevant basis for an assessment of the future is often an account of past events.

6 We therefore agree that both accountability and decision-usefulness should form part of the objectives of financial reporting. That said, it is probable that the relative emphasis between them varies depending on the nature of the report concerned. One might take the view, for example, that accountability suggests financial statements should report the actual outturn on pension scheme assets but that in the Management Commentary an expected return measure could be reported because it is thought to be a more appropriate basis for decision making. IPSASB should consider whether this potential difference in emphasis should be acknowledged in the Framework.

Qualitative characteristics

7 It is not clear that the qualitative characteristics that are appropriate for financial statements are equally appropriate for all the information within the proposed scope of the Consultation Paper. This is illustrated by the acknowledgement in paragraph 4.28 of the Consultation Paper that the quality of 'verifiability' is often referred to as 'supportability' in the context of qualitative and prospective information: this seems to be more than merely a difference in terminology. Another example: it is unclear how the quality of 'faithful representation' may be applied to prospective financial information, which is not part of financial statements but is part of wider financial reporting.

8 In our response to the IASB Exposure Draft on this matter, we argued against the replacement of the qualitative characteristic of "reliability" with "faithful representation". In our view, reliability is particularly important in the context of the financial statements and less so in other forms of financial reporting. That said, we acknowledge that IPSASB is attempting to conform with the IASB Exposure Draft. Assuming the IASB retain the Exposure Draft position, it is our view that, in the absence of compelling public sector reasons, the advantages of alignment are greater than the improvements that would be secured by IPSASB using reliability.

9 The IASB's Discussion Paper on 'Management Commentary' (authored by the staff of partner standard-setters and others) discusses the qualitative characteristics that are appropriate for Management Commentary and also discusses 'placement criteria' that may assist in determining where information may be placed in a financial report.

Developing the Framework

10 We think that in the later phases of the Conceptual Framework project, the wide scope will give rise to great difficulties, for example we presume that the definition of assets and liabilities will provide a suitable foundation for financial statements but will not embrace all that will be reported elsewhere in financial reports. Similarly, the material on measurement will consider the issue in the context of financial <u>statements</u> and we note that the Project Brief envisages that paper (e) (elements) will also be addressed specifically in the context of financial <u>statements</u>.

11 We believe that IPSASB should consider developing a Framework in two stages that focuses initially on financial statements (including the notes) and then address how it might apply to other kinds of financial reporting. This will enable a robust framework to be developed for financial statements, but will also highlight their limitations and hence show the need for other kinds of information. Although this would differ from the sequencing adopted by the IASB in its Framework project, we believe it is likely to result in a higher quality product and would hope that differences could be resolved as the IPSASB and IASB Frameworks develop.

12 Our suggestion is not premised on the view that financial statements are more important than other elements of financial reporting, but rather on the desirability for a clear delineation between the two. Financial statements and other parts of financial reporting are both vitally important and complementary, but there are significant differences between them. At a general level, financial statements are, for good reason, bounded by conventions and constraints that limit what they can deal with: other parts of financial reporting seek to provide information beyond the bounds of these limitations, including information on process, performance, policy and programmes, and in so doing enhance the usefulness of financial reporting.

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13 The Appendix to this letter sets out our views on each of the preliminary views in the Consultation Paper. We are pleased to support IPSASB in the development of the Paper and look forward to continuing to contribute to its work on the Framework.

14 Because it covers much of the same ground as the Consultation Paper, we have attached a copy of our response to the IASB Exposure Draft '*An improved Conceptual Framework for Financial Reporting – Chapter 1 The Objective of Financial Reporting, and Chapter 2 Qualitative Characteristics and Constraints on Decision-useful Financial Reporting Information*'. If you require any further information please contact me or Alan O'Connor (a.oconnor@frc-asb.org.uk or telephone +44 (0)20 7492 2421).

Yours sincerely

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Appendix

IPSASB Preliminary View 1 - The Authority of the IPSASB Framework

The IPSASB Framework will not establish new authoritative requirements for financial reporting by public sector entities that adopt IPSASs, nor will it override the requirements of existing IPSASs.

In selecting accounting policies to deal with circumstances not dealt with in IPSASs or other guidance issued by the IPSASB, public sector entities will refer to, and consider the applicability of, the definitions, recognition criteria, measurement principles, and other concepts identified in the IPSASB Framework.

1.1 We agree. IPSASs are inevitably more specific than the Framework, and it would therefore be undesirable to allow the Framework to be used as authority to depart from an IPSAS.

1.2 We note the approach suggested in paragraph 1.5 for conflicts between an IPSAS and the Framework. Whilst IPSASB should be alert for departures between the Framework and standards, we agree that it would not be reasonable for IPSASB to respond to all possible conflicts.

IPSASB Preliminary View 2 - General Purpose Financial Reports (GPFRs)

GPFRs are financial reports intended to meet the common information needs of a potentially wide range of users who are unable to demand the preparation of financial reports tailored to meet their specific information needs.

2.1 We agree that GPFRs should seek to meet the demands of users who are unable to demand the preparation of financial reports, and that it is useful for the Framework to differentiate GPFRs from specialised reports.

IPSASB Preliminary View 3 - The Users of GPFRs

As a mechanism for focusing on their common information needs, the potential users of GPFRs of public sector entities are identified as:

- *recipients of services or their representatives;*
- *providers of resources or their representatives; and*
- *other parties, including special interest groups and their representatives.*

The legislature is a major user of GPFRs. It acts in the interest of members of the community, whether as recipients of services, providers of resources, or citizens with an interest in, or need for, particular services or activities.

3.1 Whilst we agree that financial reporting should seek to satisfy many of the information needs of a variety of users, the relative emphasis between different groups will vary in differing cases. As regards the financial statements, we would suggest greater emphasis upon providers of resources would provide a helpful focus for standard setting and the further development of the Framework. Recipients of services will often be more interested in information accompanying the financial statements.

3.2 We would hope that the reference to "common information needs" in the preliminary view is not intended to imply that information that is required by some, but not all, users need not be provided.

3.3 Whilst we agree that some of the information in GPFRs may be useful to special interest groups, it is not clear to us that the information needs of such groups is always a relevant consideration for financial reporting.

3.4 We also agree that, although it may also have the authority to demand certain information that might be deemed specific purpose, the legislature is a major user of general purpose financial reports.

IPSASB Preliminary View 4 - The Objectives of Financial Reporting

The objectives of financial reporting by public sector entities are to provide information about the reporting entity useful to users of GPFRs for:

- *accountability purposes; and*
- *for making resource allocation, political and social decisions.*

4.1 As stated in our covering letter, we believe that providing information for accountability (or stewardship) purposes is part of the objectives of financial reporting, and that it is particularly relevant in the case of the public sector. We therefore support the specific inclusion of accountability as a complement to decision-usefulness. The emphasis given to these two aspects may not always be the same and, in our view, accountability is particularly important in the context of financial statements.

IPSASB Preliminary View 5 - The Scope of Financial Reporting

The scope of financial reporting encompasses the provision of financial and non-financial information about:

- *economic resources of the reporting entity at the reporting date and claims to those resources;*
- *the effect of transactions, other events, and activities that change the economic resources of the reporting entity and claims to those resources during the reporting period, including cash inflows and outflows and financial performance;*
- *the reporting entity's compliance with relevant legislation or regulation and legally adopted or approved budgets used to justify the raising of monies from taxpayers and ratepayers;*
- *the reporting entity's achievement of its service delivery objectives; and*
- *prospective financial and other information about the reporting entity's future service delivery activities and objectives, and the resources necessary to support those activities.*

It also encompasses explanatory material about: (a) the major factors underlying the financial performance of the entity, the achievement of its service delivery and other objectives and the factors which are likely to influence its performance in the future; and (b) the assumptions underlying and major uncertainties affecting the information included in GPFRs.

5.1 By setting out a very broad range of information, it is not clear that the Consultation Paper's discussion of this preliminary view is very useful. Its usefulness would be greatly enhanced if the scope of the various parts of financial reporting were identified separately. In broad terms, it would seem that the first two bullets would relate to financial statements and that most of the last two bullets (and the closing paragraph on explanatory material) would primarily be met by other parts of financial reporting.

5.2 We agree that non-financial information is important in the public sector. However, we believe such information should not be included in the financial statements.

5.3 Information to allow a comparison between budgets and outturn is a legitimate aspiration for financial reporting. However, the third bullet suggests that financial reporting provides information about compliance with a much wider set of legislation or regulation, and we question whether this is appropriate.

IPSASB Preliminary View 6 - Evolution of the Scope of Financial Reporting

The scope of financial reporting should evolve in response to users' information needs, consistent with the objectives of financial reporting.

6.1 We agree with this view.

IPSASB Preliminary View 7 - The Qualitative Characteristics of Information Included in GPFRs

The qualitative characteristics of information included in GPFRs of public sector entities are:

- *relevance, which encompasses confirmatory value, predictive value, or both;*
- *faithful representation, which is attained when depiction of economic or other phenomena is complete, neutral, and free from material error;*
- *understandability;*
- *timeliness;*
- *comparability; and*
- *verifiability (including supportability).*

Constraints on financial reporting are materiality, cost, and the balance between the qualitative characteristics.

7.1 We refer in paragraph 8 of the covering letter to our concerns about the replacement of the qualitative characteristic "reliability" with "faithful representation". This point is also discussed in the attached letter responding to the IASB Exposure Draft. However, as explained in the covering letter, assuming the IASB retain the Exposure Draft position, we think IPSASB should align with the IASB and use the term faithful representation.

7.2 We believe the IPSASB Framework should provide additional emphasis on the significance of materiality based on the "context and nature" of an item as this is likely to be a common and significant feature in the accounts of public sector entities.

IPSASB Preliminary View 8 – Characteristics of a Reporting Entity

The key characteristic of a reporting entity is the existence of users who are dependant on GPFRs of the entity for information for accountability purposes, and for making resource allocation, political, and social decisions.

A public sector reporting entity may be an entity with a separate legal identity or other organizational structure or arrangement.

8.1 We agree that a key characteristic of a reporting entity is the existence of users who are dependent on general purpose financial reports, although the proposed broad range of potential users identified in preliminary view 3 raises the question of whether it is necessary for the proposed Framework to direct which entities should report.

8.2 We also believe the preliminary view would be more helpful if it identified some other, more neutral, criteria for a reporting entity, such as the existence of separately identifiable transactions, assets and other economic events that make an entity accountable to users and that can be economically impacted by users' decisions. A further criterion could be having separate management accountable for the activities of the entity.

8.3 We also consider that it may be helpful for the Framework to explain that, in addition to reporting entities, data may also be presented for specific "activities", such as the collection of taxation revenues or for a number of reporting entities within a sector, such as housing or health. Although accounting standards may provide guidance in such a case, the resulting statement would not be GPFRs if it did not relate to a reporting entity.

IPSASB Preliminary View 9 – The Composition of a Group Reporting Entity

A group reporting entity will comprise the government (or other public sector entity) and other entities when the government (or other public sector entity):

- *has the power to govern the strategic financing and operating policies of the other entities (a "power criterion"); and*
- *can benefit from the activities of the other entities, or is exposed to a financial burden that can arise as a result of the operations or actions of those entities; and can use its power to increase, maintain, or protect the amount of those benefits, or maintain, reduce, or otherwise influence the financial burden that may arise as a result of the operations or actions of those entities (a "benefit or financial burden/loss" criterion).*

9.1 We agree the composition of a group reporting entity should be determined by controlling entity model and agree with the two criteria put forward in the preliminary view. We also agree with the need to demonstrate that both these criteria apply.

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International Accounting Standards Board
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2 October 2008

Dear Li Li

IASB Exposure draft '*An improved Conceptual Framework for Financial Reporting – Chapter 1 The Objective of Financial Reporting, and Chapter 2 Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information*'

This letter contains the views of the UK Accounting Standards Board (ASB) on the above IASB Exposure Draft (the ED). The ASB welcomes the opportunity to comment on this IASB ED.

The ASB notes that the version of chapters 1 and 2 of the Framework proposed in the ED has been significantly improved compared to those proposed at the DP stage. In this respect, the ASB would commend the IASB in the efforts made to rewrite certain sections including those concerning the references to stewardship in the objective of financial reporting, the reduced emphasis on cashflow forecasting and the inclusion of references to decisions taken by investors that are not buy, sell or hold.

Despite the efforts made by the IASB and FASB in improving the proposals in the ED the ASB continues to have a number of key areas of concern. These are listed below and discussed in more detail in the Appendix to this letter.

Key concerns regarding Chapter 1

Piecemeal finalisation of the Framework

1) The ASB remains concerned at the IASB's proposals to finalise each chapter of the Framework independently of the others so that some of the earlier chapters will be completed a long time in advance of the rest of the Framework. For example, chapters 1 and 2 as proposed in the ED could be finalised within the year (in 2009) whilst we are aware that some of the later phases of the conceptual framework project have yet to be started. So conceivably there could be a number of years between the finalisation of the earlier chapters and some of the later parts of the even being discussed.

2) Although the IASB intends to address the apparent inconsistencies with the rest of the Framework as the project progresses, the ASB believes that not all of them can be eliminated by adopting this approach. This letter provides some examples of areas where inconsistencies will continue to exist partly because the impact of earlier changes on the rest of the Framework has not been fully discussed yet. For example, the impact of adopting the entity approach has not been fully considered (see below for further discussion on this).

3) The ASB can understand the pressures on the IASB to have some aspects of the Framework in place. However, we fail to understand how an internally inconsistent Framework will be useful in either one of its purposes – as a backdrop to the standard-setting process or as part of the hierarchy of IFRS. The ASB believes that the IASB, by adopting this chapter-by-chapter finalisation approach, is putting undue pressure on itself and the constituents and that it will lead to the undesirable outcome of an internally inconsistent Framework over a long period of time.

4) The ASB therefore recommends that the IASB does not finalise any section of the Framework until all parts are ready to be finalised.

Stewardship

5) As noted above, while the ASB acknowledges that the ED now contains an expanded objective of financial reporting to encompass stewardship, it takes the view that the spirit of a number of the concerns raised in the ASB's response of 2 November 2006 to the IASB's Preliminary Views Discussion Paper (see paragraphs 6-16 of the appendix to that letter) remain to be addressed.

Adoption of the entity perspective

6) The ASB is concerned that the ED proposes the adoption of the entity perspective in the Framework but fails to provide adequate justification for this or discuss the potential impact on other parts of the Framework. The ASB is concerned that without an in depth discussion of the issues arising from adopting the entity perspective, as opposed to any of the other possible perspectives (including the proprietary perspective, the parent shareholder perspective and other hybrid models), the detailed implications of this proposals to the remainder of the Framework and IFRS in general will be difficult to ascertain.

7) The ASB recommends that a full debate on the issues arising from adopting the entity perspective needs to take place before a decision can be made on its adoption and its consequences on the remainder of the Framework. (see Appendix paragraphs 1-10)

Boundaries of financial reporting

8) The ASB is concerned that the ED makes no reference to what constitutes general purpose financial reports. The consideration of specific issues concerning the boundaries of financial reporting and distinctions between financial statements and other parts of financial reporting have been deferred to a later phase (Phase E) of the Framework project. In our view, there is a need for the IASB to

first define what is covered by financial reporting. A widening of the application of the Framework (currently applied only to financial statements) to all financial reporting will give rise to problems as it will be attempting to outline the concepts that underpin two fundamentally different things: financial statements and financial reports (which can comprise of corporate annual reports, prospectuses, news releases, managements forecasts, etc). In our view, users have very different expectations from financial statements and financial reporting. The latter are more explicitly forward looking and accordingly users recognise the differences in the qualitative characteristics of these two types of reports.

Key concerns regarding Chapter 2

9) Many of the concerns raised in the ASB's response to the IASB DP in the letter dated 2 November 2006 still remain. The ASB believes that the term "faithful representation" as defined in the ED is not well understood outside of the United States. The ASB is not in favour of this change and would recommend that the IASB instead spend time improving the definition of reliability so that it conveys the meaning as understood by the IASB. However, if the IASB were to continue with the proposals in the ED the ASB would encourage greater rigour in the language of the definition. (See Appendix paragraphs 19-24)

10) The differentiation between fundamental and enhancing QCs proposed in the ED is artificial. The ASB believes that which QCs are more important depends on the circumstances and the information being conveyed. The ASB would recommend that this differentiation is removed and instead a general reference is made to the QCs the IASB would expect to be considered first in the vast majority of the cases. (See Appendix paragraphs 14-18)

11) The ASB also continues to have concerns with the qualitative characteristic of verifiability which were also raised in the letter dated 2 November 2006. The ED notes that verifiability is a quality of information that is arrived at as a result of consensus between different knowledgeable and independent observers. When reviewed in light of the statements in OB14 that equate financial models to judgements it concerns the ASB that the results from the models may be verifiable and objective but not always a good approximation of the underlying economics.

If you would like to discuss any of the comments made above then please contact Seema Jamil-O'Neill on 020 7492 2422 or myself on 020 7492 2434.

Yours sincerely

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Appendix

Chapter 1 ***The objective of financial reporting***

1 The boards decided that an entity's financial reporting should be prepared from the perspective of the entity (entity perspective) rather than the perspective of its owners or a particular class of owners (proprietary perspective). (See paragraphs OB5–OB8 and paragraphs BC1.11–BC1.17.) Do you agree with the boards' conclusion and the basis for it? If not why?

1) The ED introduces the notion of financial reporting being produced from the entity's perspective for the first time. The discussion in OB5 asserts the "financial reports reflect the perspective of the entity rather than the perspective of the entity's equity investors, particular group of its equity investors or any other group of capital providers. Adopting the entity perspective does not preclude the inclusion in financial reports of additional information that is primarily directed to the needs of an entity's equity investors or to another group of capital providers."

2) These assertions are left largely unsupported and little information is provided on why it is appropriate to choose the entity perspective rather than the proprietary perspective. BC 1.13-1.14 note that under the proprietary perspective "the reporting entity does not have substance of its own separately from that of its proprietors or owners" and that the proprietary perspective belongs in the times when "entities were owner-managed and owner-managers had unlimited liability for the debts incurred in the course of the business".

3) This appears to be a generalisation and has little basis in the contemporary corporate world. In the UK and certain other countries for example, the concept of the "veil of incorporation" and limitation of liability has been enshrined in company law since the case of Salomon v Salomon & Co. (1897). This important case sets out that a limited liability company is not an agent or trustee of its shareholders. Therefore, the comments in relation to the proprietary perspective in BC 1.13-1.14 have not applied to companies, whether publicly traded or privately held, in these countries for over a century. For example, All such limited companies in the UK are required to produce financial statements in accordance with GAAP (either UK GAAP or EU adopted IFRS).

4) An area where limitation of liability does not apply is in relation to certain partnerships and co-operatives. A number of these entities are set-up so that the owner-managers do have unlimited liability for the debts incurred in the course of business. A large number of these entities are currently complying with IFRS. The proprietary perspective, as explained in the ED, could be appropriate for such entities.

5) BC1.15 goes on to note that the two boards concluded that "the entity perspective is more consistent with the fact that the vast majority of today's business entities engaged in financial reporting have substance distinct from that of their capital providers. As such, the proprietary perspective generally does not reflect a

realistic view of financial reporting." The ED contains no further discussion of the issues arising from the adoption of the entity perspective for the remainder of the Framework or financial reporting as a whole. The ASB is concerned that without an in depth discussion of the issues arising from adopting the entity perspective, as opposed to any of the other possible perspectives (including the proprietary perspective, the parent shareholder perspective and other hybrid models), the detailed implications for this proposals to the remainder of the Framework and IFRS in general will be difficult to ascertain.

6) For example, one of the potential issues that the ASB has noted is that the stewardship objective relies on an element of the proprietary perspective – shareholders want financial reporting to contain information that would enable them to evaluate management's performance and whether it aligns with their objectives. Management does not have this responsibility towards any of the other primary users identified in the ED. This aspect of stewardship does not appear to be best served by adopting the entity perspective.

7) A potential implication of the entity perspective may be on the elements phase of the Framework project. Currently, that phase is considering the definitions of assets, liabilities and equity. The entity perspective is sometimes depicted with the following simple equation:

Assets = Liability + Equity

8) Therefore, one could deduce that from the entity's perspective any item on the balance sheet that is not an asset of the entity is a claim on those assets. This approach would not differentiate between liabilities and equity, both of which represent claims against the entity. This then begs the question as to why the differentiation between liabilities and equity is still maintained. This line of reasoning can be used to justify the claims approach and an elimination of the distinction between equity and liability.

9) In view of the above, the ASB would recommend that the IASB considers this issue more thoroughly, taking into account all relevant issues, as well as engaging constituents in this debate before making any conclusions.

2 The boards decided to identify present and potential capital providers as the primary user group for general purpose financial reporting. (See paragraphs OB5–OB8 and paragraphs BC1.18–BC1.24.) Do you agree with the boards' conclusion and the basis for it? If not why?

10) The ASB is in general agreement with the IASB that the primary user group comprises the present and potential capital providers. However, there are a few inconsistencies in the way this has been expressed in the proposals in the ED.

11) In this respect, the ASB would like to ensure that it is clear from the Framework that management is primarily accountable to the equity investors. Currently, and

to our minds incorrectly, OB12 notes that "Management is accountable to the entity's capital providers for the custody and safekeeping of the entity's economic resources." We would prefer to see the reference to "capital providers" in that sentence and the last sentence in OB12 to be changed to "equity investors".

3 The boards decided that the objective should be broad enough to encompass all the decisions that equity investors lenders and other creditors make in their capacity as capital providers including resource allocation decisions as well as decisions made to protect and enhance their investments. (See paragraphs OB9–OB12 and paragraphs BC1.24–BC1.30.) Do you agree with that objective and the boards' basis for it? If not why? Please provide any alternative objective that you think the boards should consider.

12) The ASB agrees that the objective as identified in the ED is broad enough to encompass the decisions of capital providers. There are few minor adjustments, as noted in the answers above, which would ensure that it is relevant for all profit making entities.

13) However, our concern is in relation to the not-for-profit entities which we feel may not be as well served by the objective as identified. In this respect, we would recommend that the IASB refers to the July 2008 report produced by the chairs and senior staff of the Australian, Canadian, New Zealand and United Kingdom Accounting Standards Boards on the implications for the not-for profit sector of the Framework proposals (we enclose the report with our letter). This report considers how some of the differences in the not-for-profit sector affect the possible application of the concepts proposed by the IASB and FASB to entities in that sector. In this respect, the report raises particular concerns with the adequacy of the emphasis on accountability/stewardship and a need to broaden the identified users and establish an alternative primary user group.

Other

14) We are concerned that statements in paragraph OB14 equate financial models to judgements. We believe that models inform estimates and judgements and not equate to estimates and judgements, which must incorporate qualitative aspects as well.

Chapter 2 ***Qualitative characteristics and constraints of decision-useful financial reporting information***

1 Do you agree that: (a) *relevance* and *faithful representation* are fundamental qualitative characteristics? (See paragraphs QC2–QC15 and BC2.3–BC2.24.) If not, why? (b) *comparability*, *verifiability*, *timeliness* and *understandability* are enhancing qualitative characteristics? (See paragraphs QC17–QC35 and BC2.25–BC2.35.) If not, why? (c) *materiality* and *cost* are pervasive constraints? (See QC29–QC32 and BC2.60–2.66.) If not, why? Is the importance of the pervasive constraints relative to the qualitative characteristics appropriately represented in Chapter 2?

15) The ASB has a number of concerns with the proposals as set out in QC1-QC15 and the explanations provided in BC2.3-BC2.24. These include: the differentiation between fundamental and enhancing qualitative characteristics (QCs); the replacement of reliability with faithful representation; and the interaction between relevance and faithful representation. These are explored in more detail below and in the answer to question 2.

16) QC1 notes that the QCs of general purpose financial reporting can be "…distinguished as fundamental or enhancing characteristics, depending on how they affect the usefulness of the information." The ED then goes on to note that relevance and faithful representation are considered fundamental QCs whilst comparability, verifiability, timeliness and understandability are enhancing characteristics. BC2.54 notes that this distinction between the QCs was provided because there is some confusion among respondents to the DP about how the QCs relate to each other.

17) The ASB considers such a distinction between the QCs to be artificial. The ASB would suggest that the application of all the qualitative characteristics (not just the enhancing characteristics as noted in QC26) is an iterative process that does not follow a prescribed order. It agrees with the sentiment in paragraph 45 of the current IASB Framework which notes that, "In practice a balancing, or trade-off, between qualitative characteristics is often necessary… The relative importance of the characteristics in different cases is a matter of professional judgement."

18) In general we would agree that any information to be potentially included in the financial reports would first be judged on its relevance. However, we can foresee cases where the so called "enhancing" characteristics are as important as the "fundamental" characteristics. For example, information that is relevant but so out-of-date (i.e. not timely) that its inclusion is likely to confuse the users thus impacting its understandability. In such a case, faithful representation is a secondary consideration.

19) The ASB's concerns with the replacement of the QC "reliability" with "faithful representation" are set out in the answer to question 2 below.

> 2 The boards have identified two fundamental qualitative characteristics—*relevance* and *faithful representation*:
> (a) Financial reporting information that has *predictive value* or *confirmatory value* is relevant.
> (b) Financial reporting information that is *complete*, *free from material error* and *neutral* is said to be a faithful representation of an economic phenomenon.
> (i) Are the fundamental qualitative characteristics appropriately identified and sufficiently defined for them to be consistently understood? If not, why?
> (ii) Are the components of the fundamental qualitative characteristics appropriately identified and sufficiently defined for them to be consistently understood? If not, why?

20) Although verifiability is no longer a component of faithful representation, the ASB still remains concerned that the IASB is persisting in its replacement of the QC "reliability" in its current Framework with "faithful representation". BC2.11 sets out the Board's thinking when it notes that "neither board's [IASB or FASB] existing framework conveys the meaning of reliability clearly enough to avoid misunderstandings." However, many of the concerns raised in the ASB's response to the IASB DP on 2 November 2006 still remain (see paragraphs 27-35 in Appendix to the letter).

21) The ASB believes that although the meaning of the two terms may overlap in some respects they mean very different things and that "reliability" may be seen as a broader notion than "faithful representation". The current IASB Framework when defining reliability notes in paragraph 31 that, "Information has the quality of reliability when it is *free from material error* and *bias* and *can be depended upon by users to represent faithfully* that which it either purports to represent or could reasonably be expected to represent." Paragraph 32 of the IASB's current Framework goes on to elaborate that, "Information may be relevant but so unreliable in *nature or representation* that its recognition may be potentially misleading."[italics added]

22) The proposed definition of faithful representation in the ED in QC7 notes that "Faithful representation is attained when the depiction of an economic phenomenon is complete, neutral, and free from material error. Financial information that faithfully represents an economic phenomenon depicts the economic substance of the underlying transaction, event or circumstances, which is not always the same as its legal form."

23) In the ASB's view, faithful representation and its components as defined cover some of the quantitative aspects of reliability, namely *free from material error* and *bias*. Although it goes on to require the depiction of the economic substance, the components appear not to address the qualitative aspect of reliability i.e. exclusion of information being so unreliable in *nature* that its recognition is potentially misleading

23) The ASB further believes that faithful representation as defined in the ED is not well understood outside the US. Furthermore, the definition and explanations provided in the ED add to the confusion. The illustration of how a single economic phenomenon may be represented in different way is included in paragraph QC8 which notes that, "…and estimate of the risk transferred in an insurance contract may be depicted qualitatively (eg a narrative description of the nature of the possible losses) or quantitatively (eg an expected loss)." The qualitative aspect noted above does not appear to us to be derived directly from the definition of faithful representation.

24) The ASB therefore feels that if the IASB were to continue with this replacement the ASB would encourage greater rigour in the language of the definition, in particular to reflect the concerns raised in paragraph 22 above.

3 Are the enhancing qualitative characteristics (*comparability, verifiability, timeliness* and *understandability*) appropriately identified and sufficiently defined for them to be consistently understood and useful? If not why?

25) The ASB is broadly happy with the proposals in this area of the ED.

4 Are the pervasive constraints (*materiality* and *cost*) appropriately identified and sufficiently defined for them to be consistently understood and useful? If not why?

26) We agree that materiality and cost are pervasive constraints. That said, the discussion of materiality in paragraph QC28 places the emphasis on the omission or misstatement of financial information. The ASB believes that it is also important to emphasise materiality in the context of excluding the provision of immaterial financial information. As noted in the ASB's 'Statement of Principles for Financial Reporting' (paragraph 3.29) "…when immaterial information is given in the financial statements, the resulting clutter can impair the understandability of the other information provided."

Other

27) The ASB also notes that the IASB is proposing to retain paragraph 23 in the current Framework, which relates to the going concern principle. We support the proposed retention, but note that the IASB has not provided any rationale as to why it considers going concern an important notion. As noted in the ASB's response of 2 November 2006 to the IASB's DP, we would urge the Boards to include a specific reference to, and rationale for, going concern in the converged framework.