THE
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Ms Stephenie Fox
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By email: EDComments@ifac.org

31 March 2009

Dear Stephenie

IPSASB CONSULTATION PAPER: CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES

The Public Sector Committee of the Institute of Chartered Accountants of Scotland (ICAS) welcomes the opportunity to comment on the International Public Sector Accounting Standards Board's (IPSASB's) Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities. The Public Sector Committee is a broad based committee of ICAS members with representation from across the public services.

The Institute's Charter requires it to act primarily in the public interest, and our submissions are therefore intended to place the general public interest first. Our Charter also requires us to represent our members' views and protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Overall Comments

We believe that a sound conceptual framework is vital to the development of principles-based financial reporting standards, representing a clear hierarchy of overriding concepts upon which all other principles are based. Therefore, we would support a single conceptual framework for general purpose financial reporting for all entities, covering the private, public and not-for-profit sectors. However, we appreciate that:

- a single conceptual framework underpinning a single set of financial reporting standards is not currently on the horizon; and
- IPSASB is working to develop a stable platform of International Public Sector Accounting Standards (IPSASs) which converge with International Financial Reporting Standards (IFRSs), departing only when there is a justifiable public sector specific reason for divergence.

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With these points in mind, we welcome IPSASB's Public Sector Conceptual Framework project and its consideration of developments emanating from the International Accounting Standards Board (IASB) Conceptual Framework project, which is being undertaken in conjunction with the US Financial Accounting Standards Board. We believe that the timing of the IASB project is a real challenge for the IPSASB project as any divergence between Frameworks could cause tension between its policy of convergence with IFRS and the development of IPSASs based on a public sector Conceptual Framework.

Our comments on the Preliminary Views set out by the IPSASB are included in the appendix to this letter, and we note here what we see as the most important issues:

- We believe that Preliminary View 1 on status of the Conceptual Framework does not reflect the authoritative status which is fundamental to its quality and usefulness. A clear statement would be welcomed from IPSASB stating that the Conceptual Framework is at the top of the hierarchy of concepts upon which other principles are based and that this is fundamental to the development of principles-based financial reporting standards.
- Preliminary View 5 sets out the scope of financial reporting for General Purpose Financial Reports (GPFRs) which in our view expands the scope well beyond what it should be. In particular, we do not consider it appropriate that performance reporting against service delivery objectives or prospective information about an entity's future activities should be included in the financial statements. We believe that information of this nature is better placed within an Operating and Financial Review or other form of report. Our comments on View 5 also impact on our view on the qualitative characteristics of information included in GPFRs and we believe that there is greater scope for aligning these characteristics with the IASB proposals, albeit we have concerns about the IASB's replacement of 'reliability' with 'fair presentation'.
- We support the inclusion of accountability as a separate objective of financial reporting in Preliminary View 4, although we believe that greater weight should be given to accountability as compared to decision-usefulness given the importance of the stewardship responsibilities of public sector entities.
- We have concerns about Preliminary View 9 on the group reporting entity as we do not believe that the criteria will facilitate the preparation of whole of government accounts, which IPSASB hopes to achieve. We believe that the 'power criterion' will exclude some public sector entities from whole of government accounts which users would otherwise expect to be included. We believe that a discussion in the Conceptual Framework on the high-level principles involved in determining the boundaries of a group reporting entity would be more appropriate than trying to develop specific criteria.

The Institute's Accounting Standards Committee (ASC) submitted comments on each of the IASB documents referred to in attachment 1 of the Consultation Paper. Our comments on IPSASB's preliminary views draw on the ASC's submissions, particularly its submissions on:

- Exposure Draft "An improved Conceptual Framework for Financial Reporting: Chapter 1 and Chapter 2" (May 2008); and
- Discussion Paper "Preliminary Views on an improved Conceptual Framework for Financial Reporting – The Reporting Entity" (May 2008).

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Copies of these submissions are enclosed for information.

Please do not hesitate to contact me if you have any queries about this submission.

Yours sincerely

Christine Scott

CHRISTINE SCOTT
Assistant Director, Charities and Public Sector

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APPENDIX

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 adopting 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 indentified in the Framework.

Comments

We believe that the Framework should be at the top of the hierarchy of concepts upon which other principles are based and that this is fundamental to the development of principles-based financial reporting standards. Therefore, we recommend that any new or revised IPSASs should flow from the Conceptual Framework, with any existing IPSASs that are inconsistent with the final version of the Framework being revised. Also, second tier guidance issued by IPSASB should also flow from the Framework and IPSASs.

Preliminary View 2 – General Purpose Financial Reports

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.

Comments

We agree that GPFRs should cater for the needs of a wide range of users. However, we explore in our comments on View 3, the merits of identifying a primary user group.

Preliminary View 3 – The Users of General Purpose Financial Reports

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 interests 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.

Comments

We broadly agree with View 3. However, we would welcome a move to identify on a more formal basis a primary user (or user group) for GPFRs than is currently suggested by the reference to the legislature as 'a major user' of GPFRs. Our initial thinking is that legislatures which represent the interests of the general public, the electorate and the taxpayer are the primary users of GPFRs prepared by public sector entities. A focus on accountability as the primary objective of financial reporting would impact on any consideration of the primary user group.

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The IASB in developing its Conceptual Framework is looking to identify present and potential capital providers as the primary user group. The ICAS Accounting Standards Committee, in its response to the IASB's Exposure Draft on "An Improved Conceptual Framework for Financial Reporting", supports the notion of a primary user group. The ASC's response goes on to state that: "providing information to meet the needs of the primary user group is likely to meet the needs of other users. Reference should continue to be made to a wide range of users otherwise an impression could be given that financial reporting is aimed at one user group."

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*
- *making resource allocation, political and social decisions.*

Comments

We agree that accountability should be a separate objective of financial reporting by public sector entities in recognition of the importance of the stewardship responsibilities of those charged with governance of public sector entities; we also recognise that GPFRs are not the sole means by which public sector entities demonstrate stewardship. In the IASB Conceptual Framework proposals, decision-usefulness is given as an overarching objective, with stewardship being a sub-category, and we believe that a change in emphasis is appropriate for public sector entities.

In View 5, the IPSASB sets out its view that "prospective financial and other information" forms part of the scope of financial reporting therefore we can see why IPSASB places equal weight on accountability and decision-making usefulness. However, we believe that the scope of financial reporting should be narrower than set out in View 5 and that "prospective financial and other information" should be excluded. Given this view, we believe that the accountability objective should be given more weight than decision-usefulness in a financial reporting framework for public sector entities.

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.*

Comments

We do not agree entirely with View 5 on the scope of financial reporting. View 5 expands the scope of financial reporting beyond the scope of historic financial information and we believe that this is not appropriate.

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We would support the following scope as a basis for further discussion:

"The scope of financial reporting encompasses the provision of financial and supporting narrative 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; and
- the reporting entity's compliance with relevant legislation."

We recognise that 'regularity' is a feature of the financial reporting framework for the UK public sector and that their auditors are required to report on 'regularity' in their audit opinion. Therefore, we support the inclusion of 'regularity' within the Conceptual Framework for public sector entities. However, we do not believe that this needs to be expanded beyond "compliance with relevant legislation" as this should be sufficient to cover the other more specific issues referred to in the third bullet of View 5. We also question whether 'regularity' is correctly included within the scope of financial reporting and would welcome further consideration by IPSASB as to whether it should be included within the objectives of financial reporting, possibly a sub-category linked to accountability: the IASB Conceptual Framework proposals refer to compliance with applicable laws within its discussion of objectives, linked to the usefulness of financial reporting in assessing stewardship.

Although outside of what we view as the scope of financial reporting, the fourth bullet on achievement of service objectives is worded in a way that could be interpreted as the entity only having to report on those objectives which it has actually achieved. We believe the issue here is about service performance rather than achievement.

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.

Comments

We agree with View 6, subject to our comments on View 5.

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 achieving an appropriate balance between the qualitative characteristics.

Comments
The qualitative characteristics set out in View 7 differ from the current proposals set out in the IASB's ED "An improved Conceptual Framework for Financial Reporting" (May 2008). In principle we favour an alignment with the qualitative characteristics in the IASB Conceptual Framework and departure only where there is clear justification.

Paragraph 4.3 of the Consultation Paper explains that the qualitative characteristics "differ in some respects from those proposed by the IASB, because they a) respond to objectives of GPFRs of public sector entities and b) reflect the potentially broader scope of financial reporting than the IASB has currently identified". Given our comments on View 5 on the scope of financial reporting we would welcome re-alignment of the qualitative characteristics in the Consultation Paper with those characteristics proposed by the IASB. Neither are we clear about exactly why the differences between the objectives set out in the two proposed frameworks would result in a divergence from the qualitative characteristics proposed in the IASB Conceptual Framework.

That said the ICAS ASC has raised concerns about aspects of the qualitative characteristics proposed by the IASB, specifically the use of 'faithful representation' rather than reliability. We have not reproduced these comments in our response: these comments, which we support, are included in the accompanying enclosure entitled "IASB Exposure Draft – An Improved Conceptual Framework for Financial Reporting".

Preliminary Views 8 and 9 - Characteristics of a Reporting Entity and the Composition of a Group Reporting Entity

Preliminary View 8
The key characteristic of a reporting entity is the existence of users who are dependent 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 organisation structure or arrangement.

Preliminary View 9
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).*

Comments
We believe that developing a principles-based approach to the reporting entity and group reporting entity in any context is very challenging. Paragraph 5.4 of the Consultation Paper appears to abandon any prospect of a principles-based definition by suggesting that the reporting entity and group reporting entity are essentially whatever legislation or government requires. We would tend to agree with such a conclusion.

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The first paragraph of View 8 essentially repeats Views 1 to 3. Given the content of paragraph 5.4, we believe it is probably sufficient to state that "A public sector reporting entity may be an entity with a separate legal identity or other organisational structure or arrangement".

View 9, as explained in paragraph 5.18 does not draw on a particular model but is designed to facilitate the preparation of whole of government accounts or other public sector group reporting. However, we do not believe that the two criteria which the Consultation Paper suggests should be met by components of a group entity will facilitate the preparation of whole of government accounts. Taking the UK as an example (although IPSASs are not applied by the UK public sector) we are not convinced that the financial statements of the Scottish Government would be consolidated into UK Whole of Government Accounts on the basis of the 'power criterion'. Paragraph 5.24 states that "The power to govern the strategic financing policies and operating policies must be presently exercisable……However, the power is not presently exercisable if it requires changes in legislation or renegotiation of agreements to be effective". Primary legislation would be required to give the UK Government power over the operating policies of the Scottish Government. There may also be barriers to including the accounts of local authorities within the UK Whole of Government Accounts on the basis of the 'power criterion'. This is in terms of the power to govern strategic financing, as local authorities have borrowing powers and set their own council tax, and to govern operating policies, for example, on the basis that local authorities have their own democratically elected Councils which are responsible for the operating policies of local authorities.

In responding to the IASB's Discussion Paper "Preliminary views on an improved conceptual framework for financial reporting – the reporting entity", the ICAS Accounting Standards Committee stated that "We believe that in most cases what is a reporting entity is self-evident and that attempting to define this may create more problems than it is seeking to resolve……We believe that it is appropriate for the framework to discuss the high-level principles involved in determining the boundaries of a group reporting entity, but we do not think that [the broad description in the Discussion Paper] or indeed a more precise description is necessary as a part of this".

Given the difficulties explained above, we also believe that it would be appropriate for a Conceptual Framework for public sector entities to discuss the high-level principles involved in determining the boundaries of a group reporting entity rather than to define what the boundaries are.

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International Accounting Standards Board
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26 September 2008

Dear Sir or Madam

IASB DISCUSSION PAPER: PRELIMINARY VIEWS ON AN IMPROVED CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING - THE REPORTING ENTITY

The Institute's Accounting Standards Committee has considered the above Discussion Paper and I am pleased to set out its comments below.

The Institute is the first incorporated professional accountancy body in the world. The Institute's Charter requires the Accounting Standards Committee to act primarily in the public interest, and our responses to consultations are therefore intended to place the general public interest first. Our Charter also requires us to represent our members' views and protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

General comments

Our responses to the questions in the Discussion Paper are set out in the appendix to this letter. Our key comments are set out below:

- We do not agree with the proposal that control should be used as the basis for determining the boundaries of a group reporting entity. We believe that risks and rewards as well as control are the high-level principles that should be established in determining the composition of a group.
- We believe that a more in-depth discussion of all of the issues involved in determining the perspective from which financial statements are presented is required both in this phase and in the objective and qualitative characteristics phase of the conceptual framework. It is premature to decide the perspective for consolidated financial statements when, as noted in our response to the Exposure Draft on chapters one and two of the framework, there has not been an adequate analysis of the entity versus proprietary perspective arguments.
- Much of this discussion paper is too detailed and rules-based to be included within a conceptual framework, which should be a concise statement of principles.

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I hope our comments are useful to you in the development of this Discussion Paper. If you wish to discuss any of them, please do not hesitate to contact me.

Yours faithfully

AMY HUTCHINSON
Assistant Director, Accounting and Auditing
Secretary to the Accounting Standards Committee

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APPENDIX

Q1: Do you agree that what constitutes a reporting entity should not be limited to business activities that are structured as legal entities? If not, why?

We agree that what constitutes a reporting entity should not be limited to business activities that are structured as legal entities.

Q2: Do you agree that the conceptual framework should broadly describe (rather than precisely define) a reporting entity as a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers? If not, why? For example, do you believe that the conceptual framework should establish a precise definition of a reporting entity? If so, how would you define the term? Do you disagree with including reference to equity investors, lenders and other capital providers in the description (or definition) of a reporting entity? If so, why?

We are not convinced that either a broad description or a precise definition of a reporting entity is necessary in a conceptual framework. We believe that in most cases what is a reporting entity is self-evident and that attempting to define this will create more problems than it is seeking to resolve. In our experience, there are few problems in defining a reporting entity and the proposed description in this discussion paper is unlikely to be helpful if in fact there was some difficulty in determining the boundaries of an entity. We believe that it is appropriate for the framework to discuss the high-level principles involved in determining the boundaries of a group reporting entity, but we do not think that this broad description (or indeed a more precise definition) is necessary as part of this.

Q3: Do you agree that the risks and rewards model does not provide a conceptually robust basis for determining the composition of a group reporting entity and that, except to the extent that it overlaps with the controlling entity model (as discussed in paragraphs 102 and 103), the risks and rewards model should not be considered further in the reporting entity phase of the conceptual framework? If not, why?

We do not agree that the risks and rewards model should be rejected at this stage, and on the contrary believe it should be given further consideration and analysis. For example, the risks and rewards model is used under UK GAAP in FRS 5 covering the accounting treatment for quasi-subsidiaries. This demonstrates that the control model alone is not appropriate to cover all types of arrangements. Indeed the discussion paper acknowledges that in relation to SPEs, 'accounting standards may look to or emphasise the ability to obtain benefits or exposure to risk.' We do not see control and risks and rewards as opposing models, instead they should be seen as elements of a single approach. Therefore we believe that the IASB should undertake some further work on developing the risks and rewards model and looking at how these elements combine with control.

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Q4: Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that:
(a) control should be defined at the conceptual level?
(b) The definition of control should refer to both power and benefits?
If not, why? For example, do you have an alternative proposed definition of control?

Assuming that control is used as the basis for determining the composition of a group reporting entity, we agree that control should be defined briefly at the conceptual level. But we do not agree that the control model is the only one that should be used – power and benefits need to be considered alongside the risks.

Q5: Do you agree that the composition of a group reporting entity should be based on control? If not, why? For example, if you consider that another basis should be used, which basis do you propose and why?

As noted above, we believe that the composition of a group reporting entity should be based on a model that combines control with risks and rewards.

Q6: Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that the controlling entity model should be used as the primary basis for determining the composition of a group entity? If not, why?

As noted above, we believe that risks and rewards should be considered in conjunction with the control model in determining the composition of a group reporting entity. In the context of this specific question, we agree that the controlling entity model, rather than the common control model, should be used as the primary basis for determining the group entity composition.

Q7: Do you agree that the common control model should be used in some circumstances only? If not, why? For example, would you limit the composition of a group reporting entity to the controlling entity model only? Or would you widen the use of the common control model, at least in some circumstances, do you regard it as an exception to (or substitute for) the controlling entity model in those circumstances, or is it a distinct approach in its own right? Please provide reasons for your responses.

We agree that there are some circumstances in which the common control model would provide useful information. This model should be used in addition to the controlling entity model, where it would provide additional information. We do not believe that there should be an in-depth discussion of the common control model at the conceptual level, instead this should be addressed within the relevant individual standards.

Q8: Do you agree that consolidated financial statements should be presented from the perspective of the group reporting entity, not from the perspective of the parent company's shareholders? If not, why?

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We have previously noted in a response to the IASB on IFRS 3 that we did not agree with the group entity perspective where the primary reporting responsibility is to the parent company shareholders. As stated in our response to the Exposure Draft on the first two chapters of the Conceptual Framework, there needs to be a full discussion of the entity versus proprietary perspective before any conclusions are reached on this. There needs to be a much more in-depth analysis of the issues than is presented in this Discussion Paper or the Exposure Draft.

Q9: Do you agree that consolidated financial statements provide useful information to equity investors, lenders and other capital providers? If not, why?

Yes, we agree that consolidated financial statements provide useful information to equity investors, lenders and other capital providers, although in many cases parent-only information is also required in order to meet the objective of financial reporting.

Q10: Do you agree that consolidated financial statements should not preclude the presentation of parent-only financial statements, provided that they are included in the same financial report as consolidated financial statements? If not, why?

Yes, we agree that consolidated financial statements should not preclude the presentation of parent-only financial statements. We believe that it is important that consolidated and parent-only financial information are presented in the same report.

Q11: With regard to the concept of control, in the context of one entity having control over another, do you agree that:

(a) establishing whether control exists involves assessing all the existing facts and circumstances and, therefore, that there are no single facts or circumstances that evidence that one entity has control over another entity in all cases, nor should any particular fact or circumstances – such as ownership of a majority voting interest – be a necessary condition for control to exist? If not, why?
(b) The concept of control should include situations in which control exists but might be temporary? If not, why?
(c) The control concept should not be limited to circumstances in which the entity has sufficient voting rights or other legal rights to direct the financing and operating policies of another entity, but rather should be a broad concept that encompasses economically similar circumstances? If not, why?
(d) In the absence of other facts and circumstances, the fact that an entity holds enough options over voting rights that, if and when exercised, would place it in control over another entity is not sufficient, in itself, to establish that the entity currently controls that other entity? If not, why?
(e) To satisfy the power element of the definition of control, power must be held by one entity only? In other words, do you agree that the power element is not satisfied if an entity must obtain the agreement of others to direct the financing and operating policies of another entity? If not, why?
(f) Having 'significant influence' over another entity's financing and operating policy decisions is not sufficient to establish the existence of control of that other entity? If not, why?

We agree with statement (a) above. We believe that it is consistent with a principles-based framework that there should be no single fact or set of circumstances that is used as a bright line to determine whether control exists. Therefore, this statement is sensible as a general principle. The other statements are too detailed to be included in the conceptual framework and should be addressed at the standards level.

Q12: Should any of the above control issues be addressed at the standards-level rather than at the concepts level? If so, which issues and why?

Yes as discussed above we believe that much of the detailed discussion and definitions of control and common control should be addressed at the standards level.

Q13: Are there any other conceptual issues, relating either to the control concept or to some other aspect of the reporting entity concept, that are not addressed in this discussion paper and should be addressed at the concepts level? If so, which issues and why?

We have not identified any other issues at this stage.

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26 September 2008

Dear Sir or Madam

IASB EXPOSURE DRAFT – AN IMPROVED CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING:
CHAPTER 1: THE OBJECTIVE OF FINANCIAL REPORTING
CHAPTER 2: QUALITATIVE CHARACTERISTICS AND CONSTRAINTS OF DECISION-USEFUL FINANCIAL REPORTING INFORMATION

The Institute's Accounting Standards Committee has considered the above Exposure Draft and I am pleased to set out its comments below.

The Institute is the first incorporated professional accountancy body in the world. The Institute's Charter requires the Accounting Standards Committee to act primarily in the public interest, and our responses to consultations are therefore intended to place the general public interest first. Our Charter also requires us to represent our members' views and protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

General comments

We believe that a sound conceptual framework is vital to the development of principles-based financial reporting standards, representing a clear hierarchy of overriding concepts upon which all other principles are based. Therefore we see this project as being of paramount importance for the IASB as it should clarify a set of principles which will guide the development and improvement of all other financial reporting standard.

We welcome the improvements that the IASB has made to this document since the discussion paper was issued, such as the improved treatment of stewardship, but there are some outstanding issues that must be resolved. Our responses to the questions in the Exposure Draft are set out in the appendix to this letter, and we have noted here what we see as the most important issues.

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- The authoritative status is absolutely fundamental to the quality and usefulness of the conceptual framework. We are therefore disappointed to note that the exposure draft states that the conceptual framework will not override individual standards. The framework should have the status that standard-setters must have regard to it in developing new standards so that these are consistent with the principles of the framework, preparers must have regard to the framework, particularly in instances where a specific event or transaction is not dealt with by an individual standard, and that where an individual standard contradicts the framework or where the application of a standard in a specific situation would not lead to a fair presentation, it is the framework that takes precedence. If the framework does not have this status under both IFRS and US GAAP, then there is a risk that there will be a demand from preparers and regulators for more guidance, as there may not be sufficient confidence in the framework.

- We still have concerns about the length of time taken to develop the revised conceptual framework and the fact that it will be finalised section by section. There must be the opportunity for the full implications of concepts agreed in the early sections of the framework document to be considered.

- As noted in our response to the earlier discussion paper, we believe that 'substance over form' is a key accounting concept that should be included in the conceptual framework. We are concerned that the references to 'economic substance' in this Exposure Draft represent a narrower and therefore less useful concept than 'substance over form.'

- We remain concerned by the replacement of the qualitative characteristic of 'reliability' with 'faithful representation.' The latter term is a weaker concept, and does not include the concept of 'can be depended upon.' We are also unconvinced by the boards' argument that faithful representation is better understood than reliability.

- The length of these two chapters is excessive for a conceptual framework document. While this exposure draft is shorter than the previous discussion paper, it is descriptive in nature when we believe it should be a more concise and straightforward statement of principles.

- We are disappointed that the boards have not given their stakeholders the opportunity to have an in-depth discussion on the perspective from which financial reporting is prepared. The arguments presented in this Exposure Draft on the entity versus proprietary perspective are superficial and do not reflect the issues faced in today's financial reporting environment.

I hope our comments are useful to you in the finalisation of these chapters. Please do not hesitate to contact me if you would like to discuss any of them.

Yours faithfully

AMY HUTCHINSON
Assistant Director, Accounting & Auditing
Secretary to the Accounting Standards Committee

APPENDIX

Chapter 1

Q1: The boards decided that an entity's financial reporting should be from the perspective of the entity (entity perspective) rather than the perspective of its owners or a particular class of owners (proprietary perspective.) Do you agree with the boards' conclusions and the basis for it? If not, why?

We are disappointed that the entity versus proprietary perspective debate is given such superficial coverage in this Exposure Draft – a comprehensive discussion of these issues is required before a conclusion is reached, not least because the perspective from which the financial statements are prepared may have important implications for other elements of the conceptual framework. We note that it was previously proposed to produce a discussion paper for public consultation on this issue and strongly urge the IASB to re-consider its decision not to do so. The brief arguments outlined in the basis for conclusions do not reflect the issues faced in today's financial reporting environment.

The entity perspective is recommended even though it is acknowledged that the boards do not know what the implications of this are for the rest of this framework – we believe that these implications should be thought through as part of a comprehensive public consultation on the perspective from which the financial statements are prepared.

Q2: The boards decided to identify present and potential capital providers as the primary user group for general purpose financial reporting. Do you agree with the boards' conclusions and the basis for it? If not, why?

We have the following comments on the discussion of users of general purpose financial reporting:

- We agree that it is probably appropriate to identify a primary user group, and that providing information to meet the needs of this user group is likely to meet the needs of other users, but we do not think that the boards have adequately demonstrated why this is the case. As noted in our previous response, a fuller discussion of the needs of users and how these needs can be met is necessary.
- The objective should continue to make reference to 'a wide range of users.' Otherwise one could gain the impression that financial reporting is aimed specifically at one user group which is contrary to the argument that the boards seem to be making in the basis for conclusions.
- Within the group defined as capital providers in the Exposure Draft there will be different information needs, for example the needs of equity investors will be different to those of lenders.
- The Exposure Draft states that the main focus should be on an entity's ability to generate net cash flows – this has not been adequately explained in the paper.

Q3: 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. 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.

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We believe that the broader objective stated in the Exposure Draft is a major improvement on the objective as stated in the discussion paper and we are pleased that the discussion of stewardship has been improved. The use of the term 'capital providers' in the objective suggests that stewardship is owed to all capital providers, when we see this as being owed only to equity investors.

As stated in our response on the previous discussion paper, we believe that there are potentially important implications arising from the fact that the purpose of financial reporting is as yet undefined. The objectives of various pieces of information that could be included within 'financial reporting' may differ.

Chapter 2

Q1: Do you agree that:
(a) relevance and faithful representation are fundamental qualitative characteristics? If not, why?
(b) Comparability, verifiability, timeliness and understandability are enhancing qualitative characteristics? If not, why?
(c) Materiality and cost are pervasive constraints? If not, why? Is the importance of the pervasive constraints relative to the qualitative characteristics appropriately represented in Chapter 2?

We are happy with relevance being described as a fundamental qualitative characteristic, but we continue to have concerns about the use of the term 'faithful representation.' We note that the boards' main reason for rejecting the term 'reliability' is that there is inconsistency in how the term is interpreted and that it is not well understood. However we do not see that there is significantly greater clarity in the understanding of 'faithful representation' and do not find this a persuasive argument. The Basis for Conclusions also states that faithful representation is deemed to encompass all of the key elements included in reliability. We disagree with this statement since faithful representation is one element of reliability under both the IASB and FASB definitions, therefore reliability is clearly a broader notion than faithful representation. It is not appropriate simply to replace reliability with faithful representation. We believe that one of the key features of 'reliable' information is that it 'can be depended upon' and this element is not reflected in 'faithful representation'. This is a very important element and one which we think is relatively easy to understand. This element relating to information that can be depended on is particularly important in demonstrating that the stewardship objective has been met, and we believe that 'reliability' has an important role to play in demonstrating that financial reporting is of a high quality and can be trusted.

There are also problems with the understanding of the term faithful representation as defined in this Exposure Draft. For example, the basis for conclusions states that faithful representation can be equated with fair presentation or a true and fair view. We see fair presentation/a true and fair view as a wider notion which relates to the financial statements as a whole, so this paper seems to be attempting to define faithful representation both at this level and at the individual transaction level. We do not believe that it is helpful to attempt to use the term on two different levels.

We also believe that substance over form should be re-instated as a component of reliability. We note that the Exposure Draft has included economic substance as part of the definition of faithful representation, but we believe that this is a narrower notion than substance over form. We get the sense that economic substance relates to individual components of a transaction, whereas substance over form should focus on the overall picture. For example, in some standards there is reference to the economic substance of contractual terms, which is too closely linked to the legal form.

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We agree with the enhancing qualitative characteristics and the pervasive constraints.

Q2: 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?

Please see our comments on faithful representation above.

Q3: 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?

We believe that the enhancing qualitative characteristics are appropriately identified and sufficiently defined for them to be consistently understood and useful. In particular, we support the improvement in the definition of verifiability from the discussion paper phase – we prefer the reference to 'an appropriate recognition or measurement method' rather than ' the chosen recognition or measurement method.'

Q4: Are the pervasive constraints (materiality and cost) appropriately identified and sufficiently defined for them to be consistently understood and useful? If not, why?

We believe that the pervasive constraints are appropriately identified and sufficiently defined for them to be consistently understood and useful.

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