A F E P

Association Française des Entreprises Privées

IASB
30 Cannon Street
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Paris, September 29, 2008

Ref: Conceptual framework: Objective of financial reporting and Qualitative Characteristics

ACTEO, AFEP & MEDEF have considered the exposure draft proposing the two first chapters of a revised conceptual framework: Objectives of financial reporting and Qualitative Characteristics.

The issuance of this exposure draft exacerbates concerns that we have had since the Boards have initiated the revision of the conceptual framework, a project that we believe is crucial for the quality of IFRS.

1) **We remain strongly opposed to a process whereby the conceptual framework is finalised on a piecemeal basis:**

a. Conclusions are drawn without being fully tested and validated, and may trigger far reaching changes at the standard level decided somewhat light-headedly. The IASB itself indicates that the first chapters may be subject for future amendments, once later phases are completed and that the consequences of some decisions made are not yet considered (BC 1.16). These are good reasons, we believe, not to make changes in the conceptual framework at this stage.

b. Going to the ED phases is time-consuming, both for the Boards and their staffs, and therefore delays subsequent phases of the project unduly.

c. One of the main arguments put forward by the IASB – in public meetings with stakeholders - is that parts of the conceptual framework need to be completed before the full replacement of the 2001 IASB takes place, because successors might re-debate issues and come to different conclusions. We fully disagree with this reasoning for the following reasons:

i. Appointments to the IASB have been decided by the IASCF in such a manner that part of the Board would rotate in a continuous process over time, in order to provide as much continuity as possible. As a result, the IASB work program has to be managed on the assumption of continuity.

ii. If the IASB is confident that its choices are well thought through, the risk that successors would make different decisions is very low. If, on the contrary, the IASB's fears are justified, careful standard setting commands **not to introduce changes in the conceptual framework at this stage**– and not to reflect them at standard level, because the direction taken is not sound enough to be supported by IASB members' peers. High quality standards are not expected to be controversial, at least not among thoroughly selected experts.

2) The bases for conclusions to the exposure draft discuss only a very small subset of concerns expressed in commenting the Discussion Paper, as if the Boards were escaping from the debate that Discussion Papers are meant to stimulate. Responding to the IASB Discussion Papers is a costly exercise that we carry out very thoroughly. We expect the analysis of comments received to be at least as thorough. When an exposure draft follows a discussion paper, the basis for conclusions of Exposure Drafts should take the form of a feedback statement, such as the document that the IASB has published when issuing IFRS 3 R and IAS 27 R. No area of concern expressed at the DP stage should be left unanswered at the next step.

3) As a result, our letter will reiterate a significant number of comments that do not seem to have been appropriately considered. Those include:

a. The call for an in-depth analysis of users' needs, that would help characterise information useful to capital providers for assessing cash flow prospects. This analysis remains absent. Instead the Board introduces the usefulness of market participants' judgements (including implicitly the highly controversial issue of own credit risk), without a line in the basis for conclusions to support such a mention. (Please refer to section 2 on page 1 of the Appendix to our letter commenting the DP);

b. The decision to retain the entity's perspective remains unsupported, is nonetheless reaffirmed, although the IASB indicates that it has not considered all possible consequences of such a decision.

c. The link between external and internal reporting remains excluded from the first chapter: although the needs of capital providers and of management are now acknowledged as reasonably consistent, no satisfactory consequence is drawn from this acknowledgement and this acknowledgement is included in the bases for conclusions only. (Please refer to section 2 on page 3 of the Appendix to our letter commenting the DP and read more in the Appendix to this letter).

d. The approach to performance is not improved and none of our comments and explanations receives any response. The bases for conclusions remain basically unchanged. (Please refer to section 3 on page 4 of the Appendix to our letter commenting the DP).

e. Faithful representation has been left unchanged. (Please refer to section 6 and 7 on pages 5 and 6 of the Appendix to our letter commenting the DP).

f. The IASB should issue accounting standards only. As a result, the framework should remain focused on financial statements only (Please refer to section 5 on page 2 of the Appendix to our letter commenting the DP).

4) Notwithstanding the comments above, the exposure draft reflects significant improvements over the Discussion Paper. It has gained in conciseness and some issues have been clarified. In particular we agree with:

   a. The revised formulation of the objective of financial reporting, and the way it encompasses all decisions capital providers have to make, including the assessment of management's stewardship

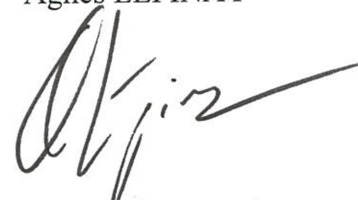
   b. The role and status of the framework have been explained (we understand the preface as a preface to the framework and not only to the ED)

   c. Substance over form is not left implicit (QC7).

Our detailed comments and answers to the question raised in the invitation for comments are provided in the appendix.

We remain at your disposal should you need further clarification or background information.

Yours sincerely,

ACTEO	**AFEP**	**MEDEF**
Patrice MARTEAU	Alexandre TESSIER	Agnès LEPINAY
		
Chairman	Director General	Director of economic and financial affairs

Appendix to ACTEO, AFEP and MEDEF's letter on the exposure draft presenting the two first chapters of a revised conceptual framework: Objectives of financial reporting and Qualitative Characteristics

Chapter 1: The objective of financial reporting

Question 1.1

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). Do you agree with the Boards' conclusion and the basis for it? If not, why?

This issue is of high concern to us. We note that the IASB fails to adopt a consistent approach throughout the various documents it issues. In the ED, the entity's perspective is opposed to the proprietary perspective, a perspective that is not supported by any respondent. The discussion arises between the entity's perspective and the parent company's perspective (two variations in the entity's perspective), as is well reflected in the DP recently issued discussing the reporting entity. We also observe that the IASB has abandoned the parent company's perspective when revising IFRS 3 and IAS 27, although the issue has raised a lot of controversy, not only with constituents, but also within the Board itself.

Moreover, we are not convinced by the arguments put forward by the Board. The objective to serve all capital providers is not contrary, in our view, to the parent company's perspective. Only capital providers to the parent company have interest in the consolidated financial statements of the group. Others, capital providers to subsidiaries, shareholders and lenders and other creditors, are users of the financial statements of the entity in which they have placed their interests. Assessing the cash flow prospects of the group tells them nothing about the possible return and safeguard of their assets.

Finally, the open debate of the issue called by constituents has not been launched, staff advising the Board against such a debate because all consequences of the entity's perspective cannot be considered at this stage (BC1.16).

As a result the decision should remain pending and the conceptual framework should for the time being remain either silent or mention that no decision is made yet. The issue cannot be considered as being solved at the conceptual level. The framework should offer no guidance for standard setting.

Question 1.2

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' conclusion and the basis for it? If not, why?

We agree with present and potential capital providers being identified as the primary user group for general purpose financial reporting. As explained in our answer to question 1.1 above, we see no conflict between the parent company's perspective and having all present and potential capital providers identified as the primary user group.

Question 1.3

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. 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.

We agree with the revised formulation of the objective and believe that the issue of stewardship has been appropriately dealt with. We see the change in wording as guiding the Board to ensure that financial statements prepared in compliance with IFRS are an appropriate basis for management's accountability. We believe that future bases for conclusions and feedback statement prepared by the IASB should systematically address this issue.

Chapter 2: Qualitative characteristics

Question 2.1

Do you agree that:

a) *relevance and faithful representation are fundamental characteristics? If not, why?*

We agree that relevance and faithful representation are fundamental characteristics. However we believe that understandability belongs to those fundamental characteristics. How could anyone make decisions on the basis of financial information that one cannot understand? How could that information be qualified useful if it cannot be used? In other words, we believe that the basic characteristic of useful financial reporting is its understandability.

Beyond this comment, we approve of the difference introduced between fundamental and enhancing characteristics.

b) *Comparability, verifiability, timeliness and understandability are enhancing qualitative characteristics ? If not, why?*

We agree that comparability, verifiability and timeliness are enhancing characteristics.

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 agree that materiality and cost are pervasive constraints. The discussion on faithful representation (QC11) suggests that explicit disclosure of the degree of uncertainty involved in estimates is needed to ascertain that the information provided is complete, neutral and free from error. Beyond the cost of preparing and using the information lies the question of the ability of a reasonably knowledgeable and diligent user to analyse and challenge all estimates subject to uncertainty. This concern seems well reflected in OB14. However we observe that the cost/benefit constraint is analysed for each transaction in isolation, project after project. We therefore believe that OB14 should be supplemented to indicate how the Board should assess the more sophisticated estimates against an overall (impacts of all IFRS requirements taken together) cost/feasibility threshold.

Furthermore we believe that the cost/benefit trade off is not necessarily assessed in a satisfactory manner as of today. Standard setting is on a trend whereby more complexity and more detailed information requirements are being introduced, as much as preparers and users can take. The cost constraint should play a greater role than the ultimate safeguard in which it seems to be placed right now. The objective of standard setters should be to **minimise the cost of preparing and using financial information**, while ensuring that users get the information they need. This approach would help to establish priorities and hence discard the “nice to have” while ensuring that the “necessary financial reporting” is presented.

Question 2.2

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,*

We do not have any comment on the description of relevance. We however believe that common understanding of the notion of relevance is void of benefit if the analysis of users’ needs – including their expectations in terms of predictive and confirmatory values – is not carried out as we had suggested in our response to the DP (Please refer to section 2 on page 1 of the Appendix to our letter of comments on the DP). Indeed the notion of relevance will be useful in standard setting only if there is a wide understanding of the cash flow prospects that users wish to assess. For example, we believe that the cash flows to be derived from an asset which is used in combination with others in the entity’s operations is better accounted for on the basis of the cost model of IAS 16 as it stands, as the current requirements already provide a basis to report changes in the useful life and residual value that are the only changes relevant to the user’s predictive process. We believe that the example of depreciation given in QC4 should be taken out as it makes the framework look as if paving the way for non-assessed, non-agreed, future directions on measurement. And the direction it shows looks rather short-sighted to us.

b) financial reporting information that is complete, free from material error and neutral is said to be a faithful representation of an economic phenomenon.

a. Are the fundamental qualitative characteristics appropriately identified and sufficiently defined for them to be consistently understood? If not, why?

b. Are the components of the fundamental qualitative characteristics appropriately identified and sufficiently defined for them to be consistently understood? If not, why?

We reiterate the comments made in our letter of comments on the DP in relation to reliability/ faithful representation/ "real-world economic basis" (Please refer to sections 6 and 7 on page 5 and 6 of the Appendix to our letter of comments on the DP).

Question 2.3

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?

We disagree with the way consistency is being described as being only means to achieve comparability. We believe that consistency is a key feature of financial reporting as it increases understandability and helps reduce costs.

We disagree with the explanations surrounding understandability. On the basis of the explanations given indeed, every accounting requirement will be deemed leading to understandable financial reporting. Complexity does not arise with the growing complexity of transactions only. It is also growing fast due to choices made by the Board in the accounting for transactions of which complexity is unchanged. We believe that BC2.32 cuts the issue rather short, in implying that the trade off lies between understandability and completeness. In the long run, the consequences of having only a few expert-advisors being able to analyse and understand financial statements would probably have quite adverse impacts on financial markets. Present and potential capital providers must remain sufficiently autonomous in their understanding of the entity's financial position and performance. If IFRS compliant financial statements cannot be understood without the help of advisors, users would rely on management to provide alternative non-GAAP financial reporting. We believe this is not desirable.

Question 2.4

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

The explanations given about cost should be altered in order to accommodate our comments made in response to question 2.1 c) above. We also believe that assessment of the cost/benefit trade-off should be carried out as part of the official due process of the IASB, and start no later than with an exposure draft. Assessing whether the proposals should be transformed into official requirements require indeed that the IASB has the appropriate information available at the time it makes the decision. The sources of that information and of the extent of inquiries and responses obtained should be made transparent.

Other comments:

❒ *Management and general purpose financial reporting*

In commenting on the DP we had insisted that management should also be looked at a user of general purpose financial reporting. The response in the ED is a clarification that management is not a user as management is no capital provider. We necessarily agree with that statement. As acknowledged in BC1.33 though, a strong commonality exists between the needs of capital providers on one hand, and those of management in its stewardship responsibilities, on the other hand. This commonality should be explained in the text of the framework and consequences for the due process of the IASB should be drawn upon. In its standard setting process, the IASB most often disregards comments brought by preparers about relevance, on the grounds that what is relevant to management needs not be considered. We believe that the IASB should have the duty of getting insight and understanding in those comments. Management's reporting needs for stewardship purposes are likely to be common with the needs of capital providers. Management is also responsible for the communication with users and is therefore well aware of the information users are seeking. New accounting requirements should therefore create new reporting requirements for preparers in rather remote circumstances. And in rare occurrences a new general purpose financial reporting requirement may lead to an improvement in company internal reporting. Feedback statements by the IASB should in our view systematically explain why a new requirement would indeed improve financial reporting when there is a wide consensus among preparers that the new requirement would lack relevance.

❒ *Relevant extracts of our letter of comments on the DP*

- *Characterisation of users' needs (section 2 on page 1)*

Current proposals concentrate the objective of financial reporting on being useful to external users in assessing the entity's ability to generate future cash-flows. Although this objective is not set new, we believe some analysis is necessary to ensure that future standard setting decisions in particular in measurement do lead to providing users with the information they need. Whether future cash-flow forecasts and hence the entity's performance should include and reflect a market benchmark instead of being consistent with an entity's business model and operations remain, in our view, to be thoroughly analysed, debated and explained.

Users' needs may indeed vary, depending on the possible outcome of their relationship with the entity. Holders of listed equity and debt instruments may invest and disinvest at any time. As is explained in OB4 and OB6, their interest in an entity's ability to generate net cash inflows is strongly interrelated with how this ability may affect the prices of their equity or debt instruments. Investors in private equity and other stakeholders as banks, suppliers, employees, members of the public, are primarily interested in the entity's sustainability, as they have entered in mid- or long-term relationship. Their first concern is whether the entity will be able to meet its obligations when due.

As the debate between IASB and its constituency has been progressing for the past five years, the need for a shared understanding of what "future cash inflows" should embody has grown more and more apparent. Such a shared understanding is in our view necessary to ensure a constructive debate in future phases of the conceptual framework project and in the development of future standards. We therefore strongly recommend that it be set as the very next step.

- *Management as a user (section 2 on page 3)*

The IASB existing framework (Framework.11) clearly states, as the proposed chapters do, that management have the authority to obtain the information they consider as being useful for carrying out their responsibilities. However that same paragraph 11 states as clearly that external reporting would be an extract of internal reporting: "published financial statements are based on the information used by management about the financial position, performance and changes in financial position of the entity". Hence the previous framework makes implicit evidence that internal and external users of an entity's financial statements had the same type of needs, ie information useful for both groups' resource allocation decisions.

As OB 9 (and BC1.42-1.43) state, management is interested, in the same manner as external users, in the entity's ability to generate net cash inflows. We therefore believe that the framework should reinstate – and indeed expand – on the commonality which exists between external users' and management's needs. Whether information or measurements *could* be useful to management should, in our view, be identified in the framework as a valid filter for relevance for external users. Indeed information or measurements which couldn't be relevant for management are not, in our view, capable of making a difference in external users' decision process. The popularity among users of "through the eyes of management approaches" is consistent with this view. In their common basis for conclusions to both SFAS 131 and ED8, IASB and FASB refer to users' almost unanimous quest for being able to see an enterprise "through the eyes of management" as it enhances their ability to predict actions or reactions of management that can significantly affect the enterprise's prospects for future cash flows.

In the past three decades, entities have made tremendous and rather successful efforts in bringing internal reporting consistent with external reporting requirements, making it clear internally that the only performance which was worth measuring was the performance delivered to shareholders. Great improvements have been achieved in corporate governance thanks to this process. Investors and analysts are increasingly expecting to have operations explained to them by managers in direct charge for them. This allows them to better understand how entities are being managed and can only be achieved if consistency between internal and external reporting is ensured. Such consistency is also necessary to establish close links between management's consideration and the entity's performance delivered to shareholders, another aspect of sound corporate governance. Unfortunately OB 9 takes a much different view, without any word of explanation or justification. OB 9 in stating that "management is able to prescribe the form and content of the information it needs in satisfying its responsibility to owners" seems to imply that general purpose financial statements do not need to be suitable for management's accountability.

We very strongly disagree with this line of thinking. In Europe at least, and in many other jurisdictions we believe, shareholders' assemblies both approve the entity's financial statements and discharge management for their stewardship responsibility over the period, on the basis of general purpose financial statements. Regulators all over the world discourage – or prohibit- non GAAP measures and formats. Any move into suggesting that there could be dual reporting by management to shareholders should in our view be eliminated.

- *Characterisation of reporting performance (section 3 on page 4)*

The IFRS existing framework assigns to each of the financial statements a specific objective (Framework 15.21) and insists on the necessary interrelationship between those statements. The discussion paper reduces the relevant information to information about an entity's resources, claims to those resources, and changes in resources and claims. We are in general supporting the balance sheet approach in accounting because it warrants consistency and more robust standards. However we do not believe that adopting a balance sheet approach implies that users of financial statements would first assess economic resources and claims in assessing an entity's ability to generate future cash-inflows as is described in OB20. We further disagree with OB22 that presents the analysis of the income statement as ***accessory*** to the user's assessment. We believe it works the other way round. Bases for conclusions are not very convincing. BC1.30 in particular explains more about the accounting process than in does about investors' analytical process, although it is the relevant process to be considered at that stage of the debate.

Future cash-flows can only be assessed with past in- and outflows as primary inputs, even if information about economic resources and claims shouldn't be omitted in the process. Let's take the example of a retail company with a very short operating cycle. The analyst or investor would not have any chance to forecast future cash-flows if they were to rely primarily on a list of economic resources and claims as of the balance sheet date ! !

We therefore believe that the extract of FASB Concept Statement 1 provided in BC1.28 is still relevant. The word "primary" that it includes designates in our view a starting point for the analysis and is not meant to indicate that information on economic resources and claims is of less importance. However if there may be a risk of misunderstanding, we believe the Boards should identify a better word and still not drop the whole paragraph which adequately characterises the investors' analytical process. We also believe that words such as revenue and expenses which best describe streams of economic resources in the entity's operations should be used.

It wouldn't harm in any way the balance sheet approach adopted in IFRS and would describe more realistically the relevance of financial statements to users.

- *Change from reliability to faithful representation (section 5 on page 5)*

We believe there is no valid reason to substitute "faithful representation" to "reliability". The only justification which is given is that the term "reliability" was not well understood. If this is the case, there is a need for clarification, not for a change of word. Notwithstanding the justification given, there is no real clarification except may be for QC19. This paragraph however lacks clarity !

Reliability should in our view be maintained, and its components be defined as including substance over form (see below), verifiability, neutrality and completeness.

In addition to the comments above, we note that in French, reliability translates really well ("fiabilité") and encompasses the components listed in the above paragraph. Faithful representation translates as "image fidèle" which is the translation for "true and fair view". The change of wording would therefore lead to translation difficulties and probably introduce confusion.

- *Faithful representation and real-world economic phenomena (section 7 on page 6)*

We have been impressed by, and approve of, the emphasis put in QC16-18 on the necessity to depict "real-world economic phenomena" to ensure that financial statements provide a faithful representation of an entity's performance and condition. As is stated in QC16, "the phenomena depicted in financial reports are *real-world* because they exist now or have already occurred".

In view of this requirement, we seriously question fair value measurements in circumstances where no market exists or is expected to exist and where models used and estimates can never be verified by *real-world transactions.* Although we believe that the use of estimates is necessary to make financial statements as relevant as possible (we support paragraphs QC20-21 dealing with certainty, precision and faithful representation), we are of the view that an estimate, or a valuation technique, must, to be of any value, have been tested at some point in time against *real-world phenomena.*

We therefore recommend the addition of a supplementary criterion (in addition to substance over form, verifiability, neutrality and completeness) to ascertain reliability. This additional criterion could be named "*real-world economic basis*", meaning that only transactions or phenomena likely to occur, even on an infrequent basis, could serve as a basis for estimates arising from market to model.

- *Scope of financial reporting (section 5 on page 2)*

We understand that the conceptual framework project is planned to be analysed and debated in phases and we support the decision made by the two Boards to issue separate discussion papers as the work progresses. We have therefore understood that the intention of the two Boards was to broaden the scope of the framework in order to encompass, not only financial statements, but financial reporting altogether. However what exactly financial reporting would include is yet to be defined. We also note that financial information described in OB18-26 designates financial statements only.

In our view, objectives and qualitative characteristics should be designed to fit financial statements only. Earlier this year, in our response to the discussion paper on Management Commentary, we have expressed the view that IASB should not deal with financial reporting issues other than financial statements. We therefore do not expect any extension of the scope of the conceptual framework.

As a consequence, all our comments apply to a set of financial statements only.

Additional comment: We note that, in QC22, FIFO is taken as an example of a valuation technique which wouldn't be likely to lead to a faithful representation of the purchase price of assets. We note that this valuation technique works with *real-world transaction prices* as inputs, is verifiable and is neutral, and as such, appears to provide a reliable estimate of the cost. We therefore recommend that the entire paragraph be dropped as it can, in our view, only bring confusion.