17 January 2007

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Dear Li Li

**Re: Discussion Paper "Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information"**

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the Discussion Paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information* (the paper).

We have structured our response as follows. Here, in the main letter we have briefly summarised our main concerns about the material in the Discussion Paper and have also made some overarching comments about the Discussion Paper and the process being followed. Attached are three appendices (one for the Introduction section of the Discussion Paper, and one for each chapter.); in those appendices we have divided our comments up under the headings 'Main concerns', 'Other concerns', and 'Other detailed points'.

We summarise our main concerns below.

*The process*

We would first of all like to say how pleased we are that the IASB has chosen to issue this material in the form of a discussion paper. The content of the IASB's Framework is of fundamental importance to the future development of IFRS and therefore of Europe's financial reporting system, so it is essential that Europe is given the opportunity to participate fully in the debate on the Framework's content. That is particularly so bearing in mind that this is the first real opportunity that many European commentators have had to debate the principles involved.

It is because of that importance that we want to comment on the next steps in the project. We talk later in this letter about the Framework representing a shared understanding between the IASB and its constituents as to the accounting model that IFRS are building/safeguarding. We think the word 'shared' is very important, not least because it helps to emphasise the spirit in which the Framework debate needs to continue to take place.

(a) We have heard it suggested that the IASB should move forward with the material in the Discussion Paper and look to issue exposure drafts in 2007. We think that would be the wrong approach. It is likely that the comments to this Discussion Paper will reveal that, while some parts of the draft revised Framework issued in the Discussion Paper have received broad support, some other parts have not. We think that, if the Framework is to represent a shared understanding of the accounting model, the next step should be to dig deeper into the issues that have received least support to develop a better understanding of the underlying issues that are causing the differences of view and how they might best be addressed.

(b) We also think it would be best if no sections of the Framework were finalised until the whole of the Framework is ready to be finalised. Constituents are doing their best to visualise the implications for the rest of the Framework of what is said in this Discussion Paper, but it is inevitable that we will overlook some implications and they will become apparent only when the consultative papers for those sections are issued. We think it only fair that constituents have the chance to comment on all the implications of what is said in the Discussion Paper.

There is another reason why we believe parts of the Framework should not be finalised until the whole of the Framework is ready to be finalised; in other words, why the IASB's Framework should at no point comprise in part the Framework that exists now and in part the new revised Framework. Such a part-new, part-old Framework would not be a coherent Framework because the changes made to the revised parts will not be reflected in the other parts of the Framework. Yet one of the essential attributes of a framework is that it is coherent; in other words, that concepts identified in the early chapters are fully taken into account in the concepts identified in later chapters. Judging by the IASB's Technical Plan, over the next few years the IASB will be issuing a number of proposals that could have a fundamental effect on the way accounting develops. We very strongly believe that this would not be the time to have a Framework that is not coherent.

*The style and language of the proposed revised Framework*

As is probably already clear, we view the IASB’s Framework as a fundamentally important document in the context of the European financial reporting system. Although it is inevitably a technical document, it has an importance that goes far beyond the narrowness that might imply. For that reason it is we believe important that it is a readable document that can be easily understood.

There is of course another reason why the document needs to be readable and easily understood: the Framework remains part of the IASB’s hierarchy which means that preparers need to be able to work their way around the document fairly easily and understand what it means.

Bearing this in mind, the style and language of the proposed revised Framework worries us. For two reasons:

(a) Some of the language used in the draft text in the Discussion Paper is quite subtle and nuanced. While that might work in countries in which English is the first language, it might mean that others will not necessarily grasp some of the meaning. A Framework that is meant to be used worldwide needs to be capable of translation without loss or distortion of meaning.

(b) Judging by these first two chapters the entire Framework will be a lengthy document; much longer than the existing IASB Framework. Yet, the longer the document is, the less likely it is to be read widely and the less easy it will be to refer to.

We thought that the paper reads in places almost as if it is a dialogue between standard-setters. Yet, as we have mentioned, its readership will extend far beyond that and it needs to be capable of being understood by all. We would therefore suggest considering ways of controlling its length (by for example moving a substantial part of the material to a 'Development of the Framework' section). We would also suggest considering ways of simplifying the drafting.

*The status of the Framework for standard-setters*

The Introduction section makes it clear that, although the purpose of the Framework is to provide direction and structure to the standard-setting process, it is a non-mandatory document for standard-setters. On the other hand (for the reasons set out in appendix 1), we think new or revised standards should be consistent with the Framework unless the inconsistency is relatively minor and temporary and certain other criteria are met.

*Users, their information needs, the objective of financial statements and the proposed focus on the entity's ability to generate future cash flows*

We have a number of concerns about the material in the Discussion Paper on users, their information needs, the objective of financial statements and the proposed focus on the reporting entity's ability to generate future cash flows. Those concerns are explained in appendix 2, but to summarise:

- There is too much assertion and not enough analysis in the paper about the information that financial statements should be designed to provide.

- We think that financial statements have a stewardship objective that is separate from their decision-usefulness objective.

- We think the statement in OB13 that the primary focus of financial statements is the ability of an entity to generate net cash inflows is an unsupported assertion.

*The need for a neutral discussion on measurement*

The IASB is about to embark on a full and proper debate about measurement. If that debate is going to be successful, it is very important that the IASB is not seen to be prejudging the issues in any way. We are therefore very concerned to see a number of instances in chapter 2 of the paper where the drafting and use of examples seems to show a bias in favour of current market-based values (such as fair value) and against cost-based measures. (Some examples of this are provided in appendix 3 of this letter.)

*Faithful representation v Reliability*

The Paper argues that, because it believes there to be long-standing problems over the meaning of reliability, that qualitative characteristic should be replaced by the characteristic of 'faithful representation'. As we explain in appendix 3, although we agree that there are problems with the reliability characteristic, we do not support the change proposed—which we, apparently unlike the IASB, believe to be a change of substance. In our view reliability should be retained but clarified through the addition of a new sub-characteristic that like verifiability focuses on the uncertainty and subjectivity involved.

We would retain faithful representation as a sub-characteristic of reliability. However, because we think it too is not a well-understood notion, we would recommend clarifying it as well.

*Substance over form*

The IASB is proposing to omit the notion of 'substance over form' on the grounds that it is not needed; it is encompassed by other qualitative characteristics and therefore adds nothing. We do not support this proposal because, as explained in appendix 3:

- We think there is considerable doubt as to whether the other characteristics do in fact encompass 'substance over form', at least as we understand the notion; and

- We think 'substance over form' is a fundamentally important notion that has been—and we believe will continue to be—an extremely valuable tool in helping to ensure the use of proper and improved accounting in all jurisdictions.

We hope that you find our comments helpful. If you wish to discuss them further, please do not hesitate to contact Paul Ebling or me.

Yours sincerely

Stig Enevoldsen
**EFRAG, Chairman**

**Appendix 1—EFRAG's detailed comments on the**
# Introduction to the [draft] Framework

## Main concerns

*The status of the Framework for standard-setters*

1 The Introduction section explains that, although the purpose of the Framework is to provide direction and structure to the standard-setting process, it is a non-mandatory document for standard-setters. We do not agree with this status.

(a) As the Introduction itself explains, the objective of the IASB's Framework is to establish the concepts that underlie financial reporting, because this provides discipline about whether one solution to a financial reporting issue is better than other potential solutions. We agree with this entirely. Indeed, the reason why Frameworks are such a valuable tool for standard-setting is precisely because they provide a coherent frame of reference for standard-setting, thus enabling those standards to be developed on a consistent and coherent basis—ie because they provide the discipline just referred to. The moment it becomes acceptable to depart from the Framework, that discipline and coherent frame of reference is lost and, every time a new standard is developed, one possibility that will need to be considered is whether the standard should depart from the Framework. The result is a devalued Framework.

(b) When the standard-setter is a global standard-setter, we think there is another reason why its Framework needs to have mandatory status. Having a fully debated conceptual framework that the standard-setter will follow represents a shared understanding between the standard-setter and its constituents as to the accounting model that future standards are to build and safeguard. It is thus the clearest indication there can be of the standards that the standard-setter believes in. On the other hand, if the Framework is not mandatory, those jurisdictions considering whether to start or continue to use the standard-setter's standards cannot assume that the Framework is a reliable indicator of future standards.

2 For those reasons, we think it ought to be acceptable to issue a new standard that is inconsistent with the Framework only if:

(a) the reasons and consequences of the decision to depart from the Framework, together with the plan for eliminating the inconsistency, are explained fully in the standard;

(b) the change to or deviation from the concepts set out in the Framework has been considered in the context of the Framework as a whole and not merely in the context of the issues addressed in the particular standard;

(c) the intention is that the inconsistency will be temporary and that the Framework and standard will be conformed as soon as practicable; and

(d) the inconsistency is relatively minor.

## Other concerns

*The role of the Framework in the preparation of financial statements*

3 Although not mentioned in the Introduction, the Framework also currently has a role in the preparation of financial statements by virtue of IAS 1.17 (the fair presentation override) and IAS 8.11 (the hierarchy).

4 We are content for the Framework to have that role. However, in order to fulfil the role effectively, it needs to be written in a form and style that makes it accessible and understandable to a wide range of readers. As already mentioned, in our view the draft set out in the Discussion Paper does not meet that criteria.

5 We note that there is not yet convergence between the IASB and FASB on this issue (because FASB's Framework plays no direct role in the preparation of financial statements). We are content for this issue to be resolved—and convergence to be achieved—later in the project.

**end**

### Appendix 2—EFRAG's detailed comments on
# Chapter 1: The objective of financial reporting

## Main concerns

*Users, their information needs, the objective of financial statements and the proposed focus on the entity's ability to generate future cash flows*

1 We have a number of concerns about the material in the Discussion Paper on users, their information needs, the objective of financial statements and the proposed focus on the reporting entity's ability to generate future cash flows. Those concerns are explained in the paragraphs that follow, but to summarise:

(a) We think there are too many assertions, and not enough proper analysis, in the paper about the information that financial statements should be designed to provide.

(b) We think the IASB is wrong not to recognise stewardship as a second, separate objective of financial statements.

(c) OB13 states, in a statement that appears to be of fundamental importance to much of what follows in the paper, that the primary focus of financial statements is the ability of an entity to generate net cash inflows. We think this is an unsupported, and probably incorrect, assertion.

Our detailed reasoning is set out in the paragraphs that follow.

**TOO MANY ASSERTIONS, NOT ENOUGH ANALYSIS**

2 It would seem logical that the analysis underlying this chapter should start by identifying the users of financial statements, continued by identifying those users' information needs, and then, by excluding those informational needs that it is not reasonable to expect general purpose financial statements to meet, arrived at a generalised summary of the remaining information needs. That generalised summary of the remaining information needs would then be translated into an objective for general purpose financial statements.

3 Indeed, although the material in the chapter does not appear in the order of that logic flow, we think that approach was probably still adopted to determine the objective. In particular, it seems to start by identifying the users of financial statements (a very wide range of people). However:

(a) OB6 then carries out an apparently superficial analysis of those users' information needs;[1]

[1] For example, in discussing the information needs of suppliers, the paragraph talks about them being "interested in assessing the likelihood that amounts an entity owes them will be paid when due" without mentioning that in some cases suppliers are also interested in assessing the likelihood of their customers continuing in business and continuing to buy their output. Similarly, in discussing the information needs of employees, the paragraph says they are "interested in information that helps them to assess the entity's continuing ability to pay salaries and wages and to provide incentive payments and retirement and other benefits." It does not however mention that employees (or perhaps more accurately, their representatives) are interested in assessing the employer's ability to pay higher wages, salaries and other benefits.

(b) there is a brief discussion in OB8 that leads to what appears to be an unsupported assertion that information that satisfies the needs of investors and creditors is likely to be useful to the other users of financial statements. This then leads into what we think is a very confusing discussion about who the primary users of financial statements are (see paragraphs 18-21 of this appendix for an explanation as to why we find that discussion confusing) which culminates in what again appears to be an unsupported assertion at the end of OB13 that "by focusing primarily on the needs of present and potential investors and creditors, the objective of financial reporting encompasses the needs of a wide range of users";

(c) there is then a discussion—again in our view rather unsatisfactory (see paragraphs 29 and 30 of this appendix)—of the limitations of general purpose external financial reporting, before the paper states with no further analysis or explanation that the objective of financial statements is "to provide information that is useful to present and potential investors and creditors and others in making investment, credit, and similar resource allocation decisions" (OB2); and

(d) finally, the paper states, again without any prior analysis or explanation, that information about the reporting entity's ability to generate net cash inflows is the primary focus of financial reporting.

4 In other words, in arriving at the objective and the proposed primary focus of financial statements, the paper makes a number of important statements that appear currently to be unsupported assertions or to be based on inadequate analysis. A number of these unsupported assertions play a fundamentally important role in the proposed new Framework. Although it might not have been necessary when the various Framework documents were first developed to ensure that such statements were capable of being fully supported, we think that 20 or 30 years later there should be no such statements. For that reason we encourage the IASB to undertake a matter of priority the research necessary to provide support for the assertions made.

5 This absence of analysis can be illustrated by considering the position of SMEs. We think everyone would agree that there are significant differences between the users of the financial statements of a large, multi-national listed entity and the users of the financial statements of a small, 'local' SME. It is likely—although we agree not certain—that those different users will have different information; after all, different people wanting to use information for different purposes usually need different information. And, if the financial statements of small local SMEs are trying to satisfy different information needs, it is possible that the objectives and concepts might be different too. Yet this possibility is not discussed.

STEWARDSHIP SHOULD BE A SEPARATE OBJECTIVE OF FINANCIAL STATEMENTS

6 We share the view, expressed in the Alternative View section of the paper (see paragraphs AV1.1-1.7), that stewardship should be identified as a separate objective of financial statements.

7 In many jurisdictions, stewardship and accountability (henceforth 'stewardship') were initially the primary reasons why financial statements were prepared. The subsequent development of capital markets means that there is now a second reason for preparing financial statements (the decision-usefulness objective), but the first reason—the stewardship objective—remains.

8 We understand that the IASB's view is that financial statements do have a stewardship objective, but that stewardship objective does not need to be identified separately because it is a part of the decision-usefulness objective. We disagree with that view.

(a) We think those who suggest that the stewardship objective is nothing more than a subset of the resource allocation decision-usefulness objective might be taking too narrow a view of the information that can be needed to assess stewardship. For example, OB3 and OB13 appear to equate the resource allocation decision-usefulness objective with the need to provide information that helps in assessing the amount, timing and uncertainty of the entity's future cash flows; in our view the stewardship objective cannot be met simply by providing information that helps in assessing future cash flows.

(b) We note furthermore that not all the decisions that are taken on the basis of financial statements about stewardship and accountability are resource allocation decisions. In some jurisdictions, for example, the financial statements are also used as one of the inputs into voting and into hiring and firing decisions.

9 Some commentators respond to the suggestion that stewardship is a separate objective by claiming that the financial statements would not be any different were a separate stewardship objective to be recognised. Again we disagree because we think that information that helps in assessing the amount, timing and uncertainty of the entity's future cash flows—which seems to be the information that the IASB believes financial statements need to provide in order for them to meet their decision-usefulness objective—is clearly not sufficient to enable the stewardship objective to be met. Some commentators also think it has implications for the qualitative characteristics (for example, to the importance attached to the reliability of measures under the existing Framework (and the verifiability of measures under the proposed new Framework)).

10 We think that the debate is easily resolved by including a separate stewardship objective for the time being. Then, the next time the Framework is revised everyone can evaluate the impact that the separate objective has had on the standards that have been developed. If it has had an impact, the separate objective is needed; if it has not, it can be omitted.

11 This whole debate has caused us to ask ourselves whether the objective of financial statements is a subject upon which it is appropriate for the IASB to impose its view. We think it probably is not; the objective of the financial statements ought to be a matter of fact, so the only debate should be over the words used to describe that objective. Our reasoning for reaching that conclusion is as follows:

(a) It seems to us that it is a matter of fact who the users of financial statements are and what their information needs are. We may not have all those facts but they can be gathered.

(b) The next issue is the extent to which general purpose external financial statements can reasonably be expected to meet all the information needs of users. Again, further work is probably needed on this but it seems to us that the IASB has taken the view that the financial statements should be designed to meet all the information needs of users that it is reasonable to expect general purpose external financial statements to meet. (We agree with that view incidentally.)

(c) If it is a matter of fact what the information needs of users are and which of those needs it is not reasonable to expect general purpose external financial statements to meet, it is also a matter of fact what the information needs of users are that the financial statements can meet.

(d) Therefore, unless the IASB is seeking to limit or in any other way change the existing objective or objectives of financial statements, their objective or objectives ought also to be a matter of fact.

**IT IS AN UNSUPPORTED ASSERTION TO SAY THAT THE PRIMARY FOCUS SHOULD BE ON AN ENTITY'S ABILITY TO GENERATE FUTURE NET CASH INFLOWS**

12 OB13 states that the primary focus of financial statements is "the ability of an entity to generate net cash inflows". As already mentioned, this appears to be an unsupported assertion. That is particularly worrying because the statement appears to be so fundamental to what the paper then goes on to say. It is therefore essential that, if the statement is to be retained, it is supported by persuasive analysis and reasoning.

13 We have two other concerns about the statement:

(a) Although the statement says that the ability of an entity to generate net cash inflows is the *primary* focus of financial statements, the paper does not explain on what else the financial statements should focus. Indeed, from OB 13 the paper reads as if the *only* focus of financial statements is the ability of an entity to generate net cash inflows.

(b) It is our understanding that this reference to an entity's ability to generate net cash inflows is a gross oversimplification of the information needs of investors (and perhaps also creditors), in that their interest is in the development of future profitability (rather than simply future net cash inflows). We would furthermore suggest that for some types of entity—for example, banks and insurers—their financial statements are *not* primarily about the reporting entity's ability to generate net cash inflows.

14 Furthermore, if a reference is to be retained to information about the entity's ability to generate future net cash inflows, the IASB needs to be aware that there is not currently a generally agreed view as to which recognition, measurement and presentation concepts are most suitable for providing information about that ability. Without there being a shared understanding of what the implications are of specifying that financial statements should provide information that enables users to assess the reporting entity's ability to generate net future cash flows, including such a reference in a revised Framework will be of only limited value.

## Other concerns

*Scope*

15 The scope of the proposed Framework is wider than that of the existing Framework because, whilst the existing Framework applies to *financial statements*, the proposed Framework applies to *financial reports*. As a matter of principle we support the extension of the Framework's scope to some or all financial reports that are not financial statements, not least because we consider that at least some of those financial reports (for example, the Management Commentary) to be an integral part of

the financial reporting package. However, we are concerned about the manner in which the IASB is proposing to extend the Framework's scope. And, because of those concerns, we do not support the Framework's scope being extended at this time. Our concerns and reasoning are set out in the paragraphs that follow.

16 It is clear that the IASB considers the term 'financial report' to have a very wide meaning. (For example, OB16 refers, inter alia, to news releases and descriptions of management's plans and expectations.) However, the IASB's intention is to address what it calls the 'boundary of financial reporting' (which we assume means a definition of what 'financial reporting' is for the purposes of the Framework) much later in the project. Such an approach means that the IASB is in effect asking its constituents when responding to the paper to consider its applicability to all types of financial report. That is not realistic.

A better approach would have been to focus on financial statements in this phase of the project stage, then consider in a later phase how the scope might be extended to some or all other financial reports.[2]

17 In developing the paper, it would appear that the IASB has assumed that the concepts that apply to financial statements apply equally—ie without amendment—to other financial reports. We think that assumption is incorrect. For example, we share the view, expressed in the recent Discussion Paper on the Management Commentary, that the desirable qualitative characteristics of the information provided in a Management Commentary are slightly different from the desirable qualitative characteristics of the information included in financial statements.

18 The IASB also seems to have assumed that the extension in scope will have no other implications for the Framework, but again we think that assumption is wrong. For example, although paragraph 12 of the existing Framework sets out the objective of the *financial statements*, OB2 of the proposed Framework sets out the objective of *financial reports*. However, OB2 does not explain whether the proposal is that every financial report should have that objective or whether the proposal is that financial reports, when taken together, should achieve that objective.

(a) Unless it is the former (ie that every financial report has the same objective), the proposed new Framework will not set out the objective of financial statements which, we think, would reduce its usefulness and make it necessary to amend IAS 1.17.

(b) However, we do not think that every single type of financial report *does* have the same objective. In our view not even the financial reports set out in the annual and interim financial reporting package have the same objective.

19 For the reasons set out in paragraphs 15-17, we do not think it is appropriate to extend the scope of the Framework from financial statements to financial reporting until both:

(a) there is clarity as to precisely which 'other' financial reports the Framework is being extended to; and

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[2] We suspect that it ought to be possible in the short- to medium-term to extend the scope to include those financial reports that are included in the annual and interim financial reporting packages alongside the financial statements; on the other hand, we think it is probably not realistic to attempt to include any other financial reports within the Framework's scope in that timescale.

(b) sufficient further work has been carried out to determine whether the concepts and principles that apply to financial statements can be applied to those other financial reports and, to the extent that they cannot be, what amendments need to be made.

*Primary users of financial statements*

20 Although the existing Framework states that the primary users of financial statements are investors, the proposal (in OB12) is that the new Framework should state that investors and creditors (potential and actual) and their advisers are the primary users of financial reports. As we think it is a matter of fact that the main (and therefore primary) users of financial statements are investors and creditors, we agree that the Framework should be amended—although we would include all creditors, not just those that fall within the meaning of the term as defined in the DP (see paragraphs 27 and 28 of this appendix).

21 We do think though the Discussion Paper is rather confusing on this issue for two reasons. Firstly, the reasoning in OB12 seems confusing in that it argues that, because:

(a) investors and creditors are the most prominent external users of financial reports,

(b) their information needs are better understood than those of other external users, and

(c) information needed by investors and creditors is also likely to be useful to other users,

it follows that investors and creditors are the primary users of financial reports. We think (b) and (c) are irrelevant to an assessment of which users are the primary users of financial reports (unless the phrase ‘primary user’ is being used in some sort of specialised sense).

22 The paper seems unclear as to the role that the primary user notion plays in the proposed Framework.

(a) OB12 and 13 argue that, because investors and creditors are the primary users of financial reports and they have a common interest in the reporting entity’s ability to generate net cash inflows, information about that ability to generate net cash inflows should be the primary focus of financial reporting. Those paragraphs therefore seem to be suggesting in effect that the primary focus of financial reporting should be determined largely by the information needs of investors and creditors. This suggestion seems to be reflected in most of the other paragraphs in the paper, which also focus on the reporting entity’s ability to generate net cash inflows and make no reference to other information needs.

(b) However, OB2 and OB10 make it clear that the financial reports should be designed to meet the needs of a wide range of users, and not just investors and creditors. In other words, it is not particularly important who the primary users of financial reports are, because financial reports should be designed to meet the needs of all users.

This confusion makes it difficult to know how to decide what information should be included in the financial statements and what information need not. In theory there is a choice, financial reports could focus either:

(i) exclusively on the information needs of investors and creditors. According to the proposed Framework this would mean focusing on the reporting entity's ability to generate net cash inflows (although as explained above we disagree with this focus because we think it ignores the separate stewardship objective that exists); or

(ii) on the information needs of all users, which would mean not focusing just on the reporting entity's ability to generate net cash inflows.

We very strongly believe that view (b) is correct; financial statements are prepared for a wide range of users and should therefore focus on the information needs of all those users.

*The role of management*

23 We believe that the role of management should be given greater emphasis in the revised Framework than it has been given in the paper. Management wants the internal financial reports to be useful, unbiased and focused on the key issues, and that is exactly what external users want as well. This does not mean that the external reporting should always follow the internal reporting, but it does mean that the Framework should acknowledge that in principle divergence between internal reporting and external reporting should not be introduced lightly and that the reasons for the divergence need to be understood and appropriately taken into account.

*Entity perspective v shareholder perspective*

24 OB10 argues that, because the information provided by financial reports is directed to the needs of a wide range of users, it follows that financial reports should adopt an entity perspective rather than a shareholder perspective. We are pleased to see the entity perspective v shareholder perspective being addressed in the proposed Framework. However, we are unconvinced by what is said. We had hoped that, when the IASB addressed the issue in its Framework, it would debate the issue thoroughly before reaching a conclusion, especially as this is such an important issue. However, the Discussion Paper merely asserts (in OB10) that there is a link between who the users are and the perspective from which the financial statements should be prepared, then concludes that because financial reports are prepared for a wide range of users (rather than just investors), it follows that an entity perspective (rather than a shareholder perspective) should be adopted.

(a) We know that some commentators think the paper is right to say there is a link between who the users are and the perspective from which the financial statements should be prepared. However, some others do not agree and we would have expected the issue to have been discussed in the paper.

(b) The paper does not explain in any detail what the two perspectives entail, nor why one may result in more useful information than the other. Again, we would have expected this to have been discussed in the paper.

*Performance reporting*

25 In the existing Framework, each primary financial statement has a separate objective; for example, the objective of the income statement is described as being to show financial performance. However, the Discussion Paper approaches the subject differently. It first summarises (in OB18) the things that financial reports should focus on: resources (ie assets), claims to resources (liabilities and equity), and "information about the effects of transactions and other events and circumstances that change resources and claims to resources". It then explains (in OB23) that information about an entity's financial performance during a period should be measured by changes in its resources and claims to them other than claims resulting from transactions with owners as owners." In other words, 'financial performance' is not about, say, net income; it is about non-owner changes in assets and liabilities (ie non-owner changes in equity).

26 Under existing standards and the existing Framework, financial performance and non-owner changes in equity are seen as different things, so the Discussion Paper is proposing a change of approach. That change is a relatively major—and for some controversial—change. Bearing that in mind, we would have expected the proposal to change approach to be accompanied by material in the Basis for Conclusions section explaining the reasoning behind the proposal. But there is no such explanation. We cannot support a fundamental change of this kind being made without the reasoning being explained so that a proper debate can take place.

**More detailed points**

*The need for some definitions*

27 OB1 has some words in italics ('entities', 'entity', and 'business entities in the private sector') which are presumably intended to be defined terms but are not, as far as we can tell, defined in the Discussion Paper or in IFRS generally. We do not think it particularly important to define 'entity' at this stage (because the reporting entity will be the focus of a later stage in the project) but we think it might be useful to define 'business entities in the private sector' so that it is clear whether the Framework is intended to apply to certain non-profit oriented entities and mutual arrangements that operate in the private sector.

*The meaning of 'creditors'*

28 We note that, as is made clear in OB7 and OB8, the term 'creditors' is used in the proposed Framework in a specialised way. (It does not include so-called 'trade creditors'.) We think this is confusing. If the Framework uses words that have a common usage, it should allow them to have their common usage meaning.

29 We were also not convinced by the reasoning in OB8 as to why the Framework should focus on the information needs of only some types of creditors (as defined for common usage).

*Limitations of general purpose external financial reporting*

30 According to the heading above the paragraphs, OB14 and OB15 describe inter alia the limitations of general purpose external financial reporting. We think this is a potentially important section in the context of financial statements because it is as important to understand what financial statements cannot achieve as to understand

what they can achieve.  However, we were disappointed by the section's content, which seems to focus more on the inability of financial reporting to meet the 'vision' set out in the Framework than on what financial reports can and cannot be expected to achieve..

31 We think this section could be improved by including some of the material on limitations contained in paragraphs 1.8 and 1.9 of the UK ASB's Framework (the Statement of Principles).  Those paragraphs read as follows:

> "1.8 Financial statements do not seek to meet all the information needs of users: users will usually have to supplement the information they obtain from financial statements with information from other sources. Furthermore, financial statements have various inherent limitations that make them an imperfect vehicle for reflecting the full effects of transactions and other events on a reporting entity's financial performance and financial position. For example:
>
> (a) they are a conventionalised representation of transactions and other events that involves a substantial degree of classification and aggregation and the allocation of the effects of continuous operations to discrete reporting periods.
>
> (b) they focus on the financial effects of transactions and other events and do not focus to any significant extent on their nonfinancial effects or on non-financial information in general.
>
> (c) they provide information that is largely historical and therefore do not reflect future events or transactions that may enhance or impair the entity's operations, nor do they anticipate the impact of potential changes in the economic environment.
>
> 1.9 These inherent limitations mean that some information on the financial performance and financial position of the reporting entity can be provided only by general purpose financial reports other than financial statements—or in some cases is better provided by such reports. For example, although a description of the business environment and markets in which a reporting entity operates and the strategies it has adopted is usually needed to put into context the numerical information provided by the financial statements, it is generally better to provide such information in the material accompanying the financial statements than in the financial statements themselves."

We recognise that the UK Framework is discussing the limitations of financial statements and the proposed Framework is focusing on financial reports in general, but we nevertheless believe that a discussion along these lines is helpful in managing the expectations of those involved in the standard-setting and financial reporting process.

*Drafting comments*

32 The third sentence of OB23 states that information about financial performance as measured by changes in resources and claims to resources "indicates the extent to which the entity has increased its available economic resources, and thus its capacity for generating net cash inflows, *through its operations*…" (emphasis added)  We think this is incorrect, for two reasons:

(a) some of the changes in resources could have been the result of value changes that had nothing to do with the entity's operations; and

(b) as long as internally generated goodwill and other intangibles are not recognised as assets on the balance sheet, information about financial performance as measured by changes in resources and claims to resources will not indicates the *full* extent to which the entity has increased its available economic resources.

**end**

**Appendix 3—EFRAG's detailed comments on**

# Chapter 2: Qualitative characteristics of decision-useful financial reporting information

## Main concerns

*The need for a neutral discussion*

1 As you are probably aware, we are waiting eagerly for the promised debate about measurement to commence. We—like everyone else presumably—want that debate to be a full and proper debate in which the conclusions are not prejudged in any way. For that reason, we are concerned that there are a number of instances in this chapter where the drafting and use of examples seems to show a bias in favour of current market-based values (such as fair value) and against cost-based measures. For example:

(a) The example in QC12 that is used to illustrate how financial information can be highly predictable without being relevant picks a cost versus current value example and concludes that cost-based depreciation may not be relevant.

Incidentally, the final sentence seems to imply that information about the decline in value of an asset-in-use and information about its "current condition in financial terms" is clearly highly relevant to an assessment of an entity's ability to generate net cash inflows. We think that is a so-far unjustified assertion. Perhaps the measurement debate will provide the justification, but until then such assertions should be avoided.

(b) The example in QC18 seems to imply that current value-based amounts are more faithfully representational than cost-based amounts. In addition, we note that, although historical cost, replacement cost, and fair value are referred to in this example, there is no reference to value-in-use even though the discussion is about information that is very useful to those wishing to make assessments about future cash inflows. This seems an odd omission unless the authors have already reached some conclusions on measurement.

(c) Similarly, the example in QC22 also criticises the use of cost. It would have been very easy to have used a current value example here, yet *again* an example is used that, in our view somewhat unfairly, criticises cost at the expense of current value.

We recognise that the actual wording used in the examples referred to above allows room for other conclusions (because phrases like 'might be more relevant' and 'might be more faithfully representational' are used) but if the above examples were simply accidental examples of bias we would have expected to see some examples in which cost is described as being perhaps more relevant or more faithfully representational than current value. There are no such examples. We cannot emphasise enough that, if the measurement debate is to be a success and to result in progress, there must be no suggestion whatsoever that the conclusion has been decided before the debate has started. The examples we have highlighted above do not help in this respect.

*Faithful representation v Reliability*

2 The Paper argues that, because it believes there to be long-standing problems over the meaning of reliability, that qualitative characteristic (which has as sub-characteristics faithful representation, substance over form, neutrality, prudence and completeness) should be replaced by the characteristic of ‘faithful representation’ (which should have as sub-characteristics verifiability, neutrality and completeness). The Paper argues that this is not a change of substance; it is merely a re-labelling.

(a) EFRAG agrees that there are long-standing problems over the meaning of reliability.

(b) EFRAG does not however support the change proposed.

(i) EFRAG believes the IASB is wrong to describe replacing ‘reliability’ with ‘faithful representation’ as not being a change of substance. ‘Faithful representation’ is a narrower notion than reliability.

(ii) EFRAG suggests that, rather than replace reliability, it should be retained and clarified. We further suggest that part of that clarification should involve adding a new sub-characteristic that like verifiability focuses on the uncertainty and subjectivity involved.

(iii) EFRAG believes that faithful representation, which should remain a sub-characteristic of reliability, should also be clarified.

**LONG-STANDING PROBLEMS OVER THE MEANING OF RELIABILITY**

3 We agree that there is some confusion as to the meaning of reliability. For example:

(a) it is common, when people talk about reliability, for them to talk about it as if as it focuses solely on the uncertainty (ie ‘‘softness’) involved in a piece of information. That is not however how the notion is described in the Framework, which talks about faithful representation, substance over form, neutrality, prudence and completeness.

(b) even when people are using the term to focus on the softness of information, there seems little agreement on what the term means.

(i) The recent Canadian Discussion Paper on Measurement appears to suggest that the use of allocation techniques reduces the reliability of information.

(ii) Some commentators believe that reliability is actually a characteristic of relevant information—or, put another way, that information that is not reliable cannot be relevant.

(iii) It has been suggested that information prepared using a “through the eyes of management” approach is inherently less reliable than information based on a more independent view of the reporting entity.

4 Clearly it is a problem if a term as important as ‘reliability’ is being used in a muddled way. The Framework project is an ideal opportunity to address the problem.

**<u>REPLACING 'RELIABILITY' WITH 'FAITHFUL REPRESENTATION' IS A MORE SIGNIFICANT CHANGE THAN A MERE RE-LABELLING.</u>**

5 The IASB suggests in the Discussion Paper that its proposal to replace 'reliability' with 'faithful representation' is not a change of substance; it is merely a re-labelling. We do not agree because we think the effect is to 'narrow' what is in the existing Framework a fairly broad notion.

6 This is apparent by looking just at the words involved. Bearing in mind that under existing Framework faithful representation is just one sub-characteristic of 'reliability', it follows that reliability must be a broader notion than faithful representation. It therefore must follow that, in replacing 'reliability' with 'faithful representation', there is either a change of substance (a narrowing) or a change in the meaning of the term 'faithful representation'. There is no other possibility. As the Discussion Paper appears to discuss faithful representation in very similar terms to the existing Framework, the implication seems to be that there has been a narrowing.

7 We think common sense also tells us that it is a narrowing. Relevance is about selecting the right aspects of the right events for portrayal in the financial statements, and reliability is about portraying those selections in a way that is both dependable (ie neutral, complete etc) and gets to the heart of what is going on and what the underlying position is (ie faithful representation, substance over form etc). Faithful representation is therefore just one of several characteristics that need to be met.

8 To have to have a debate about the meaning of what is proposed is of course not the best way to go about clarifying a term whose meaning has become confused. But more important than that, EFRAG does not support the change proposed.

(a) We see no reason to narrow the existing characteristic. The paper itself does not give any reason.

(b) We believe that if a term's meaning is unclear, the best solution is usually to clarify its meaning. As we explain under the next heading, we believe that this is the best approach—to certain and clarify 'reliability' rather than to abandon it.

(c) As is explained more fully below, we also think there is much confusion as to the meaning of the faithful representation notion, and we are not in favour of replacing one unclear term with another.

**<u>RELIABILITY SHOULD BE RETAINED BUT CLARIFIED</u>**

9 In our view, the best way of addressing the current problem over the reliability notion is to clarify it. We think the source of the problem lies with the way the notion is described in the existing Framework. In that Framework, the notion is not the sum of its sub-characteristics; in other words, although the existing sub-characteristics—faithful representation, substance over form, neutrality, prudence and completeness—describe important aspects of 'reliability', they do not explain all the aspects because they do not cover the softness/uncertainty aspect spoken of earlier.

10 We have concluded that this new sub-characteristic is needed primarily because of the way the existing reliability characteristic has been widely applied by many practitioners over the years—to relate to the softness of the information. It seems to us that this application has not arisen by accident; it has arisen because practitioners believe that

good financial information needs to strike an appropriate balance concerning its 'softness'.

11 Of course, the IASB also identified this need for a new sub-characteristic that focuses in some way on the uncertainties inherent in the information; they have called it 'verifiability'. However, for the reasons explained below and in our discussion of verifiability, we think the IASB's verifiability notion is a bit narrow and is as a result not focusing on exactly the right thing.

12 We have not attempted to work out exactly what this new characteristic would be called or would represent, but we think it would be about dependability; the information would need to be sufficiently dependable to be able to take a decision on the basis of it. Cost derived directly from transactions will invariably be 'dependable' (but depending on the circumstances may not be the most relevant information or a faithful representation). Estimates can be dependable too, although they would probably usually need to be based on the correct application of appropriate methodologies that are regularly benchmarked against actual observable transactions.

(a) The references here to the correct application of appropriate methodologies are not dissimilar to the verifiability notion.

(b) The reference to regular benchmarking has been included because we think this is an important issue that needs to be debated to a conclusion: can an estimate of a measure be dependable/reliable if the model that is being used can never be benchmarked? This is of course part of the whole issue of the reliability of various measurement bases and techniques. We have heard some commentators (including users) argue that no fair value can be reliable—presumably because all fair values are ephemeral—and some other commentators equate reliability with whether it is possible to attribute a value to an item. All these issues need to be debated and resolved if we are to have a better understanding of the reliability notion.

**FAITHFUL REPRESENTATION, WHICH SHOULD REMAIN A SUB-CHARACTERISTIC OF RELIABILITY, SHOULD ALSO BE CLARIFIED**

13 Although faithful representation has been a sub-characteristic for many years, we do not think it is a well-understood notion and some of the things we think we do understand about the notion make us uncomfortable. For example:

(a) it is argued in the paper that the sub-characteristic of 'substance over form' is not needed in the revised Framework because it is encompassed within the faithful representation characteristic. (BC2.18 says that "to represent legal form that differs from the economic substance of the underlying economic phenomenon could not result in a faithful representation.") On the face of it that is good news, because we believe very strongly that financial statements need to faithfully represent the economic substance of transactions and other events. However, IFRIC has recently been considering the role of contractual and economic obligations in the classification of financial instruments under IAS 32 *Financial Instruments: Presentation*. In our view, if, for example, the terms and conditions of the instrument being classified are such that the entity will in the future be economically compelled to redeem the instrument, that instrument, depending on the exact facts of the case, could in substance be a liability notwithstanding the absence of a contractual obligation to redeem. It is our understanding that some commentators, including some IASB and IFRIC members, argue that that is not however a faithful representation of the position. If that is the case, in our opinion the faithful representation notion does not encompass what we would consider to be the economic substance.

(b) we note (from BC2.49) that the IASB believes that the notion of faithful representation is "much the same" as the notion of 'presents fairly'. We have looked through the Discussion Paper's explanation of the faithful representation characteristic for evidence that it is the same sort of multifaceted dynamic notion as 'true and fair view' and do not see any such evidence. In particular, one of the things that the true and fair view requires is that the information presented should make sense both at a micro transaction-level and at a macro level when one stands back and considers the financial statements as a whole. However, the discussion in paragraphs QC16 - QC19 seems to be fixed firmly on the micro level. As we have to date assumed that 'present fairly' and 'true and fair view' are essentially the same notion, it follows that either the explanation of the faithful representation notion is incomplete or that the notion is *not* "much the same" as the notion of presents fairly.

(c) some commentators have suggested that the application of the faithful representation characteristic as described in the Discussion Paper would inevitably result in the more widespread use of current value measures. We think that cannot be right (despite the examples in QC18 that we mentioned earlier) because the IASB has argued that faithful representation means the same as reliability, but it is further proof that 'a faithful representation' is not a well-understood notion.

(d) the references in the discussion paper to faithful representation of *real-world economic phenomena* have also been the subject of much debate here at EFRAG.

(i) Partly this is because the term 'real-world economic phenomena' might not be used in a consistent way in the paper. QC16 seems to suggest that it was a reference to assets, liabilities, transactions and other events; but in QC18 we are told that a machine's original cost is a real-world economic phenomenon.

(ii) Probably more significantly we are not sure how to reconcile this focus on real-world economic phenomenon with some of the measurement proposals that the IASB is developing which sometimes involve estimating market prices where markets do not exist and/or where benchmarking of models is not possible. We do not see those measures as real-world economic phenomena.

14 Incidentally, bearing in mind what we said earlier about the need for the Framework to be written in a style and language that makes it easy to read and understand, we think the IASB might wish to take another look at the phrase "a faithful representation of the real-world economic phenomena that it purports to represent", which is extremely hard work for English-speakers, let alone those who do not have English as their first language.

*Substance over form*

15 We think that the notion that is often called ‘substance over form’ is a fundamentally important notion that needs to be retained in the revised Framework.

16 Experience shows that it is a very rich concept that helps to ensure proper accounting in circumstances in which the other qualitative characteristics sometimes cannot reach or fail to persuade. We understand that is particularly so in some jurisdictions that are still in the process of developing the appropriate accounting instincts. We can also imagine that, especially as it is difficult for the IASB to develop standards that fit well with all the different legal and cultural systems, that ‘substance over form’ will also be extremely useful in the future in helping to improve accounting worldwide and ensuring the appropriate application of IFRS. For those reasons, we think it is in many ways the most important qualitative characteristic.

17 We recognise that the IASB could argue that nothing that we have said in the previous two paragraphs is inconsistent with the proposals in the Discussion Paper, it is just that the IASB believes the sub-characteristic of ‘substance over form’ is encompassed within the faithful representation characteristic and therefore does not need to be highlighted separately—the IASB is in effect saying that substance over form can be omitted because it adds nothing and its omission is not a change of substance.

18 However, for the reason explained in paragraph 13(a) above (ie the discussion on economic compulsion), we do not think that our understanding of economic substance is encompassed within the IASB’s understanding of a faithful representation. Indeed, we think many commentators do not share the IASB’s view that the notion is encompassed within the faithfully represent characteristic. It follows that we (and those commentators) believe the notion adds something and that its omission *is* a change of substance. We therefore do not believe it is appropriate to omit ‘substance over form’ without doing further work.

19 It is possible that the reason the IASB believes it is encompassed within faithful representation is because the IASB has a notion of substance that is different from the notion that some other commentators have.

(a) It may be relevant to note in this context that US literature often refers to ‘legal substance’, a notion that we understand is in complex cases often closer to what many would view as legal form than to economic substance. We think the focus should be on economic substance, not legal substance.

(b) Some commentators will argue that the fact that the IASB might have a different notion of substance to that of many other commentators shows that the substance of a transaction is often not clear cut and substance over form may not be as straight-forward a notion as its supporters suggest. There is no doubt that, like almost any other accounting concept and notion, ‘economic substance’ could be refined and clarified through further work and deeper analysis, but in any case that is not the IASB’s argument for omitting the notion.

**Other concerns**

*Verifiability*

20 As already mentioned, although EFRAG believes that reliability/faithful representation does need a sub-characteristic that focuses on the uncertainty of accounting information, we do not think that verifiability as described in the paper is exactly what is needed.

(a) Partly this is because we do not think it is a sufficiently broad notion—we discussed earlier the notion of dependability.

(b) Partly it is because we are uncomfortable with how the notion is described. For example:

(i) QC23 talks about 'direct verification' and 'indirect verification'. We are concerned about the notion of indirect verification because, as recognised in QC26, it could result in information derived from the appropriate application of an inappropriate methodology being deemed to be verified or verifiable. In our view it is the information that needs to be verifiable, not the methodology, and information cannot be verifiable if it is derived from an inappropriate method.

(ii) QC23 talks about information being verifiable if observers would reach a *general consensus, although not necessarily complete agreement*…" (emphasis added) It goes on to say that "to be verifiable, information need not be a single point estimate. A range of possible amounts and the related probabilities can also be verified." We think that an implication of this might be that all information is verifiable because the range can always be made wide enough to include all the views of the observers. This cannot be right.

(iii) We also wonder how these ideas about a general consensus as to the range of possible amounts and related probabilities will work in practice. For example, in the case of litigation, is it expected that the "different knowledgeable and independent observers" will agree on the range and probabilities (because we doubt whether agreement would really be achievable)? This would benefit from further explanation.

*Relevance*

21 The Paper proposes that relevant information should be defined as information that is *capable of* making a difference in the decisions of users (rather than information that *does* make a difference). We understand that the primary reason for this change is that it has been argued in the past that if information is not made available it cannot make a difference and would therefore under a strict application of the old definition not be deemed to be relevant. That is clearly an absurd situation and we would support an amendment that prevents such an argument being applied. However, the revised wording (particularly the final sentence of QC9, which says "standard-setters cannot rely entirely on users to request or identify all of the information that is capable of making a difference in a decision") could conceivably be used by the IASB to justify it insisting on the provision of information that users do not consider relevant. As we assume that is not the intention, we suggest amending the wording so that it refers to

“information that is provided and makes a difference and information that is not provided but were it to be provided would make a difference.”

22 Incidentally, we think the term ‘relevant’ might not be used in a consistent way in the paper. For example, in QC8 the Paper talks about relevance in terms of the information provided; yet in QC43 the paper seems to be talking about relevance in terms of determining which economic phenomena should be depicted in financial statements. This might appear to be a subtle difference, but it could be important.

23 As mentioned above, some commentators argue that information cannot be relevant if it is not reliable. We share that view. We also believe that information that is not a faithful representation cannot be relevant either. We think this is what QC44 means when it says “unfaithful depictions will be either useless for making decisions or misleading”, but think the paper could be clearer.

*Prudence*

24 As paragraphs BC2.21 and 2.22 explain, the existing Framework describes prudence as “the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty…”. In the proposed new Framework, those words and the term ‘prudence’ are omitted.

25 Bearing in mind all the baggage that the term ‘prudence’ seems to carry, we do not object to the term’s omission from the revised new Framework.

26 On the other hand, the explanation about the need to exercise caution in the face of uncertainty continues to prove quite useful, particularly in jurisdictions that are fairly new to IFRS and may not yet have quite the right accounting instincts. We therefore would prefer to see the words retained (even if the word ‘prudence’ is omitted).

*Going concern assumption*

27 We note that the proposed revised Framework makes no reference to the going concern assumption. Whether or not the financial statements are prepared on a going concern basis is important, because it has implications for both recognition and measurement, and is also something that needs to be taken into account when applying some of the qualitative characteristics. We are therefore surprised to see it omitted from the draft revised Framework, particularly as its proposed omission is not explained in the Basis for Conclusions. Because of its implications for both recognition and measurement, we think the assumption should be retained in the Framework.

*Comparability*

28 We like the discussion in paragraphs QC35 – QC38 about comparability, particularly QC37’s explanation about the problems that can arise through an overemphasis on uniformity.

29 Having said that, we are concerned when the accounting allows things that are the same to look different. We are thinking here particularly of unnecessary options in standards or, a much bigger problem, recently, standards that are applied prospectively rather than retrospectively. In our view the IASB’s general principle, when issuing new or revised standards, should be to require full retrospective

application of the new requirements.  Exceptions to that general principle should be rare, and usually the IASB should impose a longer lead-time rather than allow an exception to the general principle.  We think this is important because, if prospective application is permitted or required for a particular standard, the reduction in comparability can often continue for many years   And, if prospective application is permitted but not required for a lot of standards, there is likely to be very little comparability at all between companies–which would be an extremely bad thing.

30 We are also concerned with the inference in this section that like items should be accounted for in the same way regardless of their function.  That is not currently always the case and the paper does not explain why it is necessary for that current position to change.

**More detailed points**

*Understandability*

31 We think the discussion of understandability in QC39-QC41 could be improved by explaining that understandability needs to be considered both at the level of the individual item and at the aggregate level.  We also question whether the discussion on hedging in QC41 is useful; we suggest retaining the last sentence but deleting the rest.

*Materiality*

32 We have some concerns about the way in which materiality is discussed in QC49-QC52.

(a) We do not think it is correct to describe materiality as a "constraint on financial reporting".  On the other hand, although it may not be the right description, it is not obvious to us that the 'incorrect' description does any real harm.

(b) We agree with the paper's description of materiality as being both a qualitative characteristic and a quantitative one.  For that reason we were disappointed to see so much of the discussion focusing on the quantitative aspects.

(c) We think the discussion would have been significantly more useful had it dealt with materiality in the context of disclosure, because this is an issue on which there seems to be much uncertainty.  For example, although IAS 1.31 for example permits an entity to omit a disclosure required by a standard "if the information is not material" and IFRS 3.68 talks about disclosure requirements for items that are individually not material, it is not clear whether these standards are using 'material' in both a qualitative and quantitative sense.  Nor is it clear how one judges the qualitative materiality of a disclosure.

(d) We thought some of the discussion about errors and whether they should be corrected would be more at home in an auditing discussion than a Framework for financial reporting.

*The Framework is neither a manual on standard-setting nor a commentary on past standard-setting controversies*

33 The purpose of the Framework is set out the concepts that underlie financial reporting. As such, we do not think it is the place to discuss how one should apply those concepts in setting standards, nor is it the place to comment on past standard-setting controversies. For that reason:

(a) we think QC30 should use an example that carries less 'baggage' than the employee share options example used.

(b) We think the discussion in QC31 about "political winds" and "politically motivated standards" should be omitted.

However, if material of this kind on standard-setters and how they should behave is to be retained in the Framework, we think the discussion should be comprehensive, which it clearly is not at present. One point we would like it to emphasise is that the nature and content of standards should not be based on anti-abuse concerns.

*Expectations about users and preparers*

34 Paragraphs QC3–QC6 set out a number of presumptions that the IASB makes and expectations that the IASB has about users and preparers. One of the statements is that financial reporting "cannot be of much direct help to those who are unable…to use it or who misuse it." We believe this part of the paper would be more balanced had it acknowledged that standard-setters have a responsibility in setting standards to do their best to make it possible for financial reports to be used properly.

*Depreciation is not a measure of loss in value*

35 We have already commented in paragraph 1 above about the example given in the discussion around predictive value in QC12 (straight-line depreciation of historical cost). We think there is an additional reason why the example is a poor one: it seems to imply that depreciation is some sort of forecast of an asset-in-use's loss in value. In our view that is not its purpose. Predictive value is a more complex notion than it is presented as being in this paragraph.

36 We are a bit uncomfortable with the wording used to describe the faithfully represent characteristic. For example, in the reference to "a faithful representation of *the real-world economic phenomena that it purports to represent*" (emphasis added) is difficult. The exact meaning of 'real-world phenomena' is not clear. For example, we have heard concerns raised about how is it to be applied to an accounting measure that is never trued up or cannot be calibrated against a real world transaction.

**end**