EFRAG

European Financial Reporting Advisory Group

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International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UK

Dear Sir/Madam

Exposure Draft of An improved Conceptual Framework for Financial Reporting—Chapter 1 The Objective of Financial Reporting, and Chapter 2 Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the above-named IASB Exposure Draft (the ED). This letter is submitted in EFRAG's capacity of contributing to the IASB's due process.

The ED has been prepared as part of a joint project by the IASB and FASB and it sets out the boards´ proposal for the two first chapters of their proposed common framework.

EFRAG´s general view is that the version of chapters 1 and 2 that are in the ED represent a significant improvement on the version that was set out in the earlier discussion paper. For example, we think the way stewardship has been dealt with is much better than before, there seem to be fewer assertions about users' information needs, the text is more neutral on the subject of measurement, and it is good to see ´economic substance' placed at the centre of the faithful representation characteristic and the notion of ´going concern´ retained. Bearing in mind our previous comments about the length and nuanced drafting style of the draft chapters in the discussion paper, we are also pleased that the ED's text is shorter and less nuanced.

However, we do still have concerns about some aspects of the ED, and it is those concerns that this letter focuses on.

We have structured our response as follows. Attached are two appendices. One is for some general comments about the material in the ED, the other covers EFRAG´s comments on the questions in the Invitation to comment. Here, in this cover letter we briefly summarise the main comments in those appendices.

1 EFRAG remains strongly of the view that no part of the Framework should be finalised until the whole Framework is ready to be finalised, unless all the implications of the changes being made in the finalised bits of the revised Framework are identified at the ED stage and are reflected in the consequential amendments made at the same time. Asking for final comments on chapters 1 and 2 before the implications for later chapters of the new material included in chapters 1 and 2 is in our view not appropriate. Also, as those implications appear not to be fully reflected in the consequential changes being proposed, it seems that for the next five years or so the IASB's Framework will be an incoherent mixture of the old

Framework and the new. Bearing in mind the role the Framework plays in the hierarchy, we do not think this incoherence is acceptable.

2 We think that the link between what is relevant for external users and what is relevant to management is important, and should not be overlooked. For example, when a standard-setter is told by preparers that it is proposing to require an accounting treatment or disclosure that would not provide information relevant to management, we think it important that the standard-setter is able to explain why information that is not relevant to the managers of the entity's capital would be relevant to the capital providers. In making this comment, we are not however suggesting that internal reporting should drive external reporting.

3 We understand from our discussions with users that understanding the reporting entity's business model is essential to enable them to use the financial statements effectively. We also understand that, to understand the business model, they use information from all parts of the financial statements. Yet, although the proposed Framework explains that "capital providers use information about *cash flows* to help them understand an entity´s business model" (emphasis added) it does not make a similar reference to the business model when discussing the other primary financial statements. We therefore think it is important that the reference to understanding the entity´s business model is expressed in more general terms, referring to all the primary financial statements, and be located appropriately in the revised Framework.

4 We continue to believe that a comprehensive and in-depth debate is needed on the perspective from which financial statements should be prepared. In our view, although the ED proposes the use of the entity perspective, the material in the Basis for Conclusions is insufficient to enable that debate to take place. In the absence of such a debate, we think it is premature to reach a conclusion at this stage of the Framework project. We are also concerned that, as the IASB itself acknowledges, the implications of that proposal for the rest of the Framework have not yet been identified.

5 EFRAG remains uncomfortable with the proposal that the notion of 'reliability' should be replaced by the notion of 'faithful representation'. We agree with the ED's explanation that 'reliability' is often misunderstood, but think 'faithful representation' is no better understood. Also, we believe reliability is a broader and preferable notion to faithful representation.

If you would like further clarification of the points raised in this letter, please do not hesitate to contact me or Sigvard Heurlin.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

Appendix 1
EFRAG´s general comments on The Objective of Financial Reporting and the Qualitative characteristics and Constraints of Decision-useful Financial Reporting Information

No section of the Framework should be finalised unless the implications of the proposed changes have been properly identified

1 The IASB is carrying out its proposed revision of the Framework chapter-by-chapter, and the proposal in the ED is that each chapter will be finalised independently. In other words, the intention is that some chapters will be finalised whilst work is continuing on other chapters; indeed, although chapters 1 and 2 could be completed in 2009, the revision of other chapters would not by then even have started.

2 EFRAG is strongly of the view that no part of the Framework should be finalised before the whole Framework is ready to be finalised. There are two main reasons for this:

(a) Firstly, it is difficult to comment effectively and comprehensively on chapters that the IASB wants to finalise first when it is not clear what the implications of the various changes being made in those earlier chapters are for later chapters. For example, as BC1.16 itself acknowledges, the boards have not yet considered the effect that adopting the entity perspective will have on future phases of the Framework. Bearing that in mind, not only is it difficult for the IASB's constituents to comment effectively on the proposal, we find it difficult to understand how the IASB can be confident its proposal is appropriate.

(b) Secondly, because the Framework is part of the hierarchy, it is important that it should be a coherent and consistent piece of work. As the boards do not know what the implications of deciding to adopt the entity perspective for future phases of the Framework are, it follows that it is likely that incorporating the entity perspective into chapter 1 and combining that with material on the elements etc from the existing Framework (which is what the IASB's approach amounts to) will result in a Framework that is not internally consistent. We do not believe it is appropriate to have as part of the hierarchy a Framework that is inconsistent. (Although the difficulties with the approach chosen may not be readily apparent when considering the first two chapters of the Framework, we think that later on—for example, when dealing with measurement—the problems will become apparent.)

Having a Framework that is not internally consistent could of course also have an impact on the Framework's usefulness in the standard-setting process.

3 We recognise that the IASB has a difficulty: it wishes the changes it is making to the Framework to be relevant for standard-setting and hierarchy purposes as soon as possible, but waiting for the whole Framework to be finalised will mean that the changes will not be 'in place' for many years. There is even a risk, with the substantial changes in board membership over the next few years, that new members will wish to re-debate the material if material changes are not be finalised before those membership changes occur. We sympathise with the IASB, but it does not change our view that the IASB has a choice: either it does not finalise any part of the Framework until all parts are ready to be finalised; or it finalises it on a

piecemeal basis *and in doing so identifies all the implications of the proposed changes being made and amends the current Framework for such implications at the same time*. Unfortunately, although a few consequential amendments are being proposed, it is clear that *all* the implications of the proposed changes have not been identified. We have already mentioned one example of this—the adoption of the entity perspective—but the treatment of the going concern is another example. The fact that it was not dealt with in the ED's drafts of chapters 1 and 2 but will be retained when the existing Framework is amended suggests that the IASB is intending to move it to another part of the Framework; but it is impossible to judge, when responding to this ED, whether that move will have implications for accounting or will result in the satisfactory treatment of a notion that EFRAG believes is still relevant.

The relationship between management information and information provided in the financial statements

4 Paragraph OB8 of the ED explains that, although the management of an entity is interested in financial information about the entity, general purpose financial reports are not prepared with the information needs of management in mind. That is true, because (to summarise) the proposed objective of general purpose financial reports is to provide information that is useful to the reporting entity's capital providers, and the management's primary relationship with the entity is not that of a capital provider.

5 However, we suspect the relationship between management information and general purpose financial reports is much closer than OB8 suggests. In particular, we think that logically information that is relevant for capital providers ought also usually to be relevant to those managing that capital.

6 We are not suggesting that internal reporting should drive the external reporting. We nevertheless think that this link between what is relevant for external users and what is relevant to management is important, and should not be overlooked. For example, when a standard-setter is told by preparers that it is proposing to require an accounting treatment or disclosure that would not provide information relevant to management, we think it important that the standard-setter is able to explain why information that is not relevant to the managers of the entity's capital would be relevant to the capital providers. Of course, sometimes it will be because external reporting has been deliberately moved away from internal reporting—as was, for example, the case for some entities when IFRS started requiring an expense to be recognised for share-based payments— and sometimes it will be because the demands on external reporting are different from those on internal reporting—for example, because of a need for greater comparability between entities. Nevertheless apparent differences need to be capable of being explained if the differences between internal and external reporting are to be kept to a minimum.

7 Because of the importance of this link, we think it should be referred to in the revised Framework~~.~~. For example, a sentence could be added in the discussion of relevance. Another possibility might be to address the subject in the material on faithful representation; can something be a faithful representation if the management does not recognise their business from the information provided?

Performance

8 OB23 explains that "capital providers use information about cash flows to help them understand an entity´s business model...." We note that similar references to the business model are not made when discussing the other primary financial statements. We think that there is a risk that as a result the Framework might give the impression that information provided by other primary financial statements is not useful for an understanding of an entity´s business model. And, even worse, there is a risk that it might be read to imply that it is not important for users to understand the entity's business model. Yet we understand from our discussions with users that understanding the reporting entity's business model is essential, and that users use information from all parts of the financial statements to develop that understanding. We therefore think it is important that the reference to understanding the entity´s business model is expressed in more general terms, referring to all the primary financial statements, and be located more appropriately in the revised Framework (for example, in OB15 or OB 18).

9 We are concerned about some of the words used in the discussion in paragraphs OB18-OB24 about performance. For example:

(a) According to OB18, users are interested in quantitative measures and other information about changes in economic resources and claims that are a result of the entity´s financial performance. However, our understanding is that most users would describe their interest in the entity's financial performance in rather different terms. For example, the UK CRUF (Corporate Reporting Users' Forum) states that "operating flows are generally much more important than spot values".

(b) We note a number of references in the discussion to net amounts. Those references concern us because we think users are generally interested in gross amounts. Similarly, whilst there are numerous references to the change in the entity's economic resources and claims on those resources (a net notion), there seem to be only a few references to the components of performance (a gross notion).

The result is, we think, a discussion that seems to downplay aspects of performance, of performance reporting and indeed of financial reporting in general that we think are of fundamental importance. This is probably just a problem with the wording but, if it is not, we would be very concerned~~..~~.

Appendix 2
EFRAG´s comments on the questions in the Invitation to Comment, and some other comments

Chapter 1 *The objective of financial reporting*

Chapter 1 describes the objective of financial reporting, the primary user group to which financial reporting is directed, the types of decisions made by that group and the financial information useful to that group in making those decisions.

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

1 EFRAG shares the view expressed in the OB5 that the "information provided by general purpose financial reporting focuses on the needs of all capital providers (those with a claim on the entity´s resources), not just the needs of a particular group". However, that sentence is followed immediately by the following sentence: "Financial reports reflect the perspective of the entity rather than the perspective of the equity investors, a particular group of equity investors or any other group of capital providers." This statement is not justified in the main text itself, nor does it obviously flow from anything that is said in that text. The Basis for Conclusions argues simply that the entity perspective is more consistent (than the proprietary perspective) "with the fact that the vast majority of today's business entities engaged in financial reporting have substance distinct from that of their capital providers. As such, the proprietary perspective generally does not reflect a realistic view of financial reporting".

2 We agree that the approach described in the Basis for Conclusions as the proprietary perspective (ie a perspective that does not differentiate between the assets and liabilities of the entity and the assets and liabilities of the proprietor) is not a satisfactory perspective to use when preparing general purpose financial reports. However, the Basis for Conclusions seems to imply that, if one rejects the proprietary perspective, one must adopt an entity perspective; and we do not agree that that is the case because we think there are other possible perspectives. For example, another possible perspective is the parent shareholder perspective.

3 We are also concerned, as we have mentioned already, that the ED is proposing the adoption of the entity perspective even though, as the boards themselves have admitted, they do not know what the implications of this proposal are for the rest of the Framework. There are few undeniable truths in accounting concepts, and in our view the adoption of the entity perspective is not one of them. We believe that, in the absence of an undeniable truth, it is important to understand fully the implications of any potential concept that is being proposed.

4 EFRAG members have had lengthy discussions about the connection, if any, between the users identified as the primary users of general purpose financial reports (capital providers) and the choice of perspective from which to view the reporting entity's activities (entity perspective). Some members believe that, having chosen capital providers as the primary users, it follows that the entity should be viewed from the perspective of the capital providers, which (they argue) is pretty much what the entity perspective does. Other members see the two issues as

unrelated; choosing a primary user group provides an important focus for the Framework and thereby stops it becoming too vague; but is not instrumental in the choice of perspective.

5 EFRAG thinks it is important that the IASB clarifies its position on how to align the entity perspective with the equity investor´s interest in the reporting entity´s ability to generate cash flows. Owners of NCI do not always have access to the reporting entity´s cash flows, but the entity´s perspective implies that also owners of NCI have an interest in these cash flows.

6 For all of the above reasons, EFRAG believes it is essential that there is a comprehensive and in depth debate of this issue before a conclusion is reached on the perspective that the Framework should refer to.

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

7 EFRAG believes there are at least three issues involved here.

(a) There are many different types of users of general purpose financial reporting and their information needs might differ. The first issue is whose information needs should general purpose financial reports seek to meet.

(b) The second issue is whether, by focusing on the information needs of some users, it is possible to meet the information needs of other users that general purpose financial reports are intended to meet.

(c) The third issue is what the implications are of the choice of a primary user group.

Although the focus of the IASB's Question 2 is issue (b), we deal with both issue (a) and issue (b) in the paragraphs below. We have already made reference to issue (c) in paragraph 4 above.

8 In our view the best way to approach these issues is to start by identifying the users of financial statements and their information needs, then, after considering what information general purpose financial reports could reasonably be expected to provide, narrow that down to a list of users' information needs that general purpose financial reports should be designed to meet; and then translate that into an objective for general purpose financial statements.

9 EFRAG is of the opinion that the ED makes certain assertions about users and users' needs.

(a) One example is the implication that the information needs of capital providers are homogenous. In our view that is too simplistic. Rather there is a need for a hierarchy along the following lines: (1) equity capital providers (2) other capital providers and (3) those others who are in the business with the entity and, as a result, may provide finance from-time-to-time. The term ´capital providers´ seems to have been used in a fairly loose way.

(b) A further example of unsupported assertions is the statement that the main focus should be on an entity´s ability to generate future net cash flows.

(c) Furthermore, although the ED states that users need information that helps them make an assessment about future cash flows, it does not go on to explain what sort of information is most useful for that purpose. Such a discussion in this part of the Framework would be valuable input to the measurement debate to follow in a later phase of the Framework project.

10 Paragraphs BC1.17 and 1.18 explain what the ED means by a 'primary user': it suggests that "information that satisfies the needs of the primary users is likely to meet most of the needs of other users". The ED then proposes that present and potential capital providers should be identified as the primary user group for general purpose financial reporting. We agree that it is *probably* the case that information that satisfies the needs of present and potential equity investors, lenders and other capital providers will meet *many* of the needs of other users; but we nevertheless believe this is another example of the assertions mentioned in paragraph 6. In our view, the ED is proposing to place too much of a burden on such an unsupported *a*ssertion.

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

11 EFRAG agrees in principle with the broader objective of general purpose financial reporting included in the ED. We see this objective as a major improvement on the objective set out in the discussion paper.

12 We do still have the concern that, until the term 'financial reporting' is defined, there are types of financial reports that are clearly general purpose that appear to have very different objectives and/or qualitative characteristics. For example, the securities regulators currently require certain financial information to be disclosed immediately. The resulting press releases are presumably financial reports, but the balance between the qualitative characteristics is probably not as described in the ED (because timeliness is essential, rather than just an enhancing characteristic). We recognise (or at least hope) that in Phase E of the Framework project the IASB will define 'financial reporting' in a way that excludes such reports; but it still seems odd to us that we have to assume that that will be the case in order to comment constructively on what is a key proposal in the ED.

13 EFRAG is also of the view that the language the ED uses when discussing stewardship is an improvement compared to the discussion paper. However, we do still have a couple of concerns about how stewardship is described.

(a) The ED describes management´s responsibilities in this respect to include "to the extent possible, protecting the entity's economic resources from unfavourable effects of economic factors such as price changes and technological and social changes" (paragraph OB12). This is not quite the same as paragraph OB6(a)'s explanation that management´s responsibilities in the context of stewardship is "to make efficient and profitable use of the assets entrusted to them".

(b) We also think stewardship is about more than just protecting (and maybe enhancing) the entity's resources. For example, we think it is legitimate for an investor to want to understand the extent to which the investee is aligned to their objectives. Arguably an investor also needs information that enables him/her to review the entity´s performance in light of the risks taken and to assist in making decisions about the future direction of the entity´s business. An investor is also interested in how management performed in the past so that the likely performance and position in the future can be forecasted. That will not always be the same thing as protecting the "economic resources from unfavourable effects of economic factors".

(c) We do not think that stewardship is something that is owed to all capital providers, which seems to be what the ED is proposing (see paragraphs OB6(b) and OB18 for example). In our view, stewardship is about being responsible to equity capital providers only, not to lenders. The management are accountable to the equity capital providers for their stewardship of the investments entrusted to them. The relationship between management and lenders is fundamentally different; it is simply a business relationship.

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

Chapter 2 describes the qualitative characteristics that make financial information useful. The qualitative characteristics are complementary concepts but can be distinguished as fundamental and enhancing based on how they affect the usefulness of information. Providing financial reporting information is also subject to two pervasive constraints—materiality and cost. Are the distinctions—fundamental and enhancing qualitative characteristics and pervasive constraints of financial reporting—helpful in understanding how the qualitative characteristics interact and how they are applied in obtaining useful financial reporting information? If not, why?

Question 1: Do you agree that:

(a) *relevance and faithful representation are fundamental qualitative characteristics? (See paragraphs QC2–QC15 and BC2.3–BC2.24.) If not, why?*

(b) *comparability, verifiability, timeliness and understandability are enhancing qualitative characteristics? (See paragraphs QC17–QC35 and BC2.25–BC2.35.) If not, why?*

(c) *materiality and cost are pervasive constraints? (See QC29–QC32 and BC2.60–2.66.) If not, why? Is the importance of the pervasive constraints relative to the qualitative characteristics appropriately represented in Chapter 2?*

14 BC2.13 notes that the boards have observed that there is a variety of notions of what ´reliability´ means. The boards concluded (BC2.14) that the term itself needed reconsideration. As a result the boards "sought a term that would more clearly convey the intended meaning", and they settled on 'faithful representation'. As a result, the ED is proposing that the existing notion of 'reliability' (which comprises freedom from material error, neutrality, faithful representation, and completeness) should be replaced with 'faithful representation' (which would comprise freedom from material error, neutrality, and completeness).

15 EFRAG agrees that there are problems with how reliability is interpreted currently and that the meaning attributed to the term by the existing Framework is not well-understood.

16 However, EFRAG does not believe that the notion of faithful representation is well-understood either outside of the US, although it is acknowledged that the ED makes attempts to explain the meaning of this notion. In EFRAG's view, nothing is gained by replacing one term that is being misunderstood by another term that is not understood.

17 Because we do not believe the 'faithful representation' notion is sufficiently well understood, we have looked particularly closely at how it is described in the ED. Some of this usage has confused us. For example:

(a) We have become confused as to where the ED is proposing the line should be drawn between relevance and faithful representation. We had thought that picking the aspect of the economic phenomenon to depict was about relevance, and deciding how to depict that aspect was about faithful representation. Assume we have an asset . We had thought we would first ask which attribute of the asset is the most relevant to report and, the objective would be to faithfully represent that attribute. However, that appears not to be how the ED sees the relationship; QC12 says that "relevance refers to the economic phenomena, not to their depiction". This implies that both the choice of aspect and the method of depiction as being about faithful representation, which we think might be wrong. So, in our example, we would have to ask ourselves whether it would make a difference were we to report the asset (relevance) and then ask how to depict the substance of the asset completely, accurately and neutrally (faithful representation)..

(b) Bearing that in mind, it might have been particularly insightful to have used an asset in the example in the second sentence of QC8, because it would have meant explaining whether there is more than one way to faithfully depict the asset quantitatively, and that would have helped in understanding the notion.

(c) Similarly, as the words 'faithful representation' are usually accompanied by the words 'economic phenomena' ("a faithful representation of the economic phenomenon that it purports to represent"), it is important that the ED is clear as to what it means by the term 'economic phenomena'. We do not think it is. For example:

(i) although there is a definition of an economic phenomenon at the beginning of QC2 ("economic resources, claims to those resources and the transactions and other events and circumstances that change them") which we quite like, QC8 talks about "an estimate of the risk transferred" being an economic phenomenon and that appears not to meet the definition in QC2.

(ii) in QC12 the ED states that the relevance criteria will identify "which economic phenomena should be depicted." . "Relevance refers to economic phenomena, not to their depictions..." If economic phenomena are "economic resources, claims on those resources, and the transactions and other events and circumstances that change them" as QC2 suggests, should not all economic phenomena be depicted?

As a result of these sorts of issues, EFRAG members have differing views as to what the ED means when it talks about an economic phenomenon. Some members believe the ED is talking about a relatively narrow thing; others that it could be a very broad thing (perhaps the entity as a whole). This difference was a constant issue in our discussions and became a real problem when we were discussing BC2.41 (see next comment).

(d) Paragraph BC2.41 of the ED states that "for financial reports to present a true and fair view or to present fairly is the same as faithful representation". We do not think that is correct, because we think of faithful representation as a characteristic that is applied at a transaction-level; true and fair is something that is applied to the financial statements as a whole.

(We think of faithful representation in this way because of statements such as the one in QC7 ("financial information that faithfully represents an economic phenomenon depicts the economic substance of the underlying transaction, event or circumstances…") that seem to imply that it is a notion that should be applied at the transaction-level.

True and fair view relates to a wider ´thing´. For example, 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.

We think it follows that either the explanation of the faithful representation notion is incomplete or that the notion is *not* the same as showing a true and fair view.

18 Our concerns about the proposal to replace 'reliability' with 'faithful representation' are however not just about understandability. We also think the terms have different meanings—in our view 'reliability' is a broader notion than 'faithful representation'—and we think the broader notion is preferable. In particular, we think that the notion of reliability incorporates a flavour of the uncertainty (´softness´) involved in a piece of information, particular a measure. We do not think that is true of 'faithful representation'. Although it is difficult to be sure about the generally understood meaning of these notions, EFRAG believes that faithful representation is and should be used in a context and for a specific purpose, whereas reliability is a broader and not so specific notion covering every aspect of a given phenomenon.

19 We have made some further comments about substance over form (an aspect of faithful representation) in our response below to question 2.

Question 2: The boards have identified two fundamental qualitative characteristics—relevance and faithful representation:

(a) *Financial reporting information that has predictive value or confirmatory value is relevant.*

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

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

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

20 Subject to the comments already made in responding to question 1, EFRAG generally agrees with this part of the ED and believes that the characteristics and components are sufficiently defined to be consistently understood. In particular, we agree with the ED's proposal to put ´economic substance´ at the centre of its faithful representation characteristic.

21 EFRAG´s only concern is whether the IASB´s understanding of ´economic substance' is the same as EFRAG´s. For example, EFRAG has the impression that the IASB´s notion of economic substance is focused on components; EFRAG believes that the notion involves taking more of a holistic approach. Similarly, we have noted for example that in several IFRSs there are references to the economic substance of the contractual terms. We suspect that this is similar to the notion in US literature of ´legal substance'. EFRAG understands that this notion in complex cases often is closer to what many would view as legal form than to what we would regard as the economic substance.

Question 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?

22 EFRAG is broadly happy with what is being proposed in the ED in this area.

23 We have one relatively minor comment: we have some doubts as to whether the notion of ´enhancing characteristics´ works in extreme cases. For example, although we agree that the more people that understand a piece of information, the more relevant it is; we think it is also the case that information that is understood by no one is not relevant, because it is not capable of making a difference. Similarly, whilst we agree that the more timely information is, the more relevant it will tend to be; however, information that so lacks timeliness that it is too late to be used is again not capable of making a difference and therefore is not relevant.

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

24 We agree with the treatment in chapter 2 of cost.

25 We agree also that materiality is a *pervasive* notion. It does not strike us as being a *constraint* though, because it is not clear to us how materiality constrains a reporting entity's ability to present information that meets the other qualitative characteristics. We do not however see this as a big issue.

Other comments

26 OB6(a)—The first sentence of this paragraph seems to imply that all holders of partnership interests are equity investors. That is not the case under existing IFRS; some 'holders of partnership interests'—depending on their exact terms and conditions—may meet the definition of liabilities. We recognise that in a Framework what existing standards require is not necessarily relevant, but wonder nevertheless whether it might be better not to make such a categorical statement.

27 OB15—The first sentence states that an entity's resources and the claims on them represent its financial position. We do not think that is correct; an entity's financial position is more multi-faceted than that. For example, in our view it encompasses the entity's risk profile and its capacity to adapt to changes in the environment in

which it operates, as well as information about its resources, claims on those resources, liquidity and solvency.

28 OB18—The phrase 'financial performance' seems to be being used with slightly different meanings in different places in the text. For example, in OB18 the ED talks about some things being the result of the entity's financial performance, but then in OB19 talks about the financial performance providing information, which sounds slightly different (and a bit odd). And in BC1.38 the ED talks about measuring financial performance, which sounds different again.

29 OB18 v OB21—EFRAG has also noted that, whilst OB18 talks about ´financing transactions between the entity and its owners' as not being part of the entity´s financial performance, OB21 talks about ´changes resulting from financing transactions´ not being part of financial performance. Not all financing transactions are transactions between the entity and its owners.

30 OB20—This paragraph makes a reference to "changes in fair value" when discussing financial performance reflected by accrual accounting. EFRAG believes that it might be premature to refer to a specific measurement attribute at this stage of the Framework project and suggests that the word "fair" should be omitted.

31 QC4—We do not like the depreciation example here, because we do not think any expense number when taken in isolation is "helpful in assessing an entity's ability to generate net cash inflows". The numbers need to be taken together, and we think in that context the example is arguable (even with the words "may not").

32 QC13—Why has the word 'pertinent' been used here rather than 'relevant'? What is intended to be the difference between the terms?

33 QC25—This paragraph makes the point that enhancing qualitative characteristics (including understandability) "should be maximised to the extent possible". In other words, amongst other things the understandability of financial reports should be maximised to the extent possible. We are concerned about the increasing complexity of financial reports. We recognise that users can always seek expert assistance but, as paragraph QC24 makes clear, this should be only when the underlying economic phenomena are particularly complex. We think the Framework should therefore give greater emphasis to the need to keep things as simple as possible. We therefore suggest the IASB amends paragraph QC25 as follows:

> Enhancing qualitative characteristics improve the usefulness of financial information and should be maximised to the extent possible. <u>For example, the way in which an economic phenomenon is accounted for and information about that economic phenomenon is disclosed should not add to that phenomenon's complexity. Indeed, subject to the constraints imposed by the other qualitative characteristics, the accounting, presentation and disclosure should be as simple as possible.</u> However, the enhancing qualitative characteristics, either individually or in concert with each other, cannot make information useful for decisions if that information is irrelevant or not faithfully represented.

34 QC26—EFRAG believes that comparability is very important and, as a result, believes that accounting policy changes (and therefore new or amended accounting requirements) should in the vast majority of cases be applied retrospectively. If that is difficult in a particular case, longer lead times are preferable to prospective application. In our view, the IASB allows prospective application too often. Bearing that in mind, we are concerned that the wording in paragraph QC26 could be seen as a conceptual defence of prospective application. In our view there are no

conceptual grounds for prospective application; only pragmatic grounds. We therefore suggest you delete "requires prospective application" from QC26. The words are not needed to make the point that sometimes accounting policies need to be changed to improve accounting.