Stewardship and the objectives of financial statements:

a comment on IASB’s
Preliminary Views
on an improved Conceptual Framework for Financial Reporting:
The Objective of Financial Reporting and
Qualitative Characteristics of Decision-useful Financial Reporting Information

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Summary

This paper examines the question of whether the objective of financial reporting should be based solely on ‘decision-usefulness’ or whether stewardship should be recognised as a separate objective. This question is not new, but has recently come to the fore through the publication by the IASB and FASB of their ‘Preliminary Views’ paper setting out a draft of the first chapters of their proposed improved conceptual framework. The PV paper proposes a decision-useful objective, and argues that information relevant to assessing stewardship will be encompassed in that objective. However, two IASB members have set out an ‘Alternative View’ which argues that stewardship and decision-usefulness are parallel objectives with different emphases, that should therefore be defined as separate objectives.

The present paper argues that, as suggested by the Alternative View, stewardship contributes an important dimension to financial reporting, which should be reflected by specific acknowledgement in the objectives of financial reporting. However, it suggests that stewardship should not be characterised simply as

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1 This paper has been prepared to stimulate debate. The views expressed are not an official position of the ASB, but the author cannot escape responsibility for them.
information to assist an assessment of the competence and integrity of ‘stewards’ (ie management, directors) but as the provision of information that provides a foundation for a constructive dialogue between management and shareholders.

Seen in this way, stewardship provides a direct support for many of the propositions advanced in the PV paper. For example, it highlights the importance of historical information and that information should be complete. It would, however, be easier to make a compelling case for this information if a major role for stewardship were identified in the framework, rather than being placed merely in a supporting role.

But other consequences would also follow. Exclusive focus on a decision-usefulness objective has led to an excessive emphasis on the forecasting of future cash flows, and insufficient emphasis on reliability, which seems to be an essential qualitative characteristic of financial statements. The substitution of ‘verifiability’, as proposed by the PV paper, is not adequate.

There is no conflict between decision-useful and stewardship objectives, since the information required to meet the objective of stewardship is required by decision-usefulness: however, the exclusion of stewardship incurs the risk that those who argue for the inclusion of information required for an assessment of stewardship will be placed at a disadvantage.

They will have to frame their arguments in an indirect and convoluted way, and it is accordingly unlikely that they will always succeed. So accounting standards might permit the exclusion of information, or the presentation of information in a sub-optimal way, whilst superior alternatives could be compellingly supported by appeal to an explicit objective of stewardship.
1 Introduction

The nature of the issue

1.1 The purpose of this paper is to explore an issue that arises in the context of IASB’s recently published 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.’ Should the Framework for financial reporting specify merely a ‘decision-useful’ objective, or should stewardship be identified as a separate objective?

1.2 The PV paper opts for a decision-useful objective, and states it as follows:

*The objective of general purpose external financial reporting 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)

1.3 The objective therefore highlights usefulness in making resource allocation decisions. There is no explicit reference to stewardship. However, this is discussed later, when it is explained:

*The objective of financial reporting...encompasses providing information useful in assessing management’s stewardship.* (OB28)

1.4 It is not clear that this is wholly satisfactory: many believe greater prominence should be given to providing information on stewardship. This is the view reported in the Alternative View on Chapter 1:

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2 The Discussion Paper is referred to in this note as the ‘PV paper’. Specific paragraphs are cited by paragraph number.
Two IASB members disagree with the proposal for subsuming stewardship within a decision-useful objective. They would prefer stewardship to be identified as a separate objective of financial reporting. (AV 1.1)

1.5 This has clearly been a controversial aspect of the proposals: apart from the Alternative View, there is an extended discussion of the paper’s position in the Basis for Conclusions (paragraphs BC1.32-BC1.38). This acknowledges that some—presumably including some FASB or IASB members—would argue that no specific reference to stewardship should be made.

1.6 This question may appear ‘academic’, in the worst sense of that word—abstract and of little consequence. It arises in the context of the conceptual framework, and thus may not lead directly to mandatory accounting requirements. It is also, at the end of the day, a question of emphasis. Those who support a decision-usefulness objective claim that it will encompass information that is useful for an assessment of stewardship. Equally, the dissenting IASB members do not argue that stewardship should be the only objective of financial reporting: their position is that it should take a place alongside decision-usefulness, rather than supplant it.

1.7 But if the debate is about emphasis, it is nonetheless important. Experience shows that, in the course of standard setting, it is all too easy to use the Framework in a selective way: much weight is given to certain principles and wise qualifications and limitations on them are forgotten.

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3 At present management preparing financial statements in accordance with IFRS are required to consider the IASB Framework when dealing with a matter that is not addressed in an international standard or interpretation. The position is different where financial statements are prepared under US generally accepted accounting principles. The IASB and the FASB have not yet considered whether the revised Framework will have to be considered by management. This is explained in the Preface to the PV paper at paragraph P2.
1.8 Discussion of the importance or otherwise of stewardship would be easier if it could be demonstrated that its omission or inclusion in the objectives of financial reporting would necessarily entail different accounting standards. However, the Framework does not (and probably should not) provide axioms from which specific accounting requirements can be deduced with ineluctable logic. The PV document seeks to indicate a direction of travel, and it is mainly this that needs to be considered here, rather than specific destinations. The accounting standards that will result from the new Framework cannot be deduced from its first two chapters. This is true whether or not stewardship is recognised as a fundamental part of the objectives of financial reporting.

1.9 However, the implications of the PV paper as drafted can be discerned. If these are carried through, the final Framework will support financial reporting with a content and substance that differs quite markedly from that to which many users of financial reporting standards are accustomed. Some changes in financial reporting are obviously desirable, but it is possible to question whether the direction suggested by the PV paper is wholly appropriate. The issue is significant enough to warrant careful scrutiny.

Some general points on the Framework

1.10 Although the focus of this paper is on the stewardship issue, some general points on the draft new Framework may be noted as a preliminary.

1.11 The first is that the PV paper focuses on financial reporting rather than financial statements. This wider focus means that its prescriptions apply (at least potentially) to, for example, forecasts and environmental and social information (BC1.5-1.7). An obvious example is narrative reporting, including reports such as an Operating and Financial Review, Business Review or Management Commentary. Financial reporting outside of financial statements is undoubtedly an area of immense importance and IASB is to be applauded for having it firmly in its sights. Nonetheless there are difficulties implicit in the wide focus adopted in the
PV document. Objectives (and, indeed, qualitative characteristics) have to be set at a high enough level to embrace not only financial **statements** (that is, balance sheets, profit and loss accounts and the like) but the whole of financial reporting—the boundaries of which remain undefined. If the objectives are set for a potentially large set of possible reports, it is difficult to judge whether they are appropriate. Perhaps even more worryingly, this approach incurs the risk of blurring the distinction between financial statements and other kinds of financial information. Financial statements should conform to a strictly defined framework: only if this is the case can preparers and users know what is properly included and what excluded. Worries on this point are exacerbated by the admission that the PV paper admits that the extent of ‘financial reporting’ remains undefined (BC1.7).

1.12  The PV document deals only with financial reporting by business entities in the private sector. Thus, it does not consider issues that arise in connection with not-for-profit entities (such as charities) or in the public sector. Amongst the consequences of this is an emphasis on cash flows. It seems plausible to assert in the context of the private business sector that expenditures should be judged according to their potential for future cash flows (although even in this context the relationship of expenditures to cash flows is often extremely indirect). But it is unlikely that a fire station owned by a local government will yield any cash flows to its owner. The same is true for a supply of blankets held by a charity to provide emergency aid.

1.13  The importance attached to future cash flows in the PV paper is illuminated by a circularity in its argument. The generation of cash flows is ‘the primary focus of financial reporting because it helps satisfy the needs of investors and creditors’ (OB13). But the Basis for Conclusions states:
Because present and potential investors and creditors clearly represent users of financial reports who are interested in an entity’s ability to generate net cash inflows, the boards decided to designate them as the primary users of financial reporting information. (BC1.16)

1.14 An emphasis on stewardship, would lead to consideration of real transactions in the reporting period rather than simply prospects for future cash flows, and might have prevented this circularity.

**Structure of this paper**

1.15 The remainder of this paper is organised as follows.

- Section 2 discusses the decision-usefulness objective as set out in the PV paper.
- Section 3 addresses the nature of stewardship, and suggests how its inclusion as a specific objective might affect the remainder of the Framework, and thus the accounting standards that will be set on its basis.
- Arguments against a specific reference to stewardship in the objectives are reviewed in Section 4.

A final section presents some tentative conclusions.

**2 Decision-usefulness**

2.1 The decision-useful objective adopted in the PV paper is set out in paragraph 1.3 above. It is highly significant that the dissenting IASB members do not call into question that decision-usefulness should be among the objectives of financial reporting: their position is that stewardship should be separately identified as an objective.
...stewardship and decision-usefulness for investors are parallel objectives which do not necessarily conflict, but which have different emphases. They should therefore be defined as separate objectives. (AV1.4)

2.2 The case for identifying decision-usefulness as an objective is rightly not questioned in the PV paper. Indeed there are compelling points in its favour. Considerable resources are invested in financial reporting: if it were not useful, these resources would be wasted. And if financial reporting cannot influence decisions, it would seem that it would serve no purpose. Hence the case for a decision-useful objective is almost self-evident. The issue is whether decision-usefulness in and by itself provides a sufficient and appropriate focus for the future development of financial reporting.

2.3 Obviously much depends on the decisions that are expected to be made on the basis of financial statements. Given that the primary users of financial statements include present and potential investors and creditors, the most obvious decision to be made is whether to purchase or sell their investment or continue to hold it (or in the case of creditors to extend credit). If one makes conventional assumptions about markets, the most useful information to make these decisions is the value of the company. If that amount is greater than the current market price, a buy decision is indicated, as the purchaser will be rewarded as the market moves towards true value. Conversely, a sale where true value is less than market value will obviate a loss as the market price declines.

2.4 It is seemingly a short step from the sole use of a decision-useful objective to the conclusion that, at least subject to practical constraints, the role of financial reporting should be to report the value of the firm, or at least of its individual assets and liabilities. And to an investor value is generally about future cash flows. Hence the PV paper notes:
To help achieve its objective, financial reporting should provide information to help present and potential investors and creditors and others to assess the amounts, timing and uncertainty of the entity’s future cash inflows and outflows...That information is essential in assessing an entity’s ability to generate net cash inflows and thus to provide returns to investors and creditors. (OB3)

2.5 The PV paper contains a number of qualifications to the decision-useful objective, presumably to avoid a simplistic characterisation of it of the kind given above.

- The objective is to provide information that is useful in making decisions: this does not imply that decisions will flow mechanically from the information in financial statements. Indeed, users will require access to information beyond that contained in the financial statements (OB14). This is also implicit in the reference in the objective to ‘information that is useful’ rather than, for example, information that provides a basis for a decision.

- References to cash and cash flows may be read as ‘cash, cash equivalents or other resources that can be converted into cash’ (OB5).

- Financial reports are not designed to show the value of the entity (OB20).

- The term ‘resource allocation’ as it is used in the objective includes, but is not limited to, decisions about whether to buy, sell or hold the entity’s securities or whether to lend money to the entity. Other decisions that are included in the phrase are decisions on management appointment and remuneration and voting on policies (OB28). This clarification of the decision-usefulness objective is clearly important for the claim that the decision-useful objective encompasses the provision of information that is useful in assessing stewardship.
2.6 These qualifications are entirely appropriate. But there remains room for doubt as to whether they fully correct the impression that the PV paper adopts a focus on future cash flows and thus might encourage the development of accounting standards focused on that objective to the relative neglect of other considerations.

3 Stewardship

What is stewardship?

3.1 Stewardship is frequently discussed, but less frequently characterised precisely. The current IASB Framework refers to it as follows:

Financial statements also [ie in addition to providing information that is useful in making economic decisions] show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. Those users who wish to assess the stewardship or accountability of management do so in order that they make economic decisions; these decisions may include, for example, whether to hold or sell their investment in the enterprise or whether to reappoint or replace the management. (Paragraph 14)

3.2 So the current Framework, like the PV paper, argues that stewardship accounting is implicit in a decision-relevance objective. However, unlike the PV paper this explanation is included adjacent to the definition of the objectives, and under the main heading ‘The Objective of Financial Statements’. In the new draft of Chapter 1, the discussion of stewardship is placed in the final section, implying a significant decrease in its importance.

3.3 The current Framework seems to imply that the terms ‘stewardship’ and ‘accountability’ are synonymous. There is indeed little to distinguish the two terms: this paper generally uses the term ‘stewardship’ as it has come to occupy the foreground of the debate. Nonetheless, ‘accountability’ has important associations: it refers directly to the fact that, not only does management have the responsibility
to use the assets entrusted to it for the benefit of shareholders, it also has the overarching obligation to provide those shareholders with an account of what it has done with those assets.

3.4 The view of stewardship given in the PV paper is somewhat different. It mentions that management is accountable for the custody and safekeeping of the entity’s assets and their efficient and profitable use, including protecting them from unfavourable economic effects such as inflation and technological changes. It also notes that management is responsible for ensuring compliance with laws, regulations and contractual provisions.

3.5 The dissenting IASB members describe the role of stewardship as follows:

Stewardship is concerned with the accountability of the directors, or management board, of a business entity to its proprietors or owners. This is at the heart of the financial reporting process in many jurisdictions… (AV1.3)

They go on to explain:

For example, stewardship may require more emphasis on related party transactions, and generally on past rather than future transactions or events, than would be required by the primary focus on future cash flows. Thus, stewardship and decision-usefulness for investors are parallel objectives which do not necessarily conflict, but which have different emphases. (AV1.4)

3.6 In the context of business enterprises, the need for accounting is often rationalised in terms of agency theory, on which the literature is voluminous. Here only the most salient points need be mentioned. Where a company is listed, control and ownership are separated. The company is controlled, at least on a day-to-day basis, by its management (the directors, or management board) but owned by its shareholders (or proprietors). This involves obvious benefits for both parties but also risks. These risks may be controlled or reduced by various means: one of the most obvious, and widely used, strategy is for a requirement on management to
provide regular accounts that are available to the shareholders. Financial statements therefore provide a key condition for the existence of a modern company: it is difficult to imagine how companies with widely held and traded shares would be possible if credible accounts were not generally prepared. A stewardship objective emphasises this role of financial reporting.

3.7 Most accounts of agency theory stress the possibility of a divergence of interest between management and shareholders, both of which are assumed to be relentlessly pursuing their economic self-interest (PV paper, BC1.40). Perhaps it is for this reason that the PV paper characterises stewardship as a demand for information on management’s safe custody of the assets, and compliance with laws and regulations (OB27). The stress is on whether management have behaved properly and not for example, unjustly enriched themselves at the company’s expense. The Alternative View seems to go along with this characterisation, at least to some extent: it notes that stewardship information will assist not only in assessing the competence of stewards but also their integrity (AV1.3). It also suggests that financial reporting should provide information relevant to an assessment of whether remuneration is excessive or unjust.

3.8 Characterised in this way, financial statements that are prepared from a stewardship perspective might sound formal, legalistic and of limited real usefulness. However, there is more to the stewardship dimension.

3.9 The separation of control and ownership has pervasive consequences. Even if management can be relied upon to act with unimpeachable competence and integrity, it would still be necessary for regular communication between managers and shareholders to take place. Management have many responsibilities, including, for example, to review and if necessary change the company’s business strategy; another is to consider how the company should be financed. However comprehensively the company’s objectives and strategies are specified at the outset, unforeseen and unforeseeable new challenges and opportunities will arise:
management may devise responses to these, but shareholders have the right to have their say on them.

3.10 It is therefore essential that regular dialogue take place between management and shareholders. In the modern economy, this dialogue takes place in numerous ways and in various media—not only directly with shareholders but also with others who have an interest in business information, such as analysts and business journalists, but whose activity ultimately benefits shareholders (and potential shareholders). Much of the information that a company provides will be in narrative form, and it may be oral, in print or electronic. It may well be, as is often suggested, that the annual financial statements rarely contain much news that is not already known given the frequency and variety of corporate communications. However, financial statements provide a key part of the communication package even if all they do is to provide confirmation of and further detail of information previously released. One might also expect that the information that management is prepared to release will be influenced by the knowledge that it will later be reflected in financial statements. It is worth noting that financial information conveyed outside of the financial statements is generally regarded as more useful if it is prepared on a GAAP basis—that is, using the same principles that are used in financial statements—or at least reconciled to a GAAP basis.

3.11 Regular reporting should not be seen simply as a burden imposed on management for the benefit of shareholders. Without regular reporting, management would have no way of explaining their success or their responses to new challenges. This might have an unwarranted effect on investor sentiment, and thus lead to outcomes that management would prefer to avoid, for example, a hostile takeover bid. Thus, even in the absence of legal or other regulatory requirements for regular reporting, it is to be expected that managements would
often voluntarily release information. Financial reporting benefits both management and shareholders.

3.12 It is therefore insufficient to characterise a stewardship objective as merely providing a check on the integrity, efficiency or capability of management: it is a necessary response to the development of the modern company and a fundamental building block of corporate governance. The benefits of providing reports that assist an assessment of stewardship accrue to management, as well as to shareholders.

3.13 These points might be reflected by adding an explicit objective of financial reporting as follows:

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to enable management to account to investors on the state of the entity's financial affairs and changes in those affairs, to assist in assessing the results achieved under management’s stewardship and the strategies employed and risks undertaken that have led to those results.
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3.14 The role of financial statements in facilitating dialogue between management and shareholders seems to have significant consequences. Valuable features of financial statements flow directly from a stewardship objective, whilst they can be rationalised only indirectly, and with somewhat tortuous logic, from a decision-usefulness objective. Some of these features are reviewed in the following paragraphs.

**The importance of history**

3.15 As noted in paragraph 3.5 above, the dissenting IASB members state:

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stewardship may require more emphasis on...past rather than future transactions and events, than would be required by the primary focus on future cash flows. (AV1.4)
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3.16 The case that financial reporting should include information on past transactions and events can be made, even if the objective of financial reporting is
stated purely in terms of decision-usefulness. The PV paper states, for example: ‘Investors and creditors usually find information about an entity’s past financial performance helpful in predicting the entity’s future returns on its resources, which will be its future financial performance.’

3.17 However, the importance of historical information is self-evident if stewardship is explicitly included in the objectives of financial reporting. Stewardship straightforwardly requires the provision of an account—that is statements that show and explain the assets and liabilities at the start and end of the accounting period, and how they have changed.

3.18 It is particularly important that changes in assets and liabilities are explained. In particular, it is usually essential to distinguish changes that reflect changes in prices from those that represent transactions—exchanges of assets and liabilities. Most businesses acquire goods and services in one market use their skills and abilities to transform them in various ways and then sell them, as transformed, on a different market. In order for the business to survive, it must be able to repeat this activity and do so profitably. For this reason, a natural focus of financial reporting is to report the purchases of goods and services in a year and the amounts derived from sales of products.

3.19 The importance of providing an account of transactions and the result of those transactions provides, for example, a possible justification for the reporting of purchased goodwill, but not so-called ‘internally generated’ goodwill. Because management has spent money on an acquisition, its financial statements need to provide (literally) an account of the effect of that acquisition and to place in context the returns that are earned from that investment. Whilst management are also responsible for earning a return on ‘internally generated’ goodwill this is not usually regarded as equally important and is in any event beyond the bounds of information that financial statements can be expected to capture. The omission of internally generated goodwill is not usually seen as a critical weakness of financial
reporting, but many would consider financial statements seriously deficient if they did not include purchased goodwill.

3.20 The IASB has, in various contexts, debated whether transaction costs should be reflected in the carrying amount of assets. Transaction costs include expenditures that flow directly from the purchase of an asset. The case for writing off transaction costs is that they cannot be recovered from the sale of the asset and thus, on this view, result in the asset being overstated—even if sale is only a remote possibility. But a stewardship perspective suggests that where significant costs have been incurred in acquiring assets whose returns will arise over several accounting periods, it may be appropriate to treat those costs as part of the value of the asset, to provide a more useful basis for assessing those returns. Immediate expensing of transaction costs would, on this view, lead to overstating the returns on assets made in later accounting periods.

**Credibility and completeness**

3.21 If as suggested above (paragraph 3.9), financial statements are to provide a proper foundation for a dialogue between management and its shareholders it is important that they are credible. This requires that they are prepared in accordance with a trusted set of GAAP. A user need not know the specific requirements of GAAP, although his ability to interpret the information they contain will be enhanced if he does. But the prime ingredient of credibility is that the investor is confident that the standards that are used are suitable for his purposes. If GAAP allows too much leeway for discretion, it is difficult to interpret the information that is presented. For this reason, a conventional depiction of economic phenomena may provide better (more useful) information than one that more closely reflects the future prospects of a business.

3.22 One of the more surprising features of the PV paper is that in the draft of Chapter 2—tellingly entitled ‘Qualitative Characteristics of Decision-useful Financial Reporting Information—’ reliability is not listed, although it features as an
essential qualitative characteristic in both IASB’s and FASB’s current frameworks. Instead, the PV paper proposes that reliability should be subsumed within the concept of faithful representation, the requirement that information should represent what it purports to represent. Faithful representation is said to encompass verifiability, neutrality and completeness.

**Verifiability**

3.23 But verifiability is not, as a matter of logic, a component of faithful representation. An eyewitness account of an event may be a faithful representation, even if it cannot be verified. (Of course, if it cannot be verified it may not be very useful, but that is beside the point.) Verifiability also seems to be an inadequate substitute for reliability: it requires merely that different observers will reach consensus, and not that they either base their views on reliable evidence nor that the method used for ‘indirect verification’ should be appropriate, even if it is applied without material error or bias. (See the Alternative view to Chapter 2.)

**Completeness**

3.24 A separate objective of stewardship obviously implies that the financial statements should be complete—that is they should tell, not only the truth, but the whole truth. However, it is not obvious that this necessarily follows from a decision-usefulness objective. If an event has taken place in the period, and it is clear that it will never recur, it cannot be relevant to decisions, since decisions can only be taken with respect to the future. Logic would therefore suggest that if the sole purpose of financial reporting is to provide information that is relevant to decision making, information on that event could be omitted. But stewardship requires a complete account of all the events of the period.

3.25 But if decision-usefulness might arguably imply that information of some kind could be omitted, stewardship does not. Shareholders have the right to expect that the financial statements will set out the full picture. This is particularly
important as the financial statements provide a means of raising questions as well as answering them. For example, it may not be obvious in a given case that changes in the relationship between components of working capital are significant and hence require explanation, but an astute shareholder may note that more explanation of how they have arisen and how they relate to the entity’s business would provide a useful insight. This use of financial statements to raise and answer questions seems to have much in common with the concept of ‘confirmatory value’ discussed in the PV paper. But confirmatory value is a somewhat obscure concept: a higher profile for this kind of information could easily be secured by appeal to stewardship as a distinct objective of financial statements.

3.26 In short, stewardship emphasises the value of reliability. Verifiability, as described in the PV paper is a poor substitute for it, and seems not to be a necessary part of ‘faithful representation’. Stewardship also emphasises the value of completeness and provides a more direct justification for it than does a decision-useful objective.

**Recognition and basis of measurement**

3.27 All future cash flows are relevant to decision-making, but financial statements have never attempted to provide a reflection of all such flows. Instead, financial reporting has insisted that potential assets (and liabilities) are carefully tested to see if they meet stringent definitions and recognition criteria. An exclusive focus on decision-usefulness might cause these criteria to be more relaxed.

3.28 For example, customer relationships are a source of future cash flows and thus candidates for treatment as assets, even where no contractual relationships exist. Many, however, would have qualms about the conclusion that all such relationships should properly be reflected in financial statements—presumably at the current value of the future cash flows to which they are deemed to give rise.
3.29 Even where future cash flows relate to more familiar assets, such as stock (inventory), the decision-useful objective can be used to argue for a basis of measurement that directly reflects them. Market values, where available, could be used on the reasoning that they reflect the amount timing and certainty of all future cash flows: where they are not available, the cash flows could be discounted to arrive at an amount that can be reasoned to reflect a market price. This is the essence of the proposals for fair value accounting.

3.30 There are, however, several considerations that would need to be addressed before all would agree that financial reporting should develop comprehensively in this way. One is the reliability of the methods used. Perhaps more fundamental, however, is the risk that it might obscure the economic model on which the business is based. Businesses do not usually make profits simply by nurturing customer relationships or by manufacturing stock, however valuable. Anticipating future transactions might obscure the portrayal of the underlying business model by mixing the results achieved in one period with the expected effect of transactions that are likely to arise in a later period.

3.31 None of these conclusions are inevitable. As was noted earlier in this paper, the PV paper sets out the role of financial reporting, not just that of financial statements, and it is possible that later stages will provide a clear demarcation between the information that financial statements will provide, and much that is useful to prediction of future cash flows will be dealt with elsewhere. Or it may be that some of the issues addressed above may be solved by developments in the current project on reporting financial performance. Nonetheless the risks would be less worrying if stewardship were acknowledged as a separate objective.

Management perspective

3.32 Financial statements that are designed to provide the basis for discourse between management and shareholders are inevitably the property of management: they provide an opportunity for management to explain the progress of the business
as they see it. In contrast, a decision-useful perspective can sometimes be used to justify reporting market values, even where a current transaction in the asset is not in prospect. A specialised asset can often not be sold for as much as the costs incurred in acquiring it: honest application of the market perspective would require that it be written down to its estimated sale proceeds, which might be little more than a scrap value.

3.33 Nor it is entirely convincing to suggest that this result can be avoided by insisting that, in the event of a sale, other related assets (including intangibles) would be sold to enable the purchaser to extract the same profits as those expected by the current owner. If financial reporting is to proceed on the basis of valuations made at that level of aggregation, it would seem to be necessary to report the total value of the business, or at least business units rather than the amounts of the individual assets. Much information on the nature and scale of the resources and obligations held by the entity would be lost, and no insight would be provided of how these are employed in furthering the entity’s objectives.

4 Arguments against an explicit stewardship objective

4.1 It has been said above that identifying stewardship explicitly as a separate objective of financial reporting is a controversial issue: strong views are held on either side. Yet it also appears that modifying the PV paper to explicitly include stewardship would, in several instances, provide a clearer justification for the kind of financial statements and financial reporting that is advocated in the PV paper. The reasons that might influence some to oppose the elevation of stewardship or even (as noted in BC1.35) to argue that it should be eliminated altogether, are viewed in this section. None of them appear compelling.

Historical cost

4.2 It is sometimes claimed, especially by those that consider stewardship should be the sole or primary objective of financial statements, that it requires that
financial statements should be prepared on the basis of historical cost. This might be supported by some of the considerations discussed in section 3 above: the need for financial statements to provide a clear, factual account of the transactions that took place in an accounting period, and the need for the accounting principles used to be unambiguous and robust.

4.3 But it does not appear that anyone disputes the general need for financial statements to contain a clear account of transactions. Emphasising this clearly does not necessarily entail that they should not also contain information on price changes, and often the most informative way of achieving this is to depart from a historical cost basis.

4.4 The objectivity of historical cost is much debated: some consider it highly objective, others point out that it often requires arbitrary allocations. It is not necessary to discuss this point at length here. On the other hand the relevance of historical cost seems, at least in some cases, very low. If the entity owns assets the value of which has increased in an earlier accounting period, a proper account of stewardship cannot be given by reporting the result of their sale simply as the difference between the proceeds received and their historical cost. In such a case, proper discharge of the stewardship responsibility requires that the price increase is reflected in the financial statements for the period in which it occurs, and the sale is reported, measured against current prices, in the period the sale is made.

4.5 Thus advocating stewardship does not entail adherence to historical cost: better information on stewardship may sometimes be produced by using more current values than historical cost.

A single objective?

4.6 The purpose of the conceptual framework is to provide a clear and coherent basis for financial reporting, and the objective is its foundation. It therefore seems
to be important that the objective be clearly and precisely specified. At first sight, having two or more separate objectives might appear to conflict with this.

4.7 A multiplicity of objectives might certainly be worrying, but only if they contradict each other. But stewardship and decision-usefulness do not conflict: rather they emphasise different aspects of what financial reporting can be expected to achieve. They are complementary rather than contradictory. Those who argue that adding a separate stewardship objective would ‘add nothing substantive’ (BC1.35) would presumably agree with this.

4.8 However, the omission of stewardship has the potential of placing those who argue that information for stewardship purposes at a disadvantage: rather than appeal directly to the objectives as set out in the framework, the reasons why stewardship information is essential and encompassed in the decision-useful objective has to be restated and agreed every time.

**Separation of entity/management performance**

4.9 The principal argument stated in the PV paper for the position it takes is that ‘adding a separate objective for stewardship might imply that financial reporting should attempt to separate the effects of management’s performance from the effects of events and circumstances that are beyond the control of management’ (BC1.37). It goes on, rightly, to say that this is not feasible in financial reporting. This is answered by the dissenting IASB members by explaining that this is not a necessary implication of their view: they note that ‘the stewardship responsibility of the management extends to all of the activities of the entity’ (AV1.5), and hence such a separation is not required. They also go to note, rightly, that financial

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4 The ASB’s *Statement of Principles for Financial Reporting* states: ‘The objective of financial statements is to provide information about the reporting entity’s financial performance and financial position that is useful to a wide range of users for assessing the stewardship of the entity’s management and for making economic decisions’.
reporting cannot be expected to provide all the information that is required for the purposes of stewardship, just as it cannot provide all the information necessary for the prediction of future cash flows, as required by the decision-useful objective.

4.10 Similarly, the PV paper suggests that those who would argue for a role for stewardship ‘may be mixing financial reporting and corporate governance issues’ (BC1.38). Financial reporting cannot give all the information that is needed for an assessment of corporate governance: again, this overlooks the point that financial reporting cannot give all the information necessary for any purpose.

Types of theories of accounting

4.11 Many of those who advocate a stewardship objective do so on the basis of observation of how financial reporting has evolved, and the role it has played historically. Some of these are chiefly concerned to explain the behaviour of accountants and those who use their products, rather than to construct prescriptive theories of what financial reporting should aspire to do. The relevance of current (and past) practice for the framework is not self-evident. It is obviously not intended simply to provide a rationalisation for existing practices—if it were to adopt such an approach it could hardly provide a useful tool for the improvement of financial reporting.

4.12 But evidence from the practical use and evolution of financial reporting should not, perhaps, be simply discarded. Most preparers and users of financial statements do so for a purpose (and not merely to comply with regulation, important though the role of regulation is). It is possible that the shareholders who demand regular credible financial reports and the management who agree to provide them are acting irrationally, but it is not plausible.

5 Conclusions

5.1 As promised at the outset of this paper, the relationship of stewardship to the objectives of financial reporting and, especially that of financial statements, may
only have an indirect bearing on the future of financial reporting. The omission of a specific reference in the objective specified in the PV paper may perhaps, in part, be due to ambiguity as to its meaning and purpose. It is suggested that it should not merely be seen as information to assist an assessment of the competence and integrity of ‘stewards’ (ie management, directors) but as the provision of information that provides a foundation for a constructive dialogue between management and shareholders.

5.2 If, as advocated by the dissenting IASB members, stewardship were to be identified as a separate objective of financial reporting it would change the emphasis of the Framework. In particular, as they note, cash flows would receive less emphasis, and more emphasis would be placed on reliable historical information. Although this would not change many aspects of the Framework, it would change some. These changes would make it a more useful tool for the improvement of financial reporting.

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