Date

3 October 2008

Le Président

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Européens
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Dear Mr. Enevoldsen,

Re: EFRAG Draft Comment Letter on 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

1. FEE (Fédération des Experts Comptables Européens - Federation of European Accountants) is pleased to submit its comments on the EFRAG Draft Comment Letter on the 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 (the "ED").

2. The Framework is fundamental to the future development of IFRS and, therefore for financial reporting harmonisation in Europe and at global level. We welcome the continued efforts to converge both the IASB Framework and the FASB Framework as well as the introduction of improvements to both frameworks to come to a truly global framework.

3. We acknowledge that the version of chapters 1 and 2 that are in the ED includes improvements compared to the earlier discussion paper. We appreciate that the exposure draft is shorter and more succinct than the discussion paper. We hope that the remaining chapters and the Framework as a whole will be respecting the principles-based nature of the statement on the Framework. In addition, we welcome the supporting explanation of the objective of financial reporting, which in our opinion allows for both the stewardship and cash-flow-prospects purposes of financial reporting information. We have some concerns, though, that the stewardship objective is not fully reflected throughout the exposure draft. We would also stress the need to bear in mind the importance of the stewardship objective in drafting the rest of the Framework.

Comprehensive Framework

4. We agree with EFRAG that it would be appropriate to avoid finalising any parts of the Framework until the whole Framework is finalised. The future Framework will have an impact on future standards because it provides structure and direction to the development of standards. For it to be useful, the future standards have to be based on the same concepts as the revised Framework to be consistent as a whole.

5. In addition, we think that the matter raised by EFRAG regarding the resulting incoherence between the old and new Framework should be a particular point of consideration for the IASB.

6. Careful consideration should be given to ensuring that when parts of the Framework are finalised that all the implications of the changes being made are identified and reflected in the consequential amendments. Also, as progress is made during the various phases of the Framework project, it may be useful for the IASB to clarify at an earlier stage what may be the implications on the remaining phases. Once all parts of the project have been dealt with, we suggest that the complete proposed Framework be exposed again for comment to reconsider decisions taken in the different phases. The IASB should consider to accelerate the remaining phases in order to allow for sufficient time to expose the entire revised Framework for public comment. We agree with EFRAG's comments but suggest that EFRAG should also call for re-exposure once the entire Framework is finalised.

7. We agree that to consistently achieve useful financial reporting, the body of standards taken as a whole and the application of those standards should be based on a Framework that is sound, comprehensive and internally consistent. Therefore, we believe that the Framework should have the formal status of overriding principles upon which all standards are based and be referred to when an individual standard does not cover a particular issue. We suggest that EFRAG should discuss the authoritative status of the Framework in its letter.

8. The message EFRAG provides in paragraph 1 of the covering letter is very clear and fully supported by FEE. However, we are of the opinion that paragraph 3 in Appendix 1 of the EFRAG letter gives a confusing message and is not in line with the title "no section of the Framework should be finalised unless the implications of the proposed changes have been properly identified". Clarification of the EFRAG position in paragraph 3 would be helpful.

Link between internal reporting and external reporting

9. We agree with the position set out by EFRAG in Appendix 1 on the relationship between management information and information provided in the financial statements. Management needs to provide a clear picture of its strategy and business model used to its capital providers. Capital providers may benefit in some cases from additional information based on alternative business models, strategies or policies. We believe that information needs to be disclosed if it meets both the needs of management and the needs of capital providers. In case information is not assessed to be important for management but is assessed to be important for capital providers, in the standard setting process, it needs to be explained why this is the case. EFRAG could clarify paragraph 6 of Appendix 1 in this respect. We are of the opinion that, in this respect, the first sentence of paragraph 6 of Appendix 1 is confusing and should therefore be omitted.

10. As set out above, we agree with the introduction of a sort of "comply and explain" approach, in that a standard setter should both be able to explain why information, though not relevant to the management, would be relevant to the capital providers and why that information would be relevant to the capital providers.

11. We agree with EFRAG that it would be important for the Framework to include a link between internal reporting and external reporting. This is also a key aspect of proper governance. Hence, we would be supportive of the use of one language/set of numbers to communicate internally and externally. We agree with EFRAG that the issue of how to incorporate this relation between external and internal information in the Framework should be analysed further.

Appendix: Comments to Appendix 2 of the Draft EFRAG letter and further observations on the questions raised in the invitation to comment

Performance

12. We agree with EFRAG that it can be important to disclose also information regarding the gross inflows and outflows rather than only focusing on net balance sheet movements when evaluating an entity's performance but we do not believe that it can be generally stated. We would welcome some clarification of the wording in the EFRAG letter in this respect. Performance information is broader than cash flows derived from cash flow statements only. There are situations where gross information provides a misleading picture, such as in trading activities and VAT presentation. Moreover, a generic support for gross cash flows implies a clear choice for the direct method in cash flow statements, regardless of the cost aspects involved. We are therefore not convinced that EFRAG should be so generic in its support for gross flows. We do agree that performance cannot be measured by one number. This is however not a question of gross of net inflows and outflows, but concerns the way how to measure performance.

13. We are not sure to fully understand the comments made by EFRAG regarding the users' interests in gross flows, as included in paragraph 4 of its covering letter. In particular, EFRAG needs to clarify what is meant by "gross flows" since there can be many connotations of flows and gross flows. We recommend that EFRAG clarifies this point further. In particular, it would be useful to know what form of disclosure is recommended or where in the financial statements this information should be disclosed. We appreciate that paragraph 8 of Appendix 1 of the EFRAG letter provides more details and clarifies what is meant by "gross flows".

14. We agree with EFRAG's comments set out in paragraph 9 of Appendix 1 of its letter for the need to express the reference to understanding the entity's business model in more general terms, referring to all the primary financial statements.

15. Our comments on the responses to the questions in the Invitation to comment Section of the ED are contained in the Appendix to this letter.

We would be pleased to discuss any aspect of this letter that you may wish to raise with us.

Yours sincerely,

Jacques Potdevin
President

Ref: FRP/JP/SS-SR

Appendix: Comments to Appendix 2 of the Draft EFRAG letter and further observations on the questions raised in the invitation to comment

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?

16. The ED expresses the view that financial reporting should reflect the entity perspective rather than the perspective of the owners of the entity. We note that the recent IASB standard setting has taken the entity perspective. We also note that the IASB in its Discussion Paper "Preliminary Views on an Improved Conceptual Framework for Financial Reporting: The Reporting Entity" requests comments on the entity approach. We strongly support EFRAG in that a full debate is needed on the perspective from which financial statements should be prepared, before a conclusion can be reached at this stage of the Framework project.

17. We are like EFRAG not supportive of the proprietary approach. However, although we see more merits in the entity approach since this is a principles-based model, we believe that the practical consequences of such a model need further thought in particular on issues like the dividing line between equity and debt and the treatment of goodwill under IFRS 3. Also the practicalities of such a model need further consideration. We therefore agree with the EFRAG reasoning as set out in paragraphs 1 to 6 of Appendix 2 of its letter.

18. In some standards, however, the parent company approach provides useful information to stakeholders/users of financial information (such as earnings per share). We are not convinced by the argument of the Board that because financial reports are prepared for a wide range of users, an entity perspective should be adopted. We encourage a more thorough debate on this issue. For example, the superiority of the reporting entity approach over the parent company approach is not fully discussed in the ED. Moreover, the ED does not present the consequences of implementing one approach or another. We think that a more detailed discussion would enable a clearer view of the implications for the rest of the Framework.

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?

19. We understand that capital providers have specific needs (as detailed in OB 8 of the ED). Capital providers are defined in the ED as present and potential equity investors, lenders and other creditors. However, in practice, the term capital provider is generally understood as providers of equity capital. Using a terminology that is not in line with current understanding could confuse the readers of the ED and give the perception that the primary user group has been defined more narrowly than intended. Therefore, it might be better to use a different name to describe the primary user group.

20. Like EFRAG, we question the wider definition of capital provider. We are of the opinion that the wider definition contradicts the stewardship angle since stewardship focuses on accountability to shareholders. The primary user group needs to be sufficiently narrowly defined to be able to decide what should be included in a standard, f.i. should information be more performance oriented or liquidity oriented. Different user groups have difference information needs to take meaningful decisions. We share EFRAG's view that more debate is needed on the issue.

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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.

21. We support EFRAG's observations in relation to stewardship as in particular set out in paragraph 13 of Appendix 2 of its letter. We also refer to our response to Question 2.

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?*

22. We agree with EFRAG that nothing is gained by replacing one term that is being misunderstood by another term that is not understood. We believe that, when reading the ED and notably the Basis for Conclusions, in substance the term "faithful representation" has the same meaning as "reliability" in the existing Framework. Reliability is a term that has been used for many years. Faithful representation has only a specific meaning and understanding within a US context. We are therefore not convinced either that there is a problem over the meaning of reliability that needs to be fixed or that faithful representation is a concept that will be better understood. The Basis for Conclusions does not satisfactorily justify why a well established concept is to be replaced. Also the implication of the change in terminology for the auditability of financial information should be considered.

23. In addition, it is not clear, though, how faithful representation will work when the qualitative characteristics are applied in developing the remainder of the framework – on measurement, for example. We would be concerned if faithful representation were interpreted so as to suggest that, in general, fair value only provides a faithful representation of all assets and liabilities, whereas cost-based measures do not. If such a conclusion emerged, it might cast doubt on – among other things – whether faithful representation had been correctly described.

24. We agree with EFRAG's observations in paragraph 17 of Appendix 2 of its letter on the description of faithful representation in the ED. However, we have difficulties to understand paragraph 18 of Appendix 2 of the EFRAG letter and note some inconsistencies within the paragraph.

25. The ED describes verifiability as implying that different observers could reach general consensus that *"an appropriate recognition on measurement method has been applied without material error or bias"*. The concept of verifiability could also impact the selection of the recognition or measurement method. This is not well addressed in paragraph QC21 in the description of indirect verification.

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?*

26. We are concerned about the continuing lack of emphasis on the notion "substance over form". More emphasis on this notion at the Framework level would enable a better application of the reporting requirements at standards level. Substance over form has been one of the most frequently used accounting expressions for years and represents a fundamental, easily understandable principle. Where legal form plays an important role in determining the conditions of a transaction, the concept has been very useful in accounting decisions, especially in Europe.

27. We believe it is unhelpful to omit this concept on the basis that it is implicit within the characteristics of faithful representation. Omission of this notion could cause confusion in the mind of preparers, auditors and users. For example, in our responses to the IASB Discussion Paper on Reducing Complexity in Reporting Financial Instruments, we specifically commented on the need to make the current application of the standard less complex and better adapted to the economic substance of transactions, and we also express our views on the significance of the business model as a key consideration for deciding what measurement attributes to apply for all different types of financial instruments. We do not see how the Framework proposals of the ED can help to address the existing difficulties in IFRS, for example IAS 39.

28. We question the usefulness of paragraph 21 of Appendix 2 of the EFRAG letter. We cannot see from the ED or Basis for Conclusions that the IASB uses a component approach. We agree with EFRAG that substance over form is to apply on a holistic basis.

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?

29. We agree with EFRAG in that we are broadly happy with the IASB proposals. However, we believe that the concept of understandability needs further reflection. It could be argued that understandability should also be a fundamental qualitative characteristic instead of being an enhancing qualitative characteristic.

30. BC2.34 addresses the issue of complexity and unnecessary long disclosures and concludes that information needs to be clear and concise. We would appreciate if similar wording could be included in the body of the text, for example in QC24, to make clear that more information does not always mean better information. It is the quality of information that counts.

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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?

31. We agree with EFRAG's observations on cost and materiality, in particular that materiality by nature is not a constraint. In addition, we would wish to observe that costs in our opinion also include an element of timeliness.

Other comments

32. We agree with the other comments as set out in paragraph 26 to 32 of the EFRAG letter in Appendix 2. These comments constitute however no significant issues for us. We are however less convinced about the comments raised in paragraphs 27, 29 and 31 and would suggest that comments in paragraph 27 could be clarified or enhanced and suggest that paragraphs 29 and 31 were to be deleted.