Australian Government

Australian Accounting
Standards Board

Level 7, 600 Bourke Street
MELBOURNE VIC 3000
Postal Address
PO Box 204
Collins Street West VIC 8007
Telephone: (03) 9617 7600
Facsimile: (03)9617 7608

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Ms Li Li Lian
Assistant Project Manager
International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
UNITED KINGDOM

Dear Ms Lian

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

The Australian Accounting Standards Board (AASB) is pleased to provide comments on the abovenamed Discussion Paper. In forming its views, the AASB held two Roundtables with constituents and considered comments it received in response to its Invitation to Comment on the Discussion Paper.

The AASB gives qualified support to the proposed concepts for private sector businesses and considers that the draft Chapters of the revised *Framework* generally achieve an appropriate balance of conciseness and informativeness. Its comments on its substantial concerns and on other specific aspects of those proposed concepts are in the attached submission.

A general observation of the AASB is that the proposed objective of financial reporting is not significantly different from the objective in the existing IASB *Framework*, although that *Framework* was developed almost twenty years ago and is consistent with the FASB Concepts Statements developed before then. The Discussion Paper does not indicate that the Boards considered how the significant changes in the technological environment (such as the development of XBRL) and business reporting environment (such as continuous disclosure in some jurisdictions and the accountability requirements of the Sarbanes-Oxley Act in the United States) since then may have affected the place of financial reports in the range of communications between an entity and its stakeholders, how potential users of financial reports obtain the information they need, and whether those changes have affected the profile of the users of financial reports and the types of information they require. In this regard, the AASB noted the comment in paragraph BC1.18 of the Basis for Conclusions on

Chapter 1 that some of the Boards' constituents think advances in technology may make general purpose financial reporting obsolete. The AASB considers that a fundamental review of these matters should be performed, but without delaying the progress of the other phases of the project. This fundamental review could be performed simultaneously with work on the other phases.

Primary proposals for amendment

The AASB's primary proposals for amending the proposed concepts in draft Chapters 1 and 2 of the revised *Framework* are:

(a) An additional objective of financial reporting should be included, namely, providing information useful for assessing the accountability of management.

(b) Providing information relevant for assessing the entity's future cash flows should not be treated as being synonymous with the objectives of financial reporting.

(c) The first limb of the objectives of financial reporting should refer to "making *and evaluating* … resource allocation decisions" (additional words are in italics).

(d) The concepts of relevance and materiality should be distinguished more clearly.

(e) The ability of information to be verified independently should not be an essential characteristic of faithful representation. Instead, the *Framework* should say that, for information to provide a faithful representation of economic phenomena, it must be supportable or consistent with all known facts.

Boundaries of financial reporting

The AASB's comments on the proposed objective of financial reporting are qualified because the objective depends, in part, on the boundaries or "scope" of financial reporting (which will be addressed in Phase E of the Conceptual Framework project). Decisions about the scope of financial reporting have important implications for the composition of the range of users of financial reports, which, in turn, affect the objective of those reports.

An example of this point is signalled in paragraph BC1.38 of the Basis for Conclusions on Chapter 1, which says "… assessing corporate governance may require information beyond that appropriately provided by financial reporting." In addition, consideration of the proposed objective depends on whether environmental or social information should be provided in financial reports, a "scope" issue deferred until later in the project (see paragraphs 6 and 7 of the attached Specific Comments).

Implications for not-for-profit entities

The Appendix to the submission provides the AASB's comments on potential implications of the proposed concepts for not-for-profit entities. These comments are principally provided for Phase G of the Framework project. In addition, the AASB considers it would be useful for the IASB and FASB to be aware of these implications, especially to identify opportunities to use concepts and terminology that are sufficiently broad to apply to private sector businesses and other types of entities. It is noted that the existing FASB Concepts Statements deal with the objectives of financial reporting for the not-for-profit sector in a separate Statement (Concepts Statement No. 4 *Objectives of Financial Reporting by Nonbusiness Organizations*) whereas the existing IASB *Framework* does not deal with this sector. It would be useful to know how the sector is intended to be dealt with in the revised *Framework*.

Framework purpose and status in the GAAP hierarchy

The AASB notes that the purpose of the conceptual framework and its status in the GAAP hierarchy is to be considered by the IASB and FASB in Phase F of the project. The AASB encourages the Boards to consider these issues earlier in the project, because the purpose and status of the *Framework* provide context for all of the proposed concepts being developed. Without these aspects being clarified early in the project, there is a risk that commentators might not give priority to commenting on the Boards' discussion documents.

Suggestion for using more neutral expression

The AASB is responsible for developing a conceptual framework applicable to all Australian reporting entities, regardless of the sector in which those entities operate. Its approach has been to add to the IASB *Framework* text for entities not addressed by that *Framework*, but only to the extent necessary. It would assist the AASB and other national standard setters adopting the IASB *Framework* if the expression used in the revised IASB *Framework* were as sector-neutral as possible. For example, it would be helpful if the revised *Framework* were to refer to investors and creditors as "primary users" after the first time they are mentioned. This would avoid the need for national standard setters to make numerous amendments to the expression "investors and creditors".

If you have queries regarding any matters in this submission, please contact Jim Paul (jpaul@aasb.com.au) or myself.

Yours sincerely

David Boymal

David Boymal
Chairman

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

Specific Comments in Relation to Private Sector Businesses

Main Issues

The Proposed Objective of Financial Reporting

Accountability

1. The AASB disagrees with the proposal not to specifically identify the provision of information useful for assessing the stewardship or accountability[1] of the entity's management as part of the objective of general purpose financial reporting. This is because it disagrees with the statements in the Basis for Conclusions on Chapter 1 that:

> "information … that is needed for making resource allocation decisions is the *same* information needed for assessing management's stewardship and accountability" (paragraph BC1.35, emphasis added);

and

> "assessing corporate governance may require information beyond that appropriately provided by financial reporting" (paragraph BC1.38).

2. The Discussion Paper states:

> "To help achieve its objective, financial reporting should provide information to help (users) to assess the amounts, timing and uncertainty of the entity's future cash inflows and outflows …" (Chapter 1, paragraph OB3).

3. The AASB observes that paragraphs OB5, OB12, OB13, BC1.16 and QC8,[2] together with an absence of discussion of other information relevant to resource allocation decisions, imply this purpose is synonymous with the proposed objective of financial reporting (namely, to provide information that is useful to present and potential investors and creditors and others in making investment, credit, and similar resource allocation decisions). The AASB disagrees with treating the provision of information relevant to

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1 The AASB considers that accountability is a less ambiguous term than stewardship, which is sometimes equated with custodianship. Therefore, this submission refers only to accountability. Accountability has the same meaning as a broad interpretation of stewardship, namely, efficient and effective use of the entity's resources to achieve specified objectives.

2 This paragraph says information is relevant if it helps users to evaluate the potential effects of transactions or other events on future cash flows or to confirm or correct their previous evaluations (implicitly, of the same subject matter).

assessing the entity's future cash flows as being synonymous with the objective of financial reporting, because such information would not necessarily be sufficient for making resource allocation decisions and assessing the accountability of management.

4. For example, capital restructurings may not necessarily affect an entity's future cash flows, but will affect the future yields on particular classes of equity, and therefore information about them would be relevant to resource allocation decisions. In addition, if an entity made a substantial grant of fully-vested share options to employees during the period, as part of a bonus arrangement, that information might not be particularly useful for assessing the entity's future cash flows, but would warrant disclosure in discharging management's accountability. Furthermore, some related party cash transactions (such as management's cash compensation) may be immaterial for assessing the entity's future cash flows, but nonetheless would warrant disclosure in discharging management's accountability.

5. The AASB considers that the Discussion Paper's explanation of the objective of financial reporting as providing information useful for assessing the entity's future cash flows, and its statement that assessing corporate governance may require information beyond that appropriately provided by financial reporting, seem to conflict with the statement in Chapter 1 that:

> "Decisions about whether to replace or reappoint management, how to compensate management, and how to vote on shareholder proposals about management's policies and other matters are also potential considerations in making resource allocation decisions in the broad sense in which that term is used in the framework." (paragraph OB28)

This quoted text implies a broader objective of financial reporting that encompasses all corporate governance aspects relevant to users of general purpose financial reports. However, those words are located at the end of Chapter 1, and therefore seem to be given less weight by the Boards than the points mentioned at the start of this paragraph.

6. The AASB also considers that non-financial information (such as key performance indicators and information provided by triple bottom-line reporting) is relevant for making resource allocation decisions. Although non-financial information is not currently the subject of accounting standards, the conceptual framework should not be limited to the type of information currently included in financial reports. Put another way, the *Framework* should drive the standards, rather than the Standards drive the *Framework*.

7. In relation to the provision of non-financial information, the AASB notes that paragraph BC1.7 states the Boards deferred to the "scope" phase of the project consideration of whether financial reporting should include environmental or social information. The resolution of that issue is important to the AASB in determining its views on the proposed objective. This illustrates the point in the covering letter that the AASB can only provide qualified comments about the proposed objective of financial reporting until

preliminary views on the "scope" phase of the project are developed. The AASB considers that the Boards should address scope issues before determining the objective(s) of financial reporting.

8. In relation to the comment in paragraph BC1.38 that "assessing corporate governance may require information beyond that appropriately provided by financial reporting", the AASB is of the view that it would be inappropriate to exclude information for assessing governance simply because that information might be incomplete. As paragraph OB11 says, the information needs of potential users that are able to prescribe the information they need from an entity are beyond the scope of the *Framework*. Accordingly, information about entity governance that is useful only to regulators would not be encompassed by the information that should be provided in general purpose financial reports for assessing the accountability of management.

9. For these reasons, the AASB recommends that Chapter 1 should specify the following objectives of financial reporting:

   (a) providing information useful for making resource allocation decisions; and

   (b) providing information useful for assessing the accountability of management.

10. These proposed objectives are expressed in general terms. They are modified in respect of the issue discussed in paragraphs 13 and 14 (and would be modified further if those objectives were to be applied to not-for-profit entities—see the discussion in the Appendix to this submission).

11. The AASB observes that much of the information needed for making resource allocation decisions is also needed for assessing management's accountability. Therefore, specifying dual objectives of financial reporting should not expand greatly the information the Boards would need to consider when developing proposed accounting standards on the basis of the revised (and converged) *Framework*.

12. The AASB considers that the Boards' concern, expressed in paragraph BC1.37 of the Basis for Conclusions on Chapter 1, 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" could be addressed by explaining in the *Framework* that this is not the purpose of identifying stewardship (or accountability) as an objective.

Evaluating resource allocation decisions

13. The definition of *relevance* in paragraph QC8 includes confirmatory value (that is, being capable of making a difference in the decisions of users by helping them to confirm or correct their previous evaluations). The AASB is of the view that, to integrate with the reference to confirmatory value in the definition of *relevance*, it is essential that reference be made to "making *and evaluating* ... resource allocation decisions" in the objective(s)

of financial reporting. Referring to evaluating resource allocation decisions is particularly important because many users of financial reports rely on information from other sources (typically, information that becomes available before financial reports are issued) to make resource allocation decisions, and use financial reports to confirm their previous assessments and provide input to future assessments.

14. Another reason for referring to *evaluating* resource allocation decisions is to acknowledge that part of the objective of financial reporting is to help users to evaluate the resource allocation decisions of managements.

The Proposed Qualitative Characteristics of Decision-Useful Financial Reporting Information

Faithful representation

15. The AASB agrees with replacing the qualitative characteristic of "reliability" with "faithful representation", and with adding the explanation that faithful representation relates to *real-world economic phenomena* it purports to represent. For example, faithful representation is meaningless in relation to a deferred debit because a deferred debit is merely the product of an accounting convention.

16. However, the AASB does not support using *real-world* as an adjective for *economic phenomena* because those words are redundant. Economic phenomena are inherently real-world in nature.

17. The AASB also agrees that the notions of prudence (with its proper meaning, which is incompatible with conservatism) and substance over form are subsumed within faithful representation, and therefore do not need to be separately identified as sub-characteristics.

Other Issues

The Proposed Objective of Financial Reporting

Information for assessing the entity's future cash flows

<u>Cash flow forecasts</u>

18. Paragraph BC1.6 says "The Boards decided to defer consideration of issues such as whether to include cash flow forecasts in financial reports to a later phase of the conceptual framework project." This is problematic, because Chapter 1 discusses the relevance of accrual information for assessing future cash flows without discussing whether it would simply be more useful to provide cash flow forecasts in financial reports. The implication of the above-quoted sentence is that accrual information is sufficiently relevant to be retained, and that the only question in this regard is whether to also provide cash flow forecasts. It would be useful for the Basis for Conclusions to

discuss the findings of accounting literature on the usefulness of historical information about cash flows and other changes in resources for assessing an entity's future cash flows, to provide adequate support for the assertions in paragraph QC10 about the relevance of past transactions to future cash flow assessments. Such discussion should address concerns that some historical information may not be relevant for assessing future cash flows because some past events do not recur.

19. Similarly, paragraph OB24 implies that cash flow information is superior to accrual information. It would be useful to note in this paragraph the limitations of cash flow information, such as the ability to manipulate cash flows.

Extent of information provided to help users to assess the entity's future cash flows

20. An important issue not explicitly discussed in the draft *Framework* is whether information provided for assessing the entity's future cash flows should enable users to second-guess all of the measures included in financial reports. The AASB observes that some disclosures required by accounting standards appear to have that purpose, and would disagree with financial reporting having such an objective. It is of the view that disclosures about amounts recognised in financial statements should assist users to understand the nature of the items and how they are measured, but not to reperform the calculations. To enable the latter would require disclosures of individual cash flows and their expected timing, in relation to each recognised item, which would clutter financial reports to an unacceptable degree.

21. The Board notes that paragraph QC41 says, in relation to understandability, that "conciseness is essential because to overwhelm users with unnecessarily lengthy narratives or unnecessary information can rob even relevant and representationally faithful information of its decision usefulness". However, the last sentence of paragraph OB26 is open-ended about the extent of the information that should be provided. The AASB recommends that the *Framework* clarify the Boards' position on this issue. It also observes that developing a coherent and complete principles-based *Framework* should facilitate simplification of financial reporting (particularly disclosure), because recognition and measurement policies will be less rules-based, which in turn will enhance the understandability of financial reports.

Fair value measurement objective

22. The AASB has received comments from constituents that they consider that providing information useful for assessing the entity's future cash flows is emphasised in the proposed Chapters mainly to facilitate the imposition of a fair value measurement model at a later date. The AASB suggests that the Boards indicate in the Basis for Conclusions on Chapter 1 that focusing on information for assessing future cash flows does not preordain a particular measurement outcome, and that the Boards have yet to deliberate the measurement phase of the project.

Primary users

23. The AASB agrees with using the identified information needs of present and potential investors and creditors as a proxy for the common information needs of the wide range of users that the proposed objective of financial reporting aims to meet, and therefore with describing present and potential investors and creditors as primary users of financial reports. This is because the information needs of these users are better understood than the information needs of other users.

24. However, the AASB is of the view that it is important for the revised *Framework* to clarify that identifying particular users as the primary users of financial reports does not mean that information needs of other users should be ignored. For example, the AASB suggests that the revised *Framework* should indicate that information useful for other identified users, such as employees, that could be provided at little additional cost should not be omitted even though it is not also considered particularly useful to present and potential investors and creditors.

25. Paragraph OB3 says information about the amounts, timing and uncertainty of the entity's future cash inflows and outflows "is essential in assessing an entity's ability to generate net cash inflows and thus to provide returns to investors and creditors". This implies that providing information for assessing returns to investors and creditors is the only purpose of financial reporting, which would be inconsistent with the *Framework's* identification of a broad range of users, and would in turn imply adoption of a proprietary perspective (which is inconsistent with paragraph BC1.11). Therefore, the AASB recommends that providing information useful for assessing returns to investors and creditors should be presented as an example of the uses of financial information, but not as an integral part of the objective (as in paragraph OB3).

26. Paragraph OB10 says financial reports reflect the perspective of the entity rather than only the perspective of the entity's owners because the information provided by financial reporting is directed to the needs of a wide range of users. Neither that paragraph nor paragraph BC1.11 explain why financial reporting directed to the needs of a wide range of users cannot give precedence to the information needs (or perspective) of owners or potential owners. The AASB supports adopting an entity perspective in financial reports, but is of the view that further explanation of the Boards' reasons for adopting that perspective is warranted.

27. The Discussion Paper refers to investors and creditors separately in various places. The AASB considers that the information needs of investors and creditors are unlikely to differ greatly, and therefore recommends referring to them as resource providers after their first mention.

Valuations

28. The AASB considers that the proposed *Framework* should explain in greater detail why the objective of financial reporting does not include providing a valuation of the reporting entity. Paragraph OB20 of Chapter 1 says "Estimating the value of an entity would require taking into account information in addition to that provided in financial reports, for example, general economic conditions in the industry in which the entity operates." The AASB is of the view that this discussion of the issue is too brief, particularly because valuations are used in investment (resource allocation) decisions and therefore this is an important issue.

The Proposed Qualitative Characteristics of Decision-Useful Financial Reporting Information

Distinguishing the concepts of relevance and materiality

29. The Discussion Paper does not make a clear distinction between the concepts of relevance and materiality because it describes both concepts in terms of having the potential to affect users' resource allocation decisions.[3] The AASB is of the view that these concepts should be distinguished more clearly by describing relevance as a general quality of financial information that, unlike materiality, does not depend on the individual circumstances of the reporting entity. This is elaborated on below.

30. The AASB is of the view that:

(a) Relevance should be defined as a *quality* of financial information that exists when it has the potential to affect the resource allocation decisions or other accountability assessments of users in general, and not necessarily the users of the reporting entity's financial report;

(b) Materiality should (consistent with paragraph QC49) be defined in relation to the individual circumstances of each reporting entity. Therefore, it should be defined as a threshold (determined by nature and/or amount) used to assess the *extent* to

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[3] The Discussion Paper defines "relevance" as follows:

> "*Relevant* information is capable of making a difference in the decisions of users by helping them to evaluate the potential effects of past, present, or future transactions or other events on future cash flows *(predictive value)* or to confirm or correct their previous evaluations *(confirmatory value)*." (paragraph QC8)

It describes "materiality" as follows:

> "Information is material if its omission or misstatement could influence the resource allocation decisions that users make on the basis of an entity's financial report. Materiality depends on the nature and amount of the item judged in the particular circumstances of its omission or misstatement." (paragraph QC49)

which relevant and representationally faithful information[4] may be omitted, misstated or not disclosed separately without having the potential to affect resource allocation decisions or other assessments of management's accountability made by users of the reporting entity's financial report; and

(c) Consequently, timeliness should not be treated as an aspect of relevance. Instead, the need for timeliness should be treated as a constraint on the reporting of information that is both relevant and representationally faithful. This is because timeliness relates to the circumstances of particular reporting entities, rather than the usefulness of a type of information to users in general. The time needed for a particular entity's management to establish to its satisfaction that information is representationally faithful might diminish the information's usefulness to users of *that entity's* financial report, but does not affect the relevance of that information to users generally.

31. The AASB's proposed definitions of "relevance" and "materiality test", which reflect the arguments immediately above and elsewhere in this submission, are set out in the section below.

AASB's proposed definitions of "relevance" and "materiality test"

Relevance

32. Based on its views that:

- relevance should be defined as a *quality* of financial information that exists when it has the potential to affect the resource allocation decisions or other accountability assessments of users in general, and not necessarily the users of the entity's financial report (see paragraph 30);
- the objectives of financial reporting should include providing information useful for assessing the accountability of management (see paragraph 9); and
- providing information relevant for assessing the entity's future cash flows should not be treated as being synonymous with meeting the objective of financial reporting (see paragraph 3),

the AASB proposes the following definition of "relevance", which is a mark up of the proposed definition in the Discussion Paper:

"~~*Relevant*~~ ~~information~~ *Relevance* is the quality of information that exists when that information is generally capable of making a difference ~~in the~~ to users'

[4] The other proposed qualitative characteristics—comparability and understandability—are criteria for *how* information is reported, not *whether* it is reported. Therefore, they are not relevant to the application of the materiality test. As paragraph QC45 of Chapter 2 says, "Together, relevance and faithful representation make financial reporting information decision useful."

resource allocation decisions ~~of users~~ or other assessments of management's accountability by helping them to evaluate the potential effects of past, present, or future transactions or other events ~~on future cash flows~~ *(predictive value)* or to confirm or correct their previous evaluations *(confirmatory value)*."

Materiality test

33. Based on its views in paragraph 30, the AASB recommends that:

(a) "materiality test" should be defined as:

> "a test used to assess the *extent* to which relevant and representationally faithful information may be omitted, misstated or not disclosed separately without having the potential to affect resource allocation decisions or other assessments of management's accountability by users of the reporting entity's financial report"; and

(b) the following principle should be included in the explanation of the concept of materiality:

> "Once it has been decided that financial information is, in general terms, relevant and representationally faithful, it is necessary to consider the information in the context of the individual circumstances of the reporting entity in question. For example, information may generally be relevant and representationally faithful but immaterial in the circumstances of the reporting entity."

Independent verifiability as a necessary ingredient of faithful representation

34. The AASB disagrees with the proposal that, for information to provide a faithful representation of economic phenomena, it must be independently[5] verifiable. It considers that information that is not independently verifiable (e.g., an estimate of the value in use of a unique asset) does not necessarily fail to provide a faithful representation of economic phenomena. Information could be representationally faithful without that quality being provable to, or knowable by, another party.

35. The AASB is of the view that it is highly desirable for information in financial reports to be independently verifiable, but that if independent verification is impossible, the information should not necessarily be excluded. A problem with making verifiability an essential feature of faithful representation is that it could be interpreted as precluding

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[5] Chapter 2 of the Discussion Paper does not use the term *independent verification*. However, paragraph QC23 says "*Verifiability* implies that different knowledgeable and independent observers would reach general consensus … either (a) that the information represents the economic phenomena that it purports to represent without material error or bias (by direct verification); or (b) that the chosen recognition or measurement method has been applied without material error or bias (by indirect verification)." The AASB considers that Chapter 2 effectively refers to independent verification.

disclosure of information that cannot be independently verified even if the uncertainties surrounding it are disclosed. For example, a law case might have potential financial consequences that cannot be independently verified, but management might consider it useful to users to provide its estimate of them.

36. Instead, the AASB recommends that the *Framework* should say that, for information to provide a faithful representation of economic phenomena, it must be supportable or consistent with all known facts.

37. The AASB also supports the view expressed in paragraph AV2.2 of the Alternative View published in the Discussion Paper in respect of its discussion of verifiability, namely, that a recognition or measurement method used should be one that may be expected to yield an estimate of the economic phenomenon that is free from material error or bias.

Trade-offs

Trade-off between relevance and reliability (faithful representation)

38. Unlike some conceptual frameworks,[6] the Discussion Paper does not discuss a trade-off between relevance and reliability (faithful representation). The AASB interprets the Discussion Paper as indicating such a trade-off is no longer relevant. That interpretation would be consistent with the policy adopted by the IASB in the Improvements version of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* that a voluntary change in an accounting policy should only be made if it results in "reliable and more relevant information" (IAS 8, paragraph 14(b)). The thinking underpinning that change to IAS 8 is that, of the accounting policies that would produce reliable information, the entity should choose the policy that produces the most relevant information. The AASB agrees with that thinking, but is of the view that it should be articulated in the revised *Framework's* discussion of the qualitative characteristics.

Trade-off between different aspects of understandability

39. The AASB is of the view that it would be useful to note that trade-offs can exist between different aspects of the same qualitative characteristic. For example, some commentators argue that the fair value of an asset or a liability can only be determined using an observable market price in an active market because a broader concept of fair value will not be understandable to many users. However, if fair value were to be the only basis for remeasurements, such a narrow view of fair value would require application of a mixed attribute measurement model if remeasurements occur, which would impair the understandability of reported profits/results.

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6 For example, Australian Concepts Statement SAC 3 *Qualitative Characteristics of Financial Information*, paragraph 7; FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*, paragraphs 42-45 and 90; and CICA Handbook Section 1000, *Financial Statement Concepts*, paragraph 24.

Suggestions for Editorial and Other Minor Amendments

40. The AASB's suggestions for editorial and other minor amendments are in the table below.

Para.	Comment
OB6	In relation to creditors and suppliers, in sub-paragraphs (b) and (c), the AASB suggests replacing "financial capital" with "finance".
OB9	The first sentence refers to "management and the governing board of an entity". The AASB regards a governing board as an example of an entity's management.
OB18	The last sentence refers to "... events and circumstances that change resources and claims to them". The AASB is of the view that the reference to circumstances is redundant, because any circumstance that changes something must be an event.
OB26	The last sentence refers to "judgmental information". This term is ambiguous because a common usage of "judgmental" is referring to harsh judgement. The AASB suggests using a less ambiguous term, such as "information reflecting management's judgements".
OB27 OB28	The first sentence parenthetically equates owners with shareholders. However, owners may be unitholders (in a trust), partners or other equityholders. The AASB suggests referring to shareholders as an example of owners. Similarly, the second sentence of paragraph OB28 refers to "shareholder proposals". The AASB suggests using a broader term like "equityholder" instead of "shareholder".
BC1.9	This paragraph says the proprietary perspective and entity perspective are important primarily for consolidated financial statements and for determining the distinction between liabilities and equity. Another important implication of those perspectives is for determining whether changes in the general purchasing power of the monetary unit should be recognised in financial statements (such changes would not be recognised under an entity perspective, because changes in general purchasing power affect all proprietors equally but not all entities equally; but they may be recognised under a proprietary perspective).

BC1.29, BC1.30	The mention of accrual accounting in relation to financial performance in paragraph BC1.29 seems to be disconnected from the preceding discussion, which relates to whether information about performance is more important than other financial information, not how financial performance is "measured". As a matter of expression, the phrase "financial performance measured by accrual accounting" in paragraphs BC1.29 and BC1.30 uses "measured" with a different connotation than its general meaning in the accounting literature. The AASB considers it would be preferable to say "financial performance based on accrual accounting".
QC18 QC19	The fourth sentence uses the phrase "they cannot be faithfully represented as the term is used in the framework". The word "as" is ambiguous because it could be read to mean "because". The AASB suggests saying "they cannot be faithfully represented in the sense in which that term is used in the framework". Similarly, the AASB suggests that in the last sentence of paragraph QC19, "as the framework uses that term" should be amended to "in the sense in which the framework uses that term".
QC19	The AASB found this paragraph confusing. Perhaps the penultimate sentence is meant to refer to the example at the start of the paragraph rather than the one in the immediately preceding sentence. The AASB suggests clarifying the point being made.
QC21	In relation to the last sentence, because information depicts an aspect, or aspects, of economic phenomena, the AASB suggests replacing "the extent to which the information faithfully represents the economic phenomena that it purports to represent" with "the extent to which the information faithfully represents what it purports to represent about the economic phenomena".
QC41, QC42, QC43	These paragraphs refer to "investors or creditors", whilst paragraphs QC39 and QC44 use the more neutral term "users". As commented on the covering letter to this submission, the AASB prefers the use of more neutral language after the first mention of investors and creditors.
QC52	The AASB disagrees that the materiality threshold increases as the attainable degree of precision decreases. It is of the view that, as the attainable degree of precision decreases, the ability to identify whether an estimate is erroneous decreases accordingly. However, this is not the same as changing the materiality threshold.

QC54	In the second sentence, the AASB suggests inserting the following underlined words: "more efficient functioning of the capital markets, which may result in better availability and pricing for <u>investors and</u> consumers".
QC57	In the first sentence, should "investors and ... other providers of capital" be "investors and ... other providers of finance"?
BC2.33	The first sentence does not contradict paragraph BC2.32. Therefore, the AASB suggests replacing "However" with "Moreover".

Appendix

AASB's Comments on Implications of the Proposed Concepts if They Were Applied to Not-For-Profit Entities

The Proposed Objective of Financial Reporting

Accountability

A1. The AASB is of the view that omitting accountability from the proposed objective of financial reporting would be a significant problem for private sector businesses, but a greater problem if application of the proposed objective were extended to not-for-profit entities. In this regard, the AASB agrees with the comments of the International Monitoring Group on the Not-For-Profit Entity Implications of the IASB-FASB Conceptual Framework Project in its Report on the Discussion Paper entitled, *Application to not-for-profit entities in the private and public sector* (July 2006).

A2. Some users of financial reports of not-for-profit entities will not have the same ability to make direct resource allocation decisions as occurs for private sector businesses, and will sometimes be interested in financial reports primarily to assess the accountability of the entity's management.

A3. For some not-for-profit entities, if the objective of financial reporting were only to provide information useful for making resource allocation decisions, requiring financial reports to be prepared could not be justified because there is little demand for their financial reports by those who make resource allocation decisions about the entity and cannot command the preparation of financial reports tailored to meeting their particular information needs. However, there is much greater support for requiring those entities to prepare financial reports to demonstrate their accountability.

Information for assessing the entity's future cash flows

A4. The AASB agrees with the comments of the International Not-For-Profit Monitoring Group that the Discussion Paper's pervasive focus on cash flows would be inappropriate for not-for-profit entities. The AASB has also commented in the attached submission that it disagrees with treating the provision of information relevant for assessing the entity's future cash flows as synonymous with meeting the objective of financial reporting about private sector businesses. It considers the problem with this treatment is greater in respect of not-for-profit entities.

A5. Although cash flows are important for not-for-profit entities (including, for public sector not-for-profit entities, information about budgeted cash flows), other aspects are generally more significant. These aspects include:

(a) the ability of the entity's available resources to deliver future goods and services;

(b) the quality, cost and effectiveness of goods and services that have been delivered in the past; and

(c) how well the entity is meeting its objectives, which are not primarily cash-related.

A6. Many assets of not-for-profit entities are held to provide future goods and services without necessarily generating future cash inflows. The AASB acknowledges that not-for-profit entities need cash inflows to carry out their activities and that entities that are more effective in achieving the objectives specified for them are more likely to continue to attract cash inflows. However, the nexus between particular assets of not-for-profit entities and future cash inflows may often be so indirect and difficult to determine that treating those entities' assets as potential sources of future cash inflows (and measuring the assets on that basis, for example by recognising impairments) is unlikely to be practicable or useful to users.

Investment, credit and similar resource allocation decisions

A7. Paragraph OB2 says the objective of financial reporting is to provide information useful for making "investment, credit, and *similar* resource allocation decisions" (emphasis added). The AASB is of the view that if application of the proposed objective of financial reporting were to be extended to not-for-profit entities, the objective should refer to "*other* resource allocation decisions" instead of "*similar* resource allocation decisions". This is because:

(a) Investments in, and the provision of credit to, an entity establish a financial interest in that entity's assets entitling the interest-holder to receive discretionary or non-discretionary transfers of economic benefits. Presumably, *similar* resource allocation decisions also involve deciding whether to establish a financial interest in an entity's assets.

(b) In contrast, some resource allocation decisions about a not-for-profit entity do not relate to whether to establish a financial interest in the entity's assets. For example, they could be decisions about:

(i) whether to vote for an increase in the entity's capacity to provide services to beneficiaries, having regard to the entity's reported assets;

(ii) whether to vote for a change in the entity's management, having regard to reported information about the efficiency and effectiveness of the entity's service-delivery activities; or

(iii) whether to make a donation to the entity.

A8. In regard to (b)(iii) above, decisions about whether to make donations are not unique to not-for-profit entities, but tend to be much less significant in respect of private sector businesses.

A9. In the light of the AASB's proposal that reference be made to "making *and evaluating* resource allocation decisions" in the objective of financial reporting (see paragraph 13), if application of the proposed objective of financial reporting were extended to not-for-profit entities, the AASB proposes that it be worded as:

> 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 <u>and evaluating</u> investment, credit, and ~~similar~~ <u>other</u> resource allocation decisions.[7]

Primary users

A10. The AASB largely agrees with the comments of the International Not-For-Profit Monitoring Group that when the revised *Framework* addresses not-for-profit entities, the primary user group needs to be amended to include a reference to present and potential funders and financial supporters (the not-for-profit entity equivalent of present and potential investors). However, the AASB prefers the term "resource providers", which includes creditors, donors and other financial supporters.

A11. In addition, because some users of financial reports of not-for-profit entities will lack the capacity to make direct resource allocation decisions, the AASB is of the view that information that is useful for present and potential investors and creditors and their not-for-profit entity equivalents is unlikely to be a proxy for the common information needs of all users of financial reports of not-for-profit entities. Therefore, the AASB is of the view that the primary users of financial reports of not-for-profit entities should include recipients of goods and services (including beneficiaries, such as community groups) and parties providing a review or oversight function (including, in respect of public sector not-for-profit entities, parliaments).

A12. In summary, the AASB is of the view that the primary users of financial reports of not-for-profit entities should be identified as:

(a) resource providers (including creditors, donors and other financial supporters);

(b) recipients of goods and services (including beneficiaries, such as community groups); and

(c) parties performing a review or oversight function.

A13. The AASB observes that these classes of primary users are neutral between all sectors, and therefore recommends their adoption for all entities once the IASB considers not-for-profit entities in the Conceptual Framework project.

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[7] Under the AASB's proposals, this objective would be complemented by an objective of providing information useful for assessing the accountability of management.