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IASB issues first Exposure Draft on conceptual framework

On 29 May 2008, the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) jointly published for comment an Exposure Draft (ED) **An improved Conceptual Framework for Financial Reporting – Chapter 1: Objective of Financial Reporting and Chapter 2: Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information**. The ED develops the Boards' thinking from the 2006 Discussion Paper on the same subject. The Boards are seeking comments by 29 September 2008.

This is the first ED issued in the Boards' ongoing project to develop a common conceptual framework.

Chapter 1: The objective of financial reporting

The ED concludes that the fundamental objective of general purpose financial reporting is 'to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders and other creditors in making decisions in their capacity as capital providers'.

Capital providers are identified as investors, lenders and other creditors (including suppliers, employees and customers). The reference to 'present and potential' investors is intended to acknowledge that general purpose financial reports are used both for future investment decisions and for assessing the stewardship of resources already committed to the entity.

The stewardship responsibilities of management are addressed specifically. This issue sparked considerable debate during the discussion paper phase of this project. While 'stewardship' is not a separate objective of financial reporting as some had requested, the Boards have acknowledged that evaluating past performance of an entity is as important as predicting future cash flows.

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

Chapter 2 considers the qualitative characteristics and constraints of decision-useful financial reporting information. The Boards have refined the approach in the Discussion Paper, so that two 'fundamental' qualitative characteristics are identified: relevance and faithful representation. A number of additional characteristics are highlighted that 'enhance' the decision-usefulness of financial information and that are complementary to the fundamental qualitative characteristics. The enhancing characteristics identified in the ED are comparability (including consistency), verifiability, timeliness and understandability.

Fundamental qualitative characteristics differentiate useful information from information that is not useful or is misleading – whereas enhancing qualitative characteristics differentiate more useful information from less useful information.

The Basis for Conclusions accompanying the Exposure Draft lists additional candidates for qualitative characteristics that were considered by the Boards, but not included in the proposals. These include ‘transparency’ (the Boards concluded that this characteristic is subsumed within faithful representation and understandability); ‘true and fair view’ (this is equivalent to faithful representation); ‘credibility’ (implied by verifiability); and ‘high quality’ (this is achieved by adherence to the objective and qualitative characteristics of financial reporting generally). One other candidate, ‘internal consistency’ was rejected because the Boards considered that such a requirement, although desirable and the goal of the Boards, could impede the evolution of financial reporting standards.

Constraints

Two pervasive constraints are identified that limit the information provided in useful financial reports: materiality and cost. Information is material if its omission or misstatement could influence the decisions that users make on the basis of an entity’s financial information. Materiality is not a matter to be considered by standard-setters but by preparers and their auditors. The benefits of providing financial reporting information should justify the costs of providing that information.

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Designed and produced by The Creative Studio at Deloitte, London. 25808