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ED for Conceptual Framework for Financial Reporting

Dear Sirs

In relation to the above exposure draft I would like to comment as follows.

1. Proposed Changes to Chapters 1 and 2. A number of changes have been undertaken and those that I would like to comment on are as follows
   a. The inclusion of stewardship in the function of accounting is important and recognizes an important role for financial reporting;
   b. The inclusion of prudence is appropriate and is consistent with financial statement user expectation;
   c. The inclusion of measurement uncertainty as a characteristic of relevance provides a potentially elegant solution to determination of measurement within a mixed measurement model framework, and evidence will doubtless be provided empirically over time as to whether particular financial statement information is relevant.
2. The reporting entity – Chapter 3. This aspect of the proposed framework is under-developed, and while identifying the critical concepts of direct and indirect control it fails to consider how these might be relevant for different types of users of financial statements. Furthermore it simply stipulates unconsolidated financial statements for reporting entities defined on the basis of direct control and consolidated financial statements for reporting entities defined on the basis of direct and indirect control. Ignoring the fact that consolidated is not defined, the argument between the framework and IFRS 3 Business Combinations appears circular. If you have control then consolidate, and consolidate if you have control. If the framework took the time to consider the distinct information needs of different users of financial statements it could provide a much more meaningful basis for defining the reporting entity. For example, equity investors might be concerned with direct and indirect control as an indicator of potential future returns, whereas lenders might be more concerned with direct control of resources which can be relied upon for repayment. This approach would doubtless lead to regulation prescribing consolidation in situations of direct and indirect control. More importantly, it might lead to better consideration of circumstances where defining the reporting entity on the basis of direct control only is appropriate, and this might be insightful where there are complex financial structures

and cross guarantees between entities. (This might be a regulatory condition of not preparing and lodging separate financial statement) There will also be circumstances where reporting by the parent entity (which is typically considered unconsolidated) does not necessarily correspond with direct control, and this probably requires further consideration. (This issue might be easier addressed after defining the elements of financial statements – Chapter 4)

3. Elements of financial statements – Chapter 4. While not wishing to dwell on this I continue to have the following concerns:
    a. With the definition of liability adopted the framework continues to address inadequately non-standard reporting entities, this includes trusts, hybrid entities and co-operatives. This could be addressed by excluding from the definition of liability 'the residual claimant on the assets of the entity'. It would also address issues with reporting of performance for these entities.
4. Presentation and Disclosure – Chapter 7. With the increasing prevalence of Non IFRS reporting by firms it seems the concern with how financial performance is presented is overstated. Firms are deciding how they want to present performance separately from financial reports, and there is evidence that analysts are satisfied with this as long as there is a reconciliation to statutory earnings such as that prescribed by the Australian Securities and Investments Commission (RG230). Furthermore, a constraint on any solution is that the statement of financial performance must articulate into the opening and closing balance sheets. Accordingly, I think a one statement approach is preferable. If the framework persists with a two statement approach it is essential that an appropriate definition of 'other comprehensive income' is developed. Failure to do so will perpetuate the arguments about what items should be included and issues such as recycling.

While I believe that the ED addresses some issues in developing a framework for guiding the development of regulation and financial reporting practices, there are still significant issues requiring address.

Yours faithfully

Peter Wells