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Dear Li Li

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

Thank you for the opportunity to comment on the Discussion Paper.

Our comments have been prepared in consultation with members through our Asia-Pacific Financial Reporting Advisory Group (APFRAG) which is a Board Committee representing a regional perspective from South-East Asia, Oceania and our Financial Reporting and Governance Centre of Excellence.

CPA Australia does not agree with the approach adopted by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) to develop a Framework for the for-profit private sector and later embellish the Framework for the not-for-profit private sector (and ignore the public sector). Instead, CPA Australia supports the development of a Framework that has application to all sectors (i.e., the for-profit private sector, the not-for-profit private sector and the public sector). We encourage the IASB and the FASB to undertake such an approach.

However, given that the IASB/FASB stated approach is to not develop a Framework that has application to all sectors, the balance of our comments articulate CPA Australia's position on the proposals as articulated in the Discussion Paper.

CPA Australia's consultation with our membership has identified their concerns with some of the recently developed International Financial Reporting Standards (IFRS); for example the quantum of information that IFRS 7 *Financial Instruments: Disclosures* requires to be disclosed, and notwithstanding the entity is a non-listed company. We had anticipated the Discussion Paper would articulate an objective of financial reporting that made clear the rationale for the requirements of a disclosures standard such as IFRS 7. We consider a significant limitation of the Discussion Paper is its failure to take this opportunity, as it is little more than a refreshing of the literature that is the current IASB and FASB Frameworks.

CPA Australia disagrees with the proposal in the Discussion Paper to subsume stewardship within a decision usefulness objective. We support the identification of stewardship as a separate objective of financial reporting. We agree with the alternative view put in paragraph AV1.3 that "Stewardship is concerned with the accountability of the directors, or management board, of a business entity to its proprietors or owners." We understand the decision usefulness objective to be framed around resource allocation decisions – whether to buy, sell, or hold the entity's securities or whether to lend money to the entity. We acknowledge that information relevant to predicting future cash flows is relevant to the stewardship objective. However, we do not think that such information comprises the complete set of information required to satisfy the stewardship objective. Further, we are concerned that by subsuming stewardship within a decision usefulness objective some information that would be not be reported under the decision usefulness objective for reasons of materiality may well be of significant importance from a stewardship objective.

CPA Australia is not convinced by the IASB's statement that "...for entities that do have external users to their financial reports, the objective of the reports issued to them is the same because the information needs of investors, creditors, and others who need to make resource allocation decisions about the entity are generally the same." (Paragraph BC1.24). We question the validity of this statement, particularly its application to non-listed companies, and we are unable to find evidence in support of this statement within the Basis for Conclusions to Chapter 1.

Recently published academic research makes some salient comments that are directly relevant to the financial reporting of listed companies. The relationship of principal and agent is well understood in the context of listed companies – Mack and Ryan (2006) contend that the designing and refining of contracts to align the self interests of agents with principals and therefore control their interests is aligned with the decision useful framework. Botosan et al (2006) report that empirical research on listed companies indicates that accounting earnings is associated with changes in executive compensation (stewardship objective) as well as changes in share prices (valuation objective). However, it is not clear that these statements also apply to non-listed companies. Some of our members have commented that intuitively, they expect in a tightly held family controlled large unlisted company the relationship of principal and agent is not relevant. Further, as Botosan et al (2006) note it may be difficult to generalise research on listed companies to non-listed companies (and the survey evidence that supports that generalisability was published in 1983 and apparently has not since been replicated).

CPA Australia considers it important that the IASB reconsider whether the information needs of these users are the same regardless of whether the entity is listed or unlisted (be they large or small tightly held family controlled unlisted companies) – and communicate the reasoning for its decision in the Basis for Conclusions to Chapter 1. We note that the SME project is premised on exempting those entities from specific requirements or to require other differences in reporting for those entities. While this approach to the SME project is consistent with the reasoning in paragraph BC1.25 it would not necessarily be the outcome if there was a different framework that applied to non-listed companies.

CPA Australia is disappointed that "...consideration of specific issues concerning the boundaries of financial reporting...should be deferred to a later phase of the conceptual framework project." (Paragraph BC1.4). We consider this deferral an inherent weakness of the Discussion Paper – as there is a missed opportunity to explicitly delineate the boundaries of financial reporting. We disagree with the IASB's conclusion that it does "...not expect that resolution of issues in that later phase will significantly change the proposed objective of financial reporting stated in the draft framework." (Paragraph BC1.5). We consider that one consequence of this failing is the potential for standard setters, preparers, auditors, users and commentators to not have an agreed understanding of the objective for financial reporting – an outcome that we consider is not in the public interest.

CPA Australia has considered the qualitative characteristics identified in Chapter 2 of the Discussion Paper. We note that the discussion of "understandability" does not include a discussion of granularity/level of aggregation/disaggregation (too much or too little information, too high level or too detailed level of information – which makes the information less useful). We consider such a discussion is necessary given the advancements in financial reporting that will be the result of the introduction of XBRL. In addition, we find the discussion in paragraph QC43 re economic phenomena and other phenomena confusing as the discussion seems to mix up the events and attributes/information of those events. We would support clarification of the discussion around the qualitative characteristic of "relevance".

Should you have any queries on our comments, please contact Dr Mark Shying, CPA Australia's Financial Reporting and Governance Senior Policy Adviser at mark.shying@cpaaustralia.com.au

Yours sincerely

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References

Botosan, C.A. et al (2006), Financial Accounting and Reporting Standards for Private Entities *Accounting Horizons* Vol.20, Iss. 2; 179.

Mack, J. & C. Ryan (2006) Reflections on the theoretical underpinnings of the general-purpose financial reports of Australian government departments *Accounting, Auditing & Accountability Journal* Vol.19, Iss. 4; 592.

Attachment: CPA Australia submission to the AASB (re AASB specific questions)

A: QUESTIONS RELEVANT TO ALL ENTITIES

1. Do you agree that stewardship (or accountability) should not be identified as a separate objective of financial reporting? If not, which information additional to that provided to meet the Discussion Paper's (DP's) proposed objective of financial reporting would be necessary to meet a stewardship (or accountability) objective? (See paragraphs OB27 and OB28 of Chapter 1, paragraphs BC1.32-BC1.41 of the Basis for Conclusions on Chapter 1, and the Alternative View on Chapter 1, and report of monitoring group on implications for not-for-profit entities, paragraphs 1.5 – 1.13)

   CPA Australia disagrees with the proposal in the DP to subsume stewardship within a decision usefulness objective. We support the identification of stewardship as a separate objective of financial reporting. We agree with the alternative view put in paragraph AV1.3 that "Stewardship is concerned with the accountability of the directors, or management board, of a business entity to its proprietors or owners." and consider that this concept of stewardship extends to not-for-profit sector entities. We understand the decision usefulness objective to be framed around resource allocation decisions – whether to buy, sell, or hold the entity's securities or whether to lend money to the entity. We acknowledge that information relevant to predicting future cash flows is relevant to the stewardship objective. However, we do not think that such information comprises the complete set of information required to satisfy the stewardship objective – and in the case of not-for-profit entities is most unlikely to comprise the primary set of information required. Further, we are concerned that by subsuming stewardship within a decision usefulness objective some information that would be not be reported under the decision usefulness objective for reasons of materiality may well be of significant importance from a stewardship objective.

2. Do you agree that the objective of financial reporting should identify a primary group of users of financial reports? If so, do you agree that they should be present and potential investors and creditors (and their advisers)? (See paragraphs OB12 and OB13 of Chapter 1, and paragraphs BC1.14 – BC1.17 of the Basis for Conclusions on Chapter 1)

   CPA Australia does not think it necessary to identify a primary group of users. The extensive list of users identified in paragraph OB6 seems complete. However, we consider that the wording used to identify and describe users would be improved by making it relevant to all sectors (see also our answer to question 7).

3. Do you agree with replacing reliability with faithful representation as a qualitative characteristic of decision-useful financial information? (See paragraphs QC7 and QC16 – QC34 of Chapter 2, and paragraphs BC2.13 – BC2.29 of the Basis for Conclusions on Chapter 2)

We are not aware of misunderstandings around the meaning of reliability. Nonetheless, we do not disagree with the proposal to replace reliability with faithful representation

4. Do you agree verifiability is a necessary ingredient of faithful representation? (See paragraphs QC23 – QC26 of Chapter 2, and paragraphs BC2.14, BC2.16, BC2.28 and BC2.51 of the Basis for Conclusions on Chapter 2)

We do not disagree with the DP's tentative conclusions that information needs to be verifiable to assure users that it is free from material error and bias and thus can be depended on to represent what it purports to represent (i.e., a faithful representation). However, we would be concerned if verifiable was to connote verifiability solely for the purposes of audit.

5. Do you think that the distinction between relevance and materiality is explained clearly? (See paragraphs QC8 – QC15 and QC49 – QC52 of Chapter 2, and paragraphs BC2.3 – BC2.12 and BC2.66 – BC2.67 of the Basis for Conclusions on Chapter 2)

We do not disagree with DP's tentative conclusions that information must be capable of making a difference to be relevant and that materiality is a pervasive constraint on financial reporting because it is pertinent to all of the other qualitative characteristics. We do not think the distinction between relevance and materiality to be lacking in clarity.

6. Are there any other issues regarding the DP you wish to raise?

CPA Australia does not raise any other issues.

B: QUESTIONS RELEVANT TO ENTITIES OTHER NOT-FOR-PROFIT PRIVATE SECTOR AND PUBLIC SECTOR ENTITIES

7. Should the primary group of users of financial reports identified in the objective of financial reporting include users other than present and potential investors and creditors (and their advisers)? If so, what types of users of financial reports should be identified? (See report of monitoring group on implications for not-for-profit entities, paragraphs 1.14-1.16)

CPA Australia does not support the identification of a primary group. However, we consider that the group of users identified in paragraph OB6 requires supplementation by the inclusion of funders, financial supporters and legislatures.

8. Do you agree with the statement in the DP that:

> "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) and with the concentration on information for assessing the entity's future cash flows in Chapter 2 (which discusses Qualitative Characteristics)? (See report of monitoring group on implications for not-for-profit entities, paragraphs 1.17 – 1.20)

No. CPA Australia contends that for not-for-profit private sector and public sector entities cash flows are important. However, we consider that there are other aspects that are more important – for example, the asset is a store of future services able to be delivered as opposed to a store of cash flows.

9. Are there any other issues regarding the DP you wish to raise, specifically in respect of entities other than private sector businesses?

CPA Australia does not raise any other issues.