Rådet för finansiell rapportering

The Swedish Financial Reporting Board

RFR-rs 2008:14

International Accounting Standards Board
30 Cannon Street
GB-London EC4M 6XH
United Kingdom

Dear Sirs,

Exposure Draft on An Improved Conceptual Framework for Financial Reporting (chapters 1 and 2).

We respond to the invitation to comment on the International Accounting Standards Board's Exposure Draft on An Improved Conceptual Framework for Financial Reporting (chapters 1 and 2). This letter represents the views of the Swedish Financial Reporting Board.

We appreciate the opportunity to comment on all matters in the Exposure Draft. Our comments are of a general nature and concern primarily the objectives of financial reporting and the relationship between objectives and recognition and measurement alternatives. We refrain from commenting on the specific questions. In summary we have the following view:

The picture that emerges from the Exposure Draft of management's role in the corporate reporting supply chain is incorrect on several points. We believe that the objectives chapter should be revised in this respect. As stated in the introduction, the objective of financial reporting is the foundation of the framework and the other aspects of the framework, notably recognition and measurement principles, will flow logically from the objective. In the absence of such a revision the establishment of recognition and measurement principles may be biased, not giving full consideration to all relevant facts.

In addition to commenting on the Exposure Draft we wish to express our opinion that the whole framework should be finalised at one point in time and not in parts at different point in time.

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The Relationship between Objectives and Recognition and Measurement Alternatives

The objectives established in the framework will affect the concepts in the recognition and measurement parts of the project.[1] Given that, it is important that the objectives of Financial Reporting are given due consideration. This consideration should be based on a valid description of the interests of parties involved in financial reporting. Otherwise, there is a risk that the resulting principles will not be adequate. In BC 1.37 of the ED, for example, commenting on alternative profit measures, it says that *"The boards concluded that none of the terms communicates the critical idea that in measuring performance, and entity first identifies and measures its economic resources and claims on them (and) then calculates the net change...other than changes resulting from transactions with owners."* This is a kind of normative statement, which has little descriptive validity.

We are especially concerned about the way the entity's management and its role in the corporate reporting supply chain are portrayed in the Exposure Draft. To make one point clear from the start, we certainly agree that a very important objective of general purpose financial reporting, arguably the most important one, is to provide useful information to capital providers about the entity's ability to generate future cash flows.

However, the concept of usefulness is extremely difficult. Observing a wide diversity in user practice and opinion, there is always a risk of resorting to models based on simplifying assumptions. We observe that standard setters' proposals to require a certain accounting treatment with increasing frequency have met with opposition from preparers, based on the notion that "this is not the way we see our business".

We think that there is a risk that views raised by preparers, will not be given proper consideration based on the notions established in the objectives chapter, although the views as such may be more useful also to capital providers. Being a standard setter in Sweden, a country with a long tradition of self-regulation, it is natural for us to view the evolution of financial reporting practice in the context of both the demand for and the supply of information.

In the exposure draft it is asserted that information that is relevant for capital providers usually ought to be relevant for management. In our opinion a more appropriate statement is that information that is relevant for management usually ought to be relevant for capital providers.

[1] *OB 1 The first chapter of the conceptual framework establishes the objective of general purpose financial reporting by business entities in the private sector. The objective of financial reporting is the foundation of the framework. Other aspects of the framework—qualitative characteristics, elements of financial statements, definition of a reporting entity, recognition and measurement, and presentation and disclosure—flow logically from the objective. Those aspects of the framework help to ensure that financial reporting achieves its objective.*

The Picture of Management and its Role in the Corporate Reporting Supply Chain

The view of management given in the framework relies on a number of assertions: Managers are not among the users of financial reports, they are preparers (OB 8)[2]. Managers have partly the same information needs as capital providers (BC 1.33)[3]. Furthermore, financial reports are not as important to management, since they are able to prescribe the form and content of the information they need (BC 1.33)[4]. Management plays an important part to interpret the information in financial reports (OB 25)[5]. The need to evaluate management has no decisive effects on the design of financial reports, since the information that helps a user to assess an entity's ability to generate future cash flows also helps to evaluate management (OB 18)[6].

The picture that emerges in the framework is that management and its perspectives play a minor part in the corporate reporting supply chain. It is only to interpret the financial reports that management is distinguished as a separate party. The picture given of management's role in the corporate reporting supply chain is superficial and incomplete on several points.

It is a truism that management prepares the financial reports. This statement in itself is not an argument against considering management's perspective when establishing recognition and measurement principles for financial reporting. The statement only makes sense if it is followed by an explanation of why management's perspective should be assigned less importance, e.g. because management has a self-interest because at the same time that the reports are used for predicting the entity's ability to generate future cash flows, they are also used to evaluate management's stewardship. Such an argument is never discussed and consequently couldn't be disputed. Even if it were true that considering management's view would be a potential threat to neutrality,

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[2] OB8 "Managers and the governing board of an entity (herein collectively referred to as management) are also interested in financial informationabout the entity. However, management's primary relationship with the entity is not that of a capital provider. Management is responsible for preparing financial reports; management is not their intended recipient..."

[3] "...However, an entity's management and its governing board are also interested in the entity's ability to generate net cash inflows. Thus, financial reporting information is likely to be useful to them as well as to capital providers."

[4] "...In addition, management has the ability to access financial information to meet its unique needs..."

[5] "Financial reporting should include management's explanations and other information needed to enable users to understand the information provided. Management's explanations of the information in financial reports enhance the ability of capital providers to assess the entity's performance and form expectations about the entity. Management knows more about the entity than external users and can often increase the usefulness of financial reports by identifying and explaining particular transactions and other events and circumstances that have affected or may affect the entity..."

[6] " Information about effects of transactions and other events and circumstances that change an entity's economic resources and the claims on them helps a user of the entity's financial reports to assess the amount, timing and uncertainty of its future cash flows. Such information also helps a user to assess the effectiveness with which management has discharged its stewardship responsibilities to the capital providers of the entity..."

this disadvantage would have to be weighted against potential advantages of giving management's view more prominence. Furthermore, apart from being preparers, management also use financial reports for benchmarking and evaluation of business segments.

The observations in the framework that the financial reporting is likely to be useful to management (BC 1.33) and that financial information used internally is often based at least partly on information prepared for general purpose financial reporting purposes (QC 1.31)[7] are too simplistic and not in accordance with reality.

Discussing the stewardship purpose of financial reports it seems logical to consider management's perspective when evaluating management. However, in the framework it is assumed that the distinction is not very important since management is evaluated on the entity's ability to generate future cash flows.

This avoidance of a discussion of different perspectives creates a risk that consequences of different recognition and measurement principles are not properly considered. When management refer to themselves as users, this is often in a context where they are of the opinion that their view of what is useful information differs from what is prescribed by standard setters. This does not mean that they question that the purpose of the information is to predict future cash flows. It is also acknowledged in the framework, in the context of management explanations, that management has superior knowledge of the entity. The argument that management could prescribe the information they need misses the point that this information may well be the most useful one for capital providers too.

The Consequences for Recognition and Measurement Principles

It is difficult, and perhaps not very meaningful, to discuss abstract concepts without making reference to specific recognition and measurement principles (This is one powerful argument for not finalising any individual part of the framework before the whole framework is ready). One specific area where it has been especially evident that standard setters' proposals to require a certain accounting treatment have met with opposition from preparers, based on the notion that "this is not the way we see our business", is the use of fair values in the balance sheet (and the income statement recognition of changes is these values).

The analysis in the framework concludes that management's perspective is, or at least ought to be, the same as that of the capital providers. The stewardship purpose of financial accounting is subsumed in the prediction purpose. However, investors have an opportunity cost perspective, where the actual use of resources is continuously evaluated against alternative uses. Management, on the other hand, generally have the view that they have committed resources for a certain period of time and that they will

[7] "Financial reporting information helps capital providers make better decisions, which results in more efficient functioning of capital markets and a lower cost of capital for the economy as a whole. Individual entities also enjoy benefits, including improved access to capital markets, favourable effect on public relations, and perhaps lower costs of capital. The benefits may also include better management decisions because financial information used internally is often based at least partly on information prepared for general purpose financial reporting purposes."

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do the same things tomorrow as they do today. They have a value added-perspective, based on operations, and represented by historical cost. According to management, the (legitimate) need for short period evaluations must not give misleading indications. One might ask whether this perspective might be more useful for the prediction of future cash flows.

If you have any questions concerning our comments please address our Executive member Carl-Eric Bohlin by email to: carl-eric.bohlin@radetforfinansiellrapportering.se

Stockholm, September 29, 2008

Kind regards,

THE SWEDISH FINANCIAL REPORTING BOARD

Anders Ullberg
Chairman

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