



Accounting Standards Board

Aldwych House, 71-91 Aldwych, London WC2B 4HN
Telephone: 020 7492 2300 Fax: 020 7492 2301
www.frc.org.uk/asb



Li Li Lian
Assistant Project Manager
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

2 November 2006

Dear Li Li

IASB Preliminary Views Discussion Paper: ‘The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information’

This letter sets out the Accounting Standard Board’s comments on the above IASB Discussion Paper (DP).

The ASB welcomes the IASB’s decision to issue this material in the form of a discussion paper. The Conceptual Framework is of fundamental importance to the future development of International Financial Reporting Standards and therefore it is pleasing to see that constituents are being given the opportunity to fully discuss its contents. We are also grateful to the members of the project team who participated at a public meeting on the DP that the ASB hosted on 21 September.

The ASB has some fundamental concerns with the proposals in the paper. These are summarised below and discussed in more detail in the appendix to this letter.

- Our first fundamental concern is with the proposal that the converged framework should specify only one objective of general purpose external financial reporting (paragraph OB2 of the DP), that of resource allocation decision-usefulness. The ASB supports the Alternative View set out in Chapter 1 of the DP that stewardship should be identified as a separate objective of financial reporting, or as part of the decision-usefulness objective. This issue is further discussed in paragraphs 6-16 of the appendix to this letter. As a useful contribution to the debate, I also attach a copy of Andrew Lennard’s paper on stewardship which sets out a view of what stewardship is and why it is important.
- The DP identifies the primary users of general purpose external financial reporting as being “present and potential investors and creditors (and their advisers)”. A number of problems arising from this have not been dealt with

in any detail by the DP, including: the reasons for choosing the entity perspective at the expense of the shareholder perspective; whether users of the financial reports of listed, unlisted and small and medium-sized entities have the same information needs; and the contradiction between the entity perspective chosen and the primary user group identified. We discuss these issues further in paragraphs 17-25 of the appendix. We recommend that the IASB conduct more research in this area to address these issues prior to coming to a final view on who should be the primary user.

- The DP proposes replacing the qualitative characteristic of “reliability” in the current Framework with “faithful representation”. We believe that faithful representation is a softer notion which, when combined with a lack of specific identification of substance over form as a principle and reliance on the component of “verifiability”, could lead to a number of problems. In our view, the IASB should instead seek to clarify what is meant by “reliability” as a qualitative characteristic, rather than remove it. This is discussed in more detail in paragraphs 26-37 of the appendix.
- The DP notes that the Framework being developed will apply to general purpose external financial reporting, and not just the financial statements. However, what constitutes financial reporting has been deferred to a later phase of the project. We believe that users have very different expectations from financial statements and financial reporting, the latter may be more explicitly forward looking and accordingly users will recognise that there will be differences in the “reliability” of the content. In our view, the IASB and FASB should define financial reporting sooner, rather than later, as we are not yet convinced that the Framework can be widened to encompass all financial reporting. This issue is discussed in paragraphs 3-5 of the appendix.

We have a number of other concerns as follows:

- The limitation of the scope of the Framework to business entities in the private sector and the proposal to consider the impact on not-for-profit entities towards the end of the project. In our view, the implications for not-for-profit entities should be considered as the project progresses. This is discussed in paragraphs 1-2 of the appendix to this letter.
- Finally, we would like to make a general point that the current IASB Framework is used by standard setters, preparers and auditors alike. We are concerned that if the length and theoretical arguments contained in the DP were replicated in the final Framework it will alienate preparers and auditors. As such we will urge the IASB to make every effort to ensure that the final Framework is not so theoretical and long that it acts only as a reference manual for standard setters.

Given our fundamental concerns we do not consider that the proposals in the DP should proceed to an exposure draft (ED). If they do, we could not support the ED.

We hope these comments are helpful. We are happy to provide further explanations and clarification if required. If you would like any further information on the comments made above then please contact Seema Jamil-O'Neill on 020 7492 2422, David Loweth on 020 7492 2420 or myself on 020 7492 2434.

Yours sincerely



Ian Mackintosh
Chairman, Accounting Standards Board
DDL: 020 7 492 2434



Appendix

Scope of the Framework

Entities within the scope

1. We note that the scope of the Framework has been limited to “business entities in the private sector” (see, for example, paragraphs P8 and OB1 of the DP). We know that the IASB and the FASB are to consider the impact of the Framework on not-for-profit entities in the private sector and, in some jurisdictions, business entities in the public sector, at a later stage in the project (Phase G). However, as outlined in Ian Mackintosh’s letter of 20 October 2005 to David Tweedie and Bob Herz, we feel that a more effective and efficient approach would be for the IASB and FASB to assess the applicability to not-for-profit entities as a step at each phase of the project, rather than as a separate phase towards the end of the project. That said, we acknowledge the pressures the IASB and FASB are working under and the need for the Boards to set priorities in the approach to the project as a whole.
2. As you know, the ASB is participating in a group of chairs and senior staff of the standard-setters of Australia, Canada, New Zealand and the UK (the ‘Group of Four’) that is monitoring the applicability of the conceptual framework project to the not-for-profit entities in the private and public sector. A report from this group on the key issues for such entities arising from the proposals in the DP is attached to this letter and, where appropriate, reference is made below to the issues raised in that report. You will also be aware that the International Public Sector Accounting Standards Board (IPSASB) has agreed to lead a collaborative project on the development of a conceptual framework for public sector financial reporting, in conjunction with national standard-setters and similar organizations. We hope that the three Boards will have close co-ordination and collaboration with each other during the development of their respective projects.

Financial Reporting or Financial Statements?

3. The DP notes at the outset that the proposed conceptual framework establishes the objective of general purpose external financial reporting. As the current IASB Framework only applies to financial statements this implies an expansion in the scope of the Framework. We note that consideration of specific issues concerning the boundaries of financial reporting and distinctions between financial reporting and other parts of financial reporting have been deferred to a later phase (Phase E) of the project. The DP (paragraph OB16) notes that the objective pertains to all financial reporting, not just financial statements, because some types of both financial and non-financial information may best be communicated by means other than the financial statements. This may include corporate annual reports, prospectuses, annual reports filed with government agencies, news releases, management forecasts or other descriptions of its plans and expectations, and descriptions of an entity’s social or environmental impact.

4. In our view, there is a need for the IASB and FASB to first define what is covered by financial reporting before seeking to determine what the objective should be. We are concerned that widening the application of the Framework to encompass all financial reporting (however defined) will give rise to problems, in that it may be attempting to outline the concepts that underpin two fundamentally different things: financial statements and financial reporting. . In our view, users have very different expectations from financial statements and financial reporting, the latter may be more explicitly forward looking and accordingly users will recognise that there will be differences in the “reliability” of the content.
5. We note that an attempt to define the scope of financial reporting has been made by the project team that prepared the Discussion Paper ‘Management Commentary’, which was published by the IASB in October 2005. In that paper, the project team concluded that the qualitative characteristics of management commentary should be different in some respects to those that pertain to the financial statements. Given that the qualitative characteristics described in the latest DP predominantly apply to financial statements we expect that the IASB and FASB will have to revisit these at the time the Boards undertake to define the boundary of financial reporting.

The objective of general purpose external financial reporting

Stewardship

6. The objective of general purpose external financial reporting as set out in paragraph OB2 of the DP focuses solely on the provision of information that is useful in making investment, credit and similar resource allocation decisions. Paragraph OB3 goes on to place the emphasis on the provision of information that helps in assessing future cash flows. The DP does not identify, either as part of the overall or as a separate objective, the provision of information that enables users to assess the stewardship of management. Rather, as noted in paragraph OB28, the objective “encompasses” providing information useful in assessing management’s stewardship.
7. We acknowledge that this has been portrayed as not representing a significant change from the current Framework, but we disagree with this treatment of stewardship. Instead, we support the Alternative View as set out in paragraphs AV1.1 to AV1.7. In our view, users are not only interested in stewardship because, as the DP states in paragraph OB27, it “significantly affects an entity’s ability to generate net cash inflows” but goes much wider. While acknowledging that the importance of stewardship can depend on the particular legal framework in any jurisdiction, our view is that one of the purposes of financial reporting is to provide shareholders with the information they need to make decisions as owners of the business. These decisions are not merely whether to sell their shares, or buy more, but also include their rights, as owners, to change the direction of the business, or the management, in jurisdictions where they have those rights. In not having stewardship as an objective, there is a danger in the future that information useful for stewardship purposes, for example in an area such as related party

disclosures, may not be included in financial statements on the grounds that it is not thought to be 'decision-useful' for resource allocation purposes.

8. As Andrew Lennard's paper *Stewardship and the objectives of financial statements* makes clear, stewardship should not be characterised simply as information to assist an assessment of the competence and integrity of 'stewards' (ie the management and directors), but as the provision of information that provides a foundation for a constructive dialogue between management and shareholders.
9. Users look to financial reporting not only to identify risks inherent in the business but also to identify those risks that arise solely from the management's decisions. The latter cannot be achieved simply by providing information that helps in assessing future cash flows; it requires some review of previous decisions taken and transactions entered into by management. We note that the IASB and FASB are keen to avoid the implication that they do not think that financial reports should provide information that is useful in assessing stewardship (paragraph BC1.36). But, in our view, the sole focus on decision-usefulness does run the risk of implying that investors, in particular, look to financial statements only to make decisions to buy, sell or hold securities – and that the quality of an accounting standard should be judged wholly by whether it provides information that informs such decisions.
10. Financial statements should not aspire to provide information that is sufficient for a valuation of the company to be made, nor should that be their exclusive focus. Whilst the information in financial statements should be useful, relevant, and helpful in decision-making, they will never provide all the information that is necessary to make informed investment decisions. This point is acknowledged in the ASB's *Statement of Principles for Financial Reporting* (at paragraph 1.8). Indeed, we think that the converged framework should be rather more open about the limitations of general purpose external financial reporting, along the lines of the discussion in the ASB document.
11. If the sole aim of financial statements were to be to influence decisions about buying, selling or holding the company's securities, it is arguable that the most useful form they could take is a summary of management's expectations for the future. While there is no question that forward-looking financial information would be useful, it is not expected to supplant the current form of financial statements.
12. An obvious fact about current financial statements is that they are historical—the information is nearly all about financial position at a past date and changes in that position over a past period. The Framework needs to articulate clearly why this information is useful. In particular, transactions are of central importance to economic activity, and so the summary which is provided by financial statements of past transactions and their economic impact on the entity is useful in assessing the extent to which similar transactions might recur in the future and how they might affect the entity. If, for example, sales have grown strongly but margins are squeezed, this is

important information for assessing both future sales and their profitability. Therefore, the Framework should clearly identify the reporting of information about past transactions as a central feature of financial statements.

13. In practice, not all investors are solely concerned with buy, sell or hold decisions. In the UK, for example, the vast majority of the companies are private companies of all sizes where the owners, and at times the creditors, have made the long term commitment to work with the management. In such cases, the primary users are not only looking for the potential cash inflows but also how this is being achieved. By ignoring stewardship, which is a key objective of financial reporting for the primary users of these profit-orientated companies, the IASB is at risk of not meeting their needs in the proposed Framework.
14. As one of the current IASB projects is to the development of an IFRS for 'Small and Medium-sized Entities', it is clearly right that the conceptual framework should cover these entities and their users' needs. We feel that by not referring specifically to the stewardship objective the IASB could be placed in a position where it has to devise separate frameworks for these entities. Any separate frameworks issued could create further problems upon application when entities move up from SME to listed status.
15. This is also the case when considering the applicability to not-for-profit entities in the private and public sector of the concepts proposed in the DP. As highlighted in the report prepared by the 'Group of Four', in the case of not-for-profit entities, stewardship or the discharge of accountability is a significant aspect of the objective of financial reporting and should either be identified as a separate objective or recognised within a single objective/
16. In conclusion, we feel that stewardship as an objective forms the basis of a dialogue between the management and investors of a company through the medium of financial reporting. A simple solution would be to add to the text of paragraph OB 2 (after "decisions") "and for assessing the stewardship of the entity's management". As such, adding stewardship to the objective, or alternatively as a separate objective in parallel to decision-usefulness, will help enhance the way the Framework proposes to meet the needs of the primary users. This approach also has the advantage of ensuring the applicability of the Framework to entities and their users that may otherwise be left outside its boundaries.

Primary users of general purpose external financial reporting

17. The DP notes in paragraphs OB2 and OB10 that the financial reports should be designed to meet the needs of a wide range of users and not just investors and creditors. Yet the remainder of the paper then concentrates on the needs of investors and creditors as "their uses of information needs have been studied and described to a greater extent, and thus are better understood, than those of other external groups" and that "information that meets the needs of investors and creditors is also likely to be useful to members of other

groups” (paragraph OB14). In our view, there is a lack of evidence in the DP on which to base the decision as to the primary users of financial reporting. In our view, further research is required before such a conclusion can be drawn.

18. In common with the existing IASB and FASB frameworks, the ASB’s Statement of Principles identifies a wide range of users who use financial statements in order to satisfy some of their different needs for information. It then narrows that focus to a particular, defining class of user: in the ASB’s case, present and potential investors.
19. The ASB’s defining class of user is therefore narrower than that proposed for the converged framework. The ASB is aware of concerns expressed in the UK, but also elsewhere, that maybe the primary users as identified in the ASB’s statement is too wide a class and that the defining class should be narrowed further to focus upon the existing common shareholders only. For example, the CFA Institute¹ has argued that the financial statements should be viewed from the position of an investor in the common shares of the company (ie an existing common shareholder). Any hierarchy of users of financial reports, it has been suggested, should start with the current shareholders, as the owners of the business, in order to give the framework more clarity and focus. This could affect the debate as to whether a proprietary view or an entity view is used to determine the boundary of a reporting entity.
20. The discussion paper however, notes that an entity view will be taken as the financial reporting is directed to the needs of a wide range of users which can only be satisfied by the use of the entity perspective. In our view, the reason why the discussion paper chooses the entity perspective, which focuses on the needs of stakeholders (investors, creditors, employees, suppliers, customers, etc), at the expense of the proprietary perspective, which focuses on the needs of the owners of the company (current shareholders) needs to be researched and debated further. The discussion is limited to a short section in the Basis for Conclusions (in particular, paragraphs BC1.11-BC1.13), which notes that the IASB, despite having adopted the entity perspective as the basis underlying financial reports, “does not preclude also deciding in future standards projects to include in financial statements more information that might be viewed as consistent with a proprietary perspective”. We would have expected to see more discussion in the paper as to what the two perspectives imply in terms of financial reporting information.
21. In particular the entity perspective may lead to problems further down the line when dealing with issues such as goodwill and minority interests. We are aware of user groups who are concerned that the adoption of the entity perspective at the expense of the proprietary perspective will lead to International Financial Reporting Standards in the future ignoring the needs of proprietors, the only stakeholders to whom the entity is not bound by means of a contract.

¹ CFA Centre for Financial Market Integrity ‘A Comprehensive Business Reporting Model: Financial Reporting for Investors’ (CFA, October 2005)

22. Another area we feel has been inadequately addressed is the exploration of the needs of the different user groups e.g. users of listed, unlisted, small and medium sized entities and whether they have the same information needs. As identified above, for certain categories of entity, there are primary users whose needs will not be fully addressed by the proposed framework and its objective. In particular, by identifying the primary users as investors and creditors and then concentrating on decision-usefulness there is a fear that the scope of the Framework effectively becomes limited to listed entities only.
23. One further issue is that of the contradiction that arises from choosing the entity perspective and then concentrating on investors and creditors as primary user group. As mentioned above, the entity perspective focuses on the needs of a wide range of stakeholders in the company. However, trying to meet the divergent needs of investors, creditors, employees, suppliers, customers and other stakeholders through the vehicle of financial reporting is unrealistic. It would lead to long convoluted financial reports that, by the sheer volume of information contained within them, will be of little or no use to any one of those stakeholders. Although not specifying this as the reason, the IASB has acknowledged this by concentrating on the needs of investors and creditors and claiming that their needs, i.e. assessing the entity's ability to generate cash flows, is common to all other users as well.
24. We do not feel cash flow generation alone covers adequately the needs of such a wide range of stakeholders. A different approach may work better. Investors need to know all the information that other stakeholders need. For example, they need to be able to assess the capacity of the entity to take debt, or avoid costly disputes with its employees. As such, information that has, or may have, a financial impact on the entity needs to be included and these are also likely to be the areas that will be of interest to other user groups.
25. In conclusion we would recommend that the IASB conducts more research in this area to address the issues before coming to a firm view on who should be the primary users.

Qualitative characteristics

26. There are three main areas where we are concerned by the proposals in draft Chapter 2 of the DP:
 - a. the replacement of reliability with faithful representation and the introduction of the notion of verifiability;
 - b. the omission of any reference to 'substance over form'; and
 - c. the placement of the discussion of the constraints on financial reporting.

Faithful representation or reliability

27. We note that the main change in the DP is to replace the qualitative characteristic of 'reliability' in the proposed Framework with 'faithful representation'. The DP defines the qualitative characteristic in context of information that is a 'faithful representation of the real-world economic

phenomena that it purports to represent' (paragraph QC16). The paper further defines sub-components of faithful representation as being verifiability, neutrality and completeness.

28. The IASB and FASB are proposing this change on the grounds that there have been "longstanding problems with the qualitative characteristic of reliability" and that because "further efforts to explain what reliability means did not seem likely to be productive, the Boards sought a term that would more clearly convey the message" ie faithful representation (paragraph BC2.27).
29. Information presented in financial reports and statements is stylised information which does not necessarily faithfully represent the underlying economic reality. An analogy may be the London Tube map which cannot be called a faithful representation of how the actual tube lines run in London, the distance between the stations or their actual location aboveground, in fact an aerial photograph may be more faithfully representative. However, the map can be relied on every time to find you the correct interchanges and the quickest route to your destination. So reliability may not always give the exact economic substance but it will present a picture that is accessible to the user of the financial reports.
30. The DP presents substitution of reliability with faithful representation as a change in terminology, rather than any change in substance. However, when the definition in paragraph BC2.15, as the quality of faithfully representing what information purports to represent, is combined with the fact that the reference to 'substance over form' is being dropped from the Framework (see below), it makes us concerned that 'faithful representation' might be interpreted in a legalistic way.
31. In some quarters reliability is equated with quality and faithful representation with agreement. A good example is that of the Enron special purpose entities (SPEs). It was agreed by a number of different parties that they should be left off-balance sheet and it could be argued that this was the faithful representation of their substance, at least in legal terms. However, placing them off balance sheet did not represent the economic substance of the transaction and so did not present the users of the financial statements with a reliable picture.
32. We are also concerned at the proposal to introduce verifiability as a component of faithful representation. Verifiability implies agreement between two parties of a calculation using the same assumptions rather than the testing of the underlying assumptions. So applying verifiability to Enron, as long as the auditors were able to verify the decision made by the management to place the SPEs off-balance sheet, using the same assumptions (indirect verification as identified in the DP), neither they nor the management will be culpable as they would be faithfully representing the economic substance at the time of the decision.

33. As such, we concur with the Alternative View on verifiability as set out in paragraphs AV2.1 and AV2.2 of the DP paper. On the basis of the above analysis we would further note that consensus that is not based on reliable evidence should not constitute verification.
34. Our fear is that the application of faithful representation and its component of verifiability, as currently described in the DP, would take away responsibility from management as they will be able to argue that they presented information that was the most faithful representation of the economics at the time without having to justify whether their conclusions were reliable or not. In practical terms, we have still to be convinced that faithful representation offers a sufficiently robust alternative to reliability, which can stand up to the rigour of audit in the current environment.
35. The removal of reliability also has implications for later phases of the project. The current IASB Framework, in paragraph 83, notes that one of the criteria of recognition of an element of financial statements is that it has a cost or value that can be measured with sufficient reliability. Reliability of measurement is discussed further in paragraphs 86-88 of the Framework. We would be concerned if this aspect of the recognition criteria was removed.

Substance over form

36. We note the view that the quality of faithful representation is “incompatible with representations that subordinate substance to form”. While this provides some reassurance, we do not agree with the proposal to omit any reference to substance over form as a component of faithful representation, on the grounds that any reference to it would be “redundant” (paragraph BC2.18). The notion of substance over form has in the past ensured that preparers account for the full economic substance of a transaction rather than the legal substance or form. When discussing the accounting for transactions it has generally been sufficient to rely on ‘substance over form’ to ensure that the economic substance of a transaction is reflected without the need for references to any other qualitative characteristics.
37. Given that it has been such a cornerstone principle we feel that if it is not specifically referred to in the Framework it will be forgotten in due course. We therefore feel that it is better to retain a clear reference to the principle in the Framework.

Constraints on financial reporting

38. The discussion on qualitative characteristics in draft Chapter 2 mentions two constraints on financial reporting: materiality and cost benefit concerns. Given that the Framework attempts to set out the ideal to which financial reporting should aspire (paragraph OB15), is it right that any discussion of the constraints on these ideals should be within the body of the Framework itself? We would recommend that the IASB combine the Purpose, Scope and Constraints of the Framework in an introductory section upfront so as not to detract from the main provisions of the Framework itself.

Other

39. We also have an observation that the current Framework includes references to the accruals and going concern principles in paragraphs 22 and 23. The DP omits any references to financial statements or reporting being produced on a going concern basis. We assume that the IASB continues to consider going concern an important notion and we would urge the Boards to include a specific reference to it in the converged framework.

40. If on the other hand, all references to going concern are to be deleted from the Framework, this should only be done after the rationale has been fully explained and exposed for discussion.



**Stewardship and the objectives of financial statements:
a comment on IASB's
Preliminary Views
on an improved Conceptual Framework for Financial Reporting:
The Objective of Financial Reporting and
Qualitative Characteristics of Decision-useful Financial Reporting Information**

Andrew Lennard, Accounting Standards Board¹

Summary

This paper examines the question of whether the objective of financial reporting should be based solely on 'decision-usefulness' or whether stewardship should be recognised as a separate objective. This question is not new, but has recently come to the fore through the publication by the IASB and FASB of their 'Preliminary Views' paper setting out a draft of the first chapters of their proposed improved conceptual framework. The PV paper proposes a decision-useful objective, and argues that information relevant to assessing stewardship will be encompassed in that objective. However, two IASB members have set out an 'Alternative View' which argues that stewardship and decision-usefulness are parallel objectives with different emphases, that should therefore be defined as separate objectives.

The present paper argues that, as suggested by the Alternative View, stewardship contributes an important dimension to financial reporting, which should be reflected by specific acknowledgement in the objectives of financial reporting. However, it suggests that stewardship should not be characterised simply as

¹ This paper has been prepared to stimulate debate. The views expressed are not an official position of the ASB, but the author cannot escape responsibility for them.

information to assist an assessment of the competence and integrity of 'stewards' (ie management, directors) but as the provision of information that provides a foundation for a constructive dialogue between management and shareholders.

Seen in this way, stewardship provides a direct support for many of the propositions advanced in the PV paper. For example, it highlights the importance of historical information and that information should be complete. It would, however, be easier to make a compelling case for this information if a major role for stewardship were identified in the framework, rather than being placed merely in a supporting role.

But other consequences would also follow. Exclusive focus on a decision-usefulness objective has led to an excessive emphasis on the forecasting of future cash flows, and insufficient emphasis on reliability, which seems to be an essential qualitative characteristic of financial statements. The substitution of 'verifiability', as proposed by the PV paper, is not adequate.

There is no conflict between decision-useful and stewardship objectives, since the information required to meet the objective of stewardship is required by decision-usefulness: however, the exclusion of stewardship incurs the risk that those who argue for the inclusion of information required for an assessment of stewardship will be placed at a disadvantage.

They will have to frame their arguments in an indirect and convoluted way ,and it is accordingly unlikely that they will always succeed. So accounting standards might permit the exclusion of information, or the presentation of information in a sub-optimal way, whilst superior alternatives could be compellingly supported by appeal to an explicit objective of stewardship.

1 Introduction

The nature of the issue

1.1 The purpose of this paper is to explore an issue that arises in the context of IASB's recently published 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.*'² Should the Framework for financial reporting specify merely a 'decision-useful' objective, or should stewardship be identified as a separate objective?

1.2 The PV paper opts for a decision-useful objective, and states it as follows:

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 investment, credit and similar resource allocation decisions.
(OB2)

1.3 The objective therefore highlights usefulness in making resource allocation decisions. There is no explicit reference to stewardship. However, this is discussed later, when it is explained:

The objective of financial reporting...encompasses providing information useful in assessing management's stewardship. (OB28)

1.4 It is not clear that this is wholly satisfactory: many believe greater prominence should be given to providing information on stewardship. This is the view reported in the Alternative View on Chapter 1:

² The Discussion Paper is referred to in this note as the 'PV paper'. Specific paragraphs are cited by paragraph number.

Two IASB members disagree with the proposal for subsuming stewardship within a decision-useful objective. They would prefer stewardship to be identified as a separate objective of financial reporting. (AV 1.1)

1.5 This has clearly been a controversial aspect of the proposals: apart from the Alternative View, there is an extended discussion of the paper's position in the Basis for Conclusions (paragraphs BC1.32-BC1.38). This acknowledges that some—presumably including some FASB or IASB members—would argue that no specific reference to stewardship should be made.

1.6 This question may appear 'academic', in the worst sense of that word—abstract and of little consequence. It arises in the context of the conceptual framework, and thus may not lead directly to mandatory accounting requirements.³ It is also, at the end of the day, a question of emphasis. Those who support a decision-usefulness objective claim that it will encompass information that is useful for an assessment of stewardship. Equally, the dissenting IASB members do not argue that stewardship should be the only objective of financial reporting: their position is that it should take a place alongside decision-usefulness, rather than supplant it.

1.7 But if the debate is about emphasis, it is nonetheless important. Experience shows that, in the course of standard setting, it is all too easy to use the Framework in a selective way: much weight is given to certain principles and wise qualifications and limitations on them are forgotten.

³ At present management preparing financial statements in accordance with IFRS are required to consider the IASB Framework when dealing with a matter that is not addressed in an international standard or interpretation. The position is different where financial statements are prepared under US generally accepted accounting principles. The IASB and the FASB have not yet considered whether the revised Framework will have to be considered by management. This is explained in the Preface to the PV paper at paragraph P2.

1.8 Discussion of the importance or otherwise of stewardship would be easier if it could be demonstrated that its omission or inclusion in the objectives of financial reporting would necessarily entail different accounting standards. However, the Framework does not (and probably should not) provide axioms from which specific accounting requirements can be deduced with ineluctable logic. The PV document seeks to indicate a direction of travel, and it is mainly this that needs to be considered here, rather than specific destinations. The accounting standards that will result from the new Framework cannot be deduced from its first two chapters. This is true whether or not stewardship is recognised as a fundamental part of the objectives of financial reporting.

1.9 However, the implications of the PV paper as drafted can be discerned. If these are carried through, the final Framework will support financial reporting with a content and substance that differs quite markedly from that to which many users of financial reporting standards are accustomed. Some changes in financial reporting are obviously desirable, but it is possible to question whether the direction suggested by the PV paper is wholly appropriate. The issue is significant enough to warrant careful scrutiny.

Some general points on the Framework

1.10 Although the focus of this paper is on the stewardship issue, some general points on the draft new Framework may be noted as a preliminary.

1.11 The first is that the PV paper focuses on financial **reporting** rather than financial **statements**. This wider focus means that its prescriptions apply (at least potentially) to, for example, forecasts and environmental and social information (BC1.5-1.7). An obvious example is narrative reporting, including reports such as an Operating and Financial Review, Business Review or Management Commentary. Financial reporting outside of financial statements is undoubtedly an area of immense importance and IASB is to be applauded for having it firmly in its sights. Nonetheless there are difficulties implicit in the wide focus adopted in the

PV document. Objectives (and, indeed, qualitative characteristics) have to be set at a high enough level to embrace not only financial **statements** (that is, balance sheets, profit and loss accounts and the like) but the whole of financial reporting—the boundaries of which remain undefined. If the objectives are set for a potentially large set of possible reports, it is difficult to judge whether they are appropriate. Perhaps even more worryingly, this approach incurs the risk of blurring the distinction between financial statements and other kinds of financial information. Financial statements should conform to a strictly defined framework: only if this is the case can preparers and users know what is properly included and what excluded. Worries on this point are exacerbated by the admission that the PV paper admits that the extent of ‘financial reporting’ remains undefined (BC1.7).

1.12 The PV document deals only with financial reporting by business entities in the private sector. Thus, it does not consider issues that arise in connection with not-for-profit entities (such as charities) or in the public sector. Amongst the consequences of this is an emphasis on cash flows. It seems plausible to assert in the context of the private business sector that expenditures should be judged according to their potential for future cash flows (although even in this context the relationship of expenditures to cash flows is often extremely indirect). But it is unlikely that a fire station owned by a local government will yield any cash flows to its owner. The same is true for a supply of blankets held by a charity to provide emergency aid.

1.13 The importance attached to future cash flows in the PV paper is illuminated by a circularity in its argument. The generation of cash flows is ‘the primary focus of financial reporting because it helps satisfy the needs of investors and creditors’ (OB13). But the Basis for Conclusions states:

Because present and potential investors and creditors clearly represent users of financial reports who are interested in an entity's ability to generate net cash inflows, the boards decided to designate them as the primary users of financial reporting information. (BC1.16)

1.14 An emphasis on stewardship, would lead to consideration of real transactions in the reporting period rather than simply prospects for future cash flows, and might have prevented this circularity.

Structure of this paper

1.15 The remainder of this paper is organised as follows.

- Section 2 discusses the decision-usefulness objective as set out in the PV paper.
- Section 3 addresses the nature of stewardship, and suggests how its inclusion as a specific objective might affect the remainder of the Framework, and thus the accounting standards that will be set on its basis.
- Arguments against a specific reference to stewardship in the objectives are reviewed in Section 4.

A final section presents some tentative conclusions.

2 Decision-usefulness

2.1 The decision-useful objective adopted in the PV paper is set out in paragraph 1.3 above. It is highly significant that the dissenting IASB members do not call into question that decision-usefulness should be among the objectives of financial reporting: their position is that stewardship should be separately identified as an objective.

...stewardship and decision-usefulness for investors are parallel objectives which do not necessarily conflict, but which have different emphases. They should therefore be defined as separate objectives. (AV1.4)

2.2 The case for identifying decision-usefulness as an objective is rightly not questioned in the PV paper. Indeed there are compelling points in its favour. Considerable resources are invested in financial reporting: if it were not useful, these resources would be wasted. And if financial reporting cannot influence decisions, it would seem that it would serve no purpose. Hence the case for a decision-useful objective is almost self-evident. The issue is whether decision-usefulness in and by itself provides a sufficient and appropriate focus for the future development of financial reporting.

2.3 Obviously much depends on the decisions that are expected to be made on the basis of financial statements. Given that the primary users of financial statements include present and potential investors and creditors, the most obvious decision to be made is whether to purchase or sell their investment or continue to hold it (or in the case of creditors to extend credit). If one makes conventional assumptions about markets, the most useful information to make these decisions is the value of the company. If that amount is greater than the current market price, a buy decision is indicated, as the purchaser will be rewarded as the market moves towards true value. Conversely, a sale where true value is less than market value will obviate a loss as the market price declines.

2.4 It is seemingly a short step from the sole use of a decision-useful objective to the conclusion that, at least subject to practical constraints, the role of financial reporting should be to report the value of the firm, or at least of its individual assets and liabilities. And to an investor value is generally about future cash flows. Hence the PV paper notes:

To help achieve its objective, financial reporting should provide information to help present and potential investors and creditors and others to assess the amounts, timing and uncertainty of the entity's future cash inflows and outflows...That information is essential in assessing an entity's ability to generate net cash inflows and thus to provide returns to investors and creditors. (OB3)

2.5 The PV paper contains a number of qualifications to the decision-useful objective, presumably to avoid a simplistic characterisation of it of the kind given above.

- The objective is to provide information that is useful in making decisions: this does not imply that decisions will flow mechanically from the information in financial statements. Indeed, users will require access to information beyond that contained in the financial statements (OB14). This is also implicit in the reference in the objective to 'information that **is useful**' rather than, for example, information that **provides a basis** for a decision.
- References to cash and cash flows may be read as 'cash, cash equivalents or other resources that can be converted into cash' (OB5).
- Financial reports are not designed to show the value of the entity (OB20).
- The term 'resource allocation' as it is used in the objective includes, but is not limited to, decisions about whether to buy, sell or hold the entity's securities or whether to lend money to the entity. Other decisions that are included in the phrase are decisions on management appointment and remuneration and voting on policies (OB28). This clarification of the decision-usefulness objective is clearly important for the claim that the decision-useful objective encompasses the provision of information that is useful in assessing stewardship.

2.6 These qualifications are entirely appropriate. But there remains room for doubt as to whether they fully correct the impression that the PV paper adopts a focus on future cash flows and thus might encourage the development of accounting standards focused on that objective to the relative neglect of other considerations.

3 Stewardship

What is stewardship?

3.1 Stewardship is frequently discussed, but less frequently characterised precisely. The current IASB Framework refers to it as follows:

Financial statements also [ie in addition to providing information that is useful in making economic decisions] show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. Those users who wish to assess the stewardship or accountability of management do so in order that they make economic decisions; these decisions may include, for example, whether to hold or sell their investment in the enterprise or whether to reappoint or replace the management. (Paragraph 14)

3.2 So the current Framework, like the PV paper, argues that stewardship accounting is implicit in a decision-relevance objective. However, unlike the PV paper this explanation is included adjacent to the definition of the objectives, and under the main heading 'The Objective of Financial Statements'. In the new draft of Chapter 1, the discussion of stewardship is placed in the final section, implying a significant decrease in its importance.

3.3 The current Framework seems to imply that the terms 'stewardship' and 'accountability' are synonymous. There is indeed little to distinguish the two terms: this paper generally uses the term 'stewardship' as it has come to occupy the foreground of the debate. Nonetheless, 'accountability' has important associations: it refers directly to the fact that, not only does management have the responsibility

to use the assets entrusted to it for the benefit of shareholders, it also has the overriding obligation to provide those shareholders with **an account** of what it has done with those assets.

3.4 The view of stewardship given in the PV paper is somewhat different. It mentions that management is accountable for the custody and safekeeping of the entity's assets and their efficient and profitable use, including protecting them from unfavourable economic effects such as inflation and technological changes. It also notes that management is responsible for ensuring compliance with laws, regulations and contractual provisions.

3.5 The dissenting IASB members describe the role of stewardship as follows:

Stewardship is concerned with the accountability of the directors, or management board, of a business entity to its proprietors or owners. This is at the heart of the financial reporting process in many jurisdictions... (AV1.3)

They go on to explain:

For example, stewardship may require more emphasis on related party transactions, and generally on past rather than future transactions or events, than would be required by the primary focus on future cash flows. Thus, stewardship and decision-usefulness for investors are parallel objectives which do not necessarily conflict, but which have different emphases. (AV1.4)

3.6 In the context of business enterprises, the need for accounting is often rationalised in terms of agency theory, on which the literature is voluminous. Here only the most salient points need be mentioned. Where a company is listed, control and ownership are separated. The company is controlled, at least on a day-to-day basis, by its management (the directors, or management board) but owned by its shareholders (or proprietors). This involves obvious benefits for both parties but also risks. These risks may be controlled or reduced by various means: one of the most obvious, and widely used, strategy is for a requirement on management to

provide regular accounts that are available to the shareholders. Financial statements therefore provide a key condition for the existence of a modern company: it is difficult to imagine how companies with widely held and traded shares would be possible if credible accounts were not generally prepared. A stewardship objective emphasises this role of financial reporting.

3.7 Most accounts of agency theory stress the possibility of a divergence of interest between management and shareholders, both of which are assumed to be relentlessly pursuing their economic self-interest (PV paper, BC1.40). Perhaps it is for this reason that the PV paper characterises stewardship as a demand for information on management's safe custody of the assets, and compliance with laws and regulations (OB27). The stress is on whether management have behaved properly and not for example, unjustly enriched themselves at the company's expense. The Alternative View seems to go along with this characterisation, at least to some extent: it notes that stewardship information will assist not only in assessing the competence of stewards but also their *integrity* (AV1.3). It also suggests that financial reporting should provide information relevant to an assessment of whether remuneration is excessive or unjust.

3.8 Characterised in this way, financial statements that are prepared from a stewardship perspective might sound formal, legalistic and of limited real usefulness. However, there is more to the stewardship dimension.

3.9 The separation of control and ownership has pervasive consequences. Even if management can be relied upon to act with unimpeachable competence and integrity, it would still be necessary for regular communication between managers and shareholders to take place. Management have many responsibilities, including, for example, to review and if necessary change the company's business strategy; another is to consider how the company should be financed. However comprehensively the company's objectives and strategies are specified at the outset, unforeseen and unforeseeable new challenges and opportunities will arise:

management may devise responses to these, but shareholders have the right to have their say on them.

3.10 It is therefore essential that regular dialogue take place between management and shareholders. In the modern economy, this dialogue takes place in numerous ways and in various media—not only directly with shareholders but also with others who have an interest in business information, such as analysts and business journalists, but whose activity ultimately benefits shareholders (and potential shareholders). Much of the information that a company provides will be in narrative form, and it may be oral, in print or electronic. It may well be, as is often suggested, that the annual financial statements rarely contain much news that is not already known given the frequency and variety of corporate communications. However, financial statements provide a key part of the communication package even if all they do is to provide confirmation of and further detail of information previously released. One might also expect that the information that management is prepared to release will be influenced by the knowledge that it will later be reflected in financial statements. It is worth noting that financial information conveyed outside of the financial statements is generally regarded as more useful if it is prepared on a GAAP basis—that is, using the same principles that are used in financial statements—or at least reconciled to a GAAP basis.

3.11 Regular reporting should not be seen simply as a burden imposed on management for the benefit of shareholders. Without regular reporting, management would have no way of explaining their success or their responses to new challenges. This might have an unwarranted effect on investor sentiment, and thus lead to outcomes that management would prefer to avoid, for example, a hostile takeover bid. Thus, even in the absence of legal or other regulatory requirements for regular reporting, it is to be expected that managements would

often voluntarily release information. Financial reporting benefits both management and shareholders.

3.12 It is therefore insufficient to characterise a stewardship objective as merely providing a check on the integrity, efficiency or capability of management: it is a necessary response to the development of the modern company and a fundamental building block of corporate governance. The benefits of providing reports that assist an assessment of stewardship accrue to management, as well as to shareholders.

3.13 These points might be reflected by adding an explicit objective of financial reporting as follows:

to enable management to account to investors on the state of the entity's financial affairs and changes in those affairs, to assist in assessing the results achieved under management's stewardship and the strategies employed and risks undertaken that have led to those results.

3.14 The role of financial statements in facilitating dialogue between management and shareholders seems to have significant consequences. Valuable features of financial statements flow directly from a stewardship objective, whilst they can be rationalised only indirectly, and with somewhat tortuous logic, from a decision-usefulness objective. Some of these features are reviewed in the following paragraphs.

The importance of history

3.15 As noted in paragraph 3.5 above, the dissenting IASB members state:

stewardship may require more emphasis on...past rather than future transactions and events, than would be required by the primary focus on future cash flows. (AV1.4)

3.16 The case that financial reporting should include information on past transactions and events can be made, even if the objective of financial reporting is

stated purely in terms of decision-usefulness. The PV paper states, for example: *'Investors and creditors usually find information about an entity's past financial performance helpful in predicting the entity's future returns on its resources, which will be its future financial performance.'*

3.17 However, the importance of historical information is self-evident if stewardship is explicitly included in the objectives of financial reporting. Stewardship straightforwardly requires the provision of an account—that is statements that show and explain the assets and liabilities at the start and end of the accounting period, and how they have changed.

3.18 It is particularly important that changes in assets and liabilities are explained. In particular, it is usually essential to distinguish changes that reflect changes in prices from those that represent transactions—exchanges of assets and liabilities. Most businesses acquire goods and services in one market use their skills and abilities to transform them in various ways and then sell them, as transformed, on a different market. In order for the business to survive, it must be able to repeat this activity and do so profitably. For this reason, a natural focus of financial reporting is to report the purchases of goods and services in a year and the amounts derived from sales of products.

3.19 The importance of providing an account of transactions and the result of those transactions provides, for example, a possible justification for the reporting of purchased goodwill, but not so-called 'internally generated' goodwill. Because management has spent money on an acquisition, its financial statements need to provide (literally) an account of the effect of that acquisition and to place in context the returns that are earned from that investment. Whilst management are also responsible for earning a return on 'internally generated' goodwill this is not usually regarded as equally important and is in any event beyond the bounds of information that financial statements can be expected to capture. The omission of internally generated goodwill is not usually seen as a critical weakness of financial

reporting, but many would consider financial statements seriously deficient if they did not include purchased goodwill.

3.20 The IASB has, in various contexts, debated whether transaction costs should be reflected in the carrying amount of assets. Transaction costs include expenditures that flow directly from the purchase of an asset. The case for writing off transaction costs is that they cannot be recovered from the sale of the asset and thus, on this view, result in the asset being overstated—even if sale is only a remote possibility. But a stewardship perspective suggests that where significant costs have been incurred in acquiring assets whose returns will arise over several accounting periods, it may be appropriate to treat those costs as part of the value of the asset, to provide a more useful basis for assessing those returns. Immediate expensing of transaction costs would, on this view, lead to overstating the returns on assets made in later accounting periods.

Credibility and completeness

3.21 If as suggested above (paragraph 3.9), financial statements are to provide a proper foundation for a dialogue between management and its shareholders it is important that they are credible. This requires that they are prepared in accordance with a trusted set of GAAP. A user need not know the specific requirements of GAAP, although his ability to interpret the information they contain will be enhanced if he does. But the prime ingredient of credibility is that the investor is confident that the standards that are used are suitable for his purposes. If GAAP allows too much leeway for discretion, it is difficult to interpret the information that is presented. For this reason, a conventional depiction of economic phenomena may provide better (more useful) information than one that more closely reflects the future prospects of a business.

3.22 One of the more surprising features of the PV paper is that in the draft of Chapter 2—tellingly entitled ‘Qualitative Characteristics of **Decision-useful** Financial Reporting Information—’ reliability is not listed, although it features as an

essential qualitative characteristic in both IASB's and FASB's current frameworks. Instead, the PV paper proposes that reliability should be subsumed within the concept of faithful representation, the requirement that information should represent what it purports to represent. Faithful representation is said to encompass verifiability, neutrality and completeness.

Verifiability

3.23 But verifiability is not, as a matter of logic, a component of faithful representation. An eyewitness account of an event may be a faithful representation, even if it cannot be verified. (Of course, if it cannot be verified it may not be very useful, but that is beside the point.) Verifiability also seems to be an inadequate substitute for reliability: it requires merely that different observers will reach consensus, and not that they either base their views on reliable evidence nor that the method used for 'indirect verification' should be appropriate, even if it is applied without material error or bias. (See the Alternative view to Chapter 2.)

Completeness

3.24 A separate objective of stewardship obviously implies that the financial statements should be complete—that is they should tell, not only the truth, but the whole truth. However, it is not obvious that this necessarily follows from a decision-usefulness objective. If an event has taken place in the period, and it is clear that it will never recur, it cannot be relevant to decisions, since decisions can only be taken with respect to the future. Logic would therefore suggest that if the sole purpose of financial reporting is to provide information that is relevant to decision making, information on that event could be omitted. But stewardship requires a complete account of all the events of the period.

3.25 But if decision-usefulness might arguably imply that information of some kind could be omitted, stewardship does not. Shareholders have the right to expect that the financial statements will set out the full picture. This is particularly

important as the financial statements provide a means of raising questions as well as answering them. For example, it may not be obvious in a given case that changes in the relationship between components of working capital are significant and hence require explanation, but an astute shareholder may note that more explanation of how they have arisen and how they relate to the entity's business would provide a useful insight. This use of financial statements to raise and answer questions seems to have much in common with the concept of 'confirmatory value' discussed in the PV paper. But confirmatory value is a somewhat obscure concept: a higher profile for this kind of information could easily be secured by appeal to stewardship as a distinct objective of financial statements.

3.26 In short, stewardship emphasises the value of reliability. Verifiability, as described in the PV paper is a poor substitute for it, and seems not to be a necessary part of 'faithful representation'. Stewardship also emphasises the value of completeness and provides a more direct justification for it than does a decision-useful objective.

Recognition and basis of measurement

3.27 All future cash flows are relevant to decision-making, but financial statements have never attempted to provide a reflection of all such flows. Instead, financial reporting has insisted that potential assets (and liabilities) are carefully tested to see if they meet stringent definitions and recognition criteria. An exclusive focus on decision-usefulness might cause these criteria to be more relaxed.

3.28 For example, customer relationships are a source of future cash flows and thus candidates for treatment as assets, even where no contractual relationships exist. Many, however, would have qualms about the conclusion that all such relationships should properly be reflected in financial statements—presumably at the current value of the future cash flows to which they are deemed to give rise.

3.29 Even where future cash flows relate to more familiar assets, such as stock (inventory), the decision-useful objective can be used to argue for a basis of measurement that directly reflects them. Market values, where available, could be used on the reasoning that they reflect the amount timing and certainty of all future cash flows: where they are not available, the cash flows could be discounted to arrive at an amount that can be reasoned to reflect a market price. This is the essence of the proposals for fair value accounting.

3.30 There are, however, several considerations that would need to be addressed before all would agree that financial reporting should develop comprehensively in this way. One is the reliability of the methods used. Perhaps more fundamental, however, is the risk that it might obscure the economic model on which the business is based. Businesses do not usually make profits simply by nurturing customer relationships or by manufacturing stock, however valuable. Anticipating future transactions might obscure the portrayal of the underlying business model by mixing the results achieved in one period with the expected effect of transactions that are likely to arise in a later period.

3.31 None of these conclusions are inevitable. As was noted earlier in this paper, the PV paper sets out the role of financial reporting, not just that of financial statements, and it is possible that later stages will provide a clear demarcation between the information that financial statements will provide, and much that is useful to prediction of future cash flows will be dealt with elsewhere. Or it may be that some of the issues addressed above may be solved by developments in the current project on reporting financial performance. Nonetheless the risks would be less worrying if stewardship were acknowledged as a separate objective.

Management perspective

3.32 Financial statements that are designed to provide the basis for discourse between management and shareholders are inevitably the property of management: they provide an opportunity for management to explain the progress of the business

as they see it. In contrast, a decision-useful perspective can sometimes be used to justify reporting market values, even where a current transaction in the asset is not in prospect. A specialised asset can often not be sold for as much as the costs incurred in acquiring it: honest application of the market perspective would require that it be written down to its estimated sale proceeds, which might be little more than a scrap value.

3.33 Nor it is entirely convincing to suggest that this result can be avoided by insisting that, in the event of a sale, other related assets (including intangibles) would be sold to enable the purchaser to extract the same profits as those expected by the current owner. If financial reporting is to proceed on the basis of valuations made at that level of aggregation, it would seem to be necessary to report the total value of the business, or at least business units rather than the amounts of the individual assets. Much information on the nature and scale of the resources and obligations held by the entity would be lost, and no insight would be provided of how these are employed in furthering the entity's objectives.

4 Arguments against an explicit stewardship objective

4.1 It has been said above that identifying stewardship explicitly as a separate objective of financial reporting is a controversial issue: strong views are held on either side. Yet it also appears that modifying the PV paper to explicitly include stewardship would, in several instances, provide a clearer justification for the kind of financial statements and financial reporting that is advocated in the PV paper. The reasons that might influence some to oppose the elevation of stewardship or even (as noted in BC1.35) to argue that it should be eliminated altogether, are viewed in this section. None of them appear compelling.

Historical cost

4.2 It is sometimes claimed, especially by those that consider stewardship should be the sole or primary objective of financial statements, that it requires that

financial statements should be prepared on the basis of historical cost. This might be supported by some of the considerations discussed in section 3 above: the need for financial statements to provide a clear, factual account of the transactions that took place in an accounting period, and the need for the accounting principles used to be unambiguous and robust.

4.3 But it does not appear that anyone disputes the general need for financial statements to contain a clear account of transactions. Emphasising this clearly does not necessarily entail that they should not also contain information on price changes, and often the most informative way of achieving this is to depart from a historical cost basis.

4.4 The objectivity of historical cost is much debated: some consider it highly objective, others point out that it often requires arbitrary allocations. It is not necessary to discuss this point at length here. On the other hand the relevance of historical cost seems, at least in some cases, very low. If the entity owns assets the value of which has increased in an earlier accounting period, a proper account of stewardship cannot be given by reporting the result of their sale simply as the difference between the proceeds received and their historical cost. In such a case, proper discharge of the stewardship responsibility requires that the price increase is reflected in the financial statements for the period in which it occurs, and the sale is reported, measured against current prices, in the period the sale is made.

4.5 Thus advocating stewardship does not entail adherence to historical cost: better information on stewardship may sometimes be produced by using more current values than historical cost.

A single objective?

4.6 The purpose of the conceptual framework is to provide a clear and coherent basis for financial reporting, and the objective is its foundation. It therefore seems

to be important that the objective be clearly and precisely specified. At first sight, having two or more separate objectives might appear to conflict with this.⁴

4.7 A multiplicity of objectives might certainly be worrying, but only if they contradict each other. But stewardship and decision-usefulness do not conflict: rather they emphasise different aspects of what financial reporting can be expected to achieve. They are complementary rather than contradictory. Those who argue that adding a separate stewardship objective would 'add nothing substantive' (BC1.35) would presumably agree with this.

4.8 However, the omission of stewardship has the potential of placing those who argue that information for stewardship purposes at a disadvantage: rather than appeal directly to the objectives as set out in the framework, the reasons why stewardship information is essential and encompassed in the decision-useful objective has to be restated and agreed every time.

Separation of entity/management performance

4.9 The principal argument stated in the PV paper for the position it takes is 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' (BC1.37). It goes on, rightly, to say that this is not feasible in financial reporting. This is answered by the dissenting IASB members by explaining that this is not a necessary implication of their view: they note that 'the stewardship responsibility of the management extends to all of the activities of the entity' (AV1.5), and hence such a separation is not required. They also go to note, rightly, that financial

⁴ The ASB's *Statement of Principles for Financial Reporting* states: 'The objective of financial statements is to provide information about the reporting entity's financial performance and financial position that is useful to a wide range of users for assessing the stewardship of the entity's management and for making economic decisions'.

reporting cannot be expected to provide all the information that is required for the purposes of stewardship, just as it cannot provide all the information necessary for the prediction of future cash flows, as required by the decision-useful objective.

4.10 Similarly, the PV paper suggests that those who would argue for a role for stewardship ‘may be mixing financial reporting and corporate governance issues’ (BC1.38). Financial reporting cannot give all the information that is needed for an assessment of corporate governance: again, this overlooks the point that financial reporting cannot give all the information necessary for any purpose.

Types of theories of accounting

4.11 Many of those who advocate a stewardship objective do so on the basis of observation of how financial reporting has evolved, and the role it has played historically. Some of these are chiefly concerned to explain the behaviour of accountants and those who use their products, rather than to construct prescriptive theories of what financial reporting should aspire to do. The relevance of current (and past) practice for the framework is not self-evident. It is obviously not intended simply to provide a rationalisation for existing practices—if it were to adopt such an approach it could hardly provide a useful tool for the improvement of financial reporting.

4.12 But evidence from the practical use and evolution of financial reporting should not, perhaps, be simply discarded. Most preparers and users of financial statements do so for a purpose (and not merely to comply with regulation, important though the role of regulation is). It is possible that the shareholders who demand regular credible financial reports and the management who agree to provide them are acting irrationally, but it is not plausible.

5 Conclusions

5.1 As promised at the outset of this paper, the relationship of stewardship to the objectives of financial reporting and, especially that of financial statements, may

only have an indirect bearing on the future of financial reporting. The omission of a specific reference in the objective specified in the PV paper may perhaps, in part, be due to ambiguity as to its meaning and purpose. It is suggested that it should not merely be seen as information to assist an assessment of the competence and integrity of 'stewards' (ie management, directors) but as the provision of information that provides a foundation for a constructive dialogue between management and shareholders.

5.2 If, as advocated by the dissenting IASB members, stewardship were to be identified as a separate objective of financial reporting it would change the emphasis of the Framework. In particular, as they note, cash flows would receive less emphasis, and more emphasis would be placed on reliable historical information. Although this would not change many aspects of the Framework, it would change some. These changes would make it a more useful tool for the improvement of financial reporting.

* * * * *

The IASB/FASB Conceptual Framework Project's
Preliminary Views on an Improved
Conceptual Framework for Financial Reporting:

**The Objective of Financial Reporting and Qualitative
Characteristics of Decision-useful Financial Reporting
Information**

**Application to not-for-profit entities
in the private and public sector**

Chairs and Senior Staff of:
Australian Accounting Standards Board
Canadian Accounting Standards Board
Canadian Public Sector Accounting Board
New Zealand Financial Reporting Standards Board
United Kingdom Accounting Standards Board

What this Report is About and Why it has been Prepared

This Report has been prepared by a group of chairs and senior staff members of the standard-setting bodies of Australia, Canada, New Zealand and the United Kingdom. It comments on the applicability to not-for-profit entities in the private and public sector of the concepts proposed in the first Discussion Paper in the IASB/FASB Conceptual Framework Project. The IASB/FASB Conceptual Framework Project is, for the time being, focusing exclusively on concepts for private sector businesses. The objective in publishing this Report is to highlight the key issues the group has identified:

- for the information of the IASB; and
- to inform the not-for-profit constituencies of the standard-setting bodies about issues that they may wish to consider and comment on.

Summary of the Report

- S 1 Not-for-profit entities have different objectives, different operating environments and other different characteristics to private sector businesses (profit-seeking entities). These differences are discussed in Appendix A to the Report which recognises that there are also many similarities between not-for-profit entities and private sector businesses.
- S 2 The Preliminary Views document on the Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information issued by the IASB and FASB covers private sector businesses only – this Report considers how some of the differences in the not-for-profit sector affect the possible application of the concepts proposed by the IASB and FASB to these other entities.
- S 3 Part 1 of this Report considers the applicability of the proposed Objective of Financial Reporting to not-for-profit entities in the private sector. It raises three issues:
- insufficient emphasis on accountability/stewardship;
 - a need to broaden the identified users and establish an alternative primary user group; and
 - the inappropriateness of the pervasive cash flow focus.

It also highlights a risk that the scope of financial reporting may implicitly be narrower than is necessary for it to meet the needs of users in the not-for-profit sector.

- S 4 Part 2 of this Report considers the applicability of the proposed Qualitative Characteristics of Decision-useful Financial Reporting Information to not-for-profit entities in the private sector. It notes that:
- some of the issues raised in Part 1 are also pertinent to the proposed qualitative characteristics; and
 - different cost-benefit assessments may be appropriate when considering not-for-profit entities because of the different objective for these entities, the different primary user group and because of the different incidence of benefits and costs.
- S 5 Appendix B comments on issues regarding the Objective and Qualitative Characteristics of Financial Reporting from the perspective of not-for-profit entities in the *public* sector.

Preface

Background

P1 On 6 July 2006 the International Accounting Standards Board (“IASB”) and Financial Accounting Standards Board (“FASB”) published the first in a series of publications as part of a joint project to develop a common Conceptual Framework for Financial Reporting. The first document is entitled “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 *Preliminary Views* document). Comments have been requested by 3 November 2006.

This Report

P2 This Report comments on the applicability of the concepts proposed by the IASB and FASB to not-for-profit entities in the private sector and, in Appendix B, to public sector entities that do not have a profit objective. The Report results from the efforts of a “monitoring group” consisting of board chairs and senior staff members of the standard-setting bodies of Australia, Canada, New Zealand and the United Kingdom.

P3 When the IASB and FASB commenced their joint Conceptual Framework project, they decided to focus initially on business entities in the private sector. Once concepts for those entities have been developed, the boards have indicated they will consider the applicability of those concepts to financial reporting by other entities, such as not-for-profit entities in the private sector and business entities in the public sector.¹

P4 The writers of this Report were concerned about the implications of the IASB/FASB Conceptual Framework project for not-for-profit entities² and encouraged the IASB and FASB to consider these entities continuously throughout their project but this was not accepted. At a later stage, the writers proposed that the implications for not-for-profit entities be considered at the end of each phase of the IASB/FASB project but this was also not agreed to.

¹ Paragraph P8 of the *Preface* to the *Preliminary Views* document.

² Their concerns stem from the fact that the standard-setters involved have a responsibility to develop standards for not-for-profit entities and are committed to using the pronouncements of the IASB in their work.

- P5 The representatives of the four countries concerned discussed the possibility of monitoring the project from the perspective of private and public sector not-for-profit entities. The representatives put forward the view, which the IASB accepted, that consideration of matters from a different perspective can “add robustness” to the conclusions reached when considering only the perspective of business entities in the private sector. The representatives were encouraged by the IASB to undertake some monitoring work and have been considering issues on a monthly basis. Issues identified are, where appropriate, drawn to the attention of the IASB and FASB. The International Public Sector Accounting Standards Board is an observer of the monitoring group process and receives all reports.
- P6 The monitoring group considers it is important that the more significant issues it has identified are considered by individuals and organisations considering the *Preliminary Views* document from the IASB and FASB, in particular the not-for-profit constituencies of the standard-setting bodies involved. Accordingly it has prepared this report and made it available publicly.
- P7 The approach taken is to highlight implications of applying the concepts proposed by the IASB and FASB to private sector not-for-profit entities (and, in Appendix B, public sector not-for-profit entities). Because the IASB/FASB project is at this stage developing concepts for private sector businesses only, comments are not criticisms of the material as it applies to the entities for which it is intended³ but rather identify issues that would need to be considered (and most likely addressed) if the material was also to be applied to not-for-profit entities in the private and public sectors.
- P8 Appendix A to the Report describes in general terms some of the characteristics of not-for-profit entities in the private sector and public sector.

³ This Report does not express any views in relation to the appropriateness of the concepts proposed for private sector businesses.

Monitoring group members

Australia	David Boymal, Chairman Australian Accounting Standards Board
	Angus Thomson, Technical Director Australian Accounting Standards Board
	Jim Paul, Senior Project Manager Australian Accounting Standards Board
Canada	Paul Cherry, Chair Accounting Standards Board
	Ron Salole, Vice-President – Standards The Canadian Institute of Chartered Accountants
	Tim Beauchamp, Director – Public Sector Accounting Public Sector Accounting Board
New Zealand	Joanna Perry, Chair Financial Reporting Standards Board New Zealand Institute of Chartered Accountants
	Simon Lee, Director – Accounting Standards New Zealand Institute of Chartered Accountants
United Kingdom	Ian Mackintosh, Chairman Accounting Standards Board
	David Loweth, Technical Director Accounting Standards Board
	Andrew Lennard, Research Director Accounting Standards Board

Principal author

The principal author of this report is Kevin Simpkins, an independent consultant in New Zealand with many years of experience in senior positions in the not-for-profit and public sectors.

Part 1 The Objective of Financial Reporting

- 1.1 The objective of financial reporting is, as stated in the *Preliminary Views* document, the foundation of the Framework. Other aspects of the Framework should flow logically from the objective and help ensure that financial reporting achieves its objective to the maximum extent feasible.⁴
- 1.2 Accordingly, it is essential that the objective of financial reporting is appropriate to the contexts in which it applies.
- 1.3 The objective of financial reporting proposed in the *Preliminary Views* document is as follows:

*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 investment, credit, and similar resource allocation decisions.*⁵

- 1.4 There are three issues that have emerged from our review of the applicability of the proposed objective to not-for-profit entities or from the associated commentary in Chapter 1 of the *Preliminary Views* document. These issues are:
- insufficient emphasis on accountability/stewardship;
 - a need to broaden the identified users and establish an alternative primary user group; and
 - the inappropriateness of the pervasive cash flow focus.

Each of these issues is considered below.

Insufficient emphasis on accountability/stewardship

- 1.5 The IASB and FASB have proposed a decision-usefulness objective, although they acknowledge that the objective encompasses providing information useful in assessing management's stewardship.⁶

⁴ Paragraph OB1 of Chapter 1 of the *Preliminary Views* document.

⁵ Paragraph OB2 of Chapter 1 of the *Preliminary Views* document.

⁶ Paragraph OB28 of Chapter 1 of the *Preliminary Views* document.

- 1.6 In the case of not-for-profit entities, we consider that stewardship or the discharge of accountability is a significant aspect of the objective of financial reporting and should either be identified as a separate objective or recognised within a single objective.^{7 8}
- 1.7 The Conceptual Framework of each of the countries participating in the monitoring group includes accountability or stewardship explicitly within its objective of financial reporting. In some cases this is included as a separate additional objective and in other cases by inclusion within a single objective.
- 1.8 The recent UK exposure draft of the *Statement of Principles for Financial Reporting: Proposed Interpretation for Public Benefits Entities* explains that some users will not have the same ability to make direct economic decisions as occurs for private sector businesses and will sometimes be interested in the financial statements primarily in order to assess the adequacy of stewardship exercised by the entity's management.⁹
- 1.9 The Canadian Section 1000 *financial statement concepts* (applicable to for-profit entities and private sector not-for-profit entities) states that the objective of financial statements is to communicate information that is useful to investors, members, contributors, creditors and other users...in making their resource allocation decisions and/or assessing management stewardship.¹⁰ It also states: "Information regarding discharge of the stewardship responsibilities is especially important in the not-for-profit sector where resources are often contributed for specific purposes and management is accountable for the appropriate utilization of such resources."¹¹
- 1.10 New Zealand's *Framework for the Preparation and Presentation of Financial Statements* is the same as the existing IASB Framework except for a small number of modifications. It adds to the IASB's Objective, for **all entities** in New Zealand, as follows: "In addition to making economic decisions ... users of financial statements of New Zealand entities may also be interested in how well an entity has demonstrated its accountability in relation to a range of obligations including the entity's compliance with legislation, regulations, common law and contractual agreements."

⁷ We draw your attention to Appendix B to Chapter 1 of the *Preliminary Views* document which indicates that two IASB Board members would prefer stewardship to be identified as a separate objective of financial reporting.

⁸ The latter could be done as currently done in Australia – see paragraph 1.11 below.

⁹ Refer to Paragraph 1.4 of the ED *Statement of Principles for Financial Reporting: Proposed Interpretation for Public Benefit Entities*.

¹⁰ Paragraph 15 of Section 1000 *financial statement concepts*.

¹¹ Paragraph 14 of Section 1000 *financial statement concepts*.

- 1.11 The Australian Framework is also the same as the existing IASB Framework except for a small number of modifications. It has not added to the IASB's Objective but has referred readers to a more detailed discussion in a separate Statement of Accounting Concepts¹². That Statement specifies the objective as being to "provide information useful to users for making **and evaluating** decisions about the allocation of scarce resources"¹³. (emphasis added) It goes on to state a further concept namely that: "Managements and governing bodies shall present general purpose financial reports in a manner which assists in discharging their accountability".¹⁴
- 1.12 The International Public Sector Accounting Standards Board has stated the objectives of financial reporting should be to provide information useful for decision-making, and to demonstrate accountability of the entity for the resources entrusted to it.¹⁵
- 1.13 Not-for-profit entities have an obligation to account for their use of the resources made available to them – resources are typically provided from sources unrelated to the recipients of goods and services delivered by the entities. Users want to know how resources were acquired and used, whether the ability to deliver goods and services has improved or deteriorated from the previous year and how well the goods and services were delivered. While some users will make resource allocation decisions with this information (such as to increase or decrease their support) some will have no such power but will still desire the information. We do not therefore suggest that an accountability or stewardship objective should replace the decision-usefulness objective, but that it should be an additional objective or recognised within a single objective.

A need to broaden the users and establish an alternative primary user group

- 1.14 The *Preliminary Views* document identifies equity investors, creditors, suppliers, employees, customers, governments and their agencies and regulatory bodies, and members of the public as the potential users of financial reports.¹⁶ The document

¹² SAC 2 Objective of General Purpose Financial Reporting.

¹³ Paragraph 43 of SAC 2.

¹⁴ Paragraph 44 of SAC 2.

¹⁵ IPSAS 1 The Presentation of Financial Reports, paragraph 13.

¹⁶ Chapter 1, paragraph OB6 of the *Preliminary Views* document.

goes on to highlight present and potential investors and creditors as the primary users.¹⁷

- 1.15 Not-for-profit entities have a wider group of users. The users include those who provide resources to the organisation in the form of contributions. This category of user might be described as present and potential funders and financial supporters.¹⁸ These users are interested in information about the utilisation of the resources provided to the entity that might be useful in making decisions about resources they may choose, or be required, to provide in the future. They are also interested in stewardship of management of the resources under its control.
- 1.16 In considering the designation of a primary user group, it is important to note that the primary user group designated in the *Preliminary Views* document (present and potential investors and creditors) typically only exists in the form of creditors in the context of not-for-profit entities. We consider the most appropriate primary user group for not-for-profit entities is the funders and financial supporters. These may be described as the not-for-profit sector equivalent of investors.

The inappropriateness of the pervasive cash flow focus

- 1.17 The *Preliminary Views* document states that “to help achieve its objective, financial reporting should provide information to help present and potential investors and creditors and others to assess the amounts, timing, and uncertainty of the entity’s future cash inflows and outflows (the entity’s future cash flows). That information is essential in assessing an entity’s ability to generate net cash inflows and thus to provide returns to investors and creditors.”¹⁹
- 1.18 A concentration and focus on the ability to assess cash flow prospects is evident throughout the discussion of the Objective of Financial Reporting and is also evident in the following chapter on the Qualitative Characteristics of Decision-useful Financial Reporting Information.
- 1.19 For not-for-profit entities, cash flows are also important. However other aspects are generally more significant. These are matters related to the resources that are

¹⁷ Chapter 1, paragraph OB12 of Chapter 1 of the *Preliminary Views* document. The reasons for designating a primary group of users and for the primary user group selected are explained in Paragraphs BC1.14 to BC1.17 of the *Preliminary Views* document.

¹⁸ Refer to Paragraph 1.2(b) of the UK ED *Statement of Principles for Financial Reporting: Proposed Interpretation for Public Benefit Entities*.

¹⁹ Chapter 1, paragraph OB3 of the *Preliminary Views* document.

available to deliver future goods and services, the quality, cost and effectiveness of goods and services that have been delivered in the past and how well the organisation is meeting its objectives.

- 1.20 Assets of not-for-profit entities typically represent a store of future services rather than a means to generate cash flows. This has a pervasive and significant impact on the objective of financial reporting for not-for-profit entities.

A possible future issue - the scope of financial reporting

- 1.21 The objective of financial reporting as stated in the *Preliminary Views* document pertains to all of financial reporting, not just financial statements.²⁰ The monitoring group welcomes this.
- 1.22 However, we note that in the context of not-for-profit entities information about service performance is also important and the issue of what information is necessary to achieve the objective of financial reporting for these entities is a matter of importance to be considered as the project progresses.
- 1.23 The Basis for Conclusions in the *Preliminary Views* document has also indicated that whether financial reporting should include prospective information or forecasts is a matter to be considered later in the project.²¹ In that context, we would note that budgets and the comparison of actual amounts with budgeted amounts are more important in the not-for-profit sector. This can be because the operations of many not-for-profit entities are funded significantly by regular contributions provided on the basis of a formal published budget.
- 1.24 Accordingly, the monitoring group has identified a risk that the boundaries of the objective of financial reporting for private sector businesses may implicitly be narrower than is necessary for it to meet the needs of users in the not-for-profit sector.

²⁰ Paragraphs BC1.3 to BC1.7 of Chapter 1 of the *Preliminary Views* document.

²¹ Paragraph BC1.5 of Chapter 1 of the *Preliminary Views* document.

Part 2 Qualitative Characteristics of Decision-useful Financial Reporting Information

2.1. The *Preliminary Views* document has proposed the following as the qualitative characteristics of decision-useful information:

- relevance
- faithful representation
- comparability; and
- understandability

The qualities are subject to two pervasive constraints:

- materiality; and
- benefits that justify costs.²²

2.2. The qualitative characteristics proposed in the *Preliminary Views* document appear generally to be appropriate to not-for-profit entities. However, each characteristic needs to be interpreted in the context of the objective of financial reporting and, accordingly, our concerns in relation to the objective need also to be borne in mind here. For example, for information to be relevant, it will need to be relevant to users. As some of the users of not-for-profit entities differ from those of private sector businesses, then the nature of relevant information should also be expected to differ.

2.3. Some of the specific concerns raised in relation to the objective of financial reporting manifest themselves in the commentary supporting the qualitative characteristics. For example, paragraph QC8 states, in part, that “*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...” While this statement may be appropriate to private sector businesses, relevant information would, in our view, be described differently for not-for-profit entities. Similarly we note that what is material in the context of the constraints on the

²² Paragraph QC7 of Chapter 2 of the *Preliminary Views* document.

qualitative characteristics will probably differ in some instances for not-for-profit entities.²³

- 2.4. We also note that the concentration on cash flow prospects is evident through the qualitative characteristics material. The quote from paragraph QC8 above is illustrative of this point.
- 2.5. Apart from the flow-on effect of the issues we have raised in relation to the Objective of Financial Reporting, there is only one other issue that we wish to raise. That relates to the pervasive constraint "*that benefits should justify the costs*".
- 2.6. The discussion of this pervasive constraint, at paragraphs QC53 to QC59 of the *Preliminary Views* document, does not discuss the possibility of a different cost-benefit judgement being made for different types of entities. We note however that paragraph BC1.25 in the Basis for Conclusions for Chapter 1 of the *Preliminary Views* document suggests that cost benefit constraints may sometimes lead standard-setters to provide exemptions from specific requirements or require other differences in reporting requirements for some types of entities. We agree with that statement and the later comment in that paragraph that standard-setters have concluded in these situations that the objective can be satisfactorily achieved by financial reports prepared in accordance with such requirements, not that different requirements are needed because the objective is different. However we would emphasise that different benefit cost assessments may well be appropriate when considering not-for-profit entities because of the different objective of these entities, the broader and sometimes different users and because the incidence of the benefits and costs will differ.

²³ For example paragraph NZ 30.1 of the NZ Framework explains that information may be material where it could influence the decision-making and evaluations of users about the allocation of resources and stewardship of resources, and the performance of the entity, made on the basis of the financial statements.

Appendix A The Nature of Not-for-profit Entities in the Private and Public Sector

A 1.1 In this Appendix we set out some of the characteristics of not-for-profit entities in the private and public sector. At this stage, we do not attempt to define not-for-profit entities.

A 1.2 From our experience in monitoring the IASB/FASB Conceptual Framework Project thus far, the issues that emerge in relation to applying the concepts to all not-for-profit entities can generally be related back to the characteristics of these entities. For that reason we think it is important to explain what some of their general characteristics are.

Private sector

A 1.3 Not-for-profit entities in the private sector generally have the following characteristics:

- their objective is to provide goods and services to various recipients and not to make a profit;
- they are generally characterised by the absence of defined ownership interests that can be sold, transferred or redeemed or that convey an entitlement to a share of a residual distribution of resources, including on liquidation of the entity;
- they may have a wide group of stakeholders to consider (including the public at large in some cases);
- most of their revenues generally are contributions rather than sales. Contributions may be solicited in the form of donations or assessed such as through membership dues; and
- their capital assets are typically acquired and held to deliver services without the intention of earning a return on them.

A 1.4 There are many similarities between business (for-profit) and not-for-profit entities in the private sector. Specifically, the basic accounting systems and the accounting for most transactions is the same. However financial reporting is concerned with the needs of users of financial information and the different objective of not-for-profit

entities does have a significant influence on the needs of the users of their financial reports. Some of these issues emerge in Parts 1 and 2 of this Report.

Public sector

A 1.5 Not-for-profit entities in the public sector have very similar key characteristics to not-for-profit entities in the private sector.

A 1.6 These entities are typically established by legislation and:

- their objective is to provide goods and services to various recipients or to develop or implement policy on behalf of governments and not to make a profit;
- they are almost always characterised by the absence of defined ownership interests that can be sold, transferred or redeemed;
- they typically have a wide group of stakeholders to consider (including the public at large);
- their revenues are generally derived from taxes or other similar contributions obtained through the exercise of coercive powers; and
- their capital assets are typically acquired and held to deliver services without the intention of earning a return on them.

Appendix B Application to Not-for-profit Public Sector Entities

- B 1.1 In this Appendix we highlight some particular issues which emerge from the *Preliminary Views* document in relation to public sector entities that do not have a profit objective.
- B 1.2 Each of the significant issues raised in Parts 1 and 2 of this Report is also an issue in the context of public sector not-for-profit entities. Accordingly this Appendix highlights only those aspects that are particularly significant for these entities or where the slightly different characteristics raise additional aspects deserving comment.
- B 1.3 Accountability or stewardship is a key *objective of financial reporting* for public sector not-for-profit entities such as governments or their sub-entities. For example the Canadian Section PS 1100 *financial statement objectives – federal, provincial & territorial governments* includes as one of its objectives: “Financial statements should demonstrate the accountability of a government for the resources, obligations and financial affairs for which it is responsible by providing information useful in: (a) evaluating the financial results of the government’s management of its resources, obligations and financial affairs in the accounting period; and (b) assessing whether resources were administered by the government in accordance with the limits established by the appropriate legislative authorities.”²⁴
- B 1.4 Public sector not-for-profit entities also have additional and sometimes different *users*. They include funders and financial supporters, including the public through the payment of taxes. They also have governing or oversight bodies that might be described as legislatures or elected/appointed representatives. These representatives are likely to use information to assess the entity’s achievements against objectives including how efficiently and effectively goods and services have been provided.
- B 1.5 In the case of public sector not-for-profit entities both funders and financial supporters and legislatures should be encompassed within the primary user group.
- B 1.6 In relation to *the scope of financial reporting*, budgets have major significance for public sector not-for-profits. Furthermore, because the objective of these entities is not the making of a profit, information about the service performance of the entities is likely to be necessary to meet the needs of users.

²⁴ Paragraph .62 of Section PS 1100.