

MINUTES



To: Board Members
From: Project Team (Benson x 446)
Subject: Minutes of the February 28, 2007
Conceptual Framework Board Meeting **Date:** March 8, 2007
cc: Leisenring, Bielstein, Smith, MacDonald, Allen, Polley, Glotzer, Carney, Lott, Gabriele, Sutay, Project Team, FASB Intranet, Upton, Hickey, Crook, Lian, Hague, Villmann, Willis, GASB: Reese, Patton

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic: Comment Letter Summary: Chapters 1 and 2 of the Conceptual Framework

Basis for Discussion: Memorandum No. 49

Length of Discussion: 9:00 a.m. to 9:50 a.m.

Attendance:

Board members present: Herz, Batavick, Linsmeier, Seidman, Trott, and Young

Board members absent: Crooch

IASB members present: Leisenring

Staff in charge of topic: J. Johnson, Benson

Other staff at Board table: Bossio, L.T. Johnson, McBeth, Bielstein, and Beckendorff

Outside participants: Hague, Lian (via telephone)

Summary of Decisions Reached:

The Board approved the staff's plans for redeliberations concerning the 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*. Respondents raised the following significant issues that will be considered by the Board in its redeliberations:

1. Whether stewardship should be an explicit part of the objective of financial reporting
2. Whether the list of potential users is exhaustive
3. What the primary user group of financial reports should be
4. Whether the objective should relate to financial *reporting* or financial *statements*
5. Whether financial reports should reflect the entity or proprietary perspective
6. Whether the qualitative characteristic of relevance should be described as "capable of making a difference"
7. Whether faithful representation should replace reliability as a qualitative characteristic
8. Whether verifiability should be a component of faithful representation or a separate qualitative characteristic
9. Whether other suggested qualitative characteristics of accounting information should be included in the framework
10. Whether the qualitative characteristics should be presented in the form of a hierarchy
11. Whether materiality should be a constraint or a component of a qualitative characteristic.

The Board plans to redeliberate Chapter 2, *Qualitative Characteristics of Decision-Useful Financial Reporting Information*, in the second quarter of 2007, beginning in April. Redeliberations for Chapter 1, *The Objective of Financial Reporting*, will commence in June 2007. Other issues raised by constituents not specifically dealt with in Chapters 1 and 2 will be discussed at the IASB and

FASB joint meeting in April 2007. The FASB agreed to not hold roundtables at this time to discuss issues related to *stewardship*. Rather, the Board will consider other forms of constituent outreach to discuss the *stewardship* issue. The Board affirmed its goal of issuing an Exposure Draft of Chapters 1 and 2 in the third quarter of 2007, though the Board will reconsider that timetable once redeliberations are underway. The IASB arrived at similar conclusions at its February 20, 2007 meeting.

Objective of Meeting:

The objective of the meeting was for the Board to affirm the staff's plans for redeliberations concerning Chapters 1 and 2 of the conceptual framework. The objective of the meeting was met.

Matters Discussed and Decisions Reached:

1. Jeff Johnson led the discussion concerning general comments and Chapter 1 comments received during the comment period for the Discussion Paper. He noted that the FASB and IASB received approximately 180 comment letters from the following types of constituents:

Constituent Type	Number	%
Investor/Analyst	33	18%
Preparer	29	16%
Professional organization	27	15%
Standard-setter	22	12%
Individual	20	11%
Academic	18	10%
Not-for-profit	12	7%
Regulator	10	6%
Accounting firm	8	5%
Total	179	100%

Mr. Johnson stated that almost half of the letters received came from European constituents.

General Comments

2. Mr. Johnson stated that the Boards received comments concerning (a) the authoritative status of the framework, (b) the conceptual framework project objective, and (c) the application of the framework to not-for-profit entities.
3. The authoritative status of the framework for the FASB differs from that of the IASB in terms of how the framework applies to preparers. The Boards received comments stating (a) the FASB needs to elevate the authoritative status of its framework to match with the status of the IASB's framework, and (b) the FASB must decide whether or not to elevate the status of the framework before constituents can adequately comment on the proposed framework.
4. Concerning the conceptual framework project objective, the Boards decided at the beginning of the project to improve and converge the current IASB Conceptual Framework and FASB Concepts Statements instead of embarking on a fundamental reconsideration of the current frameworks. Some respondents disagreed with that approach and argued that the Boards should discard the current frameworks and begin a new framework from the ground up.
5. Mr. Johnson stated that the last general issue raised by respondents concerned the applicability of the proposed framework to not-for-profit entities. Some respondents argued that consideration of not-for-profit entities should occur at each phase of the conceptual framework project rather than at the end of the project.

Chapter 1 Comments

6. Mr. Johnson stated that comments related to Chapter 1 can be categorized as relating to (a) objective, (b) users, and (c) scope. Concerning the objective of financial reporting, approximately 15% of respondents who commented on the issue agreed that decision-usefulness should be the sole objective of financial reporting. These respondents agreed with the Boards' decision not to include stewardship as an explicit objective and noted that doing so would confuse corporate governance with financial reporting and risk separating entity performance from management performance.

7. Mr. Johnson stated that 85% of respondents who commented specifically on the objective of financial reporting disagreed with the Boards' proposed objective. The respondents who commented unfavorably argued that (a) stewardship is not described correctly in the Discussion Paper, and (b) stewardship should be an explicit primary objective of financial reporting, along with usefulness for resource allocation decisions. Constituents who argued for stewardship as an objective of financial reporting noted that doing so will affect the types of disclosures required in financial reporting, such as management compensation and related party disclosures. Others stated that the Boards characterize investors as more passive than they are in reality; investors not only make resource-allocation decisions but also influence the business itself. Effectively delegating responsibilities to management requires certain information for investors. Thus, stewardship should be an objective of financial reporting so investors may acquire the information they need.
8. Mr. Herz asked Mr. Johnson what percentage of the 180 comment letters made reference to the objective of financial reporting. Mr. Johnson responded that the majority of respondents commented on the issue. He added that European constituents commented most heavily on the stewardship issue.
9. Mr. Herz stated that budgets and the variances between budgeted and actual amounts are crucial to governmental accounting, and asked Mr. Johnson whether constituents suggested focusing more heavily on such budgets and variances. Mr. Johnson stated that no respondent commented on a need for budgetary information, and most people who wrote about stewardship did not describe how financial reporting and standard-setting might change if stewardship became an explicit objective.
10. Mr. Linsmeier stated that some stewardship-type information is provided in proxy statements in the U.S. He questioned whether investors have access to similar governance-related filings for European companies. Mr. Herz responded that historically in financial reporting disclosures, European companies have included information that U.S. companies include in proxy

statements. Mr. Linsmeier noted that it would be helpful to identify why European constituents heavily support stewardship as an objective of financial reporting and assess the differential demand for a stewardship objective.

11. Mr. Johnson stated that the second category of comments related to Chapter 1 relates to the identification of potential users of financial reports and whether any type of user should have primacy. Some respondents did not agree with the assertion in the Discussion Paper that regulators are a potential user of general purpose external financial reports, as regulators are capable of prescribing the specific information that entities are required to provide to them. Other constituents requested that management be added to the list of potential users, and still others stated that the Boards should focus more on investors as the end user instead of grouping together investors and their advisors.
12. Concerning whether there should be a primary user group, most respondents agreed that current and potential investors and creditors should have primacy. However, some respondents disagreed and argued (a) there should not be a primary user group, or (b) there should be a primary user group but that group should be comprised of present equity investors only or present and potential equity investors only.
13. Mr. Johnson stated that the third category of Chapter 1 comments relates to scope. Specifically, respondents commented on two main issues related to scope: (a) entity versus proprietary perspective, and (b) financial reporting versus financial statements. Concerning the Boards' adoption of the entity perspective, some constituents argued that the Boards did not justify why they chose the entity perspective over the proprietary perspective. Constituents noted that the issue should be more fully deliberated within Phase D, *Reporting Entity*.
14. Concerning whether the objective should relate to financial reporting or financial statements, most respondents agreed with the objective of financial reporting. Those who disagreed stated that (a) broadening the scope to include all aspects of financial reporting will distract standard-setters from

dealing with issues related to financial statements, or (b) Chapters 1 and 2 of the proposed framework seem to address only financial statements, not financial reporting.

15. Mr. Johnson stated that the final Chapter 1 comment received relates to balance sheet primacy. Some constituents noted that the Discussion Paper seems to imply a focus on the balance sheet, which those respondents believe is inconsistent with investor focus on the income statement.

Chapter 2 Comments

16. Ann Benson led the discussion concerning comments related to Chapter 2 of the Discussion Paper. The Discussion Paper includes qualitative characteristics (QCs) of relevance, faithful representation, comparability, understandability, and constraints of materiality and cost/benefit considerations. She stated that respondents commented most frequently on faithful representation and its components of verifiability, neutrality, and completeness.

17. Some respondents commented that the discussion paper contained references to measurement attributes such as fair value and historical cost. Those respondents claimed that the discussion paper makes fair value seem more relevant than other measurement attributes, and requested that the Boards leave judgment of different measurement attributes for the measurement phase of the project. Respondents also commented that the Discussion Paper focuses on QCs more suitable for financial **statements** than financial **reporting**, which is inconsistent with the objective of financial **reporting**.

18. Ms. Benson stated that less than half of respondents commented on relevance. Of those who did, a majority agreed with the Boards' description of the QC. A minority of respondents commented that the phrase "capable of making a difference" inappropriately broadens the definition of relevance to include information that "may possibly" influence user decisions. Rather, these respondents suggested changing the phrase to "actually making a difference" or "would make a difference if provided."

19. Some respondents wrote that timeliness shares many characteristics with materiality, in the sense that both terms are specific to pieces of information, and aren't as applicable to standard-setters as to preparers. Therefore, respondents argued that timeliness and materiality should either both be constraints, or both be components of relevance.
20. Ms. Benson stated that about 80% of respondents commented on faithful representation and its components. 5% of respondents commented favorably on the Boards' description of faithful representation and its components; 73% commented unfavorably. Respondents gave the following reasons for disagreeing with the Boards' description of faithful representation:
- a. Reliability is well understood in practice and discarding it as a QC harms the framework
 - b. Reliability is a broader term than faithful representation, as faithful representation is one component of reliability in the current framework
 - c. Reliability should be clarified, not replaced, if it is misunderstood
 - d. The description of faithful representation needs to include the notion of reliability of measurement.
- Respondents also noted that the term "real-world economic phenomena" does not translate well to other languages.
21. Mr. Trott stated that the Boards should consider why there is a misunderstanding of the term *faithful representation* among constituents. He noted his disappointment that so many respondents seemed to understand faithful representation to mean something different than the Boards' definition. Mr. Trott noted that there is a perception among constituents that the recent increase in the number of accounting restatements is due to the implementation of standards that allow for unreliable information rather than the inappropriate application of accounting standards.
22. Ms. Benson stated that many respondents commented on verifiability, a component of faithful representation. Some respondents wrote that indirect verification should not only require that the chosen recognition or measurement method be applied correctly, but also that the chosen method be reasonable and representationally faithful. Several respondents

suggested that verifiability should not be a component of faithful representation, as something can faithfully represent what it purports to represent without being verifiable. Such respondents were concerned that inclusion of verifiability as a component of faithful representation may result in excluding information from financial reporting that is useful and appropriate. Mr. Johnson stated that the staff is considering whether verifiability should be a separate QC.

23. Ms. Benson stated that few respondents disagreed with the Boards' description of comparability and consistency. A minority of respondents argued that enforcement of consistency may reduce faithful representation.
24. Ms. Benson stated that most respondents agreed with the Boards' inclusion of understandability. Those who disagreed argued that the discussion of understandability focuses on sophisticated users, whereas the primary user group identified in the objectives chapter includes common equity investors. These respondents argued that the financial reports should be understandable to the average investor, and not investors' advisors, so that investors who use reasonable diligence may not need to rely on advisors. Mr. Herz questioned whether enforcing understandability so that the common investor may understand financial reports may be unachievable given the types of complex transactions undertaken by companies. Significantly oversimplifying the accounting of complex transactions will not aid investors in understanding a company's business.
25. Ms. Benson stated that 21% of respondents commented unfavorably on the sequential order of the qualitative characteristics. Many respondents stated that the sequential order appears to make relevance the most important qualitative characteristic. However, the staff thinks the Boards clearly emphasized that the sequential consideration does not imply a hierarchy of characteristics in the Discussion Paper.
26. Ms. Benson stated that the Boards received no substantive comments concerning cost/benefit considerations. Some respondents wrote that materiality should be a component of relevance if timeliness is included as a component of relevance. Other respondents commented that the

assessment of materiality should be made relative to matters considered individually and in the aggregate, and supported the Chapter 1 Alternative View that the materiality of related party transactions and compensation for management should be based on the materiality of the issue to the manager rather than to the company.

27. Regarding the addition of other qualitative characteristics, 8% of respondents commented that *prudence* or *conservatism* should be a QC or a component of a QC. Respondents stated that prudence does not result in deliberate understatement of assets or overstatement of liabilities; rather, prudence provides for a degree of caution in exercising judgments relating to estimates. 4% of respondents suggested that *true and fair view* should be included as an overriding characteristic. 12% of respondents wrote that *substance over form* should be a component of faithful representation, as it would help in translation of the meaning of the term.

Plans for Redeliberations

28. Mr. Johnson stated that the staff plans to address redeliberations at Board meetings at least three times. The authoritative status of the framework and other issues unrelated to Chapters 1 and 2 specifically will be addressed at the April 2007 joint IASB/FASB meeting in London. Ms. Seidman asked whether Board members will be expected to determine the authoritative status of the proposed framework at the April joint meeting. She stated that she will not be ready to make such a decision until the proposed framework is fully developed. Mr. Bossio explained that at the April joint meeting, the staff plans to inform the Boards of its research to date concerning the implications of elevating the status of conceptual framework in the FASB GAAP hierarchy. However, the Boards will not be required to make a decision regarding the status of the framework in the FASB GAAP hierarchy until it is ready to do so. Ms. Benson added that a small number of U.S. preparers commented on Chapters 1 and 2 of the proposed framework. One possible reason for the small number of respondents from this constituency is that preparers in the U.S. assume the framework will not apply to them. She suggested that Board

members advise preparers that the status of the framework may change, and thus the framework may be more applicable to preparers in the future.

29. Mr. Johnson stated that Chapter 2 redeliberations will commence at the FASB's and IASB's separate April 2007 meetings. Chapter 2 redeliberations will occur prior to those for Chapter 1 for two reasons: (a) resolving some of the issues related to Chapter 2 will help in settling Chapter 1 issues, and (2) Chapter 2 redeliberations will likely be less contentious than those for Chapter 1.

30. Mr. Johnson stated that the staff does not recommend that the Boards hold public roundtables to discuss the stewardship issue at this time. Rather, the staff recommends the Boards consider other forms of constituent outreach. He noted that the IASB agreed with that recommendation at the February IASB meeting. Mr. Batavick asked whether a decision not to hold roundtables at this time would preclude the Boards from holding a roundtable concerning stewardship in the future. Mr. Johnson responded that the Boards would not be precluded from holding a roundtable in the future, such as after the Exposure Draft for Chapter 1 is issued. Mr. Linsmeier stated that it will be important for the staff to clearly communicate the results of its constituent outreach to the Boards so that Board members understand constituent views regarding the exclusion of stewardship as an objective. Ms. Bielstein noted that Board members will be able to participate in the constituent outreach if desired.

31. Mr. Johnson stated that the staff has been planning issuance of an Exposure Draft of Chapters 1 and 2 in the third quarter of 2007. At this time, the staff thinks it is possible to maintain the original timeframe for issuing an Exposure Draft. He noted that drafting of the Business Combinations standard will need to be considered in determining the timeline for issuing an Exposure Draft for Chapters 1 and 2 of the framework, as drafting resources will need to be shared between the two projects.

Follow-up Items:

None.

General Announcements:

None.