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Sir David Tweedie Chairman International Accounting Standards Board 30 Cannon Street London EC4M 6XH United Kingdom Robert Herz
Chairman
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401 Merritt 7
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Re: The Joint IASB/FASB Conceptual Framework Project

Dear Sirs:

As you are aware, CFA Institute has long been an enthusiastic supporter of the project to develop a set of high quality financial reporting standards that would be applied globally. Consequently, the CFA Institute Centre for Financial Market Integrity and its Corporate Disclosure Policy Council have been following with considerable interest the discussions that the IASB and FASB have been having on developing a common conceptual framework. This is an extremely important project with considerable significance for the future direction of financial reporting generally. However, we are very concerned at the direction the Conceptual Framework project is taking and felt that we should share our anxiety with you at an early stage in your deliberations.

During the initial deliberations of the first joint IASB/FASB meeting to discuss the common conceptual framework, members of the two Boards reached a tentative decision that financial reports should be prepared from the entity's perspective. Moreover, financial reports prepared from the entity's perspective should aim to provide information to a wide and diverse range of users, rather than to focus on the information needs of existing common shareowners. In contrast, we believe that the core objective of financial reporting standard-setting must be to serve the information needs of equity (common stock) shareowners and that it is essential that this principle continue to guide the development of such standards.

We recognize that there is a wide range, indeed, a hierarchy, of users of financial reports including current common shareowners, creditors, potential investors and various elements of our wider society. However, the central and essential focus of financial reporting must be the current common shareowners of the parent company. The equity (common stock) shareowners in the parent company are the ultimate providers of equity risk capital, and, therefore, are the last, residual risk-bearers in the company. As such, it is our firm belief that if the current common



shareowners' financial reporting needs are met, all those who rank ahead of them will also be generally satisfied. As a corollary, we believe that if the information provided does not meet the needs of other constituents, for example, creditors, then shareowners by definition will find the reporting inadequate for their purposes as well.

We are very much concerned that the loss of focus on the financial reporting needs of current shareowners, who are the owners of the business, will serve to undermine the whole framework of financial reporting. We believe it would be a profound error to begin such a process. The current equity investor has to be placed firmly at the pinnacle of the hierarchy of users.

At the same time, we acknowledge completely that other external users in the wider social constituency may have additional reporting needs. These can be fully met within the context of the general information set provided by the "Accounts" as a whole without impinging directly on the financial reporting needs of current shareowners. Corporate reporting is being asked by a growing number of constituents to fulfill a wide and growing set of needs. Those needs are often specialized and are best met by developing specific reporting to meet those precise needs. They will not be met appropriately by *ad hoc* additions to the financial reports that are prepared specifically for shareowners. Such a trend, coupled with a lack of focus as to who the financial reports are actually prepared for, we believe, would completely undermine the whole process of financial reporting to owners.

We believe that establishing the current equity investor at the pinnacle of the hierarchy of users as a core element of the conceptual framework will profoundly affect other elements of the discussions you are having. For example, we would expect that it would heavily influence your debate on defining the boundary of the reporting entity and whether you should decide to move from a proprietary view to an entity view.

The entity concept combines the interests of equity shareowners in the parent, and non-controlling, or minority, interests together as a unit. There is no economic rationale for this approach. Unlike common shareowners, minority interests are providers of capital to a subsidiary of the entity. We believe that the minority interests in subsidiaries have very different and independent reporting requirements. This difference has to be reflected in the financial statements themselves. Indeed, the only financial reports the minority interests are really interested in are those of the entities in which they themselves are equity shareowners. The same could be said for long-term creditors that have lent to a consolidated subsidiary rather than to the consolidated entity. They do not share in the risks and rewards of the consolidated entity itself.

Adoption of the entity concept also seems likely to produce some unhelpful and strange accounting consequences. Transactions in the equity of subsidiaries will presumably now be treated as transactions with owners and will not appear in the income statement at all. The income statement will presumably now look at net income in terms of the entity's income rather than the income attributable to the owners of the parent company in which they are actually invested. So, no meaningful concept of earnings attributable to the parent equity holders can drop out of the income statement at all.



Establishing the current equity investor at the pinnacle of the hierarchy of users will also influence the debate on the role of stewardship. Many believe that one of the central purposes of financial reporting is to address the agency problem; that is, to provide part of the information shareowners require as the owners of the business. The information enables owners to form their assessments of management and the strategies being adopted for the business. That process is not just about valuing the company and whether to buy or sell shares.

The income statement forms a basis for reporting some sense of financial performance. Performance cannot be meaningfully reported to the entity. However, performance can be defined and reported to the ultimate providers of risk capital, the shareowners of the parent company. Perhaps a whole new statement of transactions with owners could be engineered to address these issues, but we believe it would be simpler and more logical to retain the parent concept. However, performance reporting is just one example of the sorts of difficulties that would arise if the entity concept were to be adopted. The real problem, we believe, is that the concept will prove too amorphous and ill-defined to serve as a cornerstone principle for the setting of clear and unambiguous financial reporting standards. Such standards we believe to be critical if they are to be able to address the growing complexities of businesses in the twenty-first century.

In conclusion, we believe that widening the focus of financial reporting to an entity perspective, with the intention to provide information to a wide range of users, will result in a loss of focus for financial reporting and may well undermine the very purpose of the financial statements themselves. The Council recognizes that the IASB and the FASB must continue to develop financial reporting that reflects the ever increasing sophistication of contemporary business, and we strongly support these efforts. However, the essential focus of reporting financial performance to the parent company's shareowners must not be lost.

Respectfully,

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