MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Duke (ext. 297)
Subject:	Minutes of the June 22, 2005 Board Meeting: Conceptual Framework—Qualitative Characteristics 2
Date:	June 29 2005
cc:	Leisenring, Bielstein, Smith, Petrone, Mahoney, Polley, Lott, Gabriele, Carney, Getz, Sutay, Project Team, FASB Intranet, Upton, Hickey

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:	Qualitative Characteristics 2: Qualitative Characteristics including Comparability, Understandibility, and Potential New Characteristics
Basis for Discussion:	Agenda paper 6
Length of Discussion:	3:30 p.m. to 4:50 p.m.
Attendance:	
Board members present:	Herz, Batavick, Crooch, Schipper, Seidman, Trott, and Young
Board members absent:	none
Staff in charge of topic:	Hague (AcSB) by phone
Staff at Board table:	Bielstein, Bullen, McBeth, Duke, and Varian
Other participants:	by phone: T. Johnson, Villman (AcSB), and Willis

Summary of Decisions Reached:

The Board continued its deliberations on the joint IASB/FASB conceptual framework project. The Board discussed issues relating to qualitative characteristics of accounting information, including the existing characteristics of comparability and understandability, and potential new characteristics. The Board reached the following conclusions:

1. *Comparability* is an important characteristic of decision-useful financial information and should be included in the converged conceptual framework. Comparability—which enables users to identify similarities in and differences between economic phenomena—should be distinguished from consistency—the consistent use of accounting methods. Concerns about comparability or consistency should not preclude reporting information that is of greater relevance, or that more faithfully represents the economic phenomena it purports to represent. If such concerns arise, disclosures can help to compensate for lessened comparability or consistency.
2. *Understandability* also is an essential characteristic of decision-useful financial information and should be included in the converged conceptual framework. Information is made more understandable by aggregating, classifying, characterizing, and presenting it clearly and concisely. Whether reported information is sufficiently understandable depends on who is using it. The information in general-purpose external financial reports should be understandable to financial statement users who have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. Relevant information should not be excluded because it is too complex or difficult for some users to understand.
3. *Materiality* relates not only to relevance, but also to faithful representation. Materiality should be included in the converged framework as a screen or filter to determine whether information is sufficiently significant to influence the decisions of users in the context of the entity, rather than as a qualitative characteristic of decision-useful financial information.

4. *Transparency*, often cited recently as a desirable characteristic of financial information, seems to be difficult to define. In current usage, it appears to encompass some of the qualitative characteristics already included in the framework. Because it would be redundant, transparency should not be added to the converged framework as a separate qualitative characteristic of decision-useful financial information.
5. Other possible characteristics considered, including credibility, high quality and internal consistency, do not describe attributes of decision-useful financial information that are distinct from other qualitative characteristics. Thus, they should not be added as separate qualitative characteristics in the converged framework.
6. The converged framework should include information about the types of costs that should be considered in deciding what financial information to provide, as well as criteria to help standard setters decide how to take particular types of costs into account.
7. The converged framework should include presumptions not only about the capabilities of financial statement users but also about the capabilities of financial statement preparers and auditors.

The IASB separately discussed the same issues and reached similar conclusions. The Boards plan to discuss how the qualitative characteristics relate to one another at meetings in July.

Objective of Meeting:

The objective of the meeting was for the Board to reach conclusions on (possible) qualitative characteristics other than relevance and faithful representation. The characteristics under consideration included the existing characteristics of comparability and understandablity, as well as possible new characteristics such as materiality, transparency, true and fair, and others.

Matters Discussed and Decisions Reached:

1. Mr. Hague began the discussion by stating that the staff considered qualitative characteristics that are currently in either the FASB Concepts Statements or the IASB Framework. The staff also considered whether any other qualitative characteristics might be introduced into the converged framework.

Comparibility and Consistency

2. Mr. Hague stated the following staff recommendations related to comparability and consistency:

   a. Comparability is an important characteristic of decision-useful information and should be included as a qualitative characteristic in the converged conceptual framework.

   b. Comparability and consistency should be separately defined.

   c. Relevance and faithful representation should be considered before comparability and consistency; that is, comparable information that is irrelevant would never be preferred over relevant information that does not have a high level of comparability.

   d. Disclosures can help to compensate when comparability or consistency is overridden by a greater need for relevance or faithful representation.

3. Ms. Schipper stated that she did not agree with the staff's analysis of the issue. She stated that she disagreed with how treatment alternatives are sometimes handled. She asked if one economic event can be faithfully represented in more than one way. Providing treatment alternatives violates comparability and preparers will almost always pick the alternative that is easiest to implement or more advantageous. She said that if comparability were not important, then the disclosures that reconcile the alternative treatment to the preferred treatment would not be necessary. Comparability should be elevated as the third primary qualitative characteristic. None of the

three characteristics (relevance, faithful representation, comparability) are more important than the others, but it is more efficient to order their consideration, she said.

4. Mr. Trott stated that comparability affects relevance and faithful representation. He also would elevate comparability higher than other secondary characteristics, but perhaps not to the same level as relevance and faithful representation. He stated that comparability was one of the three touchstones (along with relevance and faithful representation) that describe the information that standard setters try to provide and that the ordering or ranking should be considered.

5. Ms. Seidman stated that she supported the staff's recommendation. The output of the application of standards must always be relevant and faithfully representative. She stated that comparability is not always satisfied by standards. Segment reporting is an example; comparability is sacrificed in order to gain insight into management's view of the business. She stated that comparability was different than consistency and added that an internal consistency of standards was provided by basing them on the framework. She stated that she agreed with staff recommendation (d), that disclosures can help when comparability is sacrificed for greater relevance or faithful representation.

6. Mr. Bullen stated that his understanding of the Japanese use of internal consistency was that standard setters should be cautious about changing a standard when economic circumstances have not changed. New standards should be consistent with other standards; if the other standards provide relevant information, then a new standard (that is consistent with the others) will by default provide relevant information.

7. Mr. Herz observed that the Japanese delegates at the June 14, 2005, Joint International Group meeting on Performance Reporting asked for scientific evidence about the increase in relevance provided for by a combined statement of earnings and comprehensive income.

8. Mr. Hague stated that internal consistency may have a role in that standards should be consistent with the conceptual framework.

9. Mr. Crooch stated that relevance and faithful representation are the most important qualitative characteristics. While comparability is more important than the other characteristics, it is not as important as relevance and faithful representation.

10. Mr. Young stated that he supported the staff's recommendation. He stated that comparability should not be elevated because a company should have the flexibility to present information differently based on its business model. He stated that disclosures and technology empower the user and that users are interested in understanding how the business model affects the information. He stated that if relevance and faithful representation were better served by giving up comparability, then comparability should be secondary; that is, comparability should not trump relevance.

11. Ms. Schipper stated that none of the three should ever "trump" the others. More important is the ordering of the characteristics when they are considered. Comparability should be considered when deciding between treatment alternatives. She would not give credence to management intent because it is difficult to build management intent into a standard and intent is only observable after the fact (or beforehand if an announcement is made). She stated that she did not agree with the current accounting for securities under FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*.

12. Mr. Batavick agreed with the staff's recommendations. He stated that comparability is a touchstone, but it should not be elevated to the same importance as relevance and faithful representation. He stated that he did not believe that a ranking of the three should be forced.

13. Mr. Herz stated that he was closer to Ms. Schipper's position but not completely in line with it. From a decision-usefulness perspective, the first question to ask is what the relevant information is; the next question to ask is

what is the faithful representation of that information. If a piece of information is the most relevant and most faithfully represents an economic phenomenon, comparability would not have to be sacrificed. However, sometimes information is not the most relevant and most faithfully representative, in which case comparability would need to be considered.

14. Ms. Schipper stated that the characteristic used by some when deciding between different treatment alternatives (provided by a standard) was cost, not relevance and reliability. She stated that preparers may choose the alternative that is the least costly to implement. Additional disclosures may help users to compare companies using different alternatives.

15. Mr. Herz stated that four Board members (GJB, GMC, DMY, and LFS) supported the staff recommendation. Ms. Schipper did not support the staff recommendation, and Mr. Herz and Mr. Trott said they would alter the categorization of the qualitative characteristics. Mr. Herz also stated that comparability would be a more effective constraint at the standard's level if it were on the same level as relevance and faithful representation.

16. Mr. Hague stated that the IASB had a similar discussion, but that Ms. Schipper raised new views. He stated that the staff would work on how to balance the three characteristics (given the Boards' views) and consider how to order them without references to primacy of one characteristic over another.

Understandability

17. Mr. Hague then began the discussion of understandability. He stated the following staff recommendations:

    a. Users (including non-professionals as well as professionals) are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.

    b. Understandability is the quality of information that enables users to perceive its significance. Mr. Hague stated that consideration had been given to this recommendation since the education session. The staff is working on a revision to convey that understandability is the quality of information that enables users to understand the economic phenomenon that the information purports to represent.

c. Relevant information should not be excluded because it is too complex or difficult for certain users to understand.

d. Understandability is enhanced by the characterisation, aggregation, classification, and presentation of financial information.

18. Mr. Crooch stated that he agreed with the staff's recommendation, subject to the change in wording for recommendation (b). Ms. Seidman and Mr. Young agreed with Mr. Crooch.

19. Mr. Trott stated that the change to recommendation (b) was helpful. The revised framework needs to acknowledge that the information must be capable of making a difference in a decision, and that the information will be useful to the users who decide to use it. Different users will focus on different aspects of the financial statements. While some may not put forth the effort to understand and use a particular attribute, that doesn't mean that others will not. He stated that he was concerned that understandability would construe that the information must be understood by all users equally. Board members stated that other parts of the framework address Mr. Trott's concerns, noting that due diligence of the user is expectated by the standard setter.

20. Mr. Batavick stated that he supported rewording recommendation (b) along the lines that understandibility is the quality of information that provides ease in ascertaining the relevance and faithful representation of the information presented. He stated that there should be further discussion on the range of users.

21. Ms. Schipper stated that understandability related to both the standard and the information that results from implementing the standard and that both should be discussed. Mr. Trott added that the standard setter's expectations of both users and preparers also should be considered.

22. Mr. Herz stated that there were no objections to the staff recommendation with the revised wording of recommendation (b).

Materiality

23. Mr. Hague then began the discussion of materiality. He stated the following staff recommendations:

    a. Materiality relates to faithful representation, in addition to relevance.

    b. Materiality should be considered as a screen or filter to determine whether information is sufficiently significant to influence decisions of users in the context of the entity, rather than a qualitative characteristic itself.

24. Mr. Herz stated that all the Board members agreed with the staff recommendation.

Transparency and Succinctness

25. Mr. Hague then began the discussion of other characteristics that the staff considered for inclusion in the converged framework. He stated that the staff considered both transparency and succinctness, and that the staff recommends that succinctness be added to the qualitative characteristics of financial information as a sub-quality linked to understandability.

26. Ms. Schipper stated that she agreed with the staff recommendation. Ms. Seidman also agreed.

27. Mr. Batavick stated that he preferred clear and concise over succinctness.

28. Mr. Trott stated that the quality of the effectiveness and efficiency of the information was what was being sought, and that it related to presentation and display. He asked if the presentation and display of the information communicated the recognition and measurement attributes of the information. He also suggested replacing succinctness with another term.

29. Ms. Bielstein stated that if transparency was not used in the framework, then it should not be prominently used on the website or in logos and banners.

30. Mr. Trott stated that transparency was similar to usefulness; that it is more the sum of the qualitative characteristics rather than a characteristic itself.

True and Fair

31. Mr. Hague began the discussion of true and fair by stating that the converged framework should explain that financial statements should reflect what they purport to represent (in addition to each individual piece of information faithfully representing what it purports to represent). However, this should not be expressed as a separate qualitative characteristic of financial information, but rather as part of faithful representation.

32. Mr. Herz stated that the Board agreed that true and fair should not be included in the framework as a qualitative characteristic.

Objectivity, Feasibility, Credibility, and High Quality

33. Mr. Hague began the discussion of objectivity and feasibility by stating that the staff believes the reasons for not including them in the original FASB framework are still valid today; that is, they are already captured by other characteristics included in the framework. The staff also considered credibility and high quality because they appear in the FASB mission statement and IASC Constitution. The following recommendations relate to credibility and high quality:

    a. Credibility is not a qualitative characteristic of decision-useful financial information, but is more a characteristic of the process by which that information is created, or the individual or entity that provides the information.

    b. High quality is not a qualitative characteristic of financial information. High quality information is information that meets the objectives and qualitative characteristics of financial reporting—it is the overall goal to be aspired to, rather than a qualitative characteristic itself.

34. Mr. Trott stated that preparers lend credibility to information and auditors add to it.

35. Mr. Herz stated that the Board agreed with the staff recommendation.

36. Mr. Hague stated that internal consistency was the only characteristic that the staff identified for possible inclusion into the converged framework, when it looked at the frameworks of other standard setters. The staff does not recommend that internal consistency be included as a qualitative characteristic in the converged framework.

37. Other "criteria for making choices" cited by Board members at different times include the following: acceptability, accuracy, precision, precisenss, anti-abusive, practicality, practicability, accessibility, availability, operationality, and simplicity. The staff does not recommend designating any of those as qualitative characteristics as they relate either to existing qualitative characteristics or costs.

38. Mr. Crooch stated that he was concerned about practicability and its use. No other Board member had comments. Mr. Herz stated that the Board agreed with the staff recommendation.

Costs

39. Mr. Hague began the discussion of costs by stating the following recommendations:

    a. Broad categories of costs similar to those identified in FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*, should be incorporated into the new framework.

    b. These categories might be embellished to incorporate additional possible reasons that Board members have cited in the past for making choices between alternative accounting methods (as discussed in paragraph 37).

    c. Consideration should be given to developing criteria that might help us decide how particular types of costs should be taken into account.

    d. Material should be included in the converged framework to state the presumptions that standard setters make about the capabilities of financial statement preparers and auditors to establish a better base for what might be considered to be 'reasonable' costs.

40. Mr. Trott stated that new standards often require preparers and auditors to learn new skills, especially valuation skills. He stated that the Board should not be precluded from developing better standards because people had to learn new skills.

41. Mr. Herz stated that there were no disagreements with the cost categories identified.

Follow-up Items:

The staff will revise the definition of understandability (paragraph 17 (b)) and work on developing alternative terminology for succinctness.

General Announcements:

None.