Conceptual Framework

Qualitative Characteristics 2: Qualitative Characteristics other than Relevance and Reliability (Faithful Representation)

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Introduction

1. This paper is for the second of three expected meetings considering issues related to qualitative characteristics. In May, the Boards considered the qualitative characteristics of relevance and reliability (faithful representation)\(^1\). In July, we\(^2\) plan to ask the Boards to consider trade-offs between qualitative characteristics and matters arising from discussions in May and June. This paper considers qualitative characteristics other than relevance and faithful representation.

2. Cross-cutting issues addressed in this paper are as follows:

QC1: In FASB Concepts Statement No. 2, “Qualitative Characteristics of Accounting Information” (CON2), should comparability be elevated to the same level as relevance and reliability (faithful representation)? (NB: also convergence issue)

QC5: Is transparency a qualitative characteristic and what does it mean? Is it the sum of all qualitative characteristics? (E.g., IASCF Constitution: objective is to develop accounting standards that require “high quality, transparent, and comparable information…”)

QC8: Is ‘true & fair’ a qualitative characteristic? Is it just faithful representation?

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\(^1\) The IASB and FASB tentatively agreed, in May 2005, to replace reliability with faithful representation. Faithful representation is, therefore, used in this paper in the manner tentatively agreed to in May – i.e., encompassing completeness, neutrality and verifiability.

\(^2\) “We” is used in this paper to refer to the staff.
Qualitative Characteristics other than Relevance and Reliability

QC9: Is materiality a QC or just a filter (e.g., to determine if information relevant in the context of the entity)?

QC10: What do we mean by understandability?

QC11: Other candidates for qualitative characteristics?

3. Like the May paper, this paper discusses the cross-cutting issues as they arise, rather than in numerical order. This paper first discusses qualitative characteristics other than relevance and reliability that are presently contained in the IASB Framework for the Preparation and Presentation of Financial Statements (IASB Framework) and the FASB Concepts Statements. The paper then considers whether there are other qualitative characteristics that should be introduced. A summary of the issues and staff recommendations is at the end of the paper, together with a diagrammatic summary of the recommended characteristics and an Appendix summarizing tentative decisions reached to date, and cross-cutting issues remaining to be considered, relating to qualitative characteristics.

COMPARABILITY

4. The overriding objective of financial reporting is to provide information that is useful in making economic decisions\(^3\). In this regard, the Report of the AICPA Study Group on the Objectives of Financial Statements\(^4\) (“Trueblood Report”) notes:

“The essence of economic decisions is choice among possible courses of action. Choice requires awareness of the opportunities offered by alternatives. Financial information should facilitate the comparisons needed to make investment and other decisions.”

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\(^3\) See, for example, IASB Framework, paragraph 12; FASB Concepts Statement No. 1, paragraph 34. This was noted in papers for the joint IASB/FASB meeting in April 2005 (IASB Agenda Paper 4, FASB Memorandum 3) and was not considered controversial in Board discussions at that time. Accordingly, this underpinning seems to be a reasonable starting point.

\(^4\) American Institute of Certified Public Accountants, October 1973, page 59.
5. Both the IASB Framework and FASB Concepts Statements acknowledge this by including comparability as a qualitative characteristic of financial information. CON 2 defines comparability as:

“the quality of information that enables users to identify similarities in and differences between two sets of economic phenomena”.

CON 2 also defines consistency as:

“conformity from period to period with unchanging policies and procedures.”

The IASB Framework discusses the need for users to “be able to compare the financial statements of an entity through time in order to identify trends in its financial position and performance” (equivalent to consistency) and “to compare the financial statements of different entities in order to evaluate their relative financial position, performance and changes in financial position” (equivalent to comparability).

6. There seems to be little or no controversy regarding the need to include comparability as a qualitative characteristic. Accordingly, we recommend that it be retained.

7. The separate definitions of comparability and consistency in CON 2 seem useful and we propose to use these going forward; probably linked to an explanation of their role in useful information, similar to that in the IASB Framework. However, care will be needed in drafting as some Board members and constituents do not use the terms consistency and comparability in as precise a manner as they are defined in CON 2. For example, some use “consistency” to refer to comparisons between entities as well as between periods. While improved consistency often improves comparability, that is not necessarily always the case. The same standard may be applied by different entities, but produce non-comparable results. For example, an overly conservative revenue recognition standard, which delays

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5 Conceptual frameworks of other standard-setters contain similar discussions. Australia, Canada, New Zealand and the UK all discuss the role of comparability and describe it in similar terms. The Japanese Discussion Paper, “Objectives of Financial Reporting”, does not consider comparability as a separate qualitative characteristic. Rather it argues that comparability is part of faithful representation.

6 See CON 2, Glossary of Terms.

7 See IASB Framework, paragraph 39.

8 The exception might be the Japanese Discussion Paper. However, even that acknowledges that comparability is important. It merely concludes that it is subsumed within faithful representation.
revenue recognition to the last possible moment, may make financial statements of entities with different revenue-generating patterns look comparable even though they aren’t.

**QC1: In CON2, should comparability be elevated to the same level as relevance and reliability (faithful representation)? (NB: also convergence issue)**

8. Where the discussion becomes more interesting in terms of the role of comparability (and consistency) in the Framework is regarding its relative importance. This is the essence of cross-cutting issue QC1.

9. The IASB Framework presents comparability as a qualitative characteristic on a par with relevance and reliability⁹, although it also points out that there are trade-offs between comparability and the relevance and reliability (faithful representation) of financial information. However, CON 2 takes the view that comparability is not a quality of information in the same sense as relevance and reliability (faithful representation) are, but is rather a quality of the relationship between two or more pieces of information.¹⁰,¹¹ It notes that improving comparability may destroy or weaken relevance or reliability if, to secure comparability between two measures, one of them has to be obtained by a method yielding less relevant or less reliable information.

10. It seems difficult to imagine that it would be useful to provide information that is comparable, but is nonetheless either irrelevant or fails to faithfully represent the phenomena it purports to represent. To be useful, all information must have an appropriate degree of relevance and representational faithfulness. Therefore, it seems that relevance and faithful representation must be considered at the same time as comparability. On the other hand, it might well be desirable to provide more relevant information or information that provides a more faithful representation, with some loss of comparability or consistency. For example, it is common to permit more capable entities to apply an improved accounting standard earlier than other entities, thus sacrificing some

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⁹ Canada, New Zealand and UK also treat comparability on a par with relevance, reliability and understandability.

¹⁰ See CON 2, paragraph 116.

¹¹ Australia also deals with comparability separately, as a characteristic of preparation of financial information, rather than a characteristic of financial information itself.
IASB/FASB – June 2005

Qualitative Characteristics other than Relevance and Reliability

comparability for a period of time in the interests of greater relevance and representational faithfulness. This suggests that relevance and faithful representation have primacy over comparability or consistency.

11. CON 2 notes that there have been extreme examples in which the use of standardized charts of accounts have been made mandatory in the interest of interfirm comparability at the expense of relevance and reliability\(^\text{12}\), but if the information is neither relevant nor reliable its use to financial statement users seems doubtful.

12. We find the positioning of the qualitative characteristic of comparability in CON 2 to be more appropriate than that in the IASB framework, and propose to deal with it in that manner - as a quality of lesser significance than relevance and faithful representation.

13. One might also question the relationship between comparability and consistency. CON 2 establishes comparability as the qualitative characteristic, noting that it includes consistency. Other frameworks, including that of the IASB, do not make this distinction, discussing comparability and consistency on equal terms.

14. In some circumstances, it might be considered more important to financial statement users to maintain inter-entity comparability than period-to-period consistency. Thus, for example, when more relevant and representationally faithful accounting polices become available (perhaps as a result of technological developments making a previously impractical policy now practical) it might be appropriate that all entities should make a change in accounting policy in the same manner and at the same time in order to maintain inter-entity comparability, even though that reduces inter-period consistency. Transitional provisions of accounting standards are often designed to facilitate this. The good news in these circumstances is that the reduction in inter-period consistency can often be compensated for by way of disclosures about the accounting polices adopted. A number of conceptual frameworks point this out to ensure that consistency does not appear to become an overriding characteristic that prevents progress in developing better accounting policies.

\(^{12}\) See CON 2, paragraph 116.
Qualitative Characteristics other than Relevance and Reliability

For example, the UK Statement of Principles deals with this by discussing the roles of both consistency and disclosure of accounting policies within comparability.

15. In some other circumstances, consistency might be emphasised when comparability is not achievable. For example, it might be concluded that it is more important for entities to use valuation methodologies that are consistent from period to period than to require that all entities use the same valuation methodology. Again, disclosures of the accounting policies used can help compensate for some lack of comparability.

16. We consider a reminder about the role of disclosure of accounting policies to be useful to include in the converged conceptual framework in the context of comparability and recommend that a reminder be included that disclosures can help to compensate when comparability or consistency is overridden by a greater need for relevance or faithful representation.

17. Recommendations:

(a) Comparability is an important characteristic of decision-useful information and should be included as a qualitative characteristic in the converged conceptual framework. [see paragraph 6]

(b) Comparability and consistency should be separately defined. [see paragraph 7]

(c) Relevance and faithful representation should have primacy compared to comparability and consistency. [see paragraph 12]

(d) Disclosures can help to compensate when comparability or consistency is overridden by a greater need for relevance or faithful representation. [see paragraph 16]

UNDERSTANDABILITY

18. Before we can evaluate what we mean by understandability, we need to consider the capabilities of those who we are expecting to understand the information provided. The IASB Framework and CON 2 describe the capabilities of users in a similar manner. Like
IASB/FASB – June 2005

Qualitative Characteristics other than Relevance and Reliability

the Australian, Canadian, New Zealand, UK and FASB frameworks13, the IASB Framework assumes users “to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.”14 CON 2 refers to the capabilities of users as follows: “Financial information is a tool and, like most tools, cannot be of much direct help to those who are unable or unwilling to use it or who misuse it. Its use can be learned, however, and financial reporting should provide information that can be used by all—non-professionals as well as professionals—who are willing to learn to use it properly.”15

19. We recommend that these characteristics of the users of financial statements are important to retain in the converged conceptual framework.

QC. 10 What do we mean by understandability?

20. Both the IASB Framework and CON 2 identify understandability as a qualitative characteristic. The IASB Framework states, “An essential quality of the information provided in financial statements is that it is readily understandable by users.”16 However, it does not define what it means by understandability. CON 2 goes a step further by describing understandability as a link between the qualities of users and qualities of accounting information, and defines understandability as “the quality of information that enables users to perceive its significance”.17 We recommend the use of the CON 2 description in the converged conceptual framework, to reinforce that for information to be useful, users must be able to perceive its significance.

13 The Japanese Discussion Paper, “Qualitative Characteristics of Accounting Information,” does not discuss this matter, since it does not focus on understandability. The paper explains that the Working Group excluded understandability as a qualitative characteristic as it “might contradict with the assumption of sophisticated investors”, it is self-evident and it was not clear how it would guide the development of standards in the future (see paragraph 21). We do not find that argument persuasive, particularly since we plan to retain the assumption that financial information should be capable of being understood by a wide range of users (not just sophisticated investors). Furthermore, the Japanese Discussion Paper does not reject understandability as a qualitative characteristic — it merely states that it is self-evident.

14 See IASB Framework, paragraph 25 and FASB Concepts Statement No. 1, paragraph 34.

15 See CON 2, paragraph 40.

16 See IASB Framework, paragraph 25.

17 See CON 2, Glossary of Terms.
21. Several of the accounting frameworks, including the IASB, the FASB, Australia and UK, explain that relevant information should not be excluded because it is too complex or difficult for certain users to understand. To exclude relevant information due to its complexity would result in financial information that is not a faithful representation. Accordingly, we recommend that this reminder be included the framework.

22. The Australian and New Zealand frameworks, like the UK framework, explain that “Whether financial information is understandable will depend on (a) the way in which the effects of transactions and other events are characterised, aggregated and classified, [and] (b) the way in which the information is presented.” As recognized in these frameworks, the clear presentation or expression of important information enhances the understandability of the financial information. We view these thoughts as useful additions to describe the characteristic of understandability and recommend that they should be added to reinforce in principle the importance of the characterisation, aggregation, classification and presentation of financial information.

23. The IASB, like Canada, New Zealand and the UK includes understandability as a primary characteristic, on a par with relevance and faithful representation. However, CON 2 establishes understandability as a link between the characteristics of users and qualities of decision useful information, rather than a quality of decision useful information. The positioning of understandability relative to other qualitative characteristics will be considered further in July.

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18 The IASB Framework, in paragraph 25, explains that “information about complex matters that should be included in the financial statements because of its relevance to the economic decision-making needs of users [and] should not be excluded merely on the grounds that it may be too difficult for certain users to understand.”

19 FASB Concepts Statement 2 explains in paragraph 40 that, “financial reporting should not exclude relevant information merely because it is difficult for some to understand or because some investors or creditors choose not to use it.”

20 UK Statement of Principles, paragraph 3.27.

21 Australia deals with understandability as a characteristic of preparation of financial information, rather than a characteristic of financial information itself.
IASB/FASB – June 2005

Qualitative Characteristics other than Relevance and Reliability

24. **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. [see paragraph 19]

   (b) Understandability is the quality of information that enables users to perceive its significance. [see paragraph 20]

   (c) Relevant information should not be excluded because it is too complex or difficult for certain users to understand. [see paragraph 21]

   (d) Understandability is enhanced by the characterisation, aggregation, classification and presentation of financial information. [see paragraph 22]

**MATERIALITY**

**QC9: Is materiality a QC or just a filter (e.g., to determine if information relevant in the context of the entity)?**

25. The primary question related to materiality seems to be whether materiality is a qualitative characteristic, or whether it is something else, and where it fits relative to qualitative characteristics. This is the subject of cross-cutting issue QC9.

26. Materiality is described in the IASB Framework in the following manner, “Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements.”\(^\text{22}\) This description is placed as a sub-set of relevance. The IASB Framework goes on to note that materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful\(^\text{21}\).

27. **CON 2** describes materiality as, “The magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been

\(^{22}\) See IASB Framework, paragraph 30.

\(^{23}\) Ibid.
Qualitative Characteristics other than Relevance and Reliability

changed or influenced by the omission or misstatement.”

CON 2 deals with materiality as a separate constraint, rather than grouping it with relevance. CON 2 continues to note, “Materiality is not a primary characteristic of the same kind. In fact, the pervasive nature of materiality makes it difficult to consider the concept except as it relates to the other qualitative characteristics, especially relevance and reliability.”

28. Unlike the FASB, the IASB Framework does not include any discussion of materiality in relation to reliability. CON 2 explains how a materiality threshold relates to reliability. Using an example of an applicant for employment who is negotiating with an employment agency, it explains that, “Salary information accurate only to the nearest thousand dollars might not be acceptable to an applicant for an $8,000 a year job, but will almost certainly be acceptable if the job pays $100,000 a year. An error of a percentage point in the employee's rate of pension contribution would rarely make information about fringe benefits unacceptable. An error of a year in the retirement date of someone who would block the applicant's advancement might be quite material. An error of a year in the applicant's mandatory retirement date will probably be immaterial to a person 20 years old, but quite material to a 63-year-old person.”

29. Each of the descriptions of materiality acknowledges that materiality is not a primary qualitative characteristic. In addition, the analysis in the previous paragraph seems to provide compelling evidence that materiality relates not only to relevance, but also to reliability; or in our new terminology, faithful representation. Accordingly, we recommend that materiality be dealt with not as a sub-set of relevance, but as a separate item.

30. It then remains to consider whether this is a separate qualitative characteristic or something else. It does not seem to be of the same nature as relevance or representational faithfulness and this has been acknowledged in both the IASB Framework and CON 2. The logic in CON 2 that materiality is a screen seems compelling. This is also consistent with the

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24 See CON 2, Glossary of Terms.
25 See CON 2, paragraph 124.
26 The Australian, Canadian, New Zealand and UK frameworks deal with materiality in a similar manner. The Japanese Discussion Paper does not refer to materiality on the grounds that it is self-evident from the viewpoint of economic reasonableness.
27 See CON 2, paragraph 127.
IASB/FASB – June 2005

Qualitative Characteristics other than Relevance and Reliability

suggestion in the IASB Framework that materiality is a threshold. Accordingly, we recommend that materiality be considered 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 a qualitative characteristic itself.

31. Recommendations:

(a) Materiality relates to faithful representation, in addition to relevance. [see paragraph 29]

(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. [see paragraph 30]

OTHER CANDIDATES FOR QUALITATIVE CHARACTERISTICS

32. So far, we have examined those qualitative characteristics that presently exist in the IASB and FASB frameworks. However, it seems appropriate to ask ourselves whether there might be other qualitative characteristics, not presently in those frameworks, that should be added. This is the subject of cross-cutting issue QC11.

33. Two candidates for consideration were explicitly suggested in identifying cross-cutting issues: (a) transparency, and (b) true and fair. These will be considered first, followed by other candidates.

Transparency

34. Transparency is an attribute commonly used today to describe information or a process considered to be of a high quality. In their respective mission statements, the IASB and the FASB describe the reliance of accounting standards on “transparent and comparable information”28 and on “credible, concise, transparent and understandable financial

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28 “The IASB is committed to developing, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements.”, IASB web site, May 2005.
The term transparency has also been used frequently in recent years by securities regulators, academics, users of financial information and many others. For example, Lynn E. Turner, Chief Accountant of the United States Securities and Exchange Commission (U.S. SEC) gave a speech in April 2001 titled “Transparent Financial Reporting and Disclosure,” sharing the Commission’s view that “Transparent financial information allows market participants to better evaluate counterparty risks and adjust the availability and pricing of funds in ways that can promote more efficient financial markets.”

In spite of its high profile use, transparency is not a qualitative characteristic presently used or defined in any current accounting framework or standard.

**QC. 5 Is transparency a qualitative characteristic and what does it mean? Is it the sum of all qualitative characteristics?**

The term transparency has been used and defined in various ways. The Merriam-Webster Online dictionary defines transparency as the quality or state of being transparent and defines transparent in two ways: (a) “having the property of transmitting light without appreciable scattering so that bodies lying beyond are seen clearly”; and (b) as being “free from pretense or deceit, easily detected or seen through.” With that latter definition in mind, the American Institute of Certified Public Accountants issued a position paper in 2004 titled, “Peer Review in an Era of Transparency,” acknowledging:

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29 “Accounting standards are essential to the efficient functioning of the economy because decisions about the allocation of resources rely heavily on credible, concise, transparent and understandable financial information,” FASB web site, May 2005.


32 None of the IASB, Australian, Canadian, New Zealand, Japanese, UK or US frameworks refers to or includes transparency as a qualitative characteristic.
We have always strived to make everything we do – the Financial Statements we audit, the advice we dispense, the tax returns we prepare - transparently communicate the facts clearly and truthfully to every one of our audiences – investors, regulators, management, and the public.”

To provide guidance to chief executive officers and chief financial officers of Canadian public companies required to certify financial statements, the Canadian Performance Reporting Board (CPR Board) identified transparency as one of the fundamental principles to guide the certification process and defines it as follows:

“Transparency refers to the degree to which the information contained in the filings being certified by the CEO and CFO enables a reader to reliably assess and interpret the financial condition, results of operations and cash flows of the issuer.”

The CPR Board recommends a balance between complete transparency of information, which would overwhelm investors with volumes of data, with providing information that is fairly presented as it is relevant, can be digested and meets investors’ needs.

The use of the word transparency has also increased in response to recent financial scandals as users demand financial information that is free from false or ambitious claims. Users do not want surprises. Transparency results in information that is trustworthy, verifiable and true.

Jonas and Blanchet note that, as part of the earnings management program undertaken by the U.S. SEC in 1999, shareholder/investor protection is based on “full and transparent financial information that is not designed to obfuscate or mislead users.”

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34 Ibid, pages 35-36.
IASB/FASB – June 2005

Qualitative Characteristics other than Relevance and Reliability

Blanchet also discuss “clarity” — a notion very similar to transparency. They describe this in the following manner, “This characteristic focuses on the understandability ...., organization and comprehension of the information. A shorthand way of thinking about clarity is to ask whether the company’s financial information is presented in an organized, clear, and concise fashion, appropriately balancing brevity with sufficiency.” 37

41. Transparency appears to be a modern “buzz word” that incorporates several of the qualitative characteristics identified in the accounting frameworks. Based on how the term is used and defined above, we suggest that financial information be considered to be transparent if it is:

- Relevant – information is what the user needs to know as it could affect a decision;
- A faithful representation – information is true to its underlying characteristics or meaning;
- Complete – all or a sufficient amount of information is provided; and
- Succinct – drawing on some of the preceding analysis, we propose to describe “succinct” as information that is presented in an efficient and effective manner, balancing brevity with sufficiency, such that its significance is explicit. 38 (This encompasses clarity, as well as the conciseness, organization and comprehension of information).

42. The first three of these components of transparency have already been recommended for inclusion in the converged conceptual framework. The possible new characteristic is succinctness. The succinctness of financial information is addressed in how items are described and presented in financial statements and in the corresponding notes to the financial statements. The key quality of succinct financial information is the clear presentation or expression of important information, accordingly, succinct financial information enhances its understandability. Some suggest that the terms “clear” and “concise” might be used rather than “succinct”. Though clear and concise may be more

38 The Merriam-Webster Online Dictionary defines succinct as, “marked by compact, precise expression, without wasted words.”
Qualitative Characteristics other than Relevance and Reliability

commonly used and understood terms, succinct information also captures the organization of the information in a manner such that the reader can understand its significance. We recommend that succinctness be added to the qualitative characteristics of financial information, identified as a sub-quality or attribute of understandability.

43. **Recommendations:**

   (a) Succinctness should be added as a qualitative characteristic, as a sub-quality or attribute of understandability. [see paragraph 42]

   (b) Succinct means that financial information is presented in an efficient and effective manner, balancing brevity with sufficiency, such that its significance is explicit.\(^{39}\) [see paragraph 41]

**QC8: Is ‘true & fair’ a qualitative characteristic? Is it just faithful representation?**

44. The notion of ‘true and fair’ appears only in the UK Statement of Principles and in the IASB Framework. It has no place in FASB Concepts Statements or the conceptual frameworks of other accounting standards-setters.\(^{40}\) It was first introduced in British legislation in the 1948 Companies Act and is also embedded in European legislation through the Fourth Directive (Article 2). Similar terminology has also been adopted in legislation in countries such as Australia, Hong Kong, Malaysia, New Zealand and Singapore. However, none of the legislative requirements have defined what they mean by ‘true and fair’.

45. When a true and fair view is included in legislative requirements, it generally provides for a “true and fair override” when compliance with accounting standards would not give a “true and fair view,” either by requiring the provision of additional information, or by departing from accounting standards. This is acknowledged in IAS 1, “Financial Statement Presentation” (IAS 1). However, the question to be considered in this paper is not whether an override should be available, but rather whether the notion of ‘true and fair’

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\(^{39}\) A possible downside to this definition is that it introduces a number of new terms, which also may need to be explained to understand the definition.

\(^{40}\) At least, not in the Australian, Canadian, Japanese or New Zealand frameworks. However, financial statements in those jurisdictions are required to present a “true and fair view” or to be “fairly presented”
IASB/FASB – June 2005

Qualitative Characteristics other than Relevance and Reliability

encompasses additional qualitative characteristics that should be included in a converged conceptual framework.

46. The notion of ‘true and fair’ has proved very difficult to define. The UK Statement of Principles for Financial Reporting describes ‘true and fair’ as follows:

“The concept of a true and fair view lies at the heart of financial reporting in the UK and the Republic of Ireland. It is the ultimate test for financial statements and, as such, has a powerful, direct effect on accounting practice. No matter how skilled the standard-setters and law-makers are, it is the need to show a true and fair view that puts their requirements in perspective.

…”

The Statement of Principles does not, however, define the meaning of true and fair — it is detailed legal requirements, accounting standards and, in their absence, other evidence of generally accepted accounting practice, rather than the Statement itself, that normally determine the content of financial statements. Nevertheless, as the Statement is a set of high-level principles designed to help in setting standards, it has the true and fair view concept at its foundation. Its insistence on relevance and reliability as prime indicators of the quality of financial information is just one example of this.”

47. David Flint, in his monograph, “A True and Fair View in Company Accounts,” notes the following, “Whatever may be the extent of prescription, an overriding requirement to give “a true and fair view” is, at the lowest level of its utility, a safety valve protecting users from bias, inadequacy or deficiency in the rules; a fail-safe device for the unavoidable shortcomings or prescription. However, its greater utility is in establishing an enduring conceptual standard for disclosure in accounting and reporting to ensure that there is always relevant disclosure – where necessary beyond the prescription — based on independent professional judgment. It has a social quality expressing the standard of accountability which society sets in company affairs in the context of a societal perception

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41 See IASB Framework, paragraphs 10 and 13.
IASB/FASB – June 2005

*Qualitative Characteristics other than Relevance and Reliability*

of truth and fairness, which is ultimately a matter of ethics or morality”. He goes on to discuss true and fair as encompassing, “full and frank disclosure … judged against ethical standards of society.”

48. The Chairman of the IASB, Sir David Tweedie, noted the following, in a speech on the occasion of the Institute of Chartered Accountants of Scotland’s 150th Anniversary in 2004, “What does a true and fair view mean? It means standing back, looking at the accounts and asking ‘from what we know about the company do the balance sheet and income statement reflect what we know to be the case?’”

49. Each of these attempts at defining ‘true and fair’ positions it as an overarching notion, which the qualitative characteristics taken together contribute to, rather than being a qualitative characteristic itself. In particular, they focus on the need to consider whether the overall view portrayed by the financial statements is consistent with what society would expect to be the case. ‘True and fair’ encompasses the view that accounting standards alone cannot always deal with all circumstances and that sometimes relevant disclosure, beyond that prescribed by standards, may be necessary. It might be considered more akin to the notion of fair presentation to which US Listed company management is now required to attest in accordance with the Sarbanes-Oxley legislation.

50. The IASB Framework takes the view that “the application of the principal characteristics and of appropriate accounting standards normally results in financial statements that convey what is generally understood as a true and fair view of, or as presenting fairly such information” [emphasis added]. However, IAS 1 goes on to note that an override to IFRS is available, but only when management concludes that compliance would be, “so misleading that it would conflict with the objective of financial statements set out in the Framework.” Guidance on this criterion states, “an item of information would conflict with the objective of financial statements when it does not represent faithfully the transactions, other events or conditions that it either purports to represent or could

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44 See IASB Framework, paragraph 46.

45 IAS 1, Presentation of Financial Statements, paragraph 17.
reasonably be expected to represent and, consequently, it would be likely to influence economic decisions made by users of financial statements” [emphasis added]. The IASB, therefore, positions ‘true and fair’ relative to faithful representation.

51. We agree that there is room for a ‘stand-back’ consideration in financial reporting — that it is useful to ensure that the overall view expressed by financial statements reflects what they purport to represent (in addition to each individual piece of information faithfully representing what it purports to represent). However, we do not agree that this should be expressed in a manner whereby it might be considered to override other qualitative characteristics (in particular, relevance and faithful representation). Accordingly, we recommend that this idea should be discussed in the converged conceptual framework, but in the context of faithful representation.

52. As an aside, it is interesting to note that the meaning of ‘true and fair’ is not translated consistently in several European countries. In particular, Nobes notes that in France, Belgium, Netherlands, Spain and Luxembourg, “true and fair” is translated as the single word “faithful” — again suggesting that some interpret ‘true and fair’ as relating to faithful representation.

53. **Recommendation:** The converged framework should explain that the overall view expressed by 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. Rather, it should be included as part of faithful representation. [see paragraph 51]

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46 Ibid, paragraph 22.
48 Whether or not a true and fair override is a good thing is not for discussion in this project. The question here is whether ‘true and fair’ encompasses additional qualitative characteristics that should be included in the conceptual framework.
The purpose of qualitative characteristics

54. In asking ourselves whether there are other qualitative characteristics that should be included in the framework we should, perhaps, first consider the purpose of the qualitative characteristics. This is described in CON 2 as follows:

“To maximize the usefulness of accounting information, subject to considerations of the costs of providing it, entails choices between alternative accounting methods. Those choices will be made more wisely if the ingredients that contribute to “usefulness” are better understood. The characteristics or qualities of the information discussed in this Statement are, indeed, the ingredients that make information useful. They are, therefore, the qualities to be sought when accounting choices are made. They are as near as one can come to a set of criteria for making those choices.”

55. The IASB Framework is much briefer, stating simply, “Qualitative characteristics are the attributes that make the information provided in financial statements useful to users.”

56. The common thread here is that both frameworks seek to establish a set of attributes of useful financial information. We have no reason to question that aspect of the frameworks and we propose that it be carried forward.

57. The first sentence of the quotation from CON 2, acknowledges the need to consider costs, as well as benefits of useful information. This is addressed later in this paper.

58. The other aspect of the quotation from CON 2, which is not dealt with in the IASB Framework, but which seems relevant to the consideration of whether there are other qualitative characteristics to be considered, is the idea that the qualitative characteristics comprise a “set of criteria for making choices”. Certainly, the existing criteria are traded off against one another in making choices – relevance versus faithful representation, etc., and the manner in which these choices should be made will be the subject of a paper for the

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49 See CON 2, paragraph 5.
50 See IASB Framework, paragraph 24.
IASB/FASB – June 2005

Qualitative Characteristics other than Relevance and Reliability

July Board meetings. However, the question at this time is whether we have a complete set of criteria from which to make choices.

Qualitative characteristics suggested in past consultations

59. A number of constituents suggested other criteria in responding to the exposure draft that preceded the issue of CON 2. In particular, CON 2, Appendix B, notes that respondents suggested “objectivity” and “feasibility” as candidates for inclusion. In each of these cases the FASB concluded that the qualitative characteristics already identified (verifiability and cost-benefit, respectively) already captured these candidates and that they added nothing. We see no reason to differ with that view of the FASB.

FASB Mission Statement and IASCF Constitution

60. We have also considered whether there are other qualitative characteristics that have come into common usage since the original frameworks were written and might become new candidates for inclusion. For example, the FASB’s mission statement refers to “credible, concise, transparent and understandable” information, and the IASCF Constitution refers to “high quality, transparent and comparable information”. Conciseness, transparency, understandability, and comparability have all been considered earlier in this paper. However, credibility and high quality might be additional candidates for consideration, each of which describes what some might think of as characteristics of financial information.

61. Credible is defined in the Merriam-Webster Online dictionary as “offering reasonable grounds for being believed”. This certainly seems to be a worthy characteristic of financial information and is perhaps not captured by existing qualitative characteristics. However, rather than being a characteristic of the information itself, it seems to be a characteristic of the process that creates the information, or the individual or entity that provides the information. It is difficult to take a view as to whether a particular piece of information is credible based on the information itself, but the fact that the information has been prepared by management who are appropriately competent, has been audited and, perhaps overseen by regulation, adds to the credibility of the information. Accordingly, we take the view that
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.

62. Credibility can also be in the eye of the beholder. What is credible to one information user may not be to another. Indeed, information might be credible to a particular user, but in fact be false, or may seem incredible to another user, but in fact be true. Many information users have fallen for what appears to be credible information that is not true. For example, consider the numbers of British Broadcasting Corporation (BBC) television viewers, some years ago, that fell for an 'April Fool' joke that the spaghetti crop in Italy was failing as the spaghetti trees were dying! Credible, but untrue information hardly seems to be a characteristic desirable of financial information.

63. **High quality** was considered by the FASB in 1999 in the context of its report on “International Standard Setting: A Vision for the Future”. That report notes that “high quality” is difficult to define, but discuses high quality accounting standards by reference to the objectives and qualitative characteristics of information, as established in conceptual frameworks – noting that application of these objectives and qualitative characteristics should lead to high quality accounting standards. Quality is defined by the qualitative characteristics. The desire for high quality information reflects the fact that the best, or most optimal, combination of qualitative characteristics should be sought. We recommend that high quality is not a qualitative characteristic of financial information. Rather, 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.

**Frameworks of other accounting standard-setters**

64. Another set of considerations we have taken into account is whether there are qualitative characteristics identified in the frameworks of other accounting standard-setters, some of

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51 Of course, in this case, the joke was enhanced by the fact that the BBC was viewed as a credible conveyer of information.

Qualitative Characteristics other than Relevance and Reliability

which have been developed more recently than those of the IASB and FASB, which might need to be taken into account. In many cases, those frameworks have been developed closely based on those of the IASB or FASB. The only possible additional candidate seems to be ‘internal consistency’, which is proposed in the Japanese Discussion Paper, “Qualitative Characteristics of Accounting Information”.

65. The Japanese Discussion Paper notes, “Internal consistency in this Discussion Paper is different from the term “consistency” that is referred to in conceptual frameworks issued overseas. While the latter requires a particular accounting procedure to be applied (for interim reporting and annual reporting) every period continuously, the former requires that any individual standard adopted should be consistent with the existing system of standards.”

66. The Japanese discussion paper also notes, “Apart from the jurisdictions of common laws such as the United States and the United Kingdom, Japan is a country of code laws. In jurisdictions of code laws, respect for internal consistency of accounting standards is strongly required in order to achieve stable order. Generally, under code laws, the relationship between a new rule and existing rules must always be considered when developing or updating rules. Unfortunately, there is little understanding about this fact globally. By clarifying the needs for emphasis on internal consistency and the limitations to focusing on internal consistency, it is expected to assist in the mutual understanding of how standards are developed globally.”

67. The Japanese Discussion Paper focuses on internal consistency of standards. However, translating this into the context of decision useful information, essentially what this seems to be saying is that a characteristic of decision useful information is that it is internally consistent with other decision useful information.

68. Certainly, it seems desirable that the information provided by a particular entity be internally consistent. Indeed, standard setters often require this by mandating that when a

53 See paragraph 16.
54 See paragraph 15.
choice of accounting policy exists, a single accounting policy should be applied by an entity for all like items.

69. Internal consistency does not seem to be a characteristic that could be applied on its own, since this would impede progress in the same way that consistency between periods on its own would do (see paragraph 14, above). Internal consistency should be relaxed in order to provide more relevant and representationally faithful information. However, perhaps, that should only be done with caution. It has been suggested that, when the environment surrounding financial reporting changes then, it is appropriate for accounting to change, but when that environment is stable, then standards consistent with the current system of accounting standards should provide useful information. In other words, when the environment changes such that more relevant and representationally faithful information is available, then the need for internal consistency may be overridden.

70. Perhaps related to this theme, is a view expressed by Forsyth, Witmer and Dugan in a recent CPA Journal article\(^5\) in which they call for the Conceptual Framework to be strengthened to minimize the possibility of issuing additional standards that are inconsistent with each other, as well as to provide an even more unified theoretical basis for the development of future GAAP.

71. Certainly, there are a number of instances today where individual accounting standards are inconsistent with corresponding conceptual frameworks\(^6\). There are also instances where the requirements of individual accounting standards are inconsistent with one another, perhaps resulting in reported financial information that is inconsistent (for example, inconsistent revenue recognition polices might be applied to different items within a particular entity’s financial statements).

72. Internal consistency seems a desirable goal. However, it needs to be carefully balanced with relevance and faithful representation. We suggest that internal consistency be discussed in the converged conceptual framework in the same context as comparability and

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\(^6\) This may be because the standards were written before the corresponding conceptual framework. However, it might also be because of decisions to depart from a particular aspect of a framework.
IASB/FASB – June 2005

Qualitative Characteristics other than Relevance and Reliability

consistency, highlighting the additional perspective that information should be consistent within an entity, subject to the need to allow for variation when needed to support greater relevance or faithful representation.

73. We also consider that it is useful to set out the objective that accounting standards should be internally consistent, both with one another and with the conceptual framework. Indeed, the IASB Framework notes that, “the Board of IASC will be guided by the Framework in the development of future Standards and in its review of existing Standards”\(^57\). However, this also acknowledges that there are a limited number of cases in which there may be a conflict between the Framework and an International Accounting Standards, but that the number of cases of conflict will diminish through time.

Other possible characteristics

74. All of the potential qualitative characteristics discussed so far in this paper have focused on the decision usefulness of information for users of financial statements. However, that is not the only constituent group that Board members consider in making standard setting decisions. Board members frequently cite reasons for making decisions in standards that reflect, not so much the needs of users, but the needs or demands of other groups, including financial statement preparers, auditors and regulators. It might be argued that a complete “set of criteria for making choices” should include other criteria commonly taken into account by Board members in choosing one accounting method rather than another. The conceptual framework seems inadequate in its inability to explain other criteria that the Boards use in making decisions. We recommend that the converged framework should contain a section capturing other criteria that the Boards use in making decisions — ones that must be balanced with those aimed at enhancing decision usefulness.

75. To commence consideration of such criteria, we have noted possible reasons that Board members have cited in the past for making choices. These include:

   (a) **acceptability** — Board members may decide that a particular solution would be unacceptable within the context of “generally accepted accounting principles”.

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\(^57\) IASB Framework, paragraph 3.
Acceptability often has a time dimension. For example, what is unacceptable at one point in time may become acceptable at a later date as a result of evolutionary change rather than an abrupt shift. The increasing use of fair value measurement for financial instruments, first for disclosure and then for balance sheet recognition and measurement of certain financial instruments, might be an example of such growing acceptability. However, it may be that there are other attributes about the information, or those preparing, using, auditing or regulating the information, (some of which may be listed below) that make a particular solution acceptable or unacceptable, rather than “acceptability” being a criterion for making choices.

(b) accuracy, precision or preciseness — Board members may decide that a certain piece of information is unlikely to be able to be determined sufficiently accurately (i.e., there is a significant risk of error), or is not sufficiently precise (i.e., the resulting information is insufficiently refined, or too vague), for inclusion in financial statements. Care needs to be taken with referring to accuracy or precision. A number might be precise, but not representationally faithful (for example, allocated historical cost). As Robert R. Sterling notes:

“Accountants who continue to seek more precision are to be admired and encouraged. However, those who seek absolute precision might be instructed by considering what has been learned in the so-called “exact” sciences. Einstein . . . drew a sharp and clear distinction between the certainty of calculation and the uncertainty of representations of phenomena: “As far as the laws of mathematics refer to reality, they are not certain; and as far as they are certain, they do not refer to reality.” The same is true for accounting: as far as the mathematical methods used in accounting refer to reality, they are not certain; as far as they are certain, they do not refer to reality.”

Indeed, it might be argued that the common reference to “generally accepted accounting principles” is a poor description of what are the accounting principles in accordance with which financial statements are prepared. Accounting principles are actually much more than “generally accepted”.

Qualitative Characteristics other than Relevance and Reliability

On the other hand, there might be a point at which a piece of information becomes so inaccurate or so imprecise that it no longer faithfully represents what it purports to represent. Accordingly, this notion may be encompassed in the qualitative characteristic of faithful representation (perhaps as part of verifiability?), discussed previously in May.

(c) *anti-abusive* — Accounting standards sometimes contain provisions designed to counteract anticipated excesses, or egregious behaviours, of some preparers. These provisions may not, themselves, meet the qualitative characteristics of financial information, but may help to ensure that those characteristics are met – in particular, in this case, the qualitative characteristic of neutrality. At the same time, the costs of anti-abusive provisions need to be weighed so that they are not unduly onerous on entities required to provide the information. [The opposite of this criterion is that accounting standards sometimes provide an accounting subsidy, perhaps intended to encourage particular actions. The pooling of interests approach to business combinations accounting might have been considered in this class since it facilitated certain mergers and acquisition activity. Lease accounting might be another example.]

(d) *practicality or practicability* — Sometimes information meeting the qualitative characteristics might be capable of being obtained, but the costs (either in monetary, or other terms, such as technical capability) of doing so are so great that a decision is made not to require such information. This might be viewed as a cost of providing information — considered more fully below.

(e) *accessibility or availability* — Board members may take into account the fact that while a particular piece of information might meet the qualitative characteristics, it might be very difficult to obtain that piece of information; perhaps because the information is located outside the entity. Like practicality or practicability, this might be viewed as a cost of providing information — considered more fully below.

(f) *operationality* — Board members might take into account the ability of preparers to generate a particular piece of information – perhaps because it would require very complex calculations or inordinate time to create the information. The ability of
auditors to audit a piece of information is also a consideration often taken into account. This might be viewed as a cost of providing information — considered more fully below.

(g) simplicity — Sometimes Board members might select an otherwise less desirable piece of information on the grounds that it can be determined simply. For example, a cost-based measure may sometimes be selected in preference to a fair value-based measure on the grounds that the cost is simple to obtain, but fair value of that particular piece of information would not be. Such action might be taken in applying a standard to less sophisticated entities – perhaps allowing them to use a simpler, yet consistent, method of providing a particular piece of information.

76. A number of the reasons suggested in the previous paragraph might seem to fit within, or overlap with, characteristics already identified. Others, it may be argued, have little, if anything, to do with decision usefulness, but are more likely to relate to costs. This paper does not consider how those criteria might be traded-off against one another – that is a subject for July. However, it does ask the Boards to consider whether any of these criteria might appear to be so significant that they need to be considered as candidates for additional qualitative characteristics (from a financial statement preparer, auditor or regulator perspective), as well as whether we have a complete set of criteria.

77. Recommendations:

(a) The purpose of the qualitative characteristics is to establish a set of attributes of useful financial information. [see paragraph 56]

(b) 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. [see paragraph 61]

(c) 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. [see paragraph 63]
IASB/FASB – June 2005

**Qualitative Characteristics other than Relevance and Reliability**

(d) Internal consistency should be discussed in the converged conceptual framework in the same context as comparability and consistency, highlighting the additional perspective that information should be consistent within an entity, subject to the need to allow for variation when needed to support greater relevance or faithful representation. [see paragraph 72]

(e) The objective that accounting standards should be internally consistent, both with one another and with the conceptual framework, should be set out in the converged conceptual framework. [see paragraph 73]

(f) The converged framework should contain a section capturing other criteria that the Boards use in making decisions from a financial statement preparer, auditor or regulator perspective — ones that must be balanced with those aimed at enhancing decision usefulness for users. [see paragraph 74]

78. **Questions:**

(a) Do Board members consider that any of the criteria in paragraph 75 should be included as qualitative characteristics of decision useful financial information?

(b) Are there other qualitative characteristics of decision useful financial information not considered in this paper that Board members propose should be considered for inclusion?

**COSTS AND BENEFITS**

79. Both the IASB Framework and CON 2 discuss the relative roles of costs and benefits.\(^{60}\) The qualitative characteristics of financial information focus on the ideal information that should be provided to users of financial statements. However, the provision of that information does not come without a cost. The IASB Framework notes, “The benefits derived from information should exceed the cost of providing it.”\(^{61}\) Similarly, CON 2

\(^{60}\) As do the frameworks of the Australian, Canadian, New Zealand and UK standard-setters. The Japanese Discussion Paper argues that costs and benefits are self-evident from the viewpoint of economic reasonableness.

\(^{61}\) See paragraph 44.
80. Neither the IASB Framework, nor CON 2, establishes costs and benefits as qualitative characteristics. They are not characteristics of information itself, but rather constraints on the ability to provide certain information.

81. We propose that costs and benefits be positioned in this same manner in the converged conceptual framework. How the trade-off between costs and benefits is to be assessed, the relationship of costs and benefits to other qualitative characteristics and whether the cost/benefit balance differs for different entities, such as large/small, listed/unlisted, widely dispersed ownership/closely held, will be considered in July. The question to be considered here is whether we have identified the types of costs that might be considered.

82. CON 2 identifies a number of groupings of the types of costs that might be considered in making cost/benefit decisions. It notes, “The costs of providing information are of several kinds, including costs of collecting and processing the information, costs of audit if it is subject to audit, costs of disseminating it to those who must receive it, costs associated with the dangers of litigation, and in some instances costs of disclosure in the form of a loss of competitive advantages vis-à-vis trade competitors, labor unions (with a consequent effect on wage demands), or foreign enterprises. The costs to the users of information, over and above those costs that preparers pass on to them, are mainly the costs of analysis and interpretation and may include costs of rejecting information that is redundant, for the diagnosis of redundancy is not without its cost.”

83. We consider that the groupings in CON 2 provide a reasonably comprehensive, yet broad, list of the types of costs that should be taken into account. Potential other candidates might be some of those identified in paragraph 75, above, as possible reasons that Board members have cited in the past for making choices between alternative accounting methods. However, those which seem to relate to costs also seem to fit within one or another of the

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62 See CON 2, paragraph 135.
63 See CON 2, paragraph 137. The IASB Framework does not contain corresponding information. Nor do the frameworks of other accounting standard setters.
candidates identified in CON 2. It might be useful to embellish some of those categories with some of these candidates in the converged framework, but we do not recommend that additional categories are necessary.

84. Unlike the qualitative characteristics of decision useful financial information, the frameworks do not presently have criteria to assist in making choices between the types of costs that might be considered in any one particular situation. In assessing the trade-offs between costs and benefits, we propose to consider, also, whether criteria might help us decide how particular types of costs should be taken into account.

85. It was suggested at the May FASB Education session that a converged conceptual framework should contain a Section dealing with characteristics of the individuals dealing with the financial information. This is considered from the financial users’ perspective in paragraph 18 of this paper. However, a similar consideration may be needed to be taken into account regarding others dealing with the financial information — financial statement preparers, auditors and regulators. In this regard, a potential qualitative characteristic might be the need for “due care” or “best efforts” to be used in dealing with financial information. In this case, the characteristic is that preparers and auditors will use due care (ethical behaviour), have reasonable knowledge, be willing to acquire new knowledge as needed, etcetera. We recommend that some discussion of the presumptions standard setters can reasonably expect of the capabilities of financial statements preparers, auditors and regulators be included in the part of the converged conceptual framework dealing with costs of providing decision useful financial information. This would help to establish a better base for what might be considered to be ‘reasonable’ costs.

86. **Recommendations:**

(a) Broad categories of costs similar to those identified in CON 2 should be incorporated into the new framework. [see paragraph 83]

(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. [see paragraph 83]
Consideration should be given to developing criteria that might help us decide how particular types of costs should be taken into account. [see paragraph 84]

Material should be included in the converged framework to make presumptions about the capabilities of financial statement preparers and auditors to establish a better base for what might be considered to be ‘reasonable’ costs. [see paragraph 85]

SUMMARY OF STAFF RECOMMENDATIONS

QC1: In CON2, should comparability be elevated to the same level as relevance and reliability? (NB: also convergence issue)

(a) Comparability is an important characteristic of decision-useful information and should be included as a qualitative characteristic in the converged conceptual framework. [see paragraph 17(a)]

(b) Comparability and consistency should be separately defined. [see paragraph 17(b)]

(c) Relevance and faithful representation should have primacy compared to comparability and consistency. [see paragraph 17(c)]

(d) Disclosures can help to compensate when comparability or consistency is overridden by a greater need for relevance or faithful representation. [see paragraph 17(d)]

QC5: Is transparency a qualitative characteristic and what does it mean? Is it the sum of all qualitative characteristics? (e.g., IASCF Constitution: objective is to develop accounting standards that require “high quality, transparent, and comparable information…)"

(a) Succinctness should be added as a qualitative characteristic, as a sub-quality or attribute of understandability. [see paragraph 43(a)]

(b) Succinct means that financial information is presented in an efficient and effective manner, balancing brevity with sufficiency, such that its significance is explicit. [see paragraph 43(b)]

QC8: Is ‘true & fair’ a qualitative characteristic? Is it just faithful representation?

(a) The converged framework should explain that the overall view expressed by 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. Rather, it should be included as part of faithful representation. [see paragraph 53]
Qualitative Characteristics other than Relevance and Reliability

**QC9:** Is materiality a QC or just a filter (e.g., to determine if information relevant in the context of the entity)?

(a) Materiality relates to faithful representation, in addition to relevance. [see paragraph 31(a)]

(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. [see paragraph 31(b)]

**QC10:** What do we mean by understandability?

(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. [see paragraph 24(a)]

(b) Understandability is the quality of information that enables users to perceive its significance. [see paragraph 24(b)]

(c) Relevant information should not be excluded because it is too complex or difficult for certain users to understand. [see paragraph 24(c)]

(d) Understandability is enhanced by the characterisation, aggregation, classification and presentation of financial information. [see paragraph 24(d)]

**QC11:** Other candidates for qualitative characteristics?

(a) The purpose of the qualitative characteristics is to establish a set of attributes of useful financial information. [see paragraph 77(a)]

(b) 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. [see paragraph 77(b)]

(c) 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. [see paragraph 77(c)]

(d) Internal consistency should be discussed in the converged conceptual framework in the same context as comparability and consistency, highlighting the additional perspective that information should be consistent within an entity, subject to the need to allow for variation when needed to support greater relevance or faithful representation. [see paragraph 77(d)]

(e) The objective that accounting standards should be internally consistent, both with one another and with the conceptual framework, should be set out in the converged conceptual framework. [see paragraph 77(e)]

(f) The converged framework should contain a section capturing other criteria that the Boards use in making decisions from a financial statement preparer, auditor or regulator perspective — ones that must be balanced with those aimed at enhancing decision usefulness for users. [see paragraph 77(f)]
Questions:

(a) Do Board members consider that any of the criteria in paragraph 75 should be included as qualitative characteristics of decision useful financial information? [see paragraph 78(a)]

(b) Are there other qualitative characteristics of decision useful financial information not considered in this paper that Board members propose should be considered for inclusion? [see paragraph 78(b)]

Costs and benefits

(a) Broad categories of costs similar to those identified in CON 2 should be incorporated into the new framework. [see paragraph 86(a)]

(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. [see paragraph 86(b)]

(c) Consideration should be given to developing criteria that might help us decide how particular types of costs should be taken into account. [see paragraph 86(c)]

(d) Material should be included in the converged framework to make presumptions about the capabilities of financial statement preparers and auditors to establish a better base for what might be considered to be ‘reasonable’ costs. [see paragraph 86(d)]

Diagrammatic Summary of Recommended Characteristics

Following is a diagrammatic summary of qualitative characteristics, showing how the staff recommendations in this memorandum might be depicted graphically, together with those discussed in May. This diagram is provided only to aid Board members in visualising the staff recommendations, not as a recommendation to include such an illustration in the Framework. The relative positioning of particular characteristics will be discussed further in July.
Characteristics of Decision Useful Financial Information

- **UNDERSTANDABILITY**
  - (incl. succinctness)

- **MATERIALITY**

- **RELEVANCE**
  - PREDICTIVE VALUE
  - CONFIRMATORY VALUE
  - TIMELINESS

- **FAITHFUL REPRESENTATION**
  - TRUE AND FAIR
  - VERIFIABILITY
  - NEUTRALITY
  - COMPLETENESS

- **COMPARABILITY and CONSISTENCY**
  - (incl. internal consistency)

**Legend**

- **Characteristics of financial information agreed upon at the May 2005 Board Meetings.**
- **Characteristics of financial information being discussed at the June 2005 Board Meetings.**
- **Positioning of the characteristic Understandability is to be discussed in July 2005.**
APPENDIX

QUALITATIVE CHARACTERISTICS - SUMMARY

Summary of tentative decisions made in prior meetings

Sources: FASB Action Alert and IASB Update

QC.2 What do we mean by reliability? (a) Many equate reliability with verifiability, not representational faithfulness. (b) Can it be empirically measured? [May 2005]

(a) Financial information needs to be verifiable to provide assurance to users that the information faithfully represents what it purports to represent and that the information is free from material error, complete, and neutral. Descriptions and measures that can be directly verified through consensus among observers are preferable to descriptions or measures that can only be indirectly verified.

Faithful representation of real-world economic phenomena is an essential qualitative characteristic, which includes capturing the substance of those economic phenomena. Faithful representation also includes the quality of completeness. The common conceptual framework will need to discuss thoroughly what faithful representation means, and what it does not mean.

(b) Although empirical research may provide evidence useful in standard-setting decisions, for example, in assessing trade-offs between desirable qualities, the conceptual framework project should not seek to develop empirical measures of faithful representation or its component qualities.

QC.3 Relevance versus reliability – does one always trump the other? [May 2005]

Relevance is an essential qualitative characteristic. To be relevant, information must be capable of making a difference in the economic decisions of users by helping them evaluate the effect of past and present events on future net cash inflows (predictive value) or confirm or correct previous evaluations (confirmatory value), even if it is not now being used. Being capable of making a difference, rather than now being used, is a change from the present IASB framework; confirmatory rather than feedback value is a change from the present FASB framework. Also, the information must be available when the users need it (timeliness).

QC.4 Different standards have different hurdles for what represents “reliable” measurement – is this because we are applying different meanings of reliable (e.g., depending on desired outcome)? Or is it because of different trade-offs between relevance and reliability? Or is it the influence of conservatism? Why is some information “sufficiently” reliable for balance sheet recognition but not for income statement (e.g., valuation changes recognised directly in equity)? [May 2005]
Qualitative Characteristics other than Relevance and Reliability

Representations are faithful - there is correspondence or agreement between the accounting measures or descriptions in financial reports and the economic phenomena they purport to represent when the measures and descriptions are verifiable and the measuring or describing is done in a neutral manner. Therefore, faithful representation requires completeness, not subordinating substance to form, verifiability, and neutrality. Consequently, the common framework should drop the widely misinterpreted term reliability from the qualitative characteristics, replacing it with faithful representation. That replacement is a change from the current IASB and FASB frameworks.

QC.6 What is predictive value? (e.g., in statistics, persistence vs. mean reversion). [May 2005]

Accounting information has predictive value if users use it, or could use it, to make predictions. Accounting information is not intended in itself as a prediction, nor as synonymous with statistical predictability or persistence.


Financial information needs to be neutral - free from bias intended to influence a decision or outcome. To that end, the common conceptual framework should not include conservatism or prudence among the desirable qualitative characteristics of accounting information. However, the framework should note the continuing need to be careful in the face of uncertainty.

Cross-cutting issues remaining to be addressed

QC12 Trade-offs between characteristics? [scheduled for July 2005]

QC13 Cost/benefit - do the qualitative characteristics, especially the cost/benefit balance, differ for different entities, e.g., large/small, listed/unlisted, widely dispersed ownership vs. closely held? [scheduled for July 2005]