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Le Président
JFL/EP

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IASB
Sir David TWEEDIE
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The CNC welcomes the opportunity to comment on the Exposure Draft of an improved conceptual framework for financial reporting.

Our comments are presented as follows:

- In the first part, we summarise our main findings on the Exposure Draft,
- In the second part, we then provide our detailed comments on: 1 – the Preface, 2 – the objectives of financial reporting, 3 information about an entity's resources, claims on those resources and changes in resources and claims, - 4 the characteristics of financial reporting information.

If you do have any question on our comment letter, do not hesitate to contact us.

Yours sincerely,

Jean-François LEPETIT

Our main findings

The revision process of the conceptual framework project

The modifications arising from the consultation on chapters 1 and 2 of the framework should not be integrated in the conceptual framework at this stage. Integrating the modifications arising from the consultation at this stage would impair the internal consistency of the framework. It would be prejudicial to the need for stability in the framework – if partial revisions were to be implemented, short and medium term changes would have to be implemented and then might be reversed. This is all the more true that, as the conceptual framework is only understandable as a whole; it is very difficult, at this stage, to envisage the consequences of the proposed changes on the rest of the framework.

Who are the users of financial reporting ?

The CNC concurs with the decision of the Board to focus on a primary group of users: capital providers (shareholders, lenders and other creditors).. However, management needs also have to be acknowledged: financial reporting is a major tool when reporting to shareholders. Thus, the role of management concerning financial reporting is an essential part of the objective of stewardship.

Information about an entity's resources, claims on those resources and changes in resources and claims

This fundamental part of the framework, which defines the main characteristics of the content of financial reporting appears to be very far from the actual preoccupations of the users of financial statements, and in particular investors. In particular, it is not in line with the work and procedures of financial analysts. Also, compared to the former version of the framework, definitions are less precise and useful.

In particular, the CNC working group on this issue would expect financial information to provide tools that enable an understanding of an entity's "business model", and assess past performances.

When first looking at a business model, and evaluating its related cash flows, analysts first look at the income statement, at the cash flow statement, as well as operating result. Therefore, the proposed assets/liabilities approach is different from what users do.

Past performance is central in the work that analysts do when assessing the future cash flows that will be generated by an entity. It is also key when management accounts for its stewardship of the entity to the shareholders. It should therefore also be central in the tools listed in the revised framework As for understanding the business model of an entity, it is of the utmost importance that the rules for accounting for assets and liabilities take into account their actual use, and not alternative uses, such as selling the asset.

The characteristics of financial reporting information

When looking at general purpose financial statements, users are looking for reliable information.

This contrasts with the Board's proposal to replace "reliability" by "faithful representation". Such a replacement would downgrade the level of "certainty" of the information provided to the users of financial statements, information in the notes being provided on the degree of uncertainty of the information on the financial statements to make up for the loss. Moreover, we note that reliability is one of the criteria required for financial information in decision-making and assessing stewardship under the European Regulation (EC) 1606/2002. As we think that reliability should be one of the main characteristic of the financial statements, we disagree with this change.

Our detailed comments

Preface

Potential modifications arising from the consultation on Chapters 1and 2 should not be integrated in the framework at this stage.

Because it is necessary that the conceptual framework be stable, the Conseil national de la comptabilité is not in favour of a partial revision of the conceptual framework, integrating part of the work at the end of each phase, without waiting for the finalisation of the project. The conceptual framework is only understandable as a whole, and a partial revision could only be confusing. The IASB itself has acknowledged that decisions taken at one point could be reversed, as a consequence of work on latter phases. If modifications were integrated in the framework at the end of individual phases, there is a possibility they might be reversed once again at the end of the process. As already mentioned, it is our view that the framework has to be stable.

Convergence

The CNC is strongly supportive of the convergence process and therefore of the revision of the IASB/FASB frameworks.

In accordance with the Memorandum of understanding between the IASB and the FASB, many major standards will be revised in the near future. The Conseil national de la comptabilité is fully supportive of the convergence between IFRSs and US Gaap. In order to progress in a more efficient manner on those projects, it is advisable to have a stable revised framework. It is essential that the revised framework be a stable element of reference for the major work that is going to be undertaken on the various standards.

As a side comment, it is worth mentioning that users that participated in the working group acknowledged that they currently find different useful information in both sets of standards. The converged framework should be as such that it would permit information currently in one sets of standards or the other to be still provided in the converged framework.

The conceptual framework project

In order to reconciliate these two elements (a short term need of a revised converged framework and a need for stability), we recommend that the work on the revision of the framework be accelerated. Therefore, we strongly recommend, as stated by paragraph P 8 of the draft that the Boards adopt an approach that focuses mainly on improving their existing frameworks and achieving their convergence, giving priorities to issues that are likely to yield standard setting benefits in the near term. We question whether this is the way the Board has worked so far. For example, the work on the definition of assets has lead to a new proposed definition which is actually very far away from the current one.

Also, an additional idea as to how to proceed, which could be added to paragraph 8, would be to limit the changes to parts of the framework which cover areas for which there is an actual need, because current texts are silent, or where changes have already be implemented in individual standards, to make the framework in conformity with those individual standards.

Status of the framework (P14 et P16)

The Boards decided not to make any decision with regards to the status of the framework. However, it appears that the proposed draft gives indications as to what the final decision will be (P 14 et P 16). If no decision has been taken as to the future status, then full consequences should be drawn from this. In particular, when it says that the common framework will not override those standards, the current paragraph P 14 could give the impression that the current hierarchy in IAS 8 could be revisited. Such decision, which should be fully debated, should not be taken at this stage.

Objective of financial reporting

Stewardship (OB12)
The CNC is fully supportive of stewardship being one of the main objectives of financial reporting. This seems particularly important with regards to commercial law, notably minority interests. However, the CNC does not see any improvement to the proposed definition of stewardship, compared to the former one. In particular, the CNC is uncertain of the meaning of paragraph OB 12, with regards to “unfavourable effects of economic factors, such as price changes”.

Role of management (OB8)
The CNC agrees that management has a privileged access to internal information. However, management is a main user of financial statements :

- Financial information is a major tool enabling dialogue between management and shareholders ; therefore management is a major user of financial information.
- This tool is necessary to fulfil the stewardship objective of the financial statements: it is essential that management has at its disposal a set of financial information that permit a dialogue with the shareholders. Notably, management must be able to feel comfortable that financial statements correctly depict its actions when discussing with shareholders.

Paragraph OB8 states « management is not their (financial statements) intended recipient ». This does not correctly reflect the place of management with regards to financial statements and should be deleted.

General purpose financial statements

We still believe that the respective roles of financial statements and financial information should be clarified at an early stage of the project. Notably, it appears that if financial information can cover the needs of a large group of users, as stated in the Exposure Draft, it might not be the case for financial statements.

Entity perspective/proprietary approach
The rationale used to justify the entity perspective is not at all convincing, notably caricaturing the proprietary approach as a thing of the 19th Century. We do encourage the IASB to substantiate more, and differently, its choice.
One way of proceeding would be, for example, to explore alternative approaches, for example, the notion of « parent entity owners approach».
Also, the Exposure draft is based on the focus on a primary user group. It is not obvious to reconcile this choice with the choice of the entity approach. Expanding the basis for conclusions of the Exposure draft on this issue might be helpful.

Information about an entity’s resources, claims on those resources and changes in resources and claims
This part of the draft defines the outlines of the actual information that will be provided to users. It is therefore particularly important However; the current draft is particularly vague and does not constitute an improvement compared to the current framework.
Moreover, there is a major gap between what is described as important for users, and the way they actually work.
Indeed, one major part of the work of analysts is to understand the entity « business model ». On the contrary, the focus of the Discussion Paper is from the start on assets and liabilities which appears to be, according to the draft ,the focus of financial analysis. Without a reference first to business model, the entity appears to be a collection of assets and liabilities, without any link to one another .Such an approach is disputable.

Another critical aspect of the draft is the way « accrual accounting » is described. Paragraph OB 20 uses the phrase when : « events or circumstances occur ». As what is meant by occur is not defined, there is no precise definition of what “accrual accounting” actually is. This notion, however, is central to financial reporting. One way of defining more precisely accrual accounting would have been to better define its link with finance theory. Its link with capital maintenance, return on equity, would have been helpful.
Another concern we have is the fact that solvability and liquidity are stated as secondary objectives of financial reporting, because they mainly fulfil the needs of particular user groups (BC 1.29 of the Exposure Draft). Once again, this does not correspond to the way analysts work: assessing the liquidity and solvency of an entity is a major part of their work that they undertake parallel to assessing future cash flows. This is equally true for equity investors, lenders or creditors.
To conclude, it seems to us that the Basis for conclusion on this part of the draft are nor fully developed yet. As this is such an important part of the framework, we would encourage the IASB to fully develop the rationale that lead to its conclusions.

Characteristics of financial information
The CNC questions the replacement of the notion of “reliability” by “faithful representation”. Paragraph QC 11 of the Exposure Draft states that “faithful representation does not imply total freedom from error…. because the economic phenomena presented in financial reports are generally measured under conditions of uncertainty…for a representation to imply a degree of completeness, neutrality or freedom from error that is impracticable would diminish the extent to which the information faithfully represents the economic phenomena that it purports to represent. Thus, to attain a faithful representation, it may sometimes be necessary to disclose explicitly the degree of uncertainty in the reported financial information”.
How to account for uncertainty is at the centre of current accounting debates. The formulation of paragraph QC 11 leads to accounting for every economic phenomenon, whatever its degree of uncertainty, with disclosures in the notes.

The users that participated in the CNC working group reaffirmed that, when looking at financial statements, they were looking for “reliability”. This seems to be in conflict with the proposed change from reliability to faithful representation. We are not therefore in favour of such a change.

On the contrary, because of this need for certainty, our view of what financial statements should portray is still close to what is stated in paragraphs 92 or 93 of the FASB concept statement n°2 and in paragraph 37 of the IASB current conceptual framework (to quote BC2.20 of the draft : “paragraph 37 of the framework says that the exercise of prudence is an appropriate response to the uncertainties inherent in preparing financial statements. It defines prudence as the “inclusion of a degree of caution in the exercise of judgements needed in making the estimates required under the conditions of uncertainties, such as assets or income are not overstated and liabilities and expenses are not underestimated”.
Compared to this fundamental change, the other proposals in the draft appear minor to us. We are not convinced by the analysis of qualitative characteristics between fundamental and enhancing. One example of our concerns would be “timeliness”. This characteristic is considered as enhancing the relevance of financial information. It seems to us that timeliness is much more than enhancing. In modern market places, there is no way that an information that is not timely could be relevant. We therefore suggest that timeliness is more than enhancing. To us, it is an undissociable fundamental characteristic.