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## **PRELIMINARY VIEWS – CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING**

Dear Sir,

ISDA appreciates the opportunity to comment on the Preliminary Views publication on the Conceptual Framework for Financial Reporting: Objective of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting Information.

Our members represent leading participants in the privately negotiated derivatives industry and include most of the world's major financial institutions, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities. As such, we believe ISDA brings a unique and broad perspective to the work of the IASB on accounting for financial instruments.

ISDA is supportive of the work of the IASB and FASB in developing a single Conceptual Framework. In our view, establishing a robust Conceptual Framework is key to the development of future principles-based accounting standards and we encourage the Boards to continue with their efforts in this area. Having said this, we have some concerns with the first Preliminary Views paper and the overall project as follows:

- Whilst ISDA would support the development of a Conceptual Framework for all financial reporting, we believe that in order to achieve this objective it would first be critical to get all the appropriate constituents involved in such a broad project. For example, financial services companies prepare a significant amount of information for their regulators including information on the use and adequacy of capital and notification of corporate finance activity. In our view, it would not be appropriate for either the IASB or FASB to provide guidance on the preparation of all financial information without first involving the relevant external bodies. Therefore, whilst this is a laudable long-term plan, at this time, we believe the Boards should focus only on financial statements.
- On reviewing the publication, and in anticipation of future Discussion Papers on the framework, we believe it is important to maintain a focus on the key objectives and underlying principles of financial statement reporting. In line with the concept of principles based accounting, we believe the Conceptual Framework should set out the overarching key accounting concepts and provide limited further guidance by way of explanation and examples. Where information is still required to support the conclusions reached in the paper, this could be included in the Basis of Conclusions. The completed Conceptual

Framework would then itself be in line with the principles on which future standards will themselves be developed. By reducing the level of detail in this and future Discussion Papers it should also be easier for standard setters, preparers, and users to understand and adopt the proposals.

- We would like to suggest that in order to ensure that standards currently being worked on do not conflict with the Framework, and to assist in the common goal of developing standards that are clearly based on consistent principles, the Boards consider where possible implementing each distinct part of the Framework as and when it is completed (i.e. where the guidance is not dependent on the future development of other parts of the Framework). We believe that it is critical that both Boards develop new standards in tandem with the development of a Conceptual Framework and by taking our suggested approach, the Boards will be able to consider the principles already established by the Framework as and when they develop new accounting literature.
- Whilst ISDA appreciates that any project of this kind will take a number of years to complete we would encourage the Boards to accelerate the debate on matters such as its authoritative status. In our view, it is critical that the Conceptual Framework forms part of the overall accounting hierarchy as it will establish the key accounting concepts that will underpin all new standards and ensure they are developed on a consistent basis. Should the IASB and FASB elect to implement each distinct part of the Framework separately, deciding on the authoritative status of the Framework will be of even greater importance. Whilst we understand the debate has been delayed due to current work of the FASB on the status of the US GAAP framework, we are concerned that the significant time and effort involved in developing a Framework would provide limited benefits if the Boards are unable to agree on its authority.

The Appendix to this letter sets out our detailed response to specific paragraphs of the publication. We would be pleased to discuss our comments with the Board or staff. Please contact Melissa Allen at Credit Suisse on (020) 7883 3598 or Ed Duncan at ISDA on (020) 3088 3574.

Yours sincerely



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Cc:  
Stig Enevoldsen,  
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## **Appendix**

We set out below our comments relating to specific paragraphs of the detailed guidance within the publication:

### ***Authoritative Status – Preface, paragraph 2***

The preface to the Preliminary Views paper notes that the Boards have decided to defer the debate on the authoritative status of the framework as the GAAP hierarchy in the United States is currently under review and it was considered to be more appropriate to review differences once this work was complete.

Whilst we understand the reasons for deferring any decisions on the authoritative status of the Framework, ISDA would encourage both Boards to progress this debate at the earliest opportunity, as we believe that this is a critical element in the development of an Exposure Draft on the Conceptual Framework.

In our view the Conceptual Framework should form part of an overall GAAP hierarchy as it establishes the key accounting concepts that underlie financial statements and provides direction and structure to the development of detailed accounting standards. In addition, we believe it is important that the Conceptual Framework is authoritative as it establishes guidance and protocols that the standard setters are then accountable to. Finally, a Conceptual Framework that is part of the GAAP hierarchy provides both preparers and users with a point of reference where no guidance exists in detailed accounting literature.

In determining the appropriate accounting for an underlying transaction or other event, ISDA considers that a preparer should look to accounting guidance in the following order and would propose the inclusion of the following GAAP hierarchy in the final document:

- First, the preparer should refer to detailed guidance under the relevant accounting standard;
- Second, reference should be made to guidance and interpretations issued by a recognised authority (e.g. IFRIC for IFRS);
- Third, if no detailed accounting guidance exists then the preparer should refer to the Conceptual Framework; and
- Finally, reference could be made to accounting guidance developed by other recognised accounting bodies. It is important to emphasise that this should only be used where the guidance is consistent with the Framework (e.g. when applying IFRS, reference to US GAAP DIGs would be appropriate as long as they are consistent with the principles embedded in IFRS and no other IFRS guidance exists).

Where a Standard has been in existence for many years, there may be situations where the Standard is not aligned to the principles outlined in the amended Conceptual Framework. In these situations, we still consider that it would be appropriate to follow the required accounting outlined in the standard until such a time as a comprehensive debate has occurred and the guidance amended. It will, however, be important for the Boards to consider prioritising their work to deal with the more significant inconsistencies that may arise.

### ***Objective of Financial Reporting – Chapter 1***

The first chapter of the publication establishes a Conceptual Framework for general purpose financial reporting and notes that although an entity's financial statements are a central feature of financial reporting, the Conceptual Framework should also establish a common objective for all financial reporting.

ISDA supports the development of a Conceptual Framework for all financial reporting though we believe that it would be critical to get all the appropriate constituents involved in such a project. A significant amount of

financial information is provided by an entity including a broad range of information for different users who have different requirements. For example, financial services companies prepare a lot of information for their regulators including information on use and adequacy of capital and notification of corporate finance activity such as takeovers etc. In our view, it would not be appropriate for either the IASB or FASB to provide guidance on the preparation of all financial information, as much of this is the responsibility of other external bodies. For this reason, for the time being, we believe the proposed Conceptual Framework should focus only on information within financial statements.

***Objective of Financial Reporting – Chapter 1, paragraph 2***

The Preliminary Views in the Conceptual Framework propose that financial reporting should include information to help assess an entity's future cash inflows and outflows.

As noted above, ISDA considers that the proposed Conceptual Framework should focus only on information provided in financial statements. In our view, financial statements should provide investors with information about the current use of an entity's resources and equity to enable the user to consider the future prospects of the business in light of its historical performance. We do not consider it the role of financial statements to provide predictive information about an entity's future performance and we are concerned that the Basis of Conclusions makes reference to the potential inclusion of prospective information or forecasts into an entity's reporting. Financial statements form a part of an entity's overall financial reporting and should provide information to help a user assess an entity's past performance and the risks associated with the assets held and liabilities incurred at the balance sheet date.

Furthermore, we believe it is the responsibility of management to provide investors with information on the future prospects and business strategy of the firm and it is important that this kind of information is not confused with audited factual information about an entity's past performance.

***Objective of Financial Reporting and assessing management's Stewardship – Chapter 1, paragraph 27***

The publication outlines the accountability of management for the custody and safekeeping of an entity's economic resources and their efficient and profitable use. Financial statements are used by investors and others to understand the decisions taken by an entity's management and to assist them in assessing the performance of the business. In our view whilst it is important that information is provided to enable a user to assess how management has fulfilled its stewardship responsibilities, the information needed to make this assessment is encompassed within the objective of providing information useful to making credit and investment decisions. We therefore consider it appropriate to consider Stewardship as a critical element of all decision-useful financial information rather than as a separate objective itself.

Having said this, whether or not Stewardship is determined to be a separate objective of financial reporting, it is important to emphasise that only the information to make the assessment in respect of how the management fulfilled its stewardship responsibilities should be included in the financial statements. The user, on the basis of the information provided, should then make any assessment of management's performance independently.

***Inclusion of Faithful Representation – Chapter 2, paragraph 16***

The preliminary views paper establishes that for information to be useful, it must be a faithful representation of the real-world economic phenomenon that it purports to represent and that the information must be verifiable, neutral and complete.

In doing this, the paper has replaced the concept of reliability with faithful representation and established a new principle that the information must be verifiable.

ISDA is concerned that although the IASB and FASB do not believe this to be a substantial change, the inclusion of the need for information to be verifiable could be viewed to be different from the need for information to be reliable. In the preparation of financial statements there are many situations where a preparer will need to exercise professional judgement to determine the initial and ongoing measurement of a transaction or event. In our view, the term verifiable would imply that information would need to be substantiated or validated for it to faithfully represent the transaction whereas financial statements have historically included estimates where these are considered to be reliable.

We are pleased to see that the Boards have gone on to explain the concept of verifiable and have stated that for information to be verifiable there need not be a single point estimate but a range of possible amounts with related probabilities. Having said this, we still believe that verifiable may be interpreted more narrowly than may be envisaged and would ask this to be a particular area that the Boards request feedback on in any future Exposure Draft.

***Faithful Representation – Chapter 2, paragraph 17***

As noted above, the publication states that information cannot be a faithful representation of an economic phenomenon unless it depicts the economic substance of an underlying transaction or other event. ISDA would agree that transactions should be accounted for in a way that reflects its economic substance and that this may not necessarily be the same as its legal form. However, on occasion, situations may arise where the guidance set out in an Accounting Standard, may, in a preparer's view, lead to a presentation that does not appropriately reflect the substance of the transaction.

Accounting Standards have been developed using the principles outlined in the current Framework and where a Standard provides guidance on the accounting for a transaction we consider that this should be followed without exception. However, where following the accounting guidance could lead to a distorted view of a transaction, it should be the responsibility of the entity to provide additional information to enable a user to understand the accounting treatment and the underlying economics. This is consistent with current practice where markets encourage entities to provide other disclosures where these are necessary to assist a user in their understanding of the entity's operations.

We would encourage the Boards to consider reflecting this practice within the guidance provided by the Conceptual Framework.

***Benefits and Costs – Chapter 2, paragraph 53***

The Framework is clear that standard setters should make an assessment of whether the benefits of providing information justify the relevant costs. ISDA is concerned that the proposed cost benefit assessment will not necessarily lead to a thorough analysis of the relative merits of an accounting change.

In our view, the Board should be accountable for making a robust, transparent analysis of whether the benefits of a change in accounting guidance justify the cost of change. We note that regulators, such as the UK FSA, are required to make public their analysis of such cost versus benefit analysis for any rule change and we believe this creates a good management discipline. We would encourage the Boards to adopt a similar principle in the Framework.