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**Douglas Wm. Barnert**
Executive Director

November 9, 2006

Mr. Robert Herz, Chairman
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116
UNITED STATES

Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Re: Preliminary Views/ Discussion Paper on an improved Conceptual Framework for Financial Reporting [Framework]

Dear Chairmen Herz and Tweedie:

The Group of North American Insurance Enterprises ("GNAIE[1]") appreciates the opportunity to comment on the "*Conceptual Framework for Financial Reporting: Objective of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting Information*." Recognizing the importance and significance of the effort to converge accounting standards, we believe it is timely and critical to develop a consistent global Framework for setting accounting standards and support the FASB and IASB joint initiative toward the development of a common Framework.

[1] GNAIE consists of the Chief Financial Officers of the leading North American insurance companies including life insurers, property and casualty insurers, and reinsurers. GNAIE members are the largest global providers of insurance and substantial multi-national corporations.

The goals of GNAIE are to influence accounting standards to ensure that they result in high quality accounting standards for insurance companies, and, to that end, to increase communication between insurers doing business in North America and accounting standard setters. GNAIE works to meet its goals through modeling of proposed accounting standards, analysis, comment, and coordination with various end users of financial reports.

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**Summary recommendations:**

Following extensive review, the following critical points are most important to our response and should be reflected in a Conceptual Framework:

- No single qualitative characteristic should have priority over the others, i.e., relevance should not be first. We strongly believe the Board's must recognize the fundamental inter-relationship between relevance and faithful representation (or reliability). More specifically, we believe if information reported in financial statements is to be considered relevant it must attain a minimum threshold of faithful representation (or reliability) which can be determined with respect to its neutrality and verifiability.
- The scope of the Framework should be limited to financial statements, and not cover all financial reporting.
- The primary purpose of financial statements should be historical performance reporting, which by definition does not incorporate the authoring (either directly or indirectly) of financial projections.
- Stewardship should be identified as a separate objective of financial reporting.
- So that each characteristic has only one meaning, Consistency should be a separate qualitative characteristic rather than embedded within comparability,
- Going concern and other assumptions underlying financial reporting should be reflected in the Framework for it to be complete.

## I. Chapter 1:

### Authoritative status of the framework

Paragraph P2 notes the differences between the IASB Conceptual Framework and that of the FASB Concepts and their relative positions within their respective hierarchies. We agree with and support the Boards' expressed goal in paragraph P3, i.e., the need to have a framework that is sound, comprehensive and internally consistent. We also agree that when completed the common framework should be a single document at Level 1 in the hierarchy of accounting guidance.

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**The objective of financial reporting**

The Discussion Paper, recognizing the objective of financial reporting is to provide information to present and potential investors, fails to note that investors have a range of objectives, strategies and time horizons. For example, we believe the Framework should be expanded to describe that present and potential investors employ different strategies, some with a short time horizon, e.g., certain hedge fund firms, where market timing and trading may be their first priority, while others, with a long-term strategy such as buy and hold, would be interested in an entity's risk profile and performance. As well, creditors of entities with sufficient liquid assets to satisfy existing obligations may not consider short-term performance measures to be of much importance. As such, we believe paragraph OB 13, which states, "Present and potential investors and creditors have a common interest in the ability of an entity to generate net cash flows", fails to recognize the different objectives of financial statement users and oversimplifies the investor community.

We support the view expressed in paragraph OB 10 that the information provided by general purpose financial reporting is generally directed to the needs of a wide range of users. However, we believe that the vast majority of users are better served when financial reports are prepared using the parent company perspective. We also believe the list of potential users described in paragraph OB 6 is too broad. We do not believe that general purpose financial reports should be designed to support all the needs of governmental agencies and regulatory bodies (f) as those entities generally have the authority to require the separate reporting of information to suit their needs. Moreover, while these groups may find general purpose financial reports useful in terms of the information they convey, the reports should not be focused on a basis of accounting designed for assessing solvency as that is a separate, very narrow objective, that is typically addresses through a variety special reporting conventions.

Paragraph OB 3, and other sections throughout the Discussion Paper, state, "…financial reporting should provide information…to assess the amounts, timing, and uncertainty of the entity's future cash inflows and outflow…." We strongly believe the primary objective of financial reporting is to accurately report the results of past transactions and not to predict the future. While stipulating to the fact that assessing a reporting entity's ability to generate positive cash flows in the long run is important, projecting those uncertain cash flows should not be incorporated within the scope of information to be included in the basic financial statements. In contrast, information about a reporting entity's periodic performance is extremely important to financial statement users in assessing the future cash flows of the entity as well as the entity's ability to continue as a going-concern. In connection with the preceding, FASB Statement of Financial Accounting Concepts No. 1, *Objectives of Financial Reporting by Business Enterprises* ("CON 1"), while noting the

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importance of cash flows, also states in paragraph 43 that “the primary focus of financial reporting is information about an enterprise’s performance…”. We believe that losing sight of this objective would severely diminish the usefulness of financial reporting. Stated differently, any financial reporting framework that focuses solely on the changes in the balance sheet would render the Income Statement (and with it, traditional performance measures) meaningless as the income statement would simply be reduced to a statement of changes in financial position. As a result of the preceding, we strongly encourage the Boards to reconsider their views in the Discussion Paper and include paragraphs 42-48 of CON 1 into the Conceptual Framework.

While understanding financial statement user’s desire to obtain supplemental information about the reporting entity’s ability to generate future cash flows, we are especially concerned that such information requires forward-looking (or otherwise proprietary information) that may not fall within the scope of the SEC’s Safe Harbor rules. Moerover, without protection, we believe reporting entities could be faced with significant litigation exposure to the extent its predictions of the future fail to materialize (which is almost certainly to be the case). Our concerns are not only limited to information provided in the basic financial statements but also extends to supplemental information that may be required in the financial statement footnotes which are subject to audit and as such would also need to be incorporated into the reporting entity’s Sarbanes-Oxley Section 302 and 404 control procedures, This not only significantly increases compliance costs but also exposure to the emergence of compliance issues.

Stewardship should be identified as a separate objective of financial reporting. Consistent with the alternative viewpoints expressed by two IASB members in paragraphs AV1.1 through AV1.7, the stewardship objective of financial reporting is too important to be subsumed in the investment and credit objectives. Therefore, the objective of financial reporting stated in the discussion paper should be the aggregation and dissemination of information that is relevant for making investment, credit, stewardship, and similar resource allocation decisions. “Stewardship is concerned with the accountability of the directors or management board of a business entity to its owners and it is at the heart of financial reporting.”

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## II. Chapter 2:

### The qualitative characteristics

The list of qualitative characteristics of financial statements should also include consistency. While the Discussion Paper notes that consistency is included in comparability, we believe the Framework would be enhanced by separating the two, with each having a distinct meaning. Comparability results when similar economic events are accounted for in a similar manner by different enterprises. Consistency results when an enterprise applies the same accounting policies and principles between periods. By adding consistency to the list of qualitative characteristics, we believe the Framework would make it clear that comparability of information between entities and consistency or information between periods is equally important.

The discussion paper does not mention the going concern assumption underlying the preparation of financial statements. According to paragraph 23 of the IASB's Framework, financial statements are normally prepared on the assumption that an entity is a going concern and will continue in its operational existence into the foreseeable future. This principle is important because it impacts the appropriate basis used in valuing assets and liabilities. Accordingly, "going-concern" as a cornerstone assumption of financial reporting should be reflected in the discussion paper, and where applicable, related to measurement attributes such as historical cost, fair value, market value, present value, exit value, and entry value for the purposes of helping standard setters to prescribe the appropriate measurement attribute in a given set of circumstances. For example, the use of liquidation value (i.e. exit values) as a measurement basis may be appropriate for a reporting entity in liquidation. Similarly, other critical assumptions underlying the preparation of financial statements such as periodicity, measurement, realization, accrual, as well as the entity concept should be included in the discussion paper for it to be complete.

### How should qualitative characteristics relate to the objective of financial reporting and to each other

We are extremely concerned about the views expressed in paragraphs QC43-45 which advocates a position that relevance must be considered first and it is illogical to conclude otherwise. Such a view can only be that of a theorist based upon a hypothetical set of conditions. Within the accounting community there has been a continuing debate about which is more important: relevance or reliability? Since the Discussion Paper proposes replacing reliability with faithful representation, the question remains which is more important.

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Just as the Boards have stated that relevance is first, other noted professionals could and would argue that faithful representation is first as it provides the very foundation that relevance sits atop of and as such any other conclusion is illogical. Which view is correct or are both views flawed? Our view tends to support faithful representation as the more important qualitative characteristic as all financial information must possess a requisite amount of reliability before being capable of being considered relevant. This suggests the existence of an fundamental inter-relationship that cannot be ignored as it could otherwise lead to the aggregation and dissemination of knowingly unreliable information on the basis that it might otherwise be considered relevant by a financial statement user.

In connection with the preceding, some standard setters have suggested that fair value measurement is always the most relevant basis of information and therefore should be applied to the measurement of all assets and liabilities. Assuming, for the sake of illustration, that fair value measurement (Level 3 in the SFAS No. 157, *Fair Value Measurement*, hierarchy) was mandated for inventory and a reporting entity began production of an updated model of a well-known and successful electronic device. As each updated device is finished, should the measurement be based upon the price of the existing electronic device? Since relevance is the first order, the standard setter could argue that such a measurement would be the most faithful representation since the manufacturer expects the updated model to be successful. Others would argue that this measurement is not relevant until it is realized and until then any future expectations on the part of the reporting entity are wholly unreliable, and that profits should not be recognized until the product is sold. While this example oversimplifies the situation, creating a hierarchy within the qualitative characteristics would likely lead to unintended conflicts especially by subordinating the qualitative characteristic of faithful representation (which includes reliability) to that of relevance.

We hope these comments will be of assistance to the Boards in their upcoming discussions. Moreover, in the event you, any Board Member, or any member of staff would like clarification of our views we would be happy to make ourselves available to discuss our comments and recommendations in more detail. We also welcome the chance to discuss our views at a roundtable discussion.

Respectfully submitted,

The Group of North American Insurance Enterprises

Douglas Wm. Barnert

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