THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

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Director
Board for Actuarial Standards
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**BOARD FOR ACTUARIAL STANDARDS CONSULTATION TOWARDS A CONCEPTUAL FRAMEWORK**

Dear Sir,

The Institute of Chartered Accountants in England and Wales (the ICAEW) welcomes the opportunity to comment on the consultation paper *Towards A Conceptual Framework* published by the Board for Actuarial Standards in November 2007.

The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

As the consultation paper notes, the starting point for this exercise is the accounting model. While we are not in a position to comment on the actuarial issues involved in preparing a conceptual framework for BAS standards, we do have some comments that reflect our experience of the accounting model.

First, it is unusual for a regulatory activity to have a conceptual framework. We understand that the term 'conceptual framework' comes from the academic world, where it is used to describe something that sets out the assumptions or frame of analysis for a given field of enquiry. Frameworks of this type are either accepted or argued about by the participants in each field and do not have regulatory status. So far as we know, financial reporting is unique in having a conceptual framework that is explicitly intended to be a basis for the regulator to set standards, but there may perhaps be other such frameworks of which we are unaware.

We believe that there are important questions here as to whether:

- there are particular characteristics of the regulation of financial reporting that justify it having a conceptual framework when other regulatory activities do not; or

- there is nothing special in this respect about financial reporting, and its example could usefully be followed in other areas of regulatory activity (which seems to be the assumption underlying the consultation paper); or
- there is nothing special in this respect about financial reporting, and the development of a conceptual framework for its regulation has been misconceived.

We believe that experience to date of conceptual frameworks for financial reporting still leaves these questions open.

It may be useful to consider why conceptual frameworks have been developed by financial reporting standard-setters. We believe that there have been two main motives:

- the desire of standard-setters to be able to refer to some underlying theory that will justify (though not necessarily determine) their decisions; and
- a more widespread desire to reduce arguments about what standards should require.

Financial reporting in recent decades has been a highly disputed area, with strongly held views on such matters as whether items in accounts should be measured at historical cost or current value. As there has been no consensus on these issues and in practice different items in accounts have been measured in different ways, we believe that there has been some concern among standard-setters that their decisions might appear to be either arbitrary or haphazard. If their decisions could be shown to be rooted in a conceptual framework, they would, arguably, be less vulnerable to such criticisms.

At the same time, many of those involved in the debate on standards have been frustrated by the lack of agreement on key issues and have often expressed views to the effect that 'This would be a lot easier if we could agree on what we are trying to do'. From this point of view, a conceptual framework is intended to provide unanimity on 'what we are trying to do'.

We do not believe that experience to date has realised the expectations of those who advocate a conceptual framework as an aid to the regulation of financial reporting. In practice, it has hitherto proved impossible to develop a framework that leads unambiguously to one conclusion rather than another as to:

- what information should be disclosed or
- how items should be measured,

which are the two key questions in financial reporting. It has also been noted that standard-setters sometimes set standards that appear to contradict their conceptual frameworks.

It could be argued that these are merely historical problems that show the need for a better, more comprehensive and more specific conceptual framework and for more rigorous adherence to such a framework by standard-setters in the future. However, we have noted some problems that seem to be inherent in conceptual frameworks and it is possible that the development of a 'better', more rigorously enforced framework will accentuate these rather than alleviate them:

- There is a tendency to oversimplify. For example, financial reporting serves various purposes for diverse users. This is unhelpful if the object of a conceptual framework is to reduce arguments. The tendency therefore is to simplify the purposes of financial reporting so as to have a conceptual

- framework that ‘works’, but this is arguably achieved at the expense of overlooking complicating factors.
- There is a tendency to overrationalise and not to understand why things are the way they are. The conceptual frameworks developed for financial reporting started off from principles derived by rationalising key aspects of current practice, but then developed a life of their own, and became a basis for criticising the inadequacies of current practice. This may well be a beneficial process, but there is a risk that the conceptual framework will fail to capture all the reasons why a particular practice is useful (or, for that matter, might be harmful). The tendency then is for standard-setters either to try to mould reality to fit a deliberately simplified theory or to feel frustrated because they are unable to do so.
- As one of the key purposes of a conceptual framework is to reduce argument in circumstances where there is underlying disagreement, this has to be achieved by removing from the discussion those who disagree with the framework or by disregarding their views. Both processes operate currently. Advertisements for members of the International Accounting Standards Board specify that ‘qualities expected in candidates’ include ‘commitment to … the IASB’s conceptual framework’. Equally, when submissions on consultations are considered by the IASB, if an argument is inconsistent with the framework this appears to be a sufficient and conclusive reason for rejecting it. Indeed, how could it be otherwise if the conceptual framework is to be effective in shaping standards?

We noted earlier that financial reporting appears to be unique in having a conceptual framework for regulatory purposes. We suggest that the BAS considers very carefully the implications of this before embarking on a similar enterprise. If the BAS is aware of other regulatory activities that have conceptual frameworks then it would of course be sensible to consider experience in these areas as well.

As noted at the beginning of this response, we have not sought to comment on the actuarial issues involved. We have however, recently submitted a short response to the Professional Affairs Board of the Actuarial Profession’s consultation on The Actuaries’ Code and Supporting Actuarial Practice Standards. The accountancy profession itself relies upon the smooth interaction of a number of regulatory authorities and we assume that any framework that is produced will acknowledge the need, where appropriate, for standards to cross-reference to adherence to codes of ethics and other relevant standards.

I hope you have the above comments helpful. Please contact me should you wish to discuss any of the points raised in this response.

Yours faithfully,

Robert Hodgkinson

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