13 January 2014

International Accounting Standards Board
30 Cannon Street
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United Kingdom
Email: CommentLetters@ifrs.org

Dear Sir/Madam

SAICA SUBMISSION ON DP/2013/1 – *A REVIEW OF THE CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING*

In response to your request for comments on DP/2013/1 – *A Review of the Conceptual Framework for Financial Reporting*, attached is the comment letter prepared by the Accounting Practices Committee (APC) of The South African Institute of Chartered Accountants (SAICA). This comment letter results from deliberations of the APC, which comprises members from reporting organisations, regulators, auditors, IFRS specialists and academics.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours faithfully,

Sue Ludolph
Project Director – Financial Reporting

cc: Danie Coetsee (Deputy Chairman of the Accounting Practices Committee)

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GENERAL COMMENTS

We welcome the International Accounting Standards Board's (IASB) Discussion Paper on the Conceptual Framework for Financial Reporting (Conceptual Framework) and we are in agreement with most of the aspects of the proposed changes to the Conceptual Framework.

A revised Conceptual Framework could change certain principles currently applied at a standards level such as the threshold for the recognition of provisions, the presentation of items in Other Comprehensive Income (OCI), the application of the distinction between liabilities and equity and the application of measurement options. We urge the IASB to start identifying standards that should be updated to align them with the new concepts of the revised Conceptual Framework and to develop a work programme to update such identified standards. Issues might also arise when the IFRS Interpretations Committee is issuing new interpretations on standards not in line with the revised Conceptual Framework or on issues addressed in the revised Conceptual Framework before the revised Conceptual Framework is issued. The IASB should consider such transitional issues when developing the revised Conceptual Framework.

A structural issue of a new Conceptual Framework is whether the Conceptual Framework should only identify the underlying concepts of financial reporting or whether it should contain more detailed guidance. We believe that the Conceptual Framework should focus on the concepts with sufficient explanation to clarify the application of the concepts. Although we accept that detailed discussions are needed in a Discussion Paper, we feel that the proposed Conceptual Framework does sometimes provided information and examples that are only required at a standards level.

We strongly propose that both profit or loss and OCI should be sufficiently explained in section 2 as part of the elements of the statement(s) of profit or loss and OCI, so as to create robust principles to make decisions whether income and expenses should be classified in profit or loss or OCI. Such principles should start with what the role of profit and loss is in performance reporting and provide clear reasoning why certain items could be reported outside the scope of profit or loss. Without such robust principles the decision to recognise income and expenses outside profit or loss could result in arbitrary decisions. Some constituents feel strongly that without robust principles the option of OCI should be eliminated.

We feel that the business model and unit of account are considerations the IASB uses in making decisions at a standards level and should be clarified on a conceptual level since certain aspects in the proposed Conceptual Framework such as the choice of the measurement model applicable and how the chosen measurement is applied, could both be determined by the business model and the unit of account. The unit of account applied could also affect the application of the recognition and derecognition concepts and should not be developed in isolation.

Section 1 – Introduction

Question 1

Paragraphs 1.25–1.33 set out the proposed purpose and status of the Conceptual Framework. The IASB's preliminary views are that:

(a) the primary purpose of the revised Conceptual Framework is to assist the IASB by identifying concepts that it will use consistently when developing and revising IFRSs; and

(b) in rare cases, in order to meet the overall objective of financial reporting, the IASB may decide to issue a new or revised Standard that conflicts with an aspect of the Conceptual Framework. If this happens the IASB would describe the departure from the Conceptual Framework, and the reasons for that departure, in the Basis for Conclusions on that Standard.

Do you agree with these preliminary views? Why or why not?

We concur with the primary purpose of the revised Conceptual Framework as expressed in paragraph 1.26 of the Discussion Paper in that it will assist in the development and revision of IFRSs. We support the additional role of the Conceptual Framework, as articulated in paragraph 1.27, in helping parties other than the IASB to understand and interpret IFRSs and to develop accounting policies when no IFRS specifically applies to a particular transaction or event.

During our discussion of possible departures from the Conceptual Framework, the majority of the constituents agreed with the preliminary view that departure from the aspects of the Conceptual Framework might occur, especially in the light of the dynamic nature of transactions or events across industries, the passage of time and new developments in financial reporting. A minority, however, expressed the concern that this statement of departure sets a tone that departure from the underlying concepts in the Conceptual Framework articulated within IFRS is acceptable. This minority believe that the concepts developed should be sufficiently robust (i.e. straightforward and understandable) to create a framework of broad concepts, which do not require a need for departure therefrom.

Section 2 – Elements of financial statements

Question 2

The definitions of an asset and a liability are discussed in paragraphs 2.6–2.16. The IASB proposes the following definitions:

(a) an asset is a present economic resource controlled by the entity as a result of past events.

(b) a liability is a present obligation of the entity to transfer an economic resource as a result of past events.

(c) an economic resource is a right, or other source of value, that is capable of producing economic benefits.

Do you agree with these definitions? Why or why not? If you do not agree, what changes do you suggest, and why?

There was general agreement about the definitions proposed in the Discussion Paper as the majority of the constituents understood the 'new' definitions to not differ extensively from the current definitions of an asset and liability, apart from a clarification that an asset represents the source of value and a liability represents the obligation and not the expected inflow or outflow of economic benefits. Further comments on the proposed definitions in relation to the proposed recognition and derecognition definitions are included under our responses to question 8 and 9.

Some constituents questioned whether the 'past event' needs to be an event or a transaction external to the entity or can it also include the result of a mathematical formula applied, for example as developed in IAS 12 – *Income Taxes* (carrying amount – tax base = temporary difference) or even from applying the accounting equation (E = A – L). Most constituents, however, feel that this is a logical consequence of applying the 'past event' concept.

Others questioned whether the definitions need to include both a reference to 'past event' and 'present resource/obligation'. The majority of the constituents expressed the view that they would retain the concepts of a 'past event' and 'present resource/obligation' as these provide clarity.

Question 3

Whether uncertainty should play any role in the definitions of an asset and a liability, and in the recognition criteria for assets and liabilities, is discussed in paragraphs 2.17–2.36. The IASB's preliminary views are that:

(a) the definitions of assets and liabilities should not retain the notion that an inflow or outflow is 'expected'. An asset must be capable of producing economic benefits. A liability must be capable of resulting in a transfer of economic resources.

(b) the Conceptual Framework should not set a probability threshold for the rare cases in which it is uncertain whether an asset or a liability exists. If there could be significant uncertainty about whether a particular type of asset or liability exists, the IASB would decide how to deal with that uncertainty when it develops or revises a Standard on that type of asset or liability.

(c) the recognition criteria should not retain the existing reference to probability.

Do you agree? Why or why not? If you do not agree, what do you suggest, and why?

The general consensus was that the definitions need not refer to 'expected' inflows and outflows and the recognition criteria should neither include a probability threshold nor an assessment of existence (paragraphs 2.20 to 2.31) or outcome (paragraphs 2.32 to 2.34) uncertainty as transactions and items meeting the definition of assets and liabilities should be identifiable and recognised. Uncertainty should therefore be reflected in the measurement basis of an asset or liability.

We agree that the practical application of uncertainty may pose difficulties, but we believe that it will be more appropriate to deal with it at a standard/ interpretation level with a clear explanation (as suggested under Question 1) of any divergence.

We note that from a practical perspective that the exclusion of 'expected' may result in more assets and liabilities being recognised and this could be onerous specifically for low value items. Some constituents felt that this could result in insufficient assets and liabilities being recognised. However, our view is that the proposed changes to the definition of assets and liabilities are conceptually sound and that preparers would be aware of all the potential assets and liabilities.

Question 4

Elements for the statement(s) of profit or loss and OCI (income and expense), statement of cash flows (cash receipts and cash payments) and statement of changes in equity (contribution s to equity, distributions of equity and transfers between classes of equity) are briefly discussed in paragraphs 2.37–2.52.

Do you have any comments on these items? Would it be helpful for the Conceptual Framework to identify them as elements of financial statements?

We agree with the brief discussion on the elements of profit or loss and OCI, the statement of cash flows and the statement of changes in equity since most constituents are familiar with the concepts and these have not created problems in practice.

However, we strongly propose that both profit or loss and OCI should be sufficiently explained in section 2 as part of the elements of the statement(s) of profit or loss and OCI, so as to create robust principles to make decisions whether income and expenses should be classified in profit or loss or OCI. Such principles should start with what the role of profit and loss is in performance reporting, with clear reasoning why certain items could be reported outside the scope of profit or loss. Without such robust principles the decision to recognise income and expenses outside profit or loss could result in arbitrary decisions. Some constituents feel strongly that without robust principles the option of OCI should be eliminated.

Section 3 – Additional guidance to support the asset and liability definitions

Question 5

Constructive obligations are discussed in paragraphs 3.39–3.62. The discussion considers the possibility of narrowing the definition of a liability to include only obligations that are enforceable by legal or equivalent means. However, the IASB tentatively favours retaining the existing definition, which encompasses both legal and constructive obligations—and adding more guidance to help distinguish constructive obligations from economic compulsion. The guidance would clarify the matters listed in paragraph 3.50.

Do you agree with this preliminary view? Why or why not?

We agree with the retention of the concept of 'constructive obligations' as well as the proposal to clarify the matters listed in paragraph 3.50 as we believe the recognition of constructive obligations provides useful information to users about the impact a reporting entity's past practices and policies has on estimated future cash flows.

From our discussions, the following additional points could be considered either on a conceptual or standards level:

- we support adding more guidance to help distinguish 'constructive obligations' from 'economic compulsion' (which is not a trigger for the recognition of constructive obligations on its own), and
- in the context of retaining the notion of a constructive obligation, we suggest clarity about the 'enforceability' of the obligation based on past practice as there appears to be an inconsistent application of this notion in practice.

Question 6

The meaning of 'present' in the definition of a liability is discussed in paragraphs 3.63–3.97. A present obligation arises from past events. An obligation can be viewed as having arisen from past events if the amount of the liability will be determined by reference to benefits received, or activities conducted, by the entity before the end of the reporting period. However, it is unclear whether such past events are sufficient to create a present obligation if any requirement to transfer an economic resource remains conditional on the entity's future actions. Three different views on which the IASB could develop guidance for the Conceptual Framework are put forward:

(a) View 1: a present obligation must have arisen from past events and be strictly unconditional. An entity does not have a present obligation if it could, at least in theory, avoid the transfer through its future actions.

(b) View 2: a present obligation must have arisen from past events and be practically unconditional. An obligation is practically unconditional if the entity does not have the practical ability to avoid the transfer through its future actions.

(c) View 3: a present obligation must have arisen from past events, but may be conditional on the entity's future actions.

The IASB has tentatively rejected View 1. However, it has not reached a preliminary view in favour of View 2 or View 3.

Which of these views (or any other view on when a present obligation comes into existence) do you support? Please give reasons.

We are concerned with the application of the above views and believe that the IASB should do more deliberation on uncertainty.

The consensus in IFRIC 21 – *Levies* illustrates our concern. We believe that IFRIC 21 is an application of view 1. Some of our constituents believe that view 1 is a sound basis for the recognition of a liability. However, others are of the view that view 2 is more appropriate, since they are concerned that, under view 1, certain liabilities recognised today, such as some employee benefits and constructive obligations, may not necessarily be recognised. We are aware that many preparers are of the view that the liability recognition date under IFRIC 21 is too late. These preparers are generally of the view that if it is practically unconditional that the entity will stop operating before the trigger is met, and if it is highly likely that it will be met, then the liability should be recognised. The supporters of view 1 are concerned about how the boundary will be defined under view 2. Using the levies example, if a levy is only charged if an entity is still operating within a particular industry on a specified date, under view 2, for what period(s) would the entity recognise the levy? If at the interim financial period stage it is probable that the levy will be triggered at the year end, and the following 3 year-ends, under view 2 would the liability for all 4 future payments be recognised at that date? If not, what is the boundary?

The majority of our constituents believe that the concept "practical ability to avoid the transfer" requires knowledge of the specific facts and circumstances, but are unsure whether this concept provides a robust principle that could be applied in all circumstances.

Question 7

Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?

No additional comments were raised apart from those mentioned under the questions above.

Section 4 – Recognition and derecognition

Question 8

Paragraphs 4.1–4.27 discuss recognition criteria. In the IASB's preliminary view, an entity should recognise all its assets and liabilities, unless the IASB decides when developing or revising a particular Standard that an entity need not, or should not, recognise an asset or a liability because:

(a) recognising the asset (or the liability) would provide users of financial statements with information that is not relevant, or is not sufficiently relevant to justify the cost; or

(b) no measure of the asset (or the liability) would result in a faithful representation of both the asset (or the liability) and the changes in the asset (or the liability), even if all necessary descriptions and explanations are disclosed.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

The majority of the constituents agreed with the proposed recognition principle and the proposed exclusion from recognition. During our discussion on recognition, some constituents were unsure whether the definitions, in essence, include 'recognition criteria' due to the absence of a statement that 'an asset is recognised *when*…' Other constituents stated that the recognition principle was developed that an asset or liability is recognised when it meets the respective definition, subject to the exclusions stated in (a) and (b) above.

A minority of the constituents observed that this implies that, for example, the concept of 'control' plays a role to identify an asset and determines when the asset is recognised. Some constituents suggested that separate recognition criteria could be clearly stated to improve clarity, for example, if the 'control' concept determines whether a source is an asset and also determine when that asset is recognised, that fact could be clearly articulated in the revised Conceptual Framework. The majority of the constituents did, however, not see the need for such a clarification.

Question 9

In the IASB's preliminary view, as set out in paragraphs 4.28–4.51, an entity should derecognise an asset or a liability when it no longer meets the recognition criteria. (This is the control approach described in paragraph 4.36(a)). However, if the entity retains a component of an asset or a liability, the IASB should determine when developing or revising particular Standards how the entity would best portray the changes that resulted from the transaction. Possible approaches include:

(a) enhanced disclosure;

(b) presenting any rights or obligations retained on a line item different from the line item that was used for the original rights or obligations, to highlight the greater concentration of risk; or

(c) continuing to recognise the original asset or liability and treating the proceeds received or paid for the transfer as a loan received or granted.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

The response to this question is discussed under two sub-questions developed by the constituents:

Sub-question 1: Is derecognition the exact opposite of recognition?

The majority view, at a conceptual level was that derecognition should be the opposite of recognition. We concur that the recognition of an asset (or liability) might include a bundle of rights (or obligations) that are recognised simultaneously. Regarding recognition, the issue is whether a bundle of rights should be recognised together or whether the different rights should be recognised individually which could be on different dates. In our view this is also an issue of the 'unit of account' and we therefore feel that the 'unit of account' should be clarified on a conceptual level. The constituents therefore felt that the concept of 'unit of account' should not be developed in isolation.

Regarding derecognition, the 'derecognition event' may be interpreted as the event that gave rise to removing the entire bundle of rights (or obligations) or may be interpreted as the individual events removing individual rights (or obligations). The issue is when will changing circumstances result in partial or full derecognition.

Some constituents expressed a view that a clear principle of what constitutes a 'derecognition event' should be developed in order to clarify derecognition, especially in situations of contractual rights (or obligations) recognised as a bundle (for example a repurchase agreement).

Part of the issue of a bundle of transactions is also the application of the control approach. The issue is when control should be applied to the bundle of rights or individual rights. This is an issue of both recognition and derecognition and will also be the basis for deciding when to derecognise a portion of a bundle of rights or derecognising the entire bundle of rights (transaction) and recognise a new bundle (transaction), or when to still recognise the entire bundle.

We agree that the above could be clarified at a standard level for specific transactions, but the concept of 'control' and 'past event' and by implication the 'derecognition event' must be robust enough to provide sufficient guidance for the recognition or derecognition of a bundle of rights (and obligations) and would then provide sufficient guidance for making decisions regarding (a), (b) and (c) of the last part of question 9.

Sub-question 2: Should the exclusion principles provided in (a) and (b) of question 8 apply equally to derecognition?

Most constituents agreed that the exclusion principles stated under recognition do not need to apply to derecognition. The purpose of the exclusion principles under recognition is to exclude items from being recognised, and is therefore different from subsequent recognition and derecognition. Once an item is recognised, the concepts of the definitions of assets and liabilities discussed above should be used to drive derecognition.

Section 5 – Definition of equity and distinction between liabilities and equity instruments

Question 10

The definition of equity, the measurement and presentation of different classes of equity, and how to distinguish liabilities from equity instruments are discussed in paragraphs 5.1–5.59. In the IASB's preliminary view:

(a) the Conceptual Framework should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.

There was a general consensus amongst constituents that the Conceptual Framework should retain the existing definition of equity as a residual interest. The view expressed by the majority of the constituents was that the equation of assets minus liabilities equals equity (A-L=E) has stood the test of time and should therefore be retained.

(b) the Conceptual Framework should state that the IASB should use the definition of a liability to distinguish liabilities from equity instruments. Two consequences of this are:
(i) obligations to issue equity instruments are not liabilities; and
(ii) obligations that will arise only on liquidation of the reporting entity are not liabilities (see paragraph 3.89(a)).

We agree that the definition of a liability should be the starting point to distinguish liabilities from equity instruments.

Some constituents noted that the Conceptual Framework need not state that the IASB should use the definition of a liability in making the distinction between liabilities and equity instruments. They noted that this should be obvious when applying the standards. However, clarity on a conceptual level should enhance the appropriateness of the Conceptual Framework. We also feel that the practical ability to avoid transfer and economic compulsion should be included as principles to enhance this distinction.

Some of our constituents noted that it is difficult to understand and explain the concept of equity because it includes both equity instruments that currently are entitled to a residual interest (direct equity instruments) and those that will only be entitled to a residual interest in the future (indirect equity instruments). Our view is that this is a consequence of the focus on the definition of a liability and that the distinction of direct and indirect equity instruments helps to clarify the understandability of what equity represents.

We also note that it is sometimes difficult to separate a compound instrument into the liability or equity component. In South Africa we had issues in separating certain debenture units issued by property companies since the liability portion was subjected to levels of uncertainty. We, however, feel that this is an issue that should be further clarified on a standards level and that the definition of a liability creates sufficient guidance for the distinction of the liability and equity portion on a conceptual level.

We agree that obligations to issue equity instruments ((b)(i) above) are not a liability since the entity is not transferring any economic resources. We also agree that obligations arising only on liquidation ((b) (ii)) above) should not be regarded as a liability since the transfer of economic resources is based on an uncertain event that is not applicable if the entity is still a going concern.

(c) an entity should:

(i) at the end of each reporting period update the measure of each class of equity claim. The IASB would determine when developing or revising particular Standards whether that measure would be a direct measure, or an allocation of total equity.

(ii) recognise updates to those measures in the statement of changes in equity as a transfer of wealth between classes of equity claim.

The majority view is that since equity is regarded as the residual, the measure of each class of equity should not be updated as the market forces will consider this in valueing equity. We believe that analysts and valuators will ignore the value of the transfer of wealth and make their own assumptions and valuations. Equity is assets less liabilities and the measurement should only change if either the measurement of assets or liabilities change. We strongly believe that disclosure of the rights that are attached to each class of an equity instrument must instead be disclosed to provide analysts and valuators with decision useful information.

Some constituents are unsure of what is meant with ‘the transfer of wealth’ and what the purpose is of this adjustment. Some concern was expressed regarding how ‘transfer of wealth’ could be practically implemented. Reference was made, in a South African environment, to Black Economic Empowerment transactions where different rights are bestowed upon holders of the same class of equity shares. In a South African context, it would be more useful to disclose information that would assist the user measuring the proportionate share of the residual interest of certain classes of shares based on the contractual rights of those classes of shares, and where different rights exists within a class of share, those rights be clearly identified.

The minority view expressed was that it is important to distinguish between direct and indirect equity instruments and that the update of the measure of each class of equity claim would be useful information to see the effect of direct and indirect equity instruments. These constituents mentioned that different equity holders have different exposures that would be difficult to be valued by the market.

(d) if an entity has issued no equity instruments, it may be appropriate to treat the most subordinated class of instruments as if it were an equity claim, with suitable disclosure. Identifying whether to use such an approach, and if so, when, would still be a decision for the IASB to take in developing or revising particular Standards.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

Most constituents disagreed with the proposals listed under (d) from a conceptual level based on the definition of equity. Further, we note that there is no limitation on additional disclosure. Entities who find this information useful can make similar disclosures voluntary and therefore we agree that the IASB might consider additional clarification on a standards level provided that both the equity and liability features are sufficiently disclosed.

Section 6 – Measurement

Question 11

How the objective of financial reporting and the qualitative characteristics of useful financial information affect measurement is discussed in paragraphs 6.6–6.35. The IASB's preliminary views are that:

(a) the objective of measurement is to contribute to the faithful representation of relevant information about:

(i) the resources of the entity, claims against the entity and changes in resources and claims; and

(ii) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources.

(b) a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements;

(c) when selecting the measurement to use for a particular item, the IASB should consider what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI;

(d) the relevance of a particular measurement will depend on how investors, creditors and other lenders are likely to assess how an asset or a liability of that type will contribute to future cash flows. Consequently, the selection of a measurement:

(i) for a particular asset should depend on how that asset contributes to future cash flows; and

(ii) for a particular liability should depend on how the entity will settle or fulfil that liability.

(e) the number of different measurements used should be the smallest number necessary to provide relevant information. Unnecessary measurement changes should be avoided and necessary measurement changes should be explained; and

(f) the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.

Do you agree with these preliminary views? Why or why not? If you disagree, what alternative approach to deciding how to measure an asset or a liability would you support?

We agree with these broad conceptual guidelines to make decisions regarding measurement options.

Although we agree with (d) that the contribution to future cash flows should be used to assess the relevance of a particular measurement, we feel that this is an aspect where the business model applied by an entity plays an important role and was indirectly used by the IASB in making its specific conceptual guidance regarding the measurement of assets and liabilities included in question 12, 13 and 14. It was noted that when an entity chooses the measurement model to be applied, it refers to its business model and even though it would not change the principle as established, it would change the way in which measurement models are applied. The business model is further discussed in our response to Question 23.

Some constituents feel that the focus on the contribution to future cash flows will result in one measurement option identified that will be used in both the statement of financial position and the statement(s) of profit or loss and OCI and question the relevance of the guidelines provided in (c) of question 11. However, the majority believe that the IASB should consider the effect of measurement on both the statements of financial position and the statement(s) of profit or loss and OCI. We believe that performance reporting may drive the use of measures different from the statement of profit or loss and OCI and therefore we believe that performance reporting should be clarified on a conceptual basis, as discussed in our response to question 4.

Question 12

The IASB's preliminary views set out in Question 11 have implications for the subsequent measurement of assets, as discussed in paragraphs 6.73–6.96. The IASB's preliminary views are that:

(a) if assets contribute indirectly to future cash flows through use or are used in combination with other assets to generate cash flows, cost-based measurements normally provide information that is more relevant and understandable than current market prices.

(b) if assets contribute directly to future cash flows by being sold, a current exit price is likely to be relevant.

(c) if financial assets have insignificant variability in contractual cash flows, and are held for collection, a cost-based measurement is likely to provide relevant information.

(d) if an entity charges for the use of assets, the relevance of a particular measure of those assets will depend on the significance of the individual asset to the entity.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

There was a general agreement with the preliminary views expressed by the IASB as well as the proposed guidance given. Some constituents believe that use of the word 'indirectly' and 'directly' in points (a) and (b) of question 12 is not clarified sufficiently to create robust application of (a) and (b) and could lead to diversity in application.

Most constituents, however, feel that the examples used in the Discussion Paper should rather be replaced with broad guidelines. Complex financial instruments should be clarified in the standards and not used as examples to explain principles in the Conceptual Framework. This links to our view expressed in the General Comments section that the Conceptual Framework should be based on a broad framework of thought.

Question 13

The implications of the IASB's preliminary views for the subsequent measurement of liabilities are discussed in paragraphs 6.97–6.109. The IASB's preliminary views are that:

(a) cash-flow-based measurements are likely to be the only viable measurement for liabilities without stated terms.

(b) a cost-based measurement will normally provide the most relevant information about:

(i) liabilities that will be settled according to their terms; and

(ii) contractual obligations for services (performance obligations).

(c) current market prices are likely to provide the most relevant information about liabilities that will be transferred.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

We are in agreement with the proposed guidance regarding the subsequent measurement of liabilities. Some constituents believe that the word 'only' may be deleted from point (a) of question 13 as it does not provide any clarification.

Question 14

Paragraph 6.19 states the IASB's preliminary view that for some financial assets and financial liabilities (for example, derivatives), basing measurement on the way in which the asset contributes to future cash flows, or the way in which the liability is settled or fulfilled, may not provide information that is useful when assessing prospects for future cash flows. For example, cost-based information about financial assets that are held for collection or financial liabilities that are settled according to their terms may not provide information that is useful when assessing prospects for future cash flows:

(a) if the ultimate cash flows are not closely linked to the original cost;

(b) if, because of significant variability in contractual cash flows, cost-based measurement techniques may not work because they would be unable to simply allocate interest payments over the life of such financial assets or financial liabilities; or

(c) if changes in market factors have a disproportionate effect on the value of the asset or the liability (i.e. the asset or the liability is highly leveraged).

Do you agree with this preliminary view? Why or why not?

We are in agreement with the preliminary views expressed by the IASB regarding applying exceptions to the normal guideline regarding (a), (b) and (c) above.

Question 15

Do you have any further comments on the discussion of measurement in this section?

No additional comments were raised.

Section 7 – Presentation and disclosure

Question 16

This section sets out the IASB's preliminary views about the scope and content of presentation and disclosure guidance that should be included in the Conceptual Framework. In developing its preliminary views, the IASB has been influenced by two main factors:

(a) the primary purpose of the Conceptual Framework, which is to assist the IASB in developing and revising Standards (see Section 1); and

(b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 7.6–7.8), including:

(i) a research project involving IAS 1, IAS 7 and IAS 8, as well as a review of feedback received on the Financial Statement Presentation project;

(ii) amendments to IAS 1; and

(iii) additional guidance or education material on materiality.

Within this context, do you agree with the IASB's preliminary views about the scope and content of guidance that should be included in the Conceptual Framework on:

(a) presentation in the primary financial statements, including:

(i) what the primary financial statements are;

(ii) the objective of primary financial statements;

(iii) classification and aggregation;

(iv) offsetting; and
(v) the relationship between primary financial statements.
(b) disclosure in the notes to the financial statements, including:
(i) the objective of the notes to the financial statements; and
(ii) the scope of the notes to the financial statements, including the types of information and disclosures that are relevant to meet the objective of the notes to the financial statements, forward-looking information and comparative information.

We agree that the Conceptual Framework should include the scope and content on the presentation of the primary financial statements and the disclosures in the notes to the financial statements. However, we feel that the guidelines provided in the Discussion Paper and in the communication principles, identified in question 18, are too broad and are not sufficient to create a robust disclosure framework without over burdening the preparers of financial statements.

Question 17
Paragraph 7.45 describes the IASB's preliminary view that the concept of materiality is clearly described in the existing Conceptual Framework. Consequently, the IASB does not propose to amend, or add to, the guidance in the Conceptual Framework on materiality.
However, the IASB is considering developing additional guidance or education material on materiality outside of the Conceptual Framework project.
Do you agree with this approach? Why or why not?

We agree that materiality is sufficiently described in the existing Conceptual Framework, however, the problem is with the application of materiality in practice. We therefore agree that the IASB should provide additional guidance and educational material on materiality outside the Conceptual Framework project.

Question 18
The form of disclosure requirements, including the IASB's preliminary view that it should consider the communication principles in paragraph 7.50 when it develops or amends disclosure guidance in IFRSs, is discussed in paragraphs 7.48–7.52.
Do you agree that communication principles should be part of the Conceptual Framework? Why or why not?
If you agree they should be included, do you agree with the communication principles proposed? Why or why not?

We agree that the communication principles should be included in the Conceptual Framework and in principle we also agree with the communication principles proposed. However, as stated in question 16, we believe that the communication principles are not sufficient to create a robust disclosure framework that will result in a reduction of the disclosure overload. We believe that an appropriate disclosure framework is an aspect the IASB should further investigate before a final decision is made.

Section 8 – Presentation in the statement of comprehensive Income — profit or loss and other comprehensive income

Question 19
The IASB's preliminary view that the Conceptual Framework should require a total or subtotal for profit or loss is discussed in paragraphs 8.19–8.22.
Do you agree? Why or why not?
If you do not agree do you think that the IASB should still be able to require a total or subtotal profit or loss when developing or amending Standards?

We agree that the profit or loss total or subtotal should be retained as a subtotal to identify the performance of an entity for a period, based on sufficient clarification of the nature of the subtotal as discussed in our response to question 4.

However, a minority of the constituents still feel that OCI should not be identified separately in the statement of profit or loss and OCI and that all income and expenses should be included in profit or loss.

Question 20
The IASB's preliminary view that the Conceptual Framework should permit or require at least some items of income and expense previously recognised in OCI to be recognised subsequently in profit or loss, i.e. recycled, is discussed in paragraphs 8.23–8.26.
Do you agree? Why or why not? If you agree, do you think that all items of income and expense presented in OCI should be recycled into profit or loss? Why or why not?
If you do not agree, how would you address cash flow hedge accounting?

Based on our discussion in question 21 below that OCI be used for certain re-measurements, we agree that the Conceptual Framework should permit or at least require recycling for assets or liabilities that will ultimately be disposed of or settled.

Question 21
In this Discussion Paper, two approaches are explored that describe which items could be included in OCI: a narrow approach (Approach 2A described in paragraphs 8.40–8.78) and a broad approach (Approach 2B described in paragraphs 8.79–8.94).
Which of these approaches do you support, and why?
If you support a different approach, please describe that approach and explain why you believe it is preferable to the approaches described in this Discussion Paper.

We proposed in our response to question 4 that the nature of OCI should be clarified in Chapter 2 as part of the elements of the statement of profit or loss and OCI to create robust principles to separate profit or loss and OCI. In the absence of such a clarification, we believe that the narrow approach is sufficient to deal with re-measurements. We believe that long-term re-measurements can also be included in certain instances in bridging items and therefore the additional option for long-term items included in the broad approach is not needed.

Section 9 Other issues

Question 22
Chapters 1 and 3 of the existing Conceptual Framework

Paragraphs 9.2–9.22 address the chapters of the existing Conceptual Framework that were published in 2010 and how those chapters treat the concepts of stewardship, reliability and prudence. The IASB will make changes to those chapters if work on the rest of the Conceptual Framework highlights areas that need clarifying or amending. However, the IASB does not intend to fundamentally reconsider the content of those chapters.
Do you agree with this approach? Please explain your reasons.
If you believe that the IASB should consider changes to those chapters (including how those chapters treat the concepts of stewardship, reliability and prudence), please explain those changes and the reasons for them, and please explain as precisely as possible how they would affect the rest of the Conceptual Framework.

Although we acknowledge that stewardship is indirectly incorporated in chapter 1 of the existing Conceptual Framework by referring to management discharging their responsibilities, we propose that stewardship should be identified more directly as a sub-objective of financial reporting in the Conceptual Framework.

Our view is that reliability should not be re-introduced in the Conceptual Framework. We believe that faithful representation captures the economic reality better and is dealing sufficiently with aspects of uncertainty.

We acknowledge that there are different views on prudence which therefore creates practical issues in the application of this concept. We do not believe that prudence should be re-introduced in the Conceptual Framework since it contradicts neutrality.

Question 23
Business model

The business model concept is discussed in paragraphs 9.23–9.34. This Discussion Paper does not define the business model concept. However, the IASB's preliminary view is that financial statements can be made more relevant if the IASB considers, when developing or revising particular Standards, how an entity conducts its business activities.
Do you think that the IASB should use the business model concept when it develops or revises particular Standards? Why or why not?
If you agree, in which areas do you think that the business model concept would be helpful?
Should the IASB define 'business model'? Why or why not?
If you think that 'business model' should be defined, how would you define it?

We believe that the business model concept is a consideration or tool that could be used by the IASB as a basis for making decisions on a standards level. We therefore agree that the business model concept should be used to develop or revise particular standards.

We believe that that the business model should be explained on a conceptual level as one of the considerations that could be used by the IASB as a basis for making decisions on a standards level. We have indicated that the business model is central to making certain measurement decisions. The business model is also important for certain disclosures and the IASB should consider how to include the business model in the disclosure and presentation guidance or framework.

Question 24
Unit of account

The unit of account is discussed in paragraphs 9.35–9.41. The IASB's preliminary view is that the unit of account will normally be decided when the IASB develops or revises particular Standards and that, in selecting a unit of account, the IASB should consider the qualitative characteristics of useful financial information.
Do you agree? Why or why not?

As stated earlier, broad concepts of the unit of account should be included in the Conceptual Framework and with further clarification made for the application thereof in specific standards. Similar to the business model, the unit of account is in our view a consideration the IASB should use in developing or revising standards. The unit of account should not be included in isolation to recognition, measurement and derecognition, and a clear link should be created in the Conceptual Framework.

Question 25
Going concern

Going concern is discussed in paragraphs 9.42–9.44. The IASB has identified three situations in which the going concern assumption is relevant (when measuring assets and liabilities, when identifying liabilities and when disclosing information about the entity).
Are there any other situations where the going concern assumption might be relevant?

No additional situations have been identified were the going concern assumption might be relevant. Going concern should remain as a concept that is discussed in the Conceptual Framework, with further application guidance on a standards level to sufficiently identify whether or not an entity is a going concern. We believe that guidance should be incorporated at a standards level if an entity is not a going concern.

Question 26
Capital maintenance

Capital maintenance is discussed in paragraphs 9.45–9.54. The IASB plans to include the existing descriptions and the discussion of capital maintenance concepts in the revised Conceptual Framework largely unchanged until such time as a new or revised Standard on accounting for high inflation indicates a need for change.
Do you agree? Why or why not? Please explain your reasons.

For the moment we agree with the approach, but the IASB should review the appropriateness of the descriptions and discussions of capital maintenance concepts at a future stage. If capital maintenance concepts will only be used for high inflation issues, the question could be asked whether the concepts should be retained in the Conceptual Framework or not.

#446478

Hans Hoogervorst
Chairman
IASB
30 Cannon Street
London
EC4M 6XH

13 January 2014

Dear Hans

A Review of the Conceptual Framework for Financial Reporting (DP/2103/1)

The enclosed memorandum is the FRC's response to the IASB's Discussion Paper 'A Review of the Conceptual Framework for Financial Reporting. I also enclose the FRC Press Notice on the response.

As the memorandum makes clear, we attach considerable importance to the development and improvement of the Conceptual Framework. We commend the IASB in undertaking this work. Although we have some disagreements with the contents of the Discussion Paper, the Board and its staff are to be congratulated for producing a document of such high quality given the time constraints. I would also like to thank IASB Board members and staff for their support at our outreach activities.

We look forward to continuing to work together with the IASB to achieve the best Conceptual Framework possible.

Yours sincerely

Roger Marshall
Chairman, Accounting Council

FRC urges IASB to bring back prudence, stewardship and reliability

PN 001/14 13 January 2014

The Financial Reporting Council (FRC) believes the concepts of prudence, stewardship and reliability should be reintroduced to the international accounting standards Conceptual Framework, as they are fundamental to financial reporting.

The FRC's comments are made in its response to the IASB's Discussion Paper.on its Conceptual Framework which sets out the concepts that underlie the preparation and presentation of financial statements. It identifies principles for the IASB to use when it develops and revises International Financial Reporting Standards (IFRSs). The FRC believes the Paper is a detailed and thoughtful overview of many complex issues

Commenting on the FRC's response, Melanie McLaren, FRC Executive Director, Codes and Standards said:

> "The IASB's Discussion Paper makes a number of valuable and thoughtful suggestions. In particular we welcome the emphasis placed on the importance of the profit and loss account as well as the balance sheet, and the recognition that financial reporting should not be based entirely on market values. As future standards will be developed from the Conceptual Framework, it is essential that the Conceptual Framework is of the highest quality possible. We hope that our suggestions will assist the IASB in achieving that."

The FRC response also proposes that the IASB's Framework states that financial statements show the performance of an entity's business model. Of this, Melanie McLaren said:

> "It is all too often said that directors cannot recognise their business from their financial statements. Accounting standards should allow an appreciation of the results of the business model."

Roger Marshall, FRC Board member and Chairman of its Accounting Council said:

> "In 2010, the IASB made some changes that downplayed the ideas of prudence, stewardship/accountability and reliability. We are pleased that the IASB has said that it will reconsider this in the light of work on the rest of the Conceptual Framework. In our response we explain why the importance of these ideas should be clearly acknowledged in the Conceptual Framework."

The FRC's response also suggests that a more fundamental analysis of issues relating to measurement of assets and liabilities than that provided in the Discussion Paper is required, and that the objective of the statement of profit or loss needs to be specified.

A copy of the FRC response can be downloaded here.

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Notes to editors:

1. The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

2. All Press enquiries should be directed to: Peter Timberlake, Head of Communications on telephone: 020 7492 2397/ 07768 502332, or email p.timberlake@frc.org.uk; or to Sophie Broom, Communications Executive, on telephone: 020 7492 2395/ 07771 808464 or email: s.broom@frc.org.uk.

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Financial Reporting Council

‘A Review of the Conceptual Framework for Financial Reporting’ (DP/2103/1)

FRC Response

January 2014

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Introduction

IN1 The FRC is pleased to comment on the IASB's Discussion Paper 'A Review of the Conceptual Framework for Financial Reporting'. The Discussion Paper provides a detailed and thoughtful overview of many complex issues, and contains a number of proposals with which we agree.

IN2 In particular, we welcome:

- The IASB's commitment to revisit the Conceptual Framework, to bring it up-to-date and add guidance in areas that are not adequately addressed.
- The equal emphasis placed on the statement of profit or loss and OCI and the statement of financial position, and the recognition of the statement of cash flows as a primary financial statement.
- The IASB's preliminary view that a single measurement basis may not provide the most relevant information, and that the selection of a measurement basis should depend upon how an asset or liability contributes to future cash flows.
- The retention of a total (or sub-total) for profit or loss as a primary source of information about the return an entity has made on its economic resources in a period.
- The retention of the current definition of equity—the residual interest in the assets of the entity after deducting all its liabilities.
- The inclusion of principles on presentation and disclosure as the first step of the IASB's disclosure initiative.

IN3 There are, however a number of areas where further development is necessary. Examples of these include:

- clarification of the definition of liabilities to situations where the requirement to transfer economic benefits can be avoided by the entity's future actions;

- the discussion of measurement concepts;
- the objective of the statement of profit or loss; and
- the unit of account.

We should be pleased to work with the IASB on these issues.

IN4 We are pleased that the IASB is willing to consider changes to the Chapters on objectives and qualitative characteristics (which were revised in 2010) where this is shown to be necessary by the development of other parts of the Conceptual Framework. We strongly believe that these Chapters should emphasise the importance of accountability (or ‘stewardship’), reliability and prudence. These Chapters should also acknowledge that financial statements are more useful if they enable an assessment of the result of the entity’s business model. These and other fundamental concepts—substance and going concern—are discussed in Section 2 below. Subsequent sections of this response demonstrate the significance of these ideas.

1 General approach

1.1 We strongly support the IASB's decision to recommence work on its Conceptual Framework. The Conceptual Framework is the cornerstone of high quality financial reporting, and we agree that the existing Conceptual Framework is out of date and incomplete. A revised Conceptual Framework should assist the IASB in the development of new accounting standards that are consistent and reflect current thinking. It will also, importantly, improve dialogue and understanding between the IASB and its stakeholders.

1.2 We agree with the IASB's decision to undertake work on the Conceptual Framework and standards concurrently. Work in one area will usefully complement work in the other. However, the Conceptual Framework should be developed with a single-minded determination to produce the best Conceptual Framework possible that will provide the foundation for high quality accounting standards. Principles should not be discarded or diluted merely because they are inconsistent with standards: still less should the Conceptual Framework be 'reverse engineered' to provide a rationalisation for existing standards. On the contrary, the Conceptual Framework should be aspirational and so provide a basis for improvements in financial reporting.

1.3 We also support the IASB's intention to complete its revision of the Conceptual Framework expeditiously. However, we are concerned that undue haste may not allow an adequate consideration of the complex and difficult issues that need to be addressed. It is also important that the IASB's stakeholders have ample opportunity to consider and debate proposals so that they may contribute to their improvement. Full debate and consultation will also assist in promoting support for the new Conceptual Framework.

1.4 We suggest that the IASB keeps the timetable for the revisions to the Conceptual Framework under review, and should be willing to amend it if it becomes clear that a high quality Conceptual Framework cannot be finalised by next year. Alternatively, the IASB might conclude that it should publish a revised Conceptual Framework, but also commence further work on areas where further improvements seem desirable and attainable. If that approach were adopted, it is important that the revised Conceptual Framework is as complete as possible, as, despite the best efforts of all concerned, it may continue to be current for a long time: the history of standard-setting provides numerous examples of 'temporary expedients' that have endured long after they were adopted.

1.5 We welcome the statement in paragraph 1.22 of the Discussion Paper that any decision to amend an existing standard would be subject to the IASB's normal process for admission to its agenda and consultation. In our view, a standard that is consistently interpreted and producing useful information should not be revised merely to remove an inconsistency with the (new) Conceptual Framework.

2 Fundamental concepts

2.1 The Discussion Paper explains that the IASB will not fundamentally reconsider the content of Chapters 1 and 3 of the Conceptual Framework that were published in 2010, but that it will make changes if work on the rest of the Conceptual Framework highlights areas that need clarifying or amending. It discusses a number of specific topics about which concerns have been expressed:

- accountability (or 'stewardship');
- reliability and its replacement with faithful representation; and
- the removal of any reference to the concept of 'prudence'.

We very strongly share these concerns.

2.2 We also consider that the Conceptual Framework should refer to the importance of facilitating an assessment of the business model and explain the relevance of the going concern assumption.

2.3 We welcome the Discussion Paper's proposal that the Conceptual Framework should acknowledge the importance of reporting the substance of transactions. A similar discussion was contained in the Conceptual Framework's discussion of qualitative characteristics until the 2010 revisions. In our view, it would most logically be restored to the discussion of qualitative characteristics and placed in Chapter 3.

2.4 The purpose of the Conceptual Framework is to guide the development of accounting standards by setting out clearly and unambiguously concepts that are generally agreed to be important influences on financial reporting. This provides a more consistent and robust foundation than the intuitions of standard-setters, which may be based on inconsistent implicit frameworks. To fulfil this purpose the Conceptual Framework needs to be complete: important ideas, such as prudence, cannot be omitted simply because they are generally agreed: apparent agreement may mask significant underlying differences. Explicitly addressing agreed concepts in the Conceptual Framework enables their interpretation to be clarified and reduces the possibility of undesirable interpretations gaining credence. It is clear, for example, that the pre-2010 Conceptual Framework helped dispel misconceptions about the proper role of prudence. More recently, our work on going concern (the Sharman Inquiry) showed that there wide differences of view as to the meaning and implication of the going concern concept.

2.5 Moreover, for understandable reasons, the Conceptual Framework is often quoted selectively when it is referred to in the development of standards. Key concepts, such as stewardship, therefore must be prominent in the Conceptual Framework: it is not satisfactory if they are 'a bit hard to find'.

2.6 Much of financial reporting relies on a common understanding of basic ideas. There is no standard, for example, that requires the recognition of trade creditors, or explains the treatment of accruals and prepayments. There is a very real risk that these ideas will be neglected in the education of accountants, and even those that are accustomed to powerful concepts, such as that of going concern, may conclude that they are no longer applicable unless they are addressed in the Conceptual Framework.

2.7 The concepts that we are advocating should feature in the Conceptual Framework may be found in most elementary textbooks of accounting. (The business model concept may appear to be the exception to this, but we consider that it merely makes explicit an idea that has long been established.) In some recent projects (for example, the proposed revisions to IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' and the project on Revenue Recognition) the IASB's initial proposals for accounting standards were revised as respondents considered they were too 'academic' or 'technical'. A Conceptual Framework that explicitly includes these ideas would, in our view, assist the IASB in developing high-quality proposals for standards that will more readily gain acceptance and improve financial reporting.

2.8 It may be that the IASB intends to promote a change in thinking, or continue with changes introduced by its predecessors. We certainly do not object to change in principle. However, the onus is on those who urge change to make a powerful case for it and to provide evidence that shows that it will better meet the needs of users of financial statements. And if its changes prove unwise, the IASB should be willing to reconsider them.

2.9 Chapters 1 and 3 were developed jointly with the FASB and reflect some compromises that the current members of the IASB are free to correct, taking account of more recent thinking. We share the IASB's ambition to see work on the

Conceptual Framework progress expeditiously, and understand the decision not to subject Chapters 1 and 3 to a fundamental rethink. We agree that revisiting much of the material in those Chapters would be time consuming and unlikely to lead to fresh insights. However, the issues that are of concern to us may be addressed through relatively small, but significant, changes.

2.10 Although the discussion from paragraph 2.14 below addresses each concept separately, it should be appreciated that there are strong links between them. For example, an accountability objective requires an emphasis on the credibility of financial statements: reliability and prudence enhance that credibility. Prudence and reliability are related in that whether recognising a gain is prudent often depends on reliability. Accountability is enhanced by an alignment of financial reporting with the entity's business model.

2.11 The Conceptual Framework acknowledges (in paragraph OB6) that general purpose financial reports cannot provide all the information that is needed by investors and other users, who will also need to refer to other sources. But financial statements are published regularly, conform to accounting standards (as well as, in many cases, other regulations) and are audited.[1] This places financial statements in a unique position: much of the information that they provide is not completely new but they add considerable value by confirming and providing greater detail about what is already known by the market. Accountability, prudence and reliability reinforce the distinctive advantages of financial statements.

2.12 In the following discussion we indicate how the concepts whose addition or clarification we urge would affect the rest of the Conceptual Framework and standards developed from it. However, the Conceptual Framework cannot be expected to lead ineluctably to conclusions on specific accounting approaches: rather it provides a set of ideas that guide the development of standards. Standard-setting inevitably involves the exercise of judgement in balancing different, and sometimes conflicting, qualities. A specific concept taken in isolation may highlight an advantage of a particular accounting treatment, but will rarely be determinative.

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1 See Cascino *et al* 'The use of information by capital providers', recently published by the Research Committee of The Institute of Chartered Accountants of Scotland (ICAS) and the European Financial Reporting Advisory Group (EFRAG).

2.13 Many of the ideas discussed in this section have also been addressed in the series of Bulletins that we have produced in collaboration with EFRAG and other national standard-setters under the title 'Getting a Better Framework'. These may be useful to the IASB in its further consideration of these issues.

Accountability (or 'stewardship')

2.14 Although there seems little important difference between the ideas of 'accountability' and 'stewardship' we generally use the former term.

2.15 In our view, the provision of information that provides accountability is a primary objective of financial reporting. It should be reflected in the Conceptual Framework as a separate objective, equal in prominence to that of providing information that is useful for making decisions about the provision of resources to the entity.

2.16 The current Conceptual Framework adopts an objective of decision-usefulness, which it suggests essentially involves facilitating an assessment of future net cash inflows to the entity. It also suggests that information on accountability either is an ancillary part or by-product of that objective. The information that responds to accountability is that on how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources (paragraph OB4). The importance of this is clear from the Discussion Paper's careful inclusion of this wording when summarising the objective of financial reporting. Moreover, the Basis for Conclusions in the 2010 Conceptual Framework states, 'The Board did not intend to imply that assessing prospects for future cash flow or assessing the quality of management's stewardship is more important than the other.'

2.17 Shareholders entrust the management of an entity's affairs to management. Financial statements provide shareholders with an opportunity to assess the effectiveness of management, and, just as importantly, provide management with a means of reporting the results achieved under their direction. This facilitates dialogue about all aspects of a company's affairs including, for example, its competitive position, the success of its strategy and the opportunities for adopting alternative strategies. Financial statements provide a key point of reference in that dialogue, because of the features discussed in paragraph 2.11 above.

2.18 Potentially this requires that financial statements provide a much fuller set of information than that required for decisions such as whether to buy, sell or hold the shares. An accountability perspective emphasises the need for completeness, transparency and reliability and a focus on long-term considerations rather than the immediate future. It also underlines the importance of reporting past transactions and events—which is the essential subject matter of financial statements. Furthermore it emphasises the importance of 'confirmatory value': users need to be able to check the extent to which past predictions have been fulfilled.

2.19 It is, of course, not possible to distinguish transactions and events that are within or outside management's control. (Indeed we agree that ultimately management are responsible for all aspects of the entity's activities.) But an objective of accountability does not necessarily require such a distinction to be made. Financial statements can facilitate an assessment of accountability by, for example, clearly distinguishing the results of the business model (operating profit) from other income and expenses and by highlighting unusual items. An insight into management's effectiveness can also be gained by comparing the financial statements with those of other entities.

2.20 Some of the information that is required to meet an accountability objective is similar to that required by a decision-useful objective (although judgements on materiality may differ in some areas). However, even if the view is taken that the set of information is the same, it would be necessary to specify accountability as a separate objective. As the current Conceptual Framework acknowledges, it is not practicable for financial statements to provide all the information that may be required. Thus standard-setting involves selecting which information should be reported. If accountability is merely ancillary to a decision-useful objective, there is a risk that information primarily relevant to decision-usefulness would invariably be selected rather than that which contributes most to accountability.

2.21 Cases where accountability would have implications for the Conceptual Framework are noted in paragraphs 4.7, 4.32, 4.38, 7.11, 8.2 and 8.6 of this response. Further discussion of the implications of accountability is set out in the 'Getting a Better Framework' Bulletin 'Accountability and the Objective of Financial Reporting'.

Reliability and faithful representation

2.22 We urge the IASB to reconsider the replacement of the qualitative characteristic of 'reliability' with 'faithful representation'. As noted in connection with accountability above, financial statements are a key part of the dialogue that maintains trust between shareholders and management. To fulfil that requirement the financial statements must be credible: they must contain reliable information.

2.23 The Discussion Paper states that the main reason for the change from reliability to faithful representation was 'a lack of understanding of the term reliability'. We, however, are not convinced that 'reliability' is more ambiguous than many of the terms used in the Conceptual Framework. Rather we suspect that misunderstandings arose as some focussed on reliability to the exclusion of all other considerations. We do not suggest that this is appropriate: there are cases where information should be reported although it has only a low level of reliability. The Conceptual Framework should, however, challenge the standard-setter to attain the best possible balance between the qualitative characteristics. In particular, there is often a tension between relevance and reliability: the most relevant information may not be capable of being portrayed reliably, and the most reliable information may not be very relevant.

2.24 The current Conceptual Framework's approach to this is problematic: the concept of 'faithful representation' is not an adequate replacement for reliability. One of the reasons for this is that the concept and its description are too general. As described in the current Conceptual Framework, a faithful representation is given provided adequate disclosure is made, including the nature of the asset or liability, the measurement basis used and the uncertainties that significantly affect that amount. Given that description, any measurement basis of any asset or liability would be consistent with the idea of 'faithful representation' (with suitable disclosures). Thus 'faithful representation', as described, fails to exclude the provision of any information and therefore cannot guide the development of accounting standards.

2.25 Moreover, the Conceptual Framework goes on to suggest (in paragraph QC18) that the most relevant information should be identified and reported if it is available and can be faithfully represented. Given that anything can be faithfully represented, this condition will always be met. Thus, far from providing the creative tension that should require the IASB to find the best balance between relevance and reliability, the Conceptual Framework effectively requires that relevance prevails in all cases.

2.26 One of the qualities of reliable information is that the use of subjective estimates is minimised. Although such information may not be the most relevant, it enables users to form their own estimates, which may be superior. For example, suppose an entity needs to report on a new investment. Arguably the most relevant information for a user who wishes to assess the future returns from the investment is the present value of the returns: however this will probably rely on many estimates and assumptions: even if extensive disclosures are provided it may be difficult to quantify their effect and assess the quality of any estimate. In contrast, if the investment is reported at cost (which in this particular case can be determined reliably), users are enabled to make their own estimates and will fully appreciate their limitations. This, of course, does not demonstrate that cost is always to be preferred: that will be a judgement depending on the particular circumstances. But it does, we think, make the point that in some cases it may be preferable to report information that is more reliable and less relevant, especially as financial statements complement and provide confirmatory value of information for other sources, as referred to in paragraph 2.11 above.

2.27 Cases where reliability would have implications for the Conceptual Framework are noted in paragraphs 4.1, 4.28, 4.30, 6.3, 6.7 and 6.13 of this response. Further discussion of reliability is contained in the 'Getting a Better Framework' Bulletin 'Reliability of Financial Information'.

Prudence

2.28 We urge the IASB to include in the Conceptual Framework a specific discussion of the concept of prudence (or conservatism), which is an important influence on the development of financial reporting and reinforces the credibility of financial statements.

2.29 The Discussion Paper notes the description of prudence in the pre-2010 Conceptual Framework was one that 'few would disagree with' and that it is reflected in many of the standard-setting decisions of the IASB.[2] We agree with both these observations.

2.30 In our view, the Conceptual Framework should state that the role of prudence is in the development of accounting policies, particularly in ensuring that all losses and liabilities are reflected promptly and that gains are not recognised except where there is adequate evidence. Once it has been determined that an item should be recognised and an appropriate measurement basis selected, prudence has no role. The estimated amount should not deliberately depart from the selected basis.

2.31 There is considerable academic research[3] that shows that prudence—more timely recognition of losses than of gains—is valuable. One of the reasons for this is that 'good news' is rarely concealed for long and the market is often aware of it. 'Good news' that is reported before it is reasonably assured may be disregarded by users because of its lack of reliability, and if it is not confirmed by subsequent events the credibility of financial reporting is undermined.

2.32 However, the market needs reassurance that all 'bad news' is reflected in financial statements. Even if bad news is already public, a prudent account of it provides confirmatory value. Furthermore, requirements to report losses in financial statements can be expected to encourage earlier release of the news.

2.33 Prudence—considered as the development of accounting policies that ensure that losses are recognised on a timely basis and that gains are not recognised unless there is adequate evidence—is consistent with many features of current accounting:

- Assets are written down when impaired to reflect bad news but not written up for good news.

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[2] The influence of prudence/conservatism on IFRS is discussed in Richard Barker & Anne McGeachin (2013) Why is there inconsistency in accounting for liabilities under IFRS? An analysis of recognition, measurement, estimation and conservatism, Accounting and Business Research Vol 43, No 6 pp 580–604. See also Alfred Wagenhofer, The Role of Revenue Recognition in Performance reporting, paper presented at the ICAEW's Information for Better Markets Conference, December 2013.

[3] See, for example, S.P. Kothari, Karthik Ramanna, and Douglas J. Skinner (2010) Implications for GAAP from an analysis of positive research in accounting, Journal of Accounting and Economics 50 pp. 246–286, and the discussion by Richard Lambert at pp287–295 of the same issue.

- Provision is made for onerous executory contracts, but gains on contracts that are expected to be profitable are not recognised.
- Inventory is stated at cost, even when a future sale is highly probable; and even if an order has been received.

2.34 The pre-2010 Conceptual Framework stated, with admirable clarity, that 'prudence does not allow…the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses'. Thus the objection noted in the Discussion Paper (paragraph 9.18) that such deliberate misstatements would lead to a misstatement of financial performance in later periods does not apply.

2.35 The other objection noted in the Discussion Paper is that prudence is inconsistent with neutrality. The current Conceptual Framework characterises neutrality as the absence of bias, and states that 'A neutral depiction is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that financial information will be received favourably or unfavourably by users'. We do not agree that the notion of prudence, correctly understood, is incompatible with neutrality.

2.36 The value of financial statements lies in providing information, the credibility and understandability of which is enhanced by observing conventions and practices—most of which are now codified in accounting standards. The conventional nature of financial statements needs to be understood: no-one should believe that they capture the economic value of the entity or its true economic profit.

2.37 Financial statements may, for example, record liabilities for legal cases that may be lost but not assets for cases that may be won. They may also record losses on onerous contracts but not the profits that will be made on favourable contracts. Although these may be departures from 'economic reality', they are not attempts to mislead or influence users' reaction to the information, but rather the result of applying well founded conventions. Thus the financial statements are neutral, not biased. They are simply prepared in accordance with accounting principles and accounting standards.

2.38 Cases where prudence would have implications for the Conceptual Framework are noted in paragraphs 4.1, 4.28, 4.34, 4.39 and 6.13 of this response. Further discussion of the implications of prudence is set out in the 'Getting a Better Framework' Bulletin 'Prudence'.

The business model

2.39 In our view, the Conceptual Framework should acknowledge that financial statements should provide information that assists in an assessment of the entity's business model. Financial statements should not simply provide an inventory of assets and liabilities and information on changes in them, but should portray how the entity uses its assets and liabilities in order to create value. A shareholder has a stake in the success (or failure) of a business, rather than simply a portion of the entity's assets and liabilities.

2.40 Much of financial reporting already reflects a business model; for example by distinguishing inventory from property, plant and equipment; and revenue from other receipts. Thus introducing the notion of a business model would be consistent with rather than a radical departure from current practice.

2.41 As mentioned above, providing information to assist such an assessment is clearly required by an accountability objective. It is also relevant under a decision-useful objective as the predictive value of income and expenses that relate to an entity's business model is significantly different from that of other income and expenses.

2.42 We suggest that it would be appropriate for the Conceptual Framework to provide a general description of the business model, rather than a specific definition. This should emphasise that the business model focuses on the means by which an entity creates value. It should be noted that the business model for most (probably the majority) of entities involves the obtaining of inputs through exchange transactions, and using those inputs, usually after some kind of process to provide goods and services to customers from which revenue is obtained. Reporting the results of such a business model clearly requires information on the cost of inputs and their transformation and on the revenues obtained from them. Other business models involve the acquisition of assets in order to benefit from gains resulting from their increase in value: in such a case reporting assets at current value may be helpful.

2.43 The Discussion Paper notes some instances where its proposals have regard to the way in which the entity conducts its business activities. However, a general reference to the relevance of information that reflects the business model is required to ensure that it is considered in the development of new standards, or other parts of the Conceptual Framework.

2.44 In our view, a close relationship between the business model and financial reporting can significantly enhance comparability by promoting consistency of treatment by entities within a sector. This will greatly assist investors whose analysis is often focussed on detecting differences between entities within the same sector.

2.45 Furthermore, we do not believe that providing a discussion of the business model concept in the Conceptual Framework would necessarily lead to a serious loss of comparability. Its main influence is likely to be in the development of standards. It might be reflected by appropriate definitions of terms and by prescribing the circumstances in which particular accounting treatments would be used, rather than simply by permitting an unconstrained choice of treatment. Consistent with our view that the Conceptual Framework should provide a set of ideas that need to be considered together in the development of standards, the Conceptual Framework should not suggest that the business model should override all other considerations.

2.46 Cases where the business model would influence the Conceptual Framework are noted in paragraphs 6.10, 6.12–6.14, 6.17, 7.5, 7.19, 8.3, 8.7 and 8.8 of this response. Further discussion of the business model is in the 'Getting a Better Framework' Bulletin 'The Role of the Business Model in Financial Reporting'.

Going concern

2.47 The Discussion Paper identifies a few situations where the going concern assumption is relevant, and asks respondents to identify any further cases. This suggests that, apart from a passing mention in specific paragraphs, reference to the going concern might be deleted from the Conceptual Framework. We would be concerned by such a change.

2.48 The going concern assumption has long been identified as one of the fundamental accounting concepts, and can be traced back at least as far as the writings of Lawrence Dicksee in the early years of last century. Removal of the going concern concept from the Conceptual Framework would undermine its importance and could suggest that it is no longer relevant to financial reporting. It would also create the risk of divergent interpretations of the term and its implications gaining credence.

2.49 It is therefore important that the Conceptual Framework continues to reflect the concept of going concern. The most appropriate location for a discussion of the concept would be in the discussion of relevance as, in virtually all cases where general purpose financial statements are prepared, information prepared on a going concern basis is most relevant. This is the case even if continuation of the business is dependent on securing new finance, although it may be necessary to disclose material uncertainties about an entity’s ability to continue as a going concern. The explanation of the concept in paragraph 4.1 of the current Conceptual Framework is, in our view, broadly appropriate.

3 Purpose and status of the Conceptual Framework (Discussion Paper Section 1)

Question 1

Paragraphs 1.25–1.33 set out the proposed purpose and status of the Conceptual Framework. The IASB's preliminary views are that:

(a) the primary purpose of the revised Conceptual Framework is to assist the IASB by identifying concepts that it will use consistently when developing and revising IFRSs; and

(b) in rare cases, in order to meet the overall objective of financial reporting, the IASB may decide to issue a new or revised Standard that conflicts with an aspect of the Conceptual Framework. If this happens the IASB would describe the departure from the Conceptual Framework, and the reasons for that departure, in the Basis for Conclusions on that Standard.

Do you agree with these preliminary views? Why or why not?

Response to question 1

3.1 We broadly agree with the preliminary views set out in the question. However, we think that the relationship between a new or revised standard and the Conceptual Framework should be explained in the Basis for Conclusions of all standards, and not only where the new standard conflicts with the Conceptual Framework. In many cases this explanation could be concise, but it would nonetheless demonstrate that the IASB is adhering to its Conceptual Framework and provide useful insight into how the IASB interprets the Conceptual Framework. Such an explanation may be particularly relevant when an otherwise superior alternative has been rejected in the light of cost/benefit considerations.

3.2 We also agree that parties other than the IASB may find the Conceptual Framework useful for the purposes set out in paragraph 1.28 of the Discussion Paper—that is, to understand and interpret standards and develop accounting policies for circumstances not addressed by a standard or interpretation. In this connection we would observe that, in the event that the IASB restricts the use of the Conceptual Framework by preparers in developing accounting policies for circumstances not addressed by a standard or interpretation, that restriction is more appropriately reflected in IFRS than in the Conceptual Framework. As stated in paragraph 4.5 below, we do not agree that preparers should be prevented from using the guidance in the Conceptual Framework in determining whether an asset or liability should be recognised.

4 Elements of financial statements, recognition and derecognition (Discussion Paper Sections 2–4)

General comments

4.1 One of the key contributions of the Conceptual Framework is to ensure that assets and liabilities, and changes in them, are recognised only when doing so improves the usefulness of financial statements. The definitions of assets and liabilities and the recognition criteria must ensure that the information is as complete as can be expected, but also provide a robust safeguard against the recognition of assets and liabilities that merely contribute to clutter. We would question, for example, whether all the intangible assets of an acquired business should be recognised, particularly, where measurement is difficult, or if liabilities should be recognised for all claims that are highly unlikely to result in a payment. Questioning the reporting of such items is, of course, consistent with our views on reliability and prudence.

4.2 An undue proliferation of the items reported reduces the understandability of financial statements and may obscure important messages. It also significantly increases the burden on preparers. Vagueness in the definitions and recognition criteria also creates uncertainty as to whether particular items are required to be recognised.

4.3 We are therefore concerned that some of the terms used in the proposed definition of assets and liabilities, for example 'source of value' and 'capable of', are vague and that the definitions may therefore be interpreted broadly. If they are to be retained it is essential that the definitions and recognition criteria set out in the Conceptual Framework (taken together with supporting explanation) are clear and robust. The vagueness of these terms means that the control part of the definitions and the recognition criteria are especially important. In turn, the recognition criteria rely heavily on the notion of relevance: this will only be operational if supplemented by guidance along the lines suggested in paragraph 4.26 of the Discussion Paper.

4.4 In our view it is important that the Exposure Draft explains the implications of the proposed definitions and criteria for a number of possible assets and liabilities to demonstrate the probable effect at the standards level.

4.5 The Discussion Paper suggests that all assets and liabilities should be recognised ‘unless the IASB decides when developing or revising a particular Standard that an entity need not, or should not, recognise an asset or liability’. It therefore appears that an entity, when referring to the Conceptual Framework for guidance on a matter not covered by a standard, would be required to recognise all items within the definitions of assets and liabilities no matter how irrelevant or costly the information conveyed would be. We do not agree that this is appropriate, and are particularly concerned that it may lead to inappropriate recognition given the broad definitions that are proposed.

Question 2

The definitions of an asset and a liability are discussed in paragraphs 2.6–2.16. The IASB proposes the following definitions:

(a) an asset is a present economic resource controlled by the entity as a result of past events.

(b) a liability is a present obligation of the entity to transfer an economic resource as a result of past events.

(c) an economic resource is a right, or other source of value, that is capable of producing economic benefits.

Do you agree with these definitions? Why or why not? If you do not agree, what changes do you suggest, and why?

Response to question 2

4.6 In our view, the proposed definitions are an improvement on those on the existing Conceptual Framework. However, as noted in paragraphs 4.1–4.5 above, they are rather vague and may therefore be interpreted broadly. It is therefore important that the Conceptual Framework provides guidance on the intended meaning in order to ensure consistent application. In particular:

(i) ‘Other sources of value’ is potentially very wide-ranging, as evidenced by the examples listed in paragraph 3.5(c) of the Discussion Paper. We question whether all of these examples should fall within the definition of an asset. Probably they do not because the entity has no control, in which case the Conceptual Framework should make this clear. It seems likely that the notion of 'control' will play a larger role than is the case with the existing definition.

(ii) It would also be helpful to clarify the notion of 'capable of' or replace it with a more definite term. We note that the ambiguity of the term 'capable of' has been one identified by the IASB's constituents as one of the reasons that it can be difficult to determine whether an acquisition is of a business or of assets.

4.7 We agree that a reference to 'past events' should be retained. Although we understand that it may be considered unnecessary, we think it helpful as it is consistent with the historical, largely transactions-based nature of accounting, and responds to an accountability objective.

4.8 It would also be helpful to clarify that the term 'rights' is not limited to contractual rights, but also includes, for example rights arising under statute.

Question 3

Whether uncertainty should play any role in the definitions of an asset and a liability, and in the recognition criteria for assets and liabilities, is discussed in paragraphs 2.17–2.36. The IASB's preliminary views are that:

(a) the definitions of assets and liabilities should not retain the notion that an inflow or outflow is 'expected'. An asset must be capable of producing economic benefits. A liability must be capable of resulting in a transfer of economic resources.

(b the Conceptual Framework should not set a probability threshold for the rare cases in which it is uncertain whether an asset or a liability exists. If there could be significant uncertainty about whether a particular type of asset or liability exists, the IASB would decide how to deal with that uncertainty when it develops or revises a Standard on that type of asset or liability.

(c) the recognition criteria should not retain the existing reference to probability.

Do you agree? Why or why not? If you do not agree, what do you suggest, and why?

Response to question 3

4.9 Potential assets and liabilities where there is only a low probability of an inflow or outflow present a significant challenge. As noted above, reporting some such assets and liabilities may not provide useful information, and obscure more important information. It may also impose significant cost on preparers. We agree, however, that some potential assets and liabilities that have only a low probability of a future inflow and outflow—for example some derivatives—should be reported.

4.10 A possible approach would be to include a reference to the probability of a future inflow or outflow in the definitions and/or recognition criteria, and then to allow for certain exceptions. However, this might seem conceptually inconsistent, and it would be necessary to ensure the exceptions were logical and unambiguous.

4.11 We therefore are inclined to agree with the IASB’s preliminary views that definitions of assets and liabilities, and the recognition criteria should not contain a specific reference to probability. However, this is premised on the assumption that the Conceptual Framework will explain that an asset or liability may not be recognised where there is only a low probability of an inflow or outflow. As stated in paragraph 4.4 above, it is important that the Exposure Draft explains the implications of the proposed definitions and criteria for a number of possible assets and liabilities to demonstrate the probable effect at the standards level.

4.12 We agree that existence uncertainty should be resolved in the development of standards. However, acknowledging the distinction in the Conceptual Framework may be helpful as it acknowledges the variety of the practical limitations that constrain financial reporting, and may clarify thinking in considering how particular circumstances might be reflected in accounting standards.

Question 4

Elements for the statement(s) of profit or loss and OCI (income and expense), statement of cash flows (cash receipts and cash payments) and statement of changes in equity (contributions to equity, distributions of equity and transfers between classes of equity) are briefly discussed in paragraphs 2.37–2.52.

Do you have any comments on these items? Would it be helpful for the Conceptual Framework to identify them as elements of financial statements?

Response to question 4

4.13 The terms 'income' and 'expense' have established meanings and connotations that are not always appropriate for the wide compass of items that fall within these elements in the Conceptual Framework. It would therefore be more helpful and reduce misunderstanding if the Conceptual Framework were to employ more general terms, such as 'gains' and 'losses' for the elements that correspond to changes in assets and liabilities. 'Gains' and 'losses' clearly include all income and expenses but also, for example, the loss arising from natural disasters or misappropriation of assets, or the profit on sale of a major asset, which may not be thought of as 'income' and 'expenses'. Adopting such an approach would enable the terms 'income' and 'expenses' to be used for more specific purposes either elsewhere in the Conceptual Framework or, perhaps more probably, in accounting standards.

4.14 The Conceptual Framework should require that the primary financial statements should contain only elements as defined. As stated in paragraph 8.9 below, we do not consider that the Conceptual Framework should merely permit recycling where the criteria for it are met. It follows that, if recycling is to be required for certain items, the definition of income and expenses (or of gains and losses) therefore needs to be amended to include recycling adjustments.

4.15 The definition of income in the current Conceptual Framework is incorrect, as it defines income (which is a credit) as an increase in assets (which is a debit)[4]. This should be reconsidered.

4.16 As is explained in our response to question 10 below we do not support the recognition of transfers of wealth between classes of equity, and therefore these should not be defined as elements.

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4 See Richard Barker (2010) On the Definitions of Income, Expenses and Profit in IFRS, Accounting in Europe, 7:2, 147–158.

Question 5

Constructive obligations are discussed in paragraphs 3.39–3.62. The discussion considers the possibility of narrowing the definition of a liability to include only obligations that are enforceable by legal or equivalent means. However, the IASB tentatively favours retaining the existing definition, which encompasses both legal and constructive obligations—and adding more guidance to help distinguish constructive obligations from economic compulsion. The guidance would clarify the matters listed in paragraph 3.50.

Do you agree with this preliminary view? Why or why not?

Response to question 5

4.17 We agree with the IASB's preliminary view that liabilities should include constructive as well as enforceable obligations. Restricting the definition of liabilities to enforceable obligations would incur the risk of reporting based on legal niceties rather than business and economic realities. It is therefore important that the definition of liabilities should be wider than obligations that are enforceable.

4.18 For example, in the UK directors are required to have regard inter alia to the need to foster the company's business relationships and to maintain high standards of business conduct. It would be anomalous to deny that a liability exists where directors consider this requires them to honour an undertaking—for example to compensate customers for a product failure—that is not enforceable by the beneficiary.

4.19 The Discussion Paper sets out possible further guidance on 'constructive obligations' in paragraph 3.50. Whilst guidance of this nature would be helpful, aspects of the guidance may merit reconsideration. In particular:

(i) It is envisaged that the guidance would emphasise that the duty or responsibility must be owed to another party who would benefit, and can reasonably rely on, the entity to fulfil its duty or responsibility. It is not clear that this is right. The contrary view is suggested by paragraph 3.34 of the Discussion Paper, which says: 'If a liability exists for one party, an asset always exists for another party or parties, <u>except perhaps for some obligations to clean up damage to the environment</u>.'

(ii) The phrase 'reasonably rely' in sub-paragraph (c) could usefully be clarified. It may mean that the other party can 'rationally be confident that' or can 'rationally consider itself entitled to assume that'. The latter meaning would seem to be more appropriate as the objective should be to identify obligations rather than expectations.

(iii) The same sub-paragraph suggests that the reasonable reliance should be based on the entity's 'past actions'. This might be taken to refer to the entity's part practice of dealing with similar situations, but it does not seem right that the entity's past history should be regarded as determinative at the Conceptual Framework level (although it might be a practicable basis to use at the standards level). If 'past actions' is intended to refer, for example, to undertakings given by the entity, it would be helpful if this were clarified.

Question 6

The meaning of 'present' in the definition of a liability is discussed in paragraphs 3.63–3.97. A present obligation arises from past events. An obligation can be viewed as having arisen from past events if the amount of the liability will be determined by reference to benefits received, or activities conducted, by the entity before the end of the reporting period. However, it is unclear whether such past events are sufficient to create a present obligation if any requirement to transfer an economic resource remains conditional on the entity's future actions. Three different views on which the IASB could develop guidance for the Conceptual Framework are put forward:

(a) View 1: a present obligation must have arisen from past events and be strictly unconditional. An entity does not have a present obligation if it could, at least in theory, avoid the transfer through its future actions.

(b) View 2: a present obligation must have arisen from past events and be practically unconditional. An obligation is practically unconditional if the entity does not have the practical ability to avoid the transfer through its future actions.

(c) View 3: a present obligation must have arisen from past events, but may be conditional on the entity's future actions.

The IASB has tentatively rejected View 1. However, it has not reached a preliminary view in favour of View 2 or View 3.

Which of these views (or any other view on when a present obligation comes into existence) do you support? Please give reasons.

Response to question 6

4.20 We concur with the IASB's preliminary view that View 1 should be rejected. It is an important principle that the definition of liabilities should include all obligations that an entity has no practical ability to avoid, but further clarity on 'practical ability' is necessary: if it is interpreted narrowly, then there may be little substantive difference between View 2 and View 1. We are attracted to the underlying logic of View 3—namely that if an entity has received services under an exchange transaction then it has an obligation to pay for them: however, as many of the examples concern government-imposed levies it is difficult to be sure what the exchange is, and to what period it relates.

4.21 Clearly this is an area where further analysis is required. We suggest that it may be helpful to expand the number of examples, and also to provide a richer context for consideration. It may be more helpful to consider aspects beside the narrow question of whether a liability for the levy (or other item) exists. It may be, for example, that in some cases an entity has a liability either to pay the levy or to take action to avoid it. Or it may be necessary to consider whether assets are impaired. We would be very willing to undertake further consideration of these issues, if that would be helpful to the IASB.

Question 7

Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?

Response to question 7

Reporting the substance of transactions

4.22 As mentioned in Section 2 above, we welcome the proposal to reintroduce to the Conceptual Framework material on reporting the substance of rights and obligations, without which the Conceptual Framework would be seriously incomplete. In our view, the proposals in paragraph 3.102 of the Discussion Paper capture the essence of what this material should be.

4.23 The Conceptual Framework should make clear that considerations of substance over form applies generally to the identification of assets and liabilities. Although the interpretation of contracts is one of the areas where the issue of substance over form is often relevant, we do not consider it should be restricted to an assessment of contractual obligations. It is an overriding principle that the substance of transactions and arrangements should be reported. We therefore consider that this topic is best addressed in the discussion of qualitative characteristics, in Chapter 3.

4.24 The example of economic compulsion given in paragraph 3.108 is confusing, as it seems to suggest that an option may be substantive and yet be ignored in the assessment of the accounting treatment. If it is to be retained in the Conceptual Framework it should be clarified.

Executory contracts

4.25 We agree that it is appropriate for the Conceptual Framework to address the principles that apply to the accounting for executory contracts. We have the following comments on the discussion given in paragraphs 3.109–3.112 of the Discussion Paper.

4.26 It is explained in paragraph 3.110(c) of the Discussion Paper that executory contracts may not be recognised because either:

(i) they give rise to a right-and-obligation to exchange (typically measured at zero), rather than distinct rights to receive and obligations to transfer; or

(ii) the assets and liabilities are offset.

4.27 However, it is simply stated that which of these applies 'may depend on the circumstances'. It would be helpful to set out the principles that determine the position that applies. There is also no discussion of whether (and why) offset is appropriate for contracts in class (ii). Paragraphs 3.12 and 3.13 of the Discussion Paper discuss a similar contrast between having a single net asset or liability and offsetting but this is also incomplete, as identification of separate rights and obligations is part of the unit of account issue, which the Discussion Paper suggests the Conceptual Framework will not address. That discussion also simply notes that distinct assets and liabilities are sometimes offset, but does not explore the circumstances in which offset should be applied.[5] Offsetting is also addressed in the Discussion Paper at paragraphs 7.29–7.30, but that discussion merely refers the general concepts of faithful representation and cost-benefit.

4.28 The argument that an executory contract is not recognised (unless onerous) is essentially that 'the rights of one party have the same value as the obligations of the other party'. This seems to be plausible from the perspective of the purchaser as on performance it will recognise the asset received in place of cash or a liability and equity will be unchanged—the value of the asset is equal to that of the consideration given. However, it does not work for the seller, because it typically it will report income on performance, as the value of the cash received (or receivable) will be greater than the inventory that is derecognised. A better justification may be that recognition of an executory contract by a seller would require an allocation between the profit that is made on obtaining and performing the contract: that split would be arbitrary and of doubtful usefulness. Deferring recognition of the profit on a contract until performance is consistent with the concepts of prudence, relevance and reliability.

4.29 We note the comment made in paragraph 3.112 of the Discussion Paper that 'strictly speaking, trade date accounting is inconsistent with the concepts discussed in this Discussion Paper'. We are not sure we agree that this is a direct consequence of the Discussion Paper's proposals, and note that any change to accounting practice on this would follow from a standards-level project that would be subject to the IASB's agenda setting criteria and due process requirements.

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5 The UK accounting standard 'FRS 5 Reporting the Substance of Transactions' formerly prohibited offsetting except for monetary balances where the entity had the ability to insist on net settlement, and that ability was assured beyond reasonable doubt. This required that the debit balance matured no later than the credit balance and that the ability to insist on net settlement would survive the insolvency of the other party.

Question 8

Paragraphs 4.1–4.27 discuss recognition criteria. In the IASB's preliminary view, an entity should recognise all its assets and liabilities, unless the IASB decides when developing or revising a particular Standard that an entity need not, or should not, recognise an asset or a liability because:

(a) recognising the asset (or the liability) would provide users of financial statements with information that is not relevant, or is not sufficiently relevant to justify the cost; or

(b) no measure of the asset (or the liability) would result in a faithful representation of both the asset (or the liability) and the changes in the asset (or the liability), even if all necessary descriptions and explanations are disclosed.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

Response to question 8

4.30 We agree that assets and liabilities should not be recognised if doing so does not provide relevant information, or information that is not sufficiently relevant to justify the cost of doing so. However, in our view it is essential that the Conceptual Framework should also set out guidance, along the general lines set out in paragraph 4.26 of the Discussion Paper, to provide indicators of when recognition might not result in relevant information. We note that these include the key ideas of lack of reliability of measurement and low probability of inflow or outflow of economic benefits, which are contained in the existing Conceptual Framework.

4.31 We note that applying this approach would require an assessment of a number of factors. This is appropriate as the variety of circumstances that are encountered in standard-setting are so varied that application of any rigid rule is unlikely to provide the best solution in every case.

4.32 In developing this guidance, the IASB should consider whether additional factors should be added. In particular:

- There may be little or no additional relevance in recognising an asset or liability that is inseparable—that is, it cannot be sold except together with the business of which it forms a part.

- It may be relevant to report assets that have been purchased even though similar assets that have been internally generated are not, in order for financial statements to assist in assessing management's stewardship. This might most often arise for intangibles such as computer software. The Discussion Paper notes (at paragraph 2.30) that some consider that the purchase of an asset provides evidence of the existence of an asset: we would add that the purchase also provides evidence of its value.

4.33 It would also be helpful for the Conceptual Framework to note that decisions on whether to recognise an asset or liability should also evaluate the benefits of reporting by alternative means. For example, it may be more informative to disclose the range of possible outcomes for a highly uncertain liability than to recognise the liability—which would require assigning a specific amount to it, and may give rise to misunderstanding when that amount differs from the amount ultimately paid.

4.34 The proposals in the Discussion Paper do not distinguish between the recognition of losses and gains. In discussing prudence in Section 2 above, we explained why timely recognition of losses is more important than that of gains. The Conceptual Framework should highlight that early recognition of losses is more relevant than that of gains.

4.35 We discuss the inadequacies of the concept of 'faithful representation' as set out in the current Conceptual Framework in Section 2 above. This supports the view reported in paragraph 4.20 of the Discussion Paper that 'there are no circumstances when recognising an asset or a liability would provide information that is relevant but yet would not result in a faithful representation of that asset or liability and of changes in that asset or liability'. Accordingly adding a separate criterion that refers to faithful representation would be redundant. It may be, however, that a more careful description of the concept of 'faithful representation' would make it more useful and justify its use in the criteria for recognition.

4.36 As stated in paragraph 4.5 above, in our view entities should be able to conclude, when considering a transaction or event that is not the subject of a standard, than an asset or liability should not be recognised because it fails to meet the recognition criteria. Use of the recognition criteria should not be reserved to the IASB.

Question 9

In the IASB's preliminary view, as set out in paragraphs 4.28–4.51, an entity should derecognise an asset or a liability when it no longer meets the recognition criteria. (This is the control approach described in paragraph 4.36(a)). However, if the entity retains a component of an asset or a liability, the IASB should determine when developing or revising particular Standards how the entity would best portray the changes that resulted from the transaction. Possible approaches include:

(a) enhanced disclosure;

(b) presenting any rights or obligations retained on a line item different from the line item that was used for the original rights or obligations, to highlight the greater concentration of risk; or

(c) continuing to recognise the original asset or liability and treating the proceeds received or paid for the transfer as a loan received or granted.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

Response to question 9

4.37 We welcome the identification of the two challenges that arise on derecognition (i) reporting the assets and liabilities remaining after the transaction and (ii) faithfully reflecting the changes in assets and liabilities as a result of the transaction.

4.38 The control approach can be said to promote comparability, as two entities that have identical assets will report them in the same way. However, 'stickiness' (a prohibition of derecognition unless stringent criteria are met) also promotes comparability—that between the financial position at the beginning and end of the reporting period. This may also provide the most transparent information on the entity's history which is useful for an assessment of accountability. This is not to suggest that 'stickiness' should invariably prevail, but rather to emphasise the difficulty of the challenges that the Discussion Paper highlights.

4.39 Whether an asset or liability is derecognised should depend on the substance of the transaction. In particular, derecognition is not appropriate when a transaction has no economic substance. Furthermore, prudence requires that caution is exercised in the recognition of income on transactions where the substance is doubtful.

4.40 The risks-and-rewards approach set out in the Discussion Paper is not the same as that used in the former UK standard FRS 5 'Reporting the substance of transactions'. The FRS 5 approach, which we support, prohibits derecognition only when there is <u>no</u> significant change in the entity's exposure to risks and rewards, rather than when it retains <u>most</u> of the risks and rewards. In Example 4.1 in the Discussion Paper the receivables would not continue to be reported at the same amount, if (as assumed) the change in the exposure to credit risk is significant.

4.41 Such a risk-and-rewards approach is complementary to rather than opposed to, the 'control' approach to derecognition. Considering risks-and-rewards in assessing whether control has been retained will assist in identifying the substance of a transaction. It will, in particular avoid the conclusion that a transaction justifies derecognition merely on the grounds that legal ownership of an asset has been transferred. We note that the Basis for Conclusions to IFRS 10 'Consolidated Financial Statements' acknowledges that a consideration of risks and rewards is relevant to application of a control approach (paragraph BC32).

4.42 If a control approach contained a requirement to consider changes in risks and rewards it would seem likely that the sale of bond with a repurchase agreement (Example 4.2 in the Discussion Paper) would not lead to derecognition and would be consistent with the view that the transaction had virtually no effect on the amount, timing and uncertainty of the entity's cash flows, other than receiving cash and repaying it with interest.

5 Definition of equity and distinction between liabilities and equity instruments (Discussion Paper Section 5)

General comments

5.1 The Discussion Paper presents quite radical proposals on the accounting for equity. It would seem that implementation of many of the proposals would fall to be reflected in a future accounting standard, but there is insufficient detail to form a view as to the merits of such a standard. It would seem that the proposals have only relatively minor implications for the Conceptual Framework.

5.2 The Discussion Paper explains (in paragraph 1.20) that the Exposure Draft will contain material on the reporting entity. It provides a summary of the IASB's 2010 Exposure Draft and the comments received on it. One point made by many commentators was that there should be a discussion of the perspective from which financial statements are prepared: that is whether an entity or proprietary perspective should be used. We agree with this, and consider that the Exposure Draft should explain how its proposals relate to these perspectives.

Question 10

The definition of equity, the measurement and presentation of different classes of equity, and how to distinguish liabilities from equity instruments are discussed in paragraphs 5.1–5.59. In the IASB's preliminary view:

(a) the Conceptual Framework should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.

(b) the Conceptual Framework should state that the IASB should use the definition of a liability to distinguish liabilities from equity instruments. Two consequences of this are:

(i) obligations to issue equity instruments are not liabilities; and

(ii) obligations that will arise only on liquidation of the reporting entity are not liabilities (see paragraph 3.89(a)).

(c) an entity should:

(i) at the end of each reporting period update the measure of each class of equity claim. The IASB would determine when developing or revising particular Standards whether that measure would be a direct measure, or an allocation of total equity.

(ii) recognise updates to those measures in the statement of changes in equity as a transfer of wealth between classes of equity claim.

(d) if an entity has issued no equity instruments, it may be appropriate to treat the most subordinated class of instruments as if it were an equity claim, with suitable disclosure. Identifying whether to use such an approach, and if so, when, would still be a decision for the IASB to take in developing or revising particular Standards.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

Response to question 10

5.3 We agree that the current definition of equity—the residual interest in the assets of the entity after deducting all its liabilities—should be retained.

5.4 We do not believe that the proposed statement of changes in equity will provide useful information. In particular, we do not agree that classes of equity should be remeasured by reference to market value. The amount at which equity is stated in the financial statements does not purport to reflect the market value of the entity. For this reason, there is no logic in reducing the amount attributed to ordinary shareholders' funds, by the market value of other classes of equity (such as options). We therefore do not support further development of the Discussion Paper's proposals on this subject.

5.5 We do not consider it necessary for the Conceptual Framework to address the case of entities that have not issued any equity instruments. However, we agree that accounting standards might address the financial reporting of these entities.

6 Measurement (Discussion Paper Section 6)

General comments

6.1 The discussion of measurement in Section 6 of the Discussion Paper fails to provide the depth of analysis that is necessary if the Conceptual Framework is to provide useful guidance to the IASB for the development of accounting standards. Many of the points made are consistent with current practices (which are accepted with only cursory justification) rather than providing a foundation for the improvement of financial reporting.

6.2 The objective that is identified for measurement merely repeats the objective of financial statements and the qualitative characteristics. The discussion of specific measurement bases is superficial and incomplete. As a result it is questionable whether the proposed guidance for the Conceptual Framework will be adequate.

6.3 It appears that cash-flow based measurements are to be used wherever it is concluded that cost or current market prices are unavailable or unsuitable. They are therefore the default measure and so might, perhaps, be used fairly often. However, cash-flow based measurements are often highly dependent on subjective estimates and judgements and, as discussed in paragraph 2.26 of this response, this impairs reliability. It should therefore be acknowledged that such measures should be used only where their superior relevance outweighs this disadvantage.

6.4 As is clear from paragraphs 6.119–6.121 of the Discussion Paper, cash-flow based measurements do not respond to any specific objective: but the measurement objective should be derived from the Conceptual Framework, not invented for each individual standard.

6.5 Among the issues that might be addressed in the Conceptual Framework are:

- The relationship between entity-specific and market values, and the circumstances in which each might be used.

- The use of exit and entry values. Although the Discussion Paper notes in paragraph 6.50 that exit prices are relevant for assets that will be sold, and states that 'an entry price…<u>might</u> be relevant for assets held for use', it does not discuss <u>why</u> entry prices may be more relevant.

- Related to this is the question of the circumstances (if any) in which transaction costs should be reflected in the carrying amount of an asset or liability.

- The consequences for measurement of changing prices. It is a serious mistake to assume that changing prices are only a major issue in highly inflationary economies. The cumulative effect of even moderate inflation is often significant. Furthermore, even in those economies where general inflation has recently been relatively low, the volatility of specific prices (for example, those for commodities) has been extreme—and a return of more serious general inflation cannot be discounted. We do not suggest that the Conceptual Framework should be a manifesto for the wholesale introduction of price-level adjusted accounting; but we do think that it should provide a rationale for the circumstances in which standards should require a measurement basis that takes account of price changes.

Question 11

How the objective of financial reporting and the qualitative characteristics of useful financial information affect measurement is discussed in paragraphs 6.6–6.35. The IASB's preliminary views are that:

(a) the objective of measurement is to contribute to the faithful representation of relevant information about:

(i) the resources of the entity, claims against the entity and changes in resources and claims; and

(ii) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources.

(b) a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements;

(c) when selecting the measurement to use for a particular item, the IASB should consider what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI;

(d) the relevance of a particular measurement will depend on how investors, creditors and other lenders are likely to assess how an asset or a liability of that type will contribute to future cash flows. Consequently, the selection of a measurement:

(i) for a particular asset should depend on how that asset contributes to future cash flows; and

(ii) for a particular liability should depend on how the entity will settle or fulfil that liability.

(e) the number of different measurements used should be the smallest number necessary to provide relevant information. Unnecessary measurement changes should be avoided and necessary measurement changes should be explained; and

(f) the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.

Do you agree with these preliminary views? Why or why not? If you disagree, what alternative approach to deciding how to measure an asset or a liability would you support?

Response to question 11

6.6 As noted above, the proposed objective of measurement merely repeats material from earlier chapters about the objective of financial reporting and the qualitative characteristics, and therefore seems unexceptionable. And we question whether it provides adequate guidance for the development of sound principles that will guide the development of accounting standards.

6.7 As explained in Section 2 above, 'faithful representation' as described in the current Conceptual Framework can be attained, provided adequate disclosure is made, for any conceivable measurement basis. The concept of faithful representation therefore does not provide any useful content to the proposed objective. In contrast, reliability is a very significant factor in the selection of an appropriate measurement basis, and the Conceptual Framework's treatment of measurement will be incomplete unless the implications of reliability are addressed.

6.8 We agree with preliminary view (b) that a single measurement basis is unlikely to provide the most relevant information for users of financial statements, and that selection of an appropriate measurement basis will enhance the quality of the information in both the statement of financial position and the statement(s) of profit or loss and OCI. We welcome the IASB's preliminary view (c) that the statement of financial position and the statement(s) of profit or loss and OCI should be considered in the selection of a measurement basis.

6.9 The Discussion Paper does not discuss the concept of value and the relationship between the value of an asset or liability and the cash flow that it may contribute. In the absence of such a discussion it is difficult fully to assess preliminary view (d). An advantage of the proposed revisions to the definitions of assets and liabilities is that they bring greater clarity to the distinction between the existence of assets and liabilities and the flows that might result from them: a focus on future cash flows seems inconsistent with this.

6.10 We agree that the appropriate measurement basis for an asset should depend upon the possible ways in which it brings value or cash flows to the entity, and that the manner in which a liability will be settled or fulfilled is relevant to selecting an appropriate measurement basis for it. However, we consider that this insight should be more carefully developed. As stated, it might justify accounting based on management intent. In our view, an asset should not be written down simply because management intend to use it in a sub-optimal manner; nor should assets be written up to values that the entity has no ability to capture. The concept of a business model (which in our view is not dependent on management intent) assists in identifying the ways in which assets may bring value and cash flows to the entity. Examples of this are given in the responses to the following questions.

6.11 We agree with preliminary views (e) and (f). The Conceptual Framework should be clear that a meaningful assessment of the benefits and costs of a particular measurement basis cannot be made in isolation, but only relative to the benefits and cost of alternative measurement bases.

Question 12

The IASB's preliminary views set out in Question 11 have implications for the subsequent measurement of assets, as discussed in paragraphs 6.73–6.96. The IASB's preliminary views are that:

(a) *if assets contribute indirectly to future cash flows through use or are used in combination with other assets to generate cash flows, cost-based measurements normally provide information that is more relevant and understandable than current market prices.*

(b) *if assets contribute directly to future cash flows by being sold, a current exit price is likely to be relevant.*

(c) *if financial assets have insignificant variability in contractual cash flows, and are held for collection, a cost-based measurement is likely to provide relevant information.*

(d) *if an entity charges for the use of assets, the relevance of a particular measure of those assets will depend on the significance of the individual asset to the entity.*

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

Response to question 12

6.12 We agree that assets which provide inputs to the entity's business model should be measured at entry prices. This faithfully reflects their value to the entity and results in financial statements reporting the margin—the difference between entry prices and revenue—when revenue is recognised and the assets are derecognised.

6.13 We agree that assets that will be sold should be reported at current exit prices subject to the following points.

(i) The Discussion Paper's rationale for not applying this to inventory is unconvincing: a sounder justification is that inventory is an input to the entity's business model and therefore should be reported at an entry rather than an exit price.

(ii) Because the justification for using exit prices for assets that will be sold is to reflect the amount that will be obtained from sale, in our view the costs to sell should be deducted. In any event the Conceptual Framework should provide guidance on the treatment of transaction costs.

(iii) Where an asset is reclassified as held for sale, the measurement basis should not be increased to a current exit value that is higher than its previous carrying amount. To do so would be to recognise the profit that will be realised on sale while it was still uncertain—indeed perhaps before a buyer has been identified. This would be contrary to the concepts of prudence and reliability.

6.14 We agree that financial assets that are held for collection should be measured at entry prices, because they are inputs to the entity's business model, and the reasoning set out in paragraph 6.12 above applies.

6.15 The Discussion Paper's treatment of assets where the entity charges others for use refers to a number of ideas—the number of assets held, the value of the individual assets, and the size of the group of assets. We think the conclusion is that current values are more relevant, but that historical cost may be used where price changes are not likely to be significant and the cost of preparing information based on current prices is significantly greater than that of historical cost. We agree with that conclusion.

Question 13

The implications of the IASB's preliminary views for the subsequent measurement of liabilities are discussed in paragraphs 6.97–6.109. The IASB's preliminary views are that:

(a) cash-flow-based measurements are likely to be the only viable measurement for liabilities without stated terms.

(b) a cost-based measurement will normally provide the most relevant information about:

(i) liabilities that will be settled according to their terms; and

(ii) contractual obligations for services (performance obligations).

(c) current market prices are likely to provide the most relevant information about liabilities that will be transferred.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

Response to question 13

6.16 The IASB's preliminary views fail to establish the measurement objective that should determine the selection of a measurement basis for liabilities. As stated in paragraph 6.4 above, the Conceptual Framework should identify what that objective should be. Thus, whilst we agree that, for many liabilities, the measurement will necessarily be calculated from an estimate of future cash flows, we do not think that that conclusion will lead to noticeable improvement in financial reporting.

6.17 Liabilities with stated terms will often arise in respect of obligations to provide goods and services to customers. They are inputs to the entity's business model and consistently with our views on assets, are appropriately measured at entry costs. (The Discussion Paper addresses obligations to provide <u>services</u> but does not mention obligations to provide <u>goods</u>: we assume this is an unintentional slip.)

6.18 We agree that current exit prices are likely to be the relevant measure for liabilities that will be transferred—but, as there will often be no market, it is unclear that 'current <u>market</u> prices' is an appropriate description. As with assets, the amount should include the cost to transfer the liability.

Question 14

Paragraph 6.19 states the IASB's preliminary view that for some financial assets and financial liabilities (for example, derivatives), basing measurement on the way in which the asset contributes to future cash flows, or the way in which the liability is settled or fulfilled, may not provide information that is useful when assessing prospects for future cash flows. For example, cost-based information about financial assets that are held for collection or financial liabilities that are settled according to *their terms may not provide information that is useful when assessing prospects for future cash flows:*

(a) if the ultimate cash flows are not closely linked to the original cost;

(b) if, because of significant variability in contractual cash flows, cost-based measurement techniques may not work because they would be unable to simply allocate interest payments over the life of such financial assets or financial liabilities; or

(c) if changes in market factors have a disproportionate effect on the value of the asset or the liability (ie the asset or the liability is highly leveraged).

Do you agree with this preliminary view? Why or why not?

Response to question 14

6.19 The Discussion Paper amplifies the question by stating that current market prices are likely to be the most relevant measure for assets and liabilities of this type. We agree that current market prices may be more relevant than cost in the circumstances described in the question. The case of impaired loans would presumably fall within (a).

6.20 Further clarity is necessary about whether 'current market prices' includes estimated current market prices where market information is not available. It may be that a cash-flow based measure would be used. That this is a possible objective for such a measurement is stated in paragraph 6.119 of the Discussion Paper: but the heading of this part of the paper is 'Cash flow measurements <u>other than estimates of current prices</u>'. We are therefore unsure what is intended.

6.21 Because the Discussion Paper does not discuss the concept of value, it does not provide a justification for the circumstances referred to in preliminary view (c).

Question 15

Do you have any further comments on the discussion of measurement in this section?

Response to question 15

6.22 Our principal comments on the discussion of measurement in this Section are set out in paragraphs 6.1–6.5 above.

6.23 The Discussion Paper uses the term ‘measurement’ rather than ‘measurement basis’. But the term ‘measurement’ is ambiguous—it may refer either to the basis used (for example, historical cost or net selling price) or to the amount at which an asset or liability is stated in financial statements. The terms ‘measurement basis’ or ‘measurement attribute’ are preferable as they avoid this ambiguity.

6.24 The Discussion Paper addresses ‘Exchange of items with equal value’ in paragraphs 6.61–6.64. Most transactions take place because the value of what is exchanged differs: both parties attach a greater value to what they receive than what they give. The same asset may sometimes be sold at different prices in different transactions—for example a wholesale and a retail market. A more accurate description of what is intended may be ‘transactions on arms’ length terms’. This would additionally avoid the conclusion that such transactions are necessarily concluded at fair value.

7 Presentation and disclosure (Discussion Paper Section 7)

General comments

7.1 We note that there are gaps in the Conceptual Framework relating to presentation and disclosure and we welcome that the IASB is seeking to address these in its review of the Conceptual Framework.

7.2 We also welcome that the IASB is taking a number of steps to encourage disclosures that are more relevant for investors and reduce the disclosure burden for preparers. With that in mind, we consider that the IASB has achieved the right balance between the material that has been included on disclosures in the Discussion Paper and that planned under its ‘Disclosure Initiative’.

7.3 We broadly support the IASB’s preliminary views on presentation and disclosure. Our comments on specific aspects of the proposals are set out below.

7.4 The IASB’s Conceptual Framework sets out an objective for general purpose financial reporting. We believe that it would be helpful for the Conceptual Framework to identify the boundary of financial reporting and distinguish between financial statements and other financial reports.

7.5 We believe that this point is particularly important for the discussions around the disclosure framework. As currently drafted, some of the discussions in Section 7 of the Discussion Paper seem to be inadvertently expanding the boundary of the notes. As an example, it may be more appropriate to place disclosures describing a company’s business model in management commentary rather than in the notes.

7.6 The FRC has developed some ideas around the boundary of financial reporting and other financial reports in its October 2012 Discussion Paper ‘Thinking about disclosures in a broader context'.[6] and in its recent Exposure Draft 'Guidance on the Strategic Report'[7].

'Presentation' and 'disclosure'

7.7 Whilst there is clearly a strong link between presentation and disclosure, we believe that they are distinct, and should be dealt with in different Chapters of the Conceptual Framework. They are different considerations in the standard setting process. For example, the objective of presentation in IAS 1 'Financial Statement Presentation' is associated with the provision of information for comparability purposes.

7.8 We agree that the term 'presentation' as described in 7.10 is commonly associated with the 'disclosure of financial information on the face of an entity's the primary financial statements'. We consider this to be a suitable starting point for the defining the term. However, we would prefer to define the term as 'the display of information for comparability purposes' as using the word 'disclosure' to describe presentation blurs the boundary between the topics.

7.9 The description of 'disclosure' given in paragraph 7.11 of the Discussion Paper is unhelpful as it includes the whole of financial reporting. It would be helpful for the Conceptual Framework to provide a more focused definition, which would explain the nature of disclosure and differentiate it from presentation. We suggest: 'Disclosure is the provision of information that amplifies the information displayed in the primary financial statements'.

Question 16

This section sets out the IASB's preliminary views about the scope and content of presentation and disclosure guidance that should be included in the Conceptual

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6 A copy of the discussion paper can be accessed at http://www.frc.org.uk/getattachment/99bc28b2-c49c-4554-b129-9a6164ba78dd/Thinking-about-disclosures-in-a-broader-contex.aspx

7 A copy of the exposure draft can be accessed at http://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Exposure-Draft-Guidance-on-the-Strategic-Report-File.pdf

Framework. In developing its preliminary views, the IASB has been influenced by two main factors:

(a) the primary purpose of the Conceptual Framework, which is to assist the IASB in developing and revising Standards (see Section 1); and

(b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 7.6–7.8), including:

(i) a research project involving IAS 1, IAS 7 and IAS 8, as well as a review of feedback received on the Financial Statement Presentation project;

(ii) amendments to IAS 1; and

(iii) additional guidance or education material on materiality.

Within this context, do you agree with the IASB's preliminary views about the scope and content of guidance that should be included in the Conceptual Framework on:

(a) presentation in the primary financial statements, including:

(i) what the primary financial statements are;

(ii) the objective of primary financial statements;

(iii) classification and aggregation;

(iv) offsetting; and

(v) the relationship between primary financial statements.

(b) disclosure in the notes to the financial statements, including:

(i) the objective of the notes to the financial statements; and

(ii) the scope of the notes to the financial statements, including the types of information and disclosures that are relevant to meet the objective of the notes to the financial statements, forward-looking information and comparative information.

Why or why not? If you think additional guidance is needed, please specify what additional guidance on presentation and disclosure should be included in the Conceptual Framework.

Response to question 16

7.10 We broadly support the IASB's preliminary views on presentation. We believe that it is helpful to define the term 'primary financial statements' and differentiate these from the notes to the financial statements. In addition, we agree with the development of an approach for presentation and disclosure that identifies recognised and unrecognised items as we consider that this will be useful basis for the development of a disclosure framework.

7.11 As stated in Section 2 above, we consider that the Conceptual Framework should identify the provision of information that provides accountability as a primary objective. We also believe that one of the objectives of the primary financial statements is to present information on a consistent basis to facilitate comparison between entities. We suggest that the objective of the primary financial statements should refer specifically to accountability and comparability.

7.12 We believe that the material on aggregation should refer to disaggregation as this will provide a link between the information that is presented in line items on the face of the primary financial statements and note disclosures which disaggregate those line items.

7.13 As noted in paragraph 4.27 above, the Discussion Paper does not provide convincing principles about offsetting. We disagree with the implication of paragraph 7.30 of the Discussion Paper that offsetting should be required only on the grounds of faithful representation and cost/benefit: relevance should also be a consideration.

7.14 We consider that it would be helpful to develop an objective for the notes to the financial statements as this is would assist in determining which disclosures should be placed in the notes to the financial statements and those which should be located in other parts of the annual report. Overall, we consider that this section is based on a number of assumptions around the boundaries of financial reporting disclosures and placement of information without addressing these explicitly. The FRC has given considerable thought to placement and the FRC's draft 'Guidance on the Strategic Report' (particularly pages 9–13) may be of interest to the IASB. The

FRC is developing a 'core and supplementary' approach to structuring information in an annual report, which will enable the information that is important to investors to be given prominence.

7.15 We are concerned that the approach adopted in the Discussion Paper for developing an objective for the notes and determining the scope of the notes in paragraphs 7.33–7.41 of the Discussion Paper, is expanding the scope of the type of disclosures that would be included in the notes. Our specific comments relating to this section are set out below.

7.16 Paragraph 7.33 of the Discussion Paper describes the objective of the notes as 'to supplement the financial statements'. Many disclosures could be considered as 'supplementary' to the financial statements, including those that are included within management commentary. The IASB's 2010 Practice Statement 'Management Commentary' notes that the management commentary to 'complements and supplements the financial statements' (paragraph 10). Using the same terminology for disclosures is confusing and does not clearly differentiate between those disclosures that are placed in the notes and disclosures that would be located elsewhere.

7.17 We consider that the factors in sub-paragraphs 7.33(a) and (b) of the Discussion Paper are part of the objective of financial reporting. There is some repetition of these factors in paragraph 7.34 and 7.35(a) of the Discussion Paper. In addition, we are unclear as to how paragraphs 7.34(a) and (b) of the Discussion Paper relate to the objective of the notes to the financial statements.

7.18 We consider that the types of information included in paragraph 7.35 of the Discussion Paper would be relevant to investors. However, we question whether it is appropriate for all this information to be included within the scope of the notes.

7.19 As an example, Table 7.1 in the Discussion Paper includes a description of the business model. This is a disclosure which in practice most companies include in the front half of their annual report. The UK Government has recently introduced new regulations, to mirror current practice, which require disclosures of the business model to be provided as part of the management report.

7.20 Similarly, paragraph 7.35(d) of the Discussion Paper refers to risk information. In our view, risk information could be located in different parts of the annual report. The information about the types of risks faced by an entity and an entity's risk management, as set out in Table 7.1 in the Discussion Paper, are also often included in management commentary or a governance statement.

7.21 There is also a need for further debate on whether all disclosures relating to unrecognised assets and liabilities should be included in the notes. An example would be information about unrecognised intangibles which may be useful to investors.

7.22 We acknowledge that placement of disclosures is an area that will vary by jurisdiction. However, we suggest that it would be helpful if the Conceptual Framework facilitated a flexible approach whereby disclosures could be provided outside of the notes. This could be achieved through the use of cross-referencing or by adopting the approach in IFRS 7 (paragraphs B6 and BC43–BC46). We believe that this would be a step towards reducing duplication that exists in annual reports.

7.23 We believe that it is important for the IASB to include some guidance on when forward-looking information should be included in the notes and the nature of forward-looking information that should be included in management commentary. We broadly agree with the IASB's preliminary view that forward-looking information should be included in the notes when it relates to existing assets and liabilities that exist at the end of the reporting period. This would include disclosures around material uncertainties that affect the going concern status of the entity as they relate to the valuation and classification of existing assets and liabilities.

7.24 We suggest that the explanation given in paragraph 7.42 of the Discussion Paper on comparative information should be included in the section on presentation in the Exposure Draft.

Question 17

Paragraph 7.45 describes the IASB's preliminary view that the concept of materiality is clearly described in the existing Conceptual Framework. Consequently, the IASB does not propose to amend, or add to, the guidance in the Conceptual Framework on materiality. However, the IASB is considering developing additional guidance or education material on materiality outside of the Conceptual Framework project.

Do you agree with this approach? Why or why not?

Response to question 17

7.25 Yes. We broadly agree with this approach as we consider that a comprehensive project on materiality is required which would go beyond the scope of the Conceptual Framework. In our view, additional guidance on the application of materiality to disclosures is an important part of changing behaviour in this area and would cut clutter.

7.26 Whilst we agree that the concept of materiality is generally understood, we believe that, the description of materiality in the Conceptual Framework should make an explicit reference to the disclosure of immaterial information as it is a source of clutter in annual reports. We would therefore suggest including the following wording, which is in line with paragraph 7.46(c) of the Discussion Paper, in the Exposure Draft:

> 'When immaterial information is given in the financial statements, the resulting clutter can impair the understandability of material information. In such circumstances, the immaterial information will need to be excluded.'

7.27 Furthermore, we agree that the points made in paragraph 7.46 of the Discussion Paper are important points to emphasise in the additional guidance on materiality.

Question 18

The form of disclosure requirements, including the IASB's preliminary view that it should consider the communication principles in paragraph 7.50 when it develops or amends disclosure guidance in IFRSs, is discussed in paragraphs 7.48–7.52.

Do you agree that communication principles should be part of the Conceptual Framework? Why or why not?

If you agree they should be included, do you agree with the communication principles proposed? Why or why not?

Response to question 18

7.28 We believe that the communication principles are important and should be included as part of the Conceptual Framework. We concur with the view expressed in paragraph 7.49 of the Discussion Paper that disclosures should focus on the communication of relevant information to investors rather than be considered a compliance exercise.

7.29 We agree with the communication principles proposed. In addition, we would suggest that:

(a) the word 'concise' is added to principle (b) as we consider that it is important for disclosures to be written concisely;

(b) principle (e)—we believe that duplication is more of a problem between information that is contained in the financial statements and other parts of the annual report. Therefore, we suggest that this principle is amended to read 'disclosure guidance should not result in the duplication of the same information in different parts of the financial statements <u>or the financial report</u>.'; and

(c) the following principle is added:

'Disclosures should be current.'

7.30 We believe that it is necessary for the IASB to review disclosures periodically to ensure that disclosures that are no longer relevant are removed. For example, some disclosures may have been added in response to the financial crisis may no longer be a relevant in a few years' time.

7.31 In our view, organisation of disclosures is important, this is referred to in paragraph 7.50(c) of the Discussion Paper. Although the FRC's draft 'Guidance on the Strategic Report' focuses on narrative reporting, it sets that in the context of the annual report as a whole. We are hearing from preparers that they would like flexibility in financial reporting so that they can 'tell the story'. We would suggest that the IASB is mindful of this when setting standards to enable preparers to experiment and innovate with where disclosures are located and how they are organised.

7.32 Finally, we agree with the approach whereby the IASB sets a disclosure objective in each standard. We would also encourage the IASB to move away from setting disclosure requirements in standards which contain lists of detailed requirements as, in our view, this could lead to disclosure requirements being applied in practice as a checklist.

8 Presentation in the statement of comprehensive income—profit or loss and other comprehensive income (Discussion Paper Section 8)

General comments

8.1 The development of a principle-based approach to the reporting of financial performance should be a high priority for the IASB. We welcome the IASB's undertaking a research project reviewing IAS 1 'Presentation of Financial Statements', IAS 7 'Statement of Cash Flows' and IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'. Work on the standards-level project and the Conceptual Framework should be carried out in tandem, as the work on each should inform the other.

8.2 We would emphasise the importance of cash flow reporting in this connection. Information on liquidity is highly significant, particularly from an accountability perspective. Information on cash flow and profitability is most useful if the links between the statement of profit or loss and the cash flow statement are transparent and easily understood.

8.3 The Discussion Paper discusses only one issue relating to the reporting of performance: the distinction between profit or loss and OCI. It is, however, difficult to consider that issue in isolation. Approaching the reporting of performance in this way focuses on aggregate amounts (profit or loss and other comprehensive income), and essentially poses the question of dividing the totality of income and expense between two broad and undefined buckets. We suggest that an information set approach would be more fruitful. This would identify the components of income and expense that would provide relevant information to users and develop proposals for how income and expenses can be presented to highlight those components. One such component should be an operating result, consistent with the entity's business model.

8.4 In developing this part of the Conceptual Framework, the IASB should consider whether the label 'Other Comprehensive Income' is appropriate. In our view, it is misleading, because financial statements cannot be comprehensive, as some assets and liabilities are not recognised. A preferable label may be, for example, 'other recognised income and expenses'. As noted in paragraph 4.13 above, we suggest that it would be appropriate for the Conceptual Framework to use terms such as 'gains' and 'losses' in place of 'income' and 'expense'. If this were adopted, the term 'other recognised gains and losses' could be used in place of 'other comprehensive income', which would be more accurate and reduce the risk of misunderstanding. It would also allow the terms 'income' and 'expenses' to be used for a narrower class of changes in assets and liabilities that would correspond more closely with the natural meaning of those terms.

8.5 We also suggest that the proposition that all changes in assets and liabilities (other than those relating to transactions with owners) are 'income and expenses' should be reconsidered. An obvious exception is capital maintenance adjustments. There may be other changes, such as translation differences on foreign operations that should not be considered as income or expenses.

Question 19

The IASB's preliminary view that the Conceptual Framework should require a total or subtotal for profit or loss is discussed in paragraphs 8.19–8.22.

Do you agree? Why or why not?

If you do not agree do you think that the IASB should still be able to require a total or subtotal profit or loss when developing or revising particular Standards?

Response to question 19

8.6 We agree that the Conceptual Framework should require a total or subtotal for profit or loss as it is used as the main indicator of an entity's performance and provides a starting point for analysis. However, we do not think it is adequate for the Conceptual Framework to omit any material on its nature or purpose. This is necessary to clarify its significance and to provide a rationale for what should be included or omitted from it. One means of meeting this need this would be for the Conceptual Framework to describe the objective of the statement of profit or loss. We suggest this should be along the following lines:

> 'The objective of the statement of profit or loss is to present income and expenses for the period in order to report the returns of the period, and facilitate an assessment of accountability and future returns.'

8.7 The Conceptual Framework should also observe that the predictive value of the statement of profit or loss is enhanced by distinguishing the results of the entity's operations (corresponding to its business model); income and expenses relating to financing and taxation; and non-recurring items.

Question 20

The IASB's preliminary view that the Conceptual Framework should permit or require at least some items of income and expense previously recognised in OCI to be recognised subsequently in profit or loss, ie recycled, is discussed in paragraphs 8.23–8.26.

Do you agree? Why or why not? If you agree, do you think that all items of income and expense presented in OCI should be recycled into profit or loss? Why or why not?

If you do not agree, how would you address cash flow hedge accounting?

Response to question 20

8.8 We agree that all income and expenses should be reported in profit or loss unless their exclusion is required by an accounting standard. The treatment of such income and expenditure should depend on the reasons for its exclusion:

(a) If they are excluded because reporting them in profit or loss is not consistent with the objective of the profit and loss account, they should not be recycled.

(b) If they are excluded because an assessment of the entity's business model is facilitated by their inclusion in profit or loss for a later period, they should be recycled—that is, reported in the period that facilitates an assessment of the entity's business model.

If the Conceptual Framework provides for both types of exclusion they should be clearly differentiated.

8.9 The Conceptual Framework should require, rather than simply permit, all income and expenses that meet the criteria to be excluded from profit or loss and (if appropriate) recycled. We accept that in setting standards the IASB may depart from the Conceptual Framework (if it provides a justification for doing so). It is not, however, appropriate for the Conceptual Framework itself to set out principles that may be observed on an optional basis.

8.10 We do not agree that all items reported in OCI should be recycled. The main justification for this view seems to be that all income and expense should be reported in profit or loss at some point. But the role of the profit or loss account is to provide information of the income and expenses of the reporting period, not to ensure that the cumulative amounts reported have any particular significance. Including an item in profit or loss simply to report the 'right' cumulative position is inconsistent with that objective.

8.11 Recycling should only be required when it provides relevant information about an event of the period. The Discussion Paper suggests (paragraph 8.24(b)) that realisation is an example of such an event. However, we question whether recycling is the only or best means of providing the information about realisation that is required in order to fulfil the objectives of financial statements. The decision on how this information is best reported may be better addressed in the development of standards rather than in the Conceptual Framework.

Question 21

In this Discussion Paper, two approaches are explored that describe which items could be included in OCI: a narrow approach (Approach 2A described in paragraphs 8.40–8.78) and a broad approach (Approach 2B described in paragraphs 8.79–8.94).

Which of these approaches do you support, and why?

If you support a different approach, please describe that approach and explain why you believe it is preferable to the approaches described in this Discussion Paper.

Response to question 21

8.12 The approach we support is set out in paragraph 8.8 above.

8.13 We do not support the narrow approach (Approach 2A) as it fails to allow for some income and expenses (such as some changes in surpluses and deficits on defined benefit pension plans) that should not, in our view, be reported in profit or loss.

8.14 If the Conceptual Framework is to embed the use of 'bridging items' it should require that the IASB identify the reasons why a different measurement basis may be required in profit or loss from that used in the statement of financial position. A superior rationalisation may be that it is more informative to present separately different components of the change in the amount at which assets and liabilities are stated. For example, in the event that property, plant and equipment are revalued, it is clearly more useful to present the cost of consumption (represented by depreciation) separately from the holding gain that arises in the period. We do not necessarily agree that cost-based information on consumption is always more relevant than that based on more up to date prices and regret that the Discussion Paper assumes this, without a convincing justification.

8.15 We are not convinced that the principle set out in the Discussion Paper that 'the cumulative amount recognised in profit or loss since the entity acquired the asset or incurred the liability should be consistent with the results of a meaningful, understandable and clearly describable measure of the asset or the liability' (paragraph 8.59). As stated above, the profit or loss reports on events of the period: the cumulative amount recognised has no relevance and may be inconsistent with that objective.

9 Other issues (Discussion Paper Section 9)

Question 22

Chapters 1 and 3 of the existing Conceptual Framework

Paragraphs 9.2–9.22 address the chapters of the existing Conceptual Framework that were published in 2010 and how those chapters treat the concepts of stewardship, reliability and prudence. The IASB will make changes to those chapters if work on the rest of the Conceptual Framework highlights areas that need clarifying or amending. However, the IASB does not intend to fundamentally reconsider the content of those chapters.

Do you agree with this approach? Please explain your reasons.

If you believe that the IASB should consider changes to those chapters (including how those chapters treat the concepts of stewardship, reliability and prudence), please explain those changes and the reasons for them, and please explain as precisely as possible how they would affect the rest of the Conceptual Framework.

Response to question 22

9.1 As explained in Section 2 of this response, we are very strongly of the view that the IASB should revise Chapters 1 and 3 to:

- Identify the provision of information on accountability as a primary objective of financial reporting, equal in prominence to that of providing information that is useful for making decisions about the provision of resources to the entity.
- Reconsider the replacement of ‘reliability’ with ‘faithful representation’; the description of ‘faithful representation’ and the relationship between relevance and reliability/faithful representation.
- Identify prudence as a qualitative characteristic, confirm that it is not inconsistent with neutrality, and clarify its role.

9.2 We also note in paragraph 2.3 above that Chapter 3 would be the most logical place for the Framework to discuss the importance of reporting the substance of transactions. It would also be an appropriate place to acknowledge the importance of providing information that assists in an assessment of the entity's business model (see paragraphs 2.39-2.46 above) and to describe the going concern concept and its implications (see paragraphs 2.47-2.49 above).

9.3 The implications of these changes are explained elsewhere in this response.

Question 23

Business model

The business model concept is discussed in paragraphs 9.23–9.34. This Discussion Paper does not define the business model concept. However, the IASB's preliminary view is that financial statements can be made more relevant if the IASB considers, when developing or revising particular Standards, how an entity conducts its business activities.

Do you think that the IASB should use the business model concept when it develops or revises particular Standards? Why or why not?

If you agree, in which areas do you think that the business model concept would be helpful?

Should the IASB define 'business model'? Why or why not?

If you think that 'business model' should be defined, how would you define it?

Response to question 23

9.4 As explained in paragraphs 2.39–2.46 of this response, we consider that the Conceptual Framework should acknowledge that information is particularly relevant if it assists in an assessment of the entity's business model. It is not necessary for the Conceptual Framework to define the term 'business model'; but we suggest that it provide a general description of it as discussed in paragraph 2.42 above.

Question 24

Unit of account

The unit of account is discussed in paragraphs 9.35–9.41. The IASB's preliminary view is that the unit of account will normally be decided when the IASB develops or revises particular Standards and that, in selecting a unit of account, the IASB should consider the qualitative characteristics of useful financial information.

Do you agree? Why or why not?

Response to question 24

9.5 The unit of account issue is a highly significant issue that is pervasive in financial reporting. It is therefore not satisfactory for the Conceptual Framework to omit a discussion of the issue. Whist we acknowledge that it is not feasible to identify principles that would unambiguously point to a satisfactory solution, the Conceptual Framework should set out indicators that would guide the development and application of accounting standards.

9.6 The Conceptual Framework should also require that accounting standards clearly identify the unit of account that has been selected, and the reasons for its selection.

Question 25

Going concern

Going concern is discussed in paragraphs 9.42–9.44. The IASB has identified three situations in which the going concern assumption is relevant (when measuring assets and liabilities, when identifying liabilities and when disclosing information about the entity).

Are there any other situations where the going concern assumption might be relevant?

Response to question 25

9.7 As explained in paragraphs 2.47–2.49 of this response, it is important that the Conceptual Framework continues to reflect the concept of going concern, and explains that information that is prepared on a going concern basis is usually the most relevant.

Question 26

Capital maintenance

Capital maintenance is discussed in paragraphs 9.45–9.54. The IASB plans to include the existing descriptions and the discussion of capital maintenance concepts in the revised Conceptual Framework largely unchanged until such time as a new or revised Standard on accounting for high inflation indicates a need for change.

Do you agree? Why or why not? Please explain your reasons.

Response to question 26

9.8 As stated in paragraph 6.5 above, the issue of changing prices is too important an issue to neglect in the Conceptual Framework. It is not merely an issue for highly inflationary economies. Even moderate inflation has a significant cumulative effect, and specific price changes as well as general price changes need to be considered.

9.9 Concepts of capital maintenance are usually debated in the context of aggregate measures: as stated in Section 8 above, our view is that an information set approach, focussing on different components of income is likely to be more fruitful than a focus on high-level aggregate amounts. However, it would be possible to select different concepts of capital for different components of income. It may be, for example, that a physical concept of capital is appropriate for operating activities, but that this should not be applied to financial activities. We therefore think it would be regrettable if the IASB were to preclude further developments in its thinking in this area.

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Berlin, 14 January 2014

Dear Hans,

IASB Discussion Paper DP/2013/1 *A Review of the Conceptual Framework for Financial Reporting*

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the IASB's Discussion Paper DP/2013/1 (herein referred to as the 'DP'). We appreciate the opportunity to comment on the DP and provide our answers to the specific question in the DP in the Appendix attached to this letter.

We believe the *Conceptual Framework* has a significant role in the development of a single set of high quality, understandable, enforceable and globally accepted financial reporting standards and therefore the review project is of great importance to us. In this context we have been engaging in joint activities with other European national standard-setters and EFRAG to promote the necessary debate about changes in the *Conceptual Framework*. We are pleased and appreciate the fact that the outcome of these activities in form of Bulletins have been subject to the Board's discussion and consultation process.

Because the project is of great importance to us, we would like to convey our general remarks about the project objective and IASB's due process activities as follows:

Scope and outcome of the project

We mainly support the scope of the review efforts and IASB's decision to build on the existing *Conceptual Framework* - updating, improving and filling gaps rather than fundamentally reconsidering all aspects of the *Conceptual Framework*. We understand that the project will result in amendments to the current *Conceptual Framework* and the IASB will start using the revised *Conceptual Framework* immediately once it is finalised.

We believe some of the preliminary views and ideas would result in significant shifts in accounting if consistently implemented across all IFRSs. Hence, a revised *Conceptual Framework* version will raise questions about consequences for existing IFRSs. We have the impression that for some issues addressed in the DP the IASB may consider starting immediately follow-up projects to implement changes arising from the clarification and additions to the *Conceptual Framework*. In other parts of the document the DP repeatedly highlights that a revised *Conceptual Framework* will not necessarily lead to changes to existing IFRSs and that any proposal to change an existing Standard or Interpretation would need to go through the IASB's normal due process. In addition, some IFRSs – e.g. IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* - require the application of the *Conceptual Framework*. Therefore, the revised *Conceptual Framework* may have an immediate impact for preparers, e.g. modified definition and recognition of assets, liabilities, income and expenses (IAS 1.15).

Nevertheless, we agree with the IASB's view that immediate changes to existing IFRSs are not desirable in light of the potential instability instead of having a stable platform for financial reporting. Thus, changing the *Conceptual Framework* should not automatically trigger immediate changes to existing IFRSs. However, we strongly believe that the objective and project efforts to revise the *Conceptual Framework* should ultimately result in consistency of requirements across all IFRSs. We think consistency across IFRSs is of fundamental importance and should be considered as a key driver for the project efforts to improve financial reporting. Therefore, we think the IASB needs to develop a strategy and impact assessment for addressing the potential consequences and implications of a revised *Conceptual Framework* to existing IFRSs. Ideally this kind of information should already be part of the Exposure Draft of a revised *Conceptual Framework*. Otherwise, there should be a timely evaluation process with a thorough assessment by the IASB whether and when some framework changes should be implemented in IFRS. The outcome of this evaluation process for existing IFRSs and the IASB's strategy to achieve consistency across IFRS's should be published. As a next step, the IASB should address the consequences and implications of the revised *Conceptual Framework* to existing IFRSs in its next Agenda Consultation with corresponding questions to constituents about the future work agenda.

Overall, as a revision of the *Conceptual Framework* will probably include a number of new, untested concepts, Standards based on these new ideas need to be monitored closely. Ideally, the IASB should address issues arising from the newly introduced concepts in the *Conceptual Framework* on a timely basis to reduce the risk of (re-)introducing inconsistencies and exceptions. The IASB should also clarify the impact of the *Conceptual Framework* review for IFRS requirements that include references to the *Conceptual Framework*, especially IAS 1.15 and IAS 8.11-12.

Timing of the project steps

We have some concerns with the IASB's view relating to the progress and timing of the project. We understand the intention and benefits to revise the *Conceptual Framework* in a single phase rather than spreading the discussion into separate phases. Nevertheless, we think there are some fundamental overarching concepts that should be clarified before continuing the discussion on other conceptual issues. For example we think clarifying the concept of the reporting entity and more important the perspective of presenting financial statements is of absolute necessity before debating ensuing issues such as the definition of assets and liabilities and equity.

Furthermore, we have concerns regarding the ambitious plan to finalise the revision by the end of 2015. We have the impression that the IASB postponed some more in-depth discussions when preparing the DP. In our view the revision of the *Conceptual Framework* is of great importance for the future development of consistent IFRSs and there should be no rush in order to keep artificial timelines.

If you would like to discuss our general remarks and our detailed comments enclosed in the Appendix further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr
President

Appendix – Answers to the questions of the discussion paper

<u>Reporting entity and perspective of preparing financial statements</u>

Before answering the specific questions we highlight our concern that the IASB did not discuss the reporting entity issue and the perspective of preparing financial statements in the DP. We acknowledge the fact that the IASB had already published an Exposure Draft in 2010. However, we do not agree with the conclusion that it was unnecessary to re-discuss the concept of the reporting entity and the perspective of financial reporting. We believe those high-level concepts are of fundamental importance.

Particularly - as expressed in our previous comment letter on the Exposure Draft ED/2010/2 *Conceptual Framework Financial Reporting: The Reporting Entity* - we consider a thorough discussion of the perspective of presenting (consolidated) financial statements to be crucial. Previous discussions (e.g. within the project 'Business Combinations') as well as the academic literature have already made clear that different views and diverse interpretations exist (such as the proprietary perspective, entity perspective or economic unit concept). Therefore we encourage the IASB to address the issue in the Exposure Draft.

IASB DP - Question 1: Section 1 Introduction

Paragraphs 1.25–1.33 of the DP set out the proposed purpose and status of the *Conceptual Framework*. The IASB's preliminary views are that:

(a) the primary purpose of the revised *Conceptual Framework* is to assist the IASB by identifying concepts that it will use consistently when developing and revising IFRSs; and

(b) in rare cases, in order to meet the overall objective of financial reporting, the IASB may decide to issue a new or revised Standard that conflicts with an aspect of the *Conceptual Framework*. If this happens the IASB would describe the departure from the *Conceptual Framework*, and the reasons for that departure, in the Basis for Conclusions on that Standard.

Do you agree with these preliminary views? Why or why not?

Generally, we agree with most of the preliminary views regarding the purpose and the status of the *Conceptual Framework*. We think the primary purpose of the *Conceptual Framework* is to assist the IASB when developing and revising IFRSs and to achieve the continuity of agreed concepts, assumptions, and objectives for financial reporting, despite turnover of IASB members and its staff.

We believe the *Conceptual Framework* should retain its important role for constituents, especially for preparers as an authoritative guidance in absence of specific guidance in IFRSs as it is currently implemented through IAS 8. Thus, we have concerns and disagree with the IASB's intention that according to paragraph 1.29 in the DP "some aspects of the Conceptual Framework are intended only for the IASB's use as it develops new or revised IFRSs".. We think there is no conceptual ground for such a proposal but it rather indicates weakness of particular concepts and definitions in the *Conceptual Framework*. We strongly discourage the IASB to proceed with the idea that some parts of the *Conceptual Framework* should be considered as "IASB only" guidance.

The *Conceptual Framework* should be considered as the common starting point for the IASB when developing or revising IFRSs and any conceptual exceptions in IFRSs and their justification need to be stated explicitly. . We believe it is important to emphasise in the revised version of the *Conceptual Framework* that it presents an important tool to achieve consistency across IFRSs.

Additionally, we think the IASB needs to address the implications of a revised *Conceptual Framework* for existing IFRSs. Especially, we believe the IASB needs to clarify the role of the revised *Conceptual Framework* for the work of the IFRS Interpretations Committee when developing interpretations of IFRSs that were developed based on a potentially different *Conceptual Framework*.

We note that the IASB considers the proposed revision not being a fundamental rethink; however, in our view some of the preliminary views present significant changes from existing framework guidance and accounting principles in current IFRSs. Therefore, we strongly urge the IASB to clarify its intention and plans whether and when the current IFRSs should be reviewed in light of any *Conceptual Framework* amendment. We believe it is not desirable to revise the *Conceptual Framework* without clarification whether the amendments are (in)consistent with existing IFRSs. Therefore, we propose the IASB should carry out and publish an impact assessment for all existing IFRSs leading to potential future projects to be addressed in its next Agenda Consultation.

IASB DP - Question 2: Elements of financial statements

The definitions of an asset and a liability are discussed in paragraphs 2.6–2.16 of the DP. The IASB proposes the following definitions:

(a) an asset is a present economic resource controlled by the entity as a result of past events.

(b) a liability is a present obligation of the entity to transfer an economic resource as a result of past events.

(c) an economic resource is a right, or other source of value, that is capable of producing economic benefits.

Do you agree with these definitions? Why or why not? If you do not agree, what changes do you suggest, and why?

We acknowledge the intention to clarify the meaning of assets and liabilities in the statement of financial position. Nevertheless, in our view it is necessary to stress the distinction between the definition and recognition aspects in the *Conceptual Framework*. Thus, we disagree with the current proposals in the DP because we think it would be more useful and consistent not commingling recognition aspects with the general, and broader definition of assets and liabilities. We think separating a broader definition of assets and liabilities from recognition criteria is more understandable and more consistent with the discussion about the derecognition criteria in the DP. Therefore we propose to exclude from the asset and liability definitions:

(i) the control notion;

(ii) the notion of past event; and

(iii) the entity aspect

Those issues should be discussed in the revised *Conceptual Framework* in more detail in the context of recognition and derecognition.

Furthermore, we note differences in wording between Section 2 and Section 4 in the DP regarding the description/definition of an asset. The IASB refers in Section 4 to “components” of an asset or multiple rights, while the definition in Section 2 refers only to a single right or other source of value. In our view, this inconsistency reflects the need to address more thoroughly the link between the asset and liability definition and the unit of account. We believe the discussion and views expressed in the DP remain ambiguous ; we refer to our answer to Question 24 regarding the unit of account issue.

IASB DP - Question 3

Whether uncertainty should play any role in the definitions of an asset and a liability, and in the recognition criteria for assets and liabilities, is discussed in paragraphs 2.17–2.36 of the DP. The IASB's preliminary views are that:

(a) the definitions of assets and liabilities should not retain the notion that an inflow or outflow is 'expected'. An asset must be capable of producing economic benefits. A liability must be capable of resulting in a transfer of economic resources.

(b) the *Conceptual Framework* should not set a probability threshold for the rare cases in which it is uncertain whether an asset or a liability exists. If there could be significant uncertainty about whether a particular type of asset or liability exists, the IASB would decide how to deal with that uncertainty when it develops or revises a Standard on that type of asset or liability.

(c) the recognition criteria should not retain the existing reference to probability.

Do you agree? Why or why not? If you do not agree, what do you suggest, and why?

It is not clear to us, whether the notion of "capable" implies some limitations or a certain degree of threshold. We think the proposed definition would be equal to the following wording: An economic resource is a right or other source of value that may produce future economic benefits. Thus, the IASB should consider removing the term "capable" or it should provide some examples and scenarios where a right or other source of value is not "capable" of producing economic benefits.

Regarding IASB's preliminary view for Question 3c, we generally agree not to retain the existing reference to probability as a general recognition criterion in the revised *Conceptual Framework*. But more important, we disagree with IASB's argumentation and the preliminary view expressed in context of Question 3b for existence uncertainty. Particularly we do not agree with the wording that existence uncertainty whether the entity has an asset or a liability does only exist in "rare" cases. Furthermore we believe the revised *Conceptual Framework* should include high-level guidance and indication how the IASB could deal with that type of uncertainty in particular standards. We propose the revised *Conceptual Framework* should state that probability thresholds could be considered as an appropriate mechanism in particular Standards to operationalise professional judgement whether a present obligation or an economic resource exists, i.e. to operationalise existence uncertainty.

IASB DP – Question 4

Elements for the statement(s) of profit or loss and OCI (income and expense), statement of cash flows (cash receipts and cash payments) and statement of changes in equity (contributions to equity, distributions of equity and transfers between classes of equity) are briefly discussed in paragraphs 2.37–2.52 of the DP.

Do you have any comments on these items? Would it be helpful for the *Conceptual Framework* to identify them as elements of financial statements?

We do not think that an exhaustive enumeration of elements is particularly helpful without adding further information why these elements are conceptually important for assisting the IASB when developing or revising IFRSs. Hence, we believe it would be helpful to provide the definitions for these elements (as listed in Question 4). The definition should also clarify the conceptual distinction between income and expenses, wealth transfers, and contributions from or distribution to equity participants. In this context we propose to emphasise that the definitions of income and expense build upon the definition of assets, liabilities and changes in equity.

IASB DP – Question 5: Section 3 Additional guidance to support the asset and liability definition

Constructive obligations are discussed in paragraphs 3.39–3.62 of the DP. The discussion considers the possibility of narrowing the definition of a liability to include only obligations that are enforceable by legal or equivalent means. However, the IASB tentatively favours retaining the existing definition, which encompasses both legal and constructive obligations – and adding more guidance to help distinguish constructive obligations from economic compulsion. The guidance would clarify the matters listed in paragraph 3.50 of the DP.

Do you agree with this preliminary view? Why or why not?

We agree with the preliminary view for the reasons given in the DP. Furthermore, we support adding more high-level guidance in the revised *Conceptual Framework* to distinguish constructive obligations from economic compulsion.

IASB DP – Question 6

The meaning of 'present' in the definition of a liability is discussed in paragraphs 3.63–3.97 of the DP. A present obligation arises from past events. An obligation can be viewed as having arisen from past events if the amount of the liability will be determined by reference to benefits received, or activities conducted, by the entity before the end of the reporting period. However, it is unclear whether such past events are sufficient to create a present obligation if any requirement to transfer an economic resource remains conditional on the entity's future actions. Three different views on which the IASB could develop guidance for the *Conceptual Framework* are put forward:

(a) View 1: a present obligation must have arisen from past events and be strictly unconditional. An entity does not have a present obligation if it could, at least in theory, avoid the transfer through its future actions.

(b) View 2: a present obligation must have arisen from past events and be practically unconditional. An obligation is practically unconditional if the entity does not have the practical ability to avoid the transfer through its future actions.

(c) View 3: a present obligation must have arisen from past events, but may be conditional on the entity's future actions.

The IASB has tentatively rejected View 1. However, it has not reached a preliminary view in favour of View 2 or View 3.

Which of these views (or any other view on when a present obligation comes into existence) do you support? Please give reasons.

Generally, we believe new or revised IFRSs should not move towards View 3 because we are concerned about the degree of flexibility and complexity inherent in such an approach where the past event is sufficient to create a present obligation. We think in some cases it would be very difficult to determine the past event and therefore in our view consistent application would not be possible with View 3.

We believe the strength of View 1 is based on the fact that it is not difficult to operationalise the approach in comparison to View 2 or View 3. However, we agree with IASB's discussion and description of issues relating to View 1. Therefore, we believe the revised *Conceptual Framework* should not reflect View 1 but lean towards View 2 with more clarification regarding the meaning of "practically unconditional". We encourage the IASB to develop criteria in the *Conceptual Framework* that could be used as guidance when to conclude the existence of "practically unconditional" compared to "strictly unconditional". Furthermore, the IASB should provide more information regarding the understanding of the "past event". We think the notion remains very vague and is open to very different interpretations, especially for contingent considerations.

Because everything can be traced back to a past event, there should be more clarification in the revised *Conceptual Framework*..

The IASB could also explore whether different wording would be more appropriate to describe the underlying assumption of View 2. For example, we think the notion of “no realistic alternative” to avoid transfer of economic resources may be a better depiction of View 2 and that terminology is already used in current IAS 19 *Employee Benefits* in the context of constructive obligations.

More generally, we question why the issue regarding the timing of existence is addressed only for liabilities in the DP but not discussed for assets and for some classes of equity, i.e. obligations to issue own shares.

IASB DP – Question 7

Do you have comments on any of the other guidance proposed in this section of the DP to support the asset and liability definitions?

We do not have any further comments regarding the asset and liability definitions in the DP. Nevertheless, we refer to our answer to Question 8 where we address our concerns relating the control notion discussed in Section 3 in the DP as part of additional guidance to support the asset and liability definitions.

IASB DP – Question 8: Section 4 Recognition and Derecognition

Paragraphs 4.1–4.27 of the DP discuss recognition criteria. In the IASB’s preliminary view, an entity should recognise all its assets and liabilities, unless the IASB decides when developing or revising a particular standard that an entity need not, or should not, recognise an asset or a liability because:

(a) recognising the asset (or the liability) would provide users of financial statements with information that is not relevant, or is not sufficiently relevant to justify the cost; or

(b) no measure of the asset (or the liability) would result in a faithful representation of both the asset (or the liability) and the changes in the asset (or the liability),even if all necessary descriptions and explanations are disclosed.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

We agree with the proposals for the reasons given in the DP, except for the fact that some aspects of the proposed asset and liability definitions should be considered as recognition criteria in the revised *Conceptual Framework* and not be addressed within the broader asset and liability definitions. In this context we also refer to our answer to Question 2.

Furthermore, we note the discussion in the DP about the difference between the control notion defined in IASB's *Exposure Draft Revenue from Contracts with Customers* vs. the concept of control used in IFRS 10 *Consolidated Financial Statements.* In our view a variety of control approaches for IFRSs is not helpful and undesirable.

IASB DP – Question 9

In the IASB's preliminary view, as set out in paragraphs 4.28–4.51 of the DP, an entity should derecognise an asset or a liability when it no longer meets the recognition criteria. (This is the control approach described in paragraph 4.36(a)). However, if the entity retains a component of an asset or a liability, the IASB should determine when developing or revising particular Standards how the entity would best portray the changes that resulted from the transaction. Possible approaches include:

(a) enhanced disclosure;

(b) presenting any rights or obligations retained on a line item different from the line item that was used for the original rights or obligations, to highlight the greater concentration of risk; or

(c) continuing to recognise the original asset or liability and treating the proceeds received or paid for the transfer as a loan received or granted.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

Generally, we agree with the preliminary view for the reasons given by the IASB in the DP. However, the IASB should not describe its preliminary view as a "control approach". We think this terminology is confusing because the control aspect only applies to the derecognition of assets. Furthermore, the IASB describes in the DP the control approach for derecognition as follows:

> "derecognition is simply the mirror image of recognition. Thus, an entity would derecognise an asset or a liability when it no longer meets the criteria for recognition (or no longer exists, or is no longer an asset or a liability of the entity). This implies that the derecognition criteria for an asset would focus on the control of the asset (rather than on legal ownership or on risks and rewards) and the derecognition criteria for a liability would focus on whether the entity still has the liability."

In our view the description above used in the DP supports our proposal to address the control notion and the entity aspect as part of recognition and derecognition criteria in the revised *Conceptual Framework*.

Additionally, in light of clarification we think it is important to emphasize that the transfer of all risk and rewards would result in the loss of control. Differences between the control approach and the risk-and-reward approach would only occur if the entity retains a component that exposes the entity disproportionately to the remaining risks or rewards arising from the previously recognised asset or liability as stated in paragraph 4.36 in the DP.

As another aspect, we believe additional high-level derecognition guidance in the revised *Conceptual Framework* would be beneficial to address scenarios in which an entity is selling an asset but immediately repurchases a similar asset. Other scenarios include the modification of contractual agreements. We observe that such modification scenarios for assets and liabilities often raise questions in practice whether such transactions would require derecognition. We note the discussion in paragraphs 4.34-4.49 in the DP and would encourage the IASB to develop more guidance in the *Conceptual Framework* regarding the selection of a specific recognition approach.

IASB DP – Question 10: Section 5 Definition and distinction between liability and equity elements

The definition of equity, the measurement and presentation of different classes of equity, and how to distinguish liabilities from equity instruments are discussed in paragraphs 5.1-5.59 of the DP. In the IASB's preliminary view:

(a) the *Conceptual Framework* should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.

(b) the *Conceptual Framework* should state that the IASB should use the definition of a liability to distinguish liabilities from equity instruments. Two consequences of this are:
   (i) obligations to issue equity instruments are not liabilities; and
   (ii) obligations that will arise only on liquidation of the reporting entity are not liabilities (see paragraph 3.89(a) of the DP).

(c) an entity should:
   (i) at the end of each reporting period update the measure of each class of equity claim. The IASB would determine when developing or revising particular Standards whether that measure would be a direct measure or an allocation of total equity.
   (ii) recognise updates to those measures in the statement of changes in equity as a transfer of wealth between classes of equity claim.

(d) if an entity has issued no equity instruments, it may be appropriate to treat the most subordinated class of instruments as if it were an equity claim, with suitable disclosure. Identifying whether to use such an approach, and if so, when, would still be a decision for the IASB to take in developing or revising particular Standards.

Do you agree? Why or why not? If you do not agree, what changes do you suggest and why?

We agree with the IASB's preliminary view not to change the existing definition of equity in the *Conceptual Framework*, i.e. 'equity' is the residual interest in the assets of the entity after deducting all its liabilities.. Therefore, we generally support the strict obligation approach as discussed in the DP. Nevertheless, we reemphasise the necessity to clarify the perspective of presenting financial statements and the definition of the reporting entity because it provides the conceptual meaning of equity in accordance with IFRSs.

We generally agree with the IASB's preliminary view that the depiction of the wealth transfers between existing shareholders and option holders presents useful information for users, i.e. the value movements within equity between primary and secondary equity claim holders. However, we think it would be necessary to emphasise that these movements do not reflect a comprehensive depiction of all wealth transfers between different classes of equity holders unless all classes of equity holders are directly measured at current value. We do not support the direct measure for all classes of equity. The IASB should clarify that only secondary equity claims as described in the DP should be eligible for a direct measure.

We also agree with the conclusion in the DP that the strict obligation approach would resolve existing inconsistencies between IFRS 2 and IAS 32 and result in less complexity in IAS 32 requirements. However, the consequential requirements to remeasure all share-based payments, including all non-cash settled employee stock options, at the end of each reporting period may result in more burden for some entities. In fact, pricing options for unlisted entities would require a direct measure of the value of the entity, i.e. entity valuation, at the end of each reporting period.

Furthermore, we are supportive of the preliminary view that if an entity has issued no equity instruments, it may be appropriate having an exception from the strict obligation approach with suitable disclosures. The DP states that the narrow equity approach may underlie some of such exceptions in IAS 32 that were introduced by the IASB in the past. Beside the fact that we do not agree with the narrow equity approach in general, we are also not supportive of a narrow equity approach as described in the DP as the conceptual basis for such exceptions.

Generally, we believe that a narrow equity approach based on the most residual class of financial instruments is not a practicable approach for reporting consolidated financial statements because we question the conceptual rationale of “most residual” class of financial instruments in context of a consolidated group of entities. However, limiting the most residual class to financial instruments issued by the parent as discussed in the DP raises another concern that non-controlling interests (NCI) do not qualify in any cases as equity claims in consolidated financial statements. We note footnote #44 of the DP and the indication that a variant of the narrow equity approach might classify NCI as equity. However, in our view this footnote is inconsistent with the general definition of the narrow equity approach as described in the DP that only equity instruments issued by the parent are eligible to qualify as most residual class. We strongly believe that the development of exceptions should not be limited to instruments issued by the parent but should also enclose NCI classified as equity in separate or individual financial statements.

IASB DP – Question 11: Section 6 Measurement

How the objective of financial reporting and the qualitative characteristics of useful financial information affect measurement is discussed in paragraphs 6.6–6.35 of the DP. The IASB’s preliminary views are that:

(a) the objective of measurement is to contribute to the faithful representation of relevant information about:
   (i) the resources of the entity, claims against the entity and changes in resources and claims; and
   (ii) how efficiently and effectively the entity’s management and governing board have discharged their responsibilities to use the entity’s resources.

(b) a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements;

(c) when selecting the measurement to use for a particular item, the IASB should consider what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI;

(d) the relevance of a particular measurement will depend on how investors, creditors and other lenders are likely to assess how an asset or a liability of that type will contribute to future cash flows. Consequently, the selection of a measurement:
   (i) for a particular asset should depend on how that asset contributes to future cash flows; and
   (ii) for a particular liability should depend on how the entity will settle or fulfil that liability.

(e) the number of different measurements used should be the smallest number necessary to provide relevant information. Unnecessary measurement changes should be avoided and necessary measurement changes should be explained; and

(f) the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.

Do you agree with these preliminary views? Why or why not? If you disagree, what alternative approach to deciding how to measure an asset or a liability would you support?

In our view the discussion in the DP represents noticeable improvements compared to the measurement guidance in the current *Conceptual Framework*. We support the concept that selection of a measurement for a particular asset should depend on how that asset contributes to future cash flows; and for a particular liability should depend on how the entity will settle or fulfil that liability. Nevertheless, we have some reservations regarding the proposed measurement objective. The objective seems to us a replication of the general objective of financial reporting. We do not think this objective will be very useful and of any help for the IASB when developing or revising IFRSs.

Furthermore, we believe the reliability aspect of measurement is important and should be highlighted in the revised *Conceptual Framework* regarding the selection of measurement. While we agree with removing reliability as a general recognition criterion, we think this concept is still important for choosing the measurement attribute. From the DP it is not clear to us whether the IASB shares our view.

IASB DP – Question 12

The IASB's preliminary views set out in Question 11 have implications for the subsequent measurement of assets, as discussed in paragraphs 6.73 – 6.96 of the DP. The IASB's preliminary views are that:

(a) if assets contribute indirectly to future cash flows through use or are used in combination with other assets to generate cash flows, cost-based measurements normally provide information that is more relevant and understandable than current market prices.

(b) if assets contribute directly to future cash flows by being sold, a current exit price is likely to be relevant.

(c) if financial assets have insignificant variability in contractual cash flows, and are held for collection, a cost-based measurement is likely to provide relevant information.

(d) if an entity charges for the use of assets, the relevance of a particular measure of those assets will depend on the significance of the individual asset to the entity.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

We generally agree with the implications addressed for the subsequent measurement in the DP. Additionally, we think it is necessary for the revised *Conceptual Framework* to include high-level guidance when the measurement for an asset or a liability should change. That guidance should help to understand the consequences of the proposed implications to existing IFRSs. For example, some IFRSs, especially the measurement requirements for finished goods in IAS 2 *Inventories* and the measurement requirements in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* seem to be inconsistent in large parts with these preliminary views expressed in the DP. Thus, it is not clear to us whether these views would reflect the IASB's intention changes to the subsequent measurement requirements in IAS 2 and IFRS 5.

*Furthermore, w*e think the revised *Conceptual Framework* should also expand on the implications of the selection of the initial measurement attribute. For example, in our view the DP does not address sufficiently the conceptual basis for the different accounting treatment of cost arising subsequent to the acquisition depending on the type of initial measurement (i.e. cost based vs fair value).

IASB DP – Question 13

The implications of the IASB's preliminary views for the subsequent measurement of liabilities are discussed in paragraphs 6.97–6.109 of the DP. The IASB's preliminary views are that:

(a) cash-flow-based measurements are likely to be the only viable measurement for liabilities without stated terms.

(b) a cost-based measurement will normally provide the most relevant information about:

  (i) liabilities that will be settled according to their terms; and

  (ii) contractual obligations for services (performance obligations).

(c) current market prices are likely to provide the most relevant information about liabilities that will be transferred.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

We support the preliminary views for the reasons given in the DP.

IASB DP – Question 14

Paragraph 6.19 of the DP states the IASB's preliminary view that for some financial assets and financial liabilities (for example, derivatives), basing measurement on the way in which the asset contributes to future cash flows, or the way in which the liability is settled or fulfilled, may not provide information that is useful when assessing prospects for future cash flows. For example, cost-based information about financial assets that are held for collection or financial liabilities that are settled according to their terms may not provide information that is useful when assessing prospects for future cash flows:

(a) if the ultimate cash flows are not closely linked to the original cost;

(b) if, because of significant variability in contractual cash flows, cost-based measurement techniques may not work because they would be unable to simply allocate interest payments over the life of such financial assets or financial liabilities; or

(c) if changes in market factors have a disproportionate effect on the value of the asset or the liability (i.e. the asset or the liability is highly leveraged).

Do you agree with this preliminary view? Why or why not?

We support the preliminary view for the reasons given in the DP.

IASB DP – Question 15

Do you have any further comments on the discussion of measurement in this section?

We believe more guidance is necessary in the revised *Conceptual Framework* regarding the use of the discount rate in cash-flow-based measurements. We are aware of the fact that the IASB has a corresponding project on its research agenda. Nevertheless, we believe – in reflection of the very different approaches in existing IFRS - the revised *Conceptual Framework* should at least contain high-level guidance regarding the question whether the discount rate should reflect any form of risk and if so, the type of criteria for considering the risk.

IASB DP – Question 16: Section 7 Presentation and disclosure

This section sets out the IASB’s preliminary views about the scope and content of presentation and disclosure guidance that should be included in the *Conceptual Framework*. In developing its preliminary views, the IASB has been influenced by two main factors:

(a) the primary purpose of the *Conceptual Framework*, which is to assist the IASB in developing and revising Standards (see Section 1); and

(b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 7.6–7.8 of the DP), including:

  (i) a research project involving IAS 1, IAS 7 and IAS 8, as well as a review of feedback received on the Financial Statement Presentation project;

(ii) amendments to IAS 1; and

(iii) additional guidance or education material on materiality.

Within this context, do you agree with the IASB's preliminary views about the scope and content of guidance that should be included in the *Conceptual Framework* on:

(a) presentation in the primary financial statements, including:

(i) what the primary financial statements are;

(ii) the objective of primary financial statements;

(iii) classification and aggregation;

(iv) offsetting; and

(v) the relationship between primary financial statements.

(b) disclosure in the notes to the financial statements, including:

(i) the objective of the notes to the financial statements; and

(ii) the scope of the notes to the financial statements, including the types of information and disclosures that are relevant to meet the objective of the notes to the financial statements, forward-looking information and comparative information.

Why or why not? If you think additional guidance is needed, please specify what additional guidance on presentation and disclosure should be included in the *Conceptual Framework*.

Generally, we agree with the preliminary views expressed in the DP. We think the guidance in the *Conceptual Framework* would be even more useful if it contained a more comprehensive discussion about the boundaries of financial reporting. It still remains unclear to us whether and how the IASB draws the line between information presented in the financial statements and disclosure of other financial information that is considered to be part of management commentary and other parts of financial reporting. Thus, we strongly believe the IASB has to clarify these boundaries in the revised *Conceptual Framework*.

Furthermore, if the IASB has the intention to include the list of primary financial statements in the revised *Conceptual Framework*, we encourage the IASB to provide a clear and useful depiction what each statement should communicate to users, i.e. to explain the purpose and role of each statement.

Overall, we think the IASB should prioritise its efforts to improve presentation and disclosures for IFRSs. We believe financial reporting in accordance with IFRS have become less understandable and comparable for the users and a more structured approach for setting presentation and disclosure requirements is needed.

IASB DP – Question 17

Paragraph 7.45 of the DP describes the IASB's preliminary view that the concept of materiality is clearly described in the existing *Conceptual Framework*. Consequently, the IASB does not propose to amend, or add to, the guidance in the *Conceptual Framework* on materiality. However, the IASB is considering developing additional guidance or education material on materiality outside of the *Conceptual Framework* project.

Do you agree with this approach? Why or why not?

We believe that the concept of materiality is clearly and consistently understood as an entity-specific aspect of relevance. We acknowledge that the concept of materiality is based on quantitative as well as qualitative judgement in regard to the size and nature of the item, omission or misstatement. Also, specific facts and circumstances have to be taken into consideration for this judgement. Therefore, the concept of materiality will, by definition, result in some divergence in practice without negatively impacting the relevance of the information provided.

Because the primary purpose of the revised *Conceptual Framework* is to assist the IASB in identifying concepts that it will use consistently when developing and revising IFRSs, we agree with the view that - if considered to be useful - additional application guidance about materiality could be developed but should not be added to the *Conceptual Framework*. However, we encourage and support any efforts by the IASB in the *Conceptual Framework* that would result in a more understandable and consistent way of using terms such as “significant”, “key”, “critical”, “important”, “as a minimum” in future IFRSs. The variety and different use of these different terms across IFRSs is not beneficial and provides room for different interpretations.

IASB DP – Question 18

The form of disclosure requirements, including the IASB's preliminary view that it should consider the communication principles in paragraph 7.50 of the DP when it develops or amends disclosure guidance in IFRSs, is discussed in paragraphs 7.48–7.52 of the DP.

Do you agree that communication principles should be part of the *Conceptual Framework*? Why or why not?

If you agree they should be included, do you agree with the communication principles proposed? Why or why not?

Overall, we agree with the IASB's intention to include general presentation and disclosure concepts in the revised Conceptual. These high-level concepts should especially ensure the development of consistent and balanced disclosures across IFRSs.

Relating to the listed communication principles, we do not fully understand from the DP how the IASB will operationalise these communication principles when it develops or amends disclosure guidance in IFRSs. Beside the fact that we think "communication principles" is not the appropriate term for such high-level presentation and disclosure concepts, we think the IASB needs to clarify the relation between those communication principles and qualitative characteristics of useful financial information as listed in Chapter 3 of the *Conceptual Framework*. Many of the communication principles appear to be very similar to the requirements listed in Chapter 3. Hence, we think the IASB should better demonstrate how it considers using these principles, i.e. how these principles will provide additional assistance to the standard-setting process. Furthermore, we think the IASB needs to review carefully the wording and terms used within these principles. We may foresee questions arising from using similar but different terms for the communication principles compared to the qualitative characteristics of financial information in Chapter 3 of the *Conceptual Framework*, e.g. balanced vs. neutral, important vs. relevant, and clear vs. faithful.

IASB DP – Question 19: Section 8 Presentation in the statement of comprehensive income – profit or loss and other comprehensive income (OCI)

The IASB's preliminary view that the *Conceptual Framework* should require a total or subtotal for profit or loss is discussed in paragraphs 8.19–8.22 of the DP.

Do you agree with this preliminary view? Why or why not? If you do not agree do you think that the IASB should still be able to require a total or subtotal profit or loss when developing or revising particular Standards?

We agree with the view to require a total or subtotal for profit or loss. In our view profit or loss should present faithfully the "performance for the period". We refer to our answer to Question 21 regarding the items of income and expense that should not be considered as part of the performance for the period, but should be part of other comprehensive income.

IASB DP – Question 20

The IASB's preliminary view that the *Conceptual Framework* should permit or require at least some items of income and expense previously recognised in in OCI to be recognised subsequently in profit or loss; i.e. recycled, is discussed in paragraphs 8.23–8.26 of the DP.

Do you agree with this preliminary view? Why or why not? If you agree, do you think that all items of income and expense presented in OCI should be recycled into profit or loss? Why or why not?

If you do not agree, how would you address cash flow hedge accounting?

We think all items of income and expense presented in OCI should be recycled because profit or loss should present the performance of the entity.

IASB DP – Question 21

In this Discussion Paper, two approaches are explored that describe which items could be included in the OCI: a narrow approach (Approach 2A described in paragraphs 8.40−8.78 of the DP) and a broad approach (Approach 2B described in paragraphs 8.79-8.94 of the DP).

Which of these approaches do you support, and why?

If you support a different approach, please describe that approach why do you believe it is preferable to the approaches described in this Discussion Paper.

We acknowledge the efforts in the DP to explore a more conclusive depiction of what is considered to be performance through the meaning of profit or loss and what components belong to OCI. We generally agree with IASB's preliminary view in the DP that the use of OCI should be limited to items of income or expense resulting from changes in current measures of assets and liabilities (remeasurements).

Nevertheless, we have the impression the two approaches discussed in the DP represent an effort to justify more or less the existing accounting guidance in current IFRSs in the context of OCI. We are not convinced that this is a suitable approach to address the issue about the distinction between profit or loss and OCI and we question the conceptual robustness of both approaches discussed in the DP. For example, in context of bridging items the DP states that the IASB may "occasionally" decide that an asset or a liability should be remeasured, but that information in profit or loss should be based on a measurement that differs from the one used in the statement of financial position. The conceptual reasons for the occasional decision remain very vague in the DP and we believe a more fundamental rethinking is necessary to form a clear view.

In reflection of our reservation about the two approaches discussed in the DP, we think a more promising approach to address the distinction between profit or loss and OCI would be the development of an approach based on a combination/mix of attributes that are discussed in paragraph 8.37 in the DP. We believe the combination of "<u>unrealised</u>" gains or losses arising from "<u>long-term</u>" contracts with a reasonable chance to reverse over the remaining time of the contract may be a starting point to determine information to be eligible for presentation in OCI.

IASB DP – Question 22: Section 9 Other issues

Paragraphs 9.2–9.22 of the DP address the chapters of the existing *Conceptual Framework* that were published in 2010 and how those chapters treat the concepts of stewardship, reliability and prudence. The IASB will make changes to those chapters if work on the rest of the *Conceptual Framework* highlights areas that need clarifying or amending. However, the IASB does not intend to fundamentally reconsider the content of those chapters.

Do you agree with this approach? Please explain your reasons.

If you believe that the IASB should consider changes to those chapters (including how those chapters treat the concepts of stewardship, reliability and prudence), please explain those changes and the reasons for them, and please explain as precisely as possible how they would affect the rest of the *Conceptual Framework*.

Generally we agree with the proposed approach. We think that changes to these revised chapters need to be based on evidence of unintended consequences or should reflect new issues that the IASB did not discuss before.

Relating to the discussion about stewardship, we believe that the IASB adequately addressed the importance and the role of accountability/stewardship in its 2010 *Conceptual Framework*. Furthermore, we acknowledge the frequent references to stewardship in the DP. We are concerned that new amendments to the objective of financial reporting will bring more questions and reopen the issues the IASB addressed with the changes introduced in 2010. We do not think that the IASB neglected the importance of stewardship aspects since 2010 when developing or revising IFRSs. Furthermore, we think the standard-setting process on the basis of competing primary objectives would be ambiguous.

Similarly to the stewardship issue, we question the resurrection of prudence and reliability without having clear evidence that the changes introduced in 2010 to the *Conceptual Framework* resulted in new or revised IFRSs causing imprudent and/or unreliable financial information. In our view the IASB should undertake educational efforts to illustrate the potential risk of reintroducing these concepts and reemphasize the arguments for the decisions made in 2010.

Furthermore, in our view the IASB could clarify two issues:

- How does the IASB address the neutrality requirement relating to accounting estimates when developing or revising IFRSs to rein any propensity for optimism by management?
- Whether existing IFRS requirements, such as recognition of impairment and accounting for onerous contracts, were developed on the basis of prudence in the past. Many believe these accounting requirements are outcome of the concept of prudence and reflect the necessity of disparity treatment for assets and liabilities.

IASB DP – Question 23: Business Model

The business model concept is discussed in paragraphs 9.23–9.34. This DP does not define the business model concept. However, the IASB's preliminary view is that financial statements can be made more relevant if the IASB considers, when developing or revising particular Standards, how an entity conducts its business activities.

Do you think that the IASB should use the business model concept when it develops or revises particular Standards? Why or why not?

If you agree, in which areas do you think that the business model concept would be helpful?

Should the IASB define 'business model'? Why or why not? If you think that 'business model' should be defined, how would you define it?

Generally, we are supportive of the view that the IASB should consider the economic nature and substance of the entity's business activities, including the reflection of the entity's business environment, when developing or revising particular Standards to provide relevant information to users. We think the preliminary views developed in the DP regarding the selection of measurement, i.e. selection of measurement for assets and liabilities depending on their contribution to future cash flows, reflect a good example for such a standard-setting approach. Therefore, we think the revised *Conceptual Framework* could highlight that financial statements can be made more relevant if the IASB considers, when developing or revising particular Standards, how an entity conducts its business activities.

We would be concerned about an explicit reference to the business model without clarifying implications for developing or revising IFRSs; we are not yet convinced that such a reference would strengthen the conceptual robustness of the *Conceptual Framework*, specifically as there is no common understanding of what a business model constitutes.

Furthermore, we understand that those who are in favour of adding the business model concept to the *Conceptual Framework* think the business model notion is in-line with the qualitative characteristics of useful financial information in section 3 of the *Conceptual Framework*. However, taking this view it can be argued that the core idea of the business model is already covered by qualitative characteristics, i.e. relevance and faithful representation.

Additionally, we are concerned about scenarios where constituents refer to using a business model notion to avoid unpopular accounting requirements, i.e. to consider the business model as an overruling concept in relation to other concepts in the *Conceptual Framework*. In our view a reference in the *Conceptual Framework* to the business model notion should not lead the development of industry-specifc accounting requirements.

IASB DP – Question 24: Unit of account
The unit of account is discussed in paragraphs 9.35–9.41. The IASB's preliminary view is that the unit of account will normally be decided when the IASB develops or revises particular Standards and that, in selecting a unit of account, the IASB should consider the qualitative characteristics of useful financial information. Do you agree? Why or why not?

In the context of the discussion about the definition of assets and liabilities it is fundamentally important to address the basis for the identification, i.e. the unit of account issue. We note that the IASB is proposing to deal with this question on an individual Standard level. We disagree with this view and would encourage the IASB to set more conceptual guidance on the issue in the revised *Conceptual Framework*. We emphasise the so far conceptually unanswered questions raised in the IASB's leases project for carving out a particular right from the bundle that make up an asset and recognising it separately whilst not doing the same for other individual rights, e.g. voting right and right to receive dividends for a shareholder.

Therefore, we do not agree with the IASB's preliminary view that the unit of account will normally be decided when the IASB develops or revises particular Standards. Instead, the revised *Conceptual Framework* should state that normally the unit of account reflects the individually identifiable economic resource or the individually identifiable obligation to transfer an economic resource. We think such a common starting point for developing recognition, measurement and disclosure requirements is needed. In cases where a portfolio approach should be used, the IASB should provide an explanation of the reasons.

We generally agree that there may be transactions or events where the unit of account needs to be different. However, in such exceptional cases the IASB should explain why a departure from the default approach is necessary.

IASB DP – Question 25: Going concern
Going concern is discussed in paragraphs 9.42–9.44 of the DP. The IASB has identified three situations in which the going concern assumption is relevant (when measuring assets and liabilities, when identifying liabilities and when disclosing information about the entity). Are there any other situations where the going concern assumption might be relevant?

In our view the going concern assumption has also a relevant role in the context of presentation. For example the distinction between current and non-current line items in the statement of financial position interrelates in some scenarios with the going concern assumption.

IASB DP – Question 26: Capital maintenance

Capital maintenance is discussed in paragraphs 9.45–9.54 of the DP. The IASB plans to include the existing descriptions and the discussion of capital maintenance concepts in the revised *Conceptual Framework* largely unchanged until such time as a new or revised Standard on accounting for high inflation indicates a need for change.

Do you agree? Why or why not? Please explain your reasons.

We agree with IASB's plan for the reasons given in the DP.

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Y COMPETITIVIDAD

INSTITUTO DE CONTABILIDAD
Y AUDITORÍA DE CUENTAS

DP/2013/1
A review of the Conceptual Framework for Financial Reporting
Comment Letters
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UK

Dear Sir/Madam,

In the present letter ICAC gives its view on IASB´s DP "A review of the Conceptual Framework for Financial Reporting".

Section 1 Introduction

Question 1

Paragraphs 1.25–1.33 set out the proposed purpose and status of the Conceptual Framework. The IASB's preliminary views are that:

(a) the primary purpose of the revised Conceptual Framework is to assist the IASB by identifying concepts that it will use consistently when developing and revising IFRSs; and
(b) in rare cases, in order to meet the overall objective of financial reporting, the IASB may decide to issue a new or revised Standard that conflicts with an aspect of the Conceptual Framework. If this happens the IASB would describe the departure from the Conceptual Framework, and the reasons for that departure, in the Basis for Conclusions on that Standard.

Do you agree with these preliminary views? Why or why not?

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We generally agree with this view. We think that the purpose of the framework in relation to preparers must be the shown in paragraph 1.28, that is, to understand and interpret existing IFRS and to develop accounting policies when no IFRS specifically applies to a particular transaction or event. This purpose is for us as important as the purpose called primary in paragraph 1.26 of the DP.

Therefore, we do not support the change in framework in paragraph 1.29 of the DP. In our view, there should not be any part of the framework excluded of preparers´ purpose or, at least, only in exceptional cases.

Section 2 Elements of financial statements

<u>Question 2</u>

The definitions of an asset and a liability are discussed in paragraphs 2.6–2.16. The IASB proposes the following definitions:

(a) an asset is a present economic resource controlled by the entity as a result of past events.

(b) a liability is a present obligation of the entity to transfer an economic resource as a result of past events.

(c) an economic resource is a right, or other source of value, that is capable of producing economic benefits.

Do you agree with these definitions? Why or why not? If you do not agree, what changes do you suggest, and why?

We do not think that there is a need to change the definitions of asset and liabilities. There is no example in the DP that shows that need because all the examples are currently included as asset or liability, as there is an important concept that is missed in DP, which is the substance over the form. Applying this principle to the examples

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of the DP in paragraph 2.14, changing the definitions as proposed the DP, would lead us to the same result.

We think that any change in framework must solve a specific problem and be justified in the bases of conclusions.

Question 3

Whether uncertainty should play any role in the definitions of an asset and a liability, and in the recognition criteria for assets and liabilities, is discussed in paragraphs 2.17–2.36. The IASB's preliminary views are that:

(a) the definitions of assets and liabilities should not retain the notion that an inflow or outflow is 'expected'. An asset must be capable of producing economic benefits. A liability must be capable of resulting in a transfer of economic resources.
(b) the Conceptual Framework should not set a probability threshold for the rare cases in which it is uncertain whether an asset or a liability exists. If there could be significant uncertainty about whether a particular type of asset or liability exists, the IASB would decide how to deal with that uncertainty when it develops or revises a Standard on that type of asset or liability.
(c) the recognition criteria should not retain the existing reference to probability.

Do you agree? Why or why not? If you do not agree, what do you suggest, and why?

Notwithstanding the previous answer, we believe that nothing has changed with the definitions proposed apart from the wording. In our opinion, "future economic benefits are expected to flow" is the same that to say "that is capable of producing

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economic benefits", so we disagree with the IASB`s preliminary view of paragraph 2.35.a)(i), that is, the IASB`s conclusion that " the proposed definition of an economic resource clarifies that it need not be certain that an economic resource will generate economic benefits, but the economic resource must be capable of producing economic benefits." We do not find a reasonable argument in the DP, that justifies the above. We carry on thinking that there is a need for criteria threshold that answers all the questions about the uncertainty existence of the asset or liability, the capacity to generate economic benefits, the property of the economic benefits, etc…

We are of the view that uncertainty can be classified in two classes as the current framework:

a) Uncertainty about all the characteristics (existence, capability, ownership, consequence of past events) of an asset or liability as the proposed definitions.
b) Uncertainty about the quantification or measure of the economic benefits.

So, it is not worthy disaggregating the uncertainty in a) into two classes, because we think it is the same case when the uncertainty is about the capability of producing economic benefits as when it is about if the entity really controls the resource.

Finally we disagree with the preliminary view in paragraph 2.35 c), because we support the concept of probability in the recognition criteria, at least until the problems that it causes, are showed.

Question 4

Elements for the statement(s) of profit or loss and OCI (income and expense), statement of cash flows (cash receipts and cash payments) and statement of

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changes in equity (contributions to equity, distributions of equity and transfers between classes of equity) are briefly discussed in paragraphs 2.37–2.52.

Do you have any comments on these items? Would it be helpful for the Conceptual Framework to identify them as elements of financial statements?

ICAC is of the view that it is worthy defining all elements of the financial statements.

Section 3 Additional guidance to support the asset and liability definitions

<u>Question 5</u>

Constructive obligations are discussed in paragraphs 3.39–3.62. The discussion considers the possibility of narrowing the definition of a liability to include only obligations that are enforceable by legal or equivalent means. However, the IASB tentatively favours retaining the existing definition, which encompasses both legal and constructive obligations—and adding more guidance to help distinguish constructive obligations from economic compulsion. The guidance would clarify the matters listed in paragraph 3.50.

Do you agree with this preliminary view? Why or why not?

ICAC is of the view that the constructive obligations must be considered as a liability, including those cases in which the economic compulsion provokes the same consequences than legal enforceability. We encourage IASB to offer more guidance about this aspect.

<u>Question 6</u>

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The meaning of 'present' in the definition of a liability is discussed in paragraphs 3.63–3.97. A present obligation arises from past events. An obligation can be viewed as having arisen from past events if the amount of the liability will be determined by reference to benefits received, or activities conducted, by the entity before the end of the reporting period. However, it is unclear whether such past events are sufficient to create a present obligation if any requirement to transfer an economic resource remains conditional on the entity's future actions. Three different views on which the IASB could develop guidance for the Conceptual Framework are put forward:

(a) View 1: a present obligation must have arisen from past events and be strictly unconditional. An entity does not have a present obligation if it could, at least in theory, avoid the transfer through its future actions.

(b) View 2: a present obligation must have arisen from past events and be practically unconditional. An obligation is practically unconditional if the entity does not have the practical ability to avoid the transfer through its future actions.

(c) View 3: a present obligation must have arisen from past events, but may be conditional on the entity's future actions.

The IASB has tentatively rejected View 1. However, it has not reached a preliminaryview in favour of View 2 or View 3.

Which of these views (or any other view on when a present obligation comes intoexistence) do you support? Please give reasons.

ICAC agrees with the view exposed in paragraph 3.66 of the DP, however we think that the examples in this paragraph could cause confusion for example in the case if the condition of the obligation is require to meet in some date of the future as it is

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the case of some taxes calculated in reference to the activity but conditioned to be in activity in a date fixed in tax regulation.

We agree with the IASB´s conclusion about stand ready obligations set out in paragraph 3.71 of the DP and the exclusions of the concept of liability set out in paragraph3.89.

ICAC is on line view 3, that is the obligation of a liability arises because of past events. This is enough to raise a present obligation. Moreover, we think that this the view arises the liability at an earlier stage. However, we encourage IASB to provide further guidance on this issue.

Question 7

Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?

The definition of control of an economic resource differs from the definition of control set out in paragraph 32 of the draft Revenue Standard. In paragraph 3.25 of DP a threshold is set out in order to dereconigse an asset. ICAC is of the view that it is complicated to assume a threshold for dereconigtion when the definition of asset avoids such a concept. We encourage IASB to focus on the unit of account in this case.

Section 4 Recognition and derecognition

Question 8

Paragraphs 4.1–4.27 discuss recognition criteria. In the IASB's preliminary view, an entity should recognise all its assets and liabilities, unless the IASB

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decides when developing or revising a particular Standard that an entity need not, or should not, recognise an asset or a liability because:

(a) recognising the asset (or the liability) would provide users of financial statements with information that is not relevant, or is not sufficiently relevant to justify the cost; or
(b) no measure of the asset (or the liability) would result in a faithful representation of both the asset (or the liability) and the changes in the asset (or the liability), even if all necessary descriptions and explanations are disclosed.
Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

ICAC ´s point of view is shown in the answer to Question 2 in relation to asset and liabilities definitions. We think nothing has changed as we remark in that answer, so there is nothing explained in DP why it would be necessary to change the actual recognition criteria. In fact, the IASB´s analysis shows that it is inevitable to fix a recognition criterion because it is necessary to link the recognition to relevance and faithful representation. That is what the actual recognition criteria does in current framework.

<u>Question 9</u>

In the IASB's preliminary view, as set out in paragraphs 4.28–4.51, an entity should derecognise an asset or a liability when it no longer meets the recognition criteria.
(This is the control approach described in paragraph 4.36(a)). However, if the entity retains a component of an asset or a liability, the IASB should determine when developing or revising particular Standards how the entity would best portray the changes that resulted from the transaction. Possible approaches include:

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(a) enhanced disclosure;

(b) presenting any rights or obligations retained on a line item different from the line item that was used for the original rights or obligations, to highlight the greater concentration of risk; or

(c) continuing to recognise the original asset or liability and treating the proceeds received or paid for the transfer as a loan received or granted.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

We are of the view that CF should include the criteria for distinguishing between a modification of an asset or liability and derecognition of asset or liability and recognition of another.

Section 5 Definition of equity and distinction between liabilities and equity instruments

<u>Question 10</u>

The definition of equity, the measurement and presentation of different classes of equity, and how to distinguish liabilities from equity instruments are discussed in paragraphs 5.1–5.59. In the IASB's preliminary view:

(a) the Conceptual Framework should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.

(b) the Conceptual Framework should state that the IASB should use the definition of a liability to distinguish liabilities from equity instruments. Two consequences of this are:

(i) obligations to issue equity instruments are not liabilities; and

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(ii) obligations that will arise only on liquidation of the reporting entity are not liabilities (see paragraph 3.89(a)).

(c) an entity should:

(i) at the end of each reporting period update the measure of each class of equity claim. The IASB would determine when developing or revising particular Standards whether that measure would be a direct measure, or an allocation of total equity.

(ii) recognise updates to those measures in the statement of changes in equity as a transfer of wealth between classes of equity claim.

(d) if an entity has issued no equity instruments, it may be appropriate to treat the most subordinated class of instruments as if it were an equity claim, with suitable disclosure. Identifying whether to use such an approach, and if so, when, would still be a decision for the IASB to take in developing or revising particular Standards.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

ICAC agrees with the idea of retaining the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.

We also think that neither obligations to issue equity instruments nor obligations that will arise only on liquidation of the reporting entity are liabilities.

Finally, we share the view to treat the most subordinated class of instruments as if it were an equity claim, when the following features are met:

- The remuneration is discretionary for the entity
- The entity has to redeem it only in liquidation.

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Section 6 Measurement

Question 11

How the objective of financial reporting and the qualitative characteristics of useful financial information affect measurement is discussed in paragraphs 6.6–6.35. The IASB's preliminary views are that:

(a) the objective of measurement is to contribute to the faithful representation of relevant information about:

(i) the resources of the entity, claims against the entity and changes in resources and claims; and

(ii) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources.

(b) a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements;

(c) when selecting the measurement to use for a particular item, the IASB should consider what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI;

(d) the relevance of a particular measurement will depend on how investors, creditors and other lenders are likely to assess how an asset or a liability of that type will contribute to future cash flows. Consequently, the selection of a measurement:

(i) for a particular asset should depend on how that asset contributes to future cash flows; and

(ii) for a particular liability should depend on how the entity will settle or fulfil that liability.

(e) the number of different measurements used should be the smallest number necessary to provide relevant information. Unnecessary measurement changes should be avoided and necessary measurement changes should be explained; and

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(f) the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.

Do you agree with these preliminary views? Why or why not? If you disagree, what alternative approach to deciding how to measure an asset or a liability would you support?

ICAC agrees with these preliminary views.

Question 12

The IASB's preliminary views set out in Question 11 have implications for the subsequent measurement of assets, as discussed in paragraphs 6.73–6.96. The IASB's preliminary views are that:

(a) if assets contribute indirectly to future cash flows through use or are used in combination with other assets to generate cash flows, cost-based measurements normally provide information that is more relevant and understandable than current market prices.

(b) if assets contribute directly to future cash flows by being sold, a current exit price is likely to be relevant.

(c) if financial assets have insignificant variability in contractual cash flows, and are held for collection, a cost-based measurement is likely to provide relevant information.

(d) if an entity charges for the use of assets, the relevance of a particular measure of those assets will depend on the significance of the individual asset to the entity.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

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ICAC generally agrees with DP in this question.

Question 13

The implications of the IASB's preliminary views for the subsequent measurement of liabilities are discussed in paragraphs 6.97–6.109. The IASB's preliminary views are that:

(a) cash-flow-based measurements are likely to be the only viable measurement for liabilities without stated terms.

(b) a cost-based measurement will normally provide the most relevant information about:

(i) liabilities that will be settled according to their terms; and

(ii) contractual obligations for services (performance obligations).

(c) current market prices are likely to provide the most relevant information about liabilities that will be transferred.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

ICAC generally agrees with the DP views in these issues.

Question 14

Paragraph 6.19 states the IASB's preliminary view that for some financial assets and financial liabilities (for example, derivatives), basing measurement on the way in which the asset contributes to future cash flows, or the way in which the liability is settled or fulfilled, may not provide information that is useful when assessing prospects for future cash flows. For example, cost-based

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information about financial assets that are held for collection or financial liabilities that are settled according to their terms may not provide information that is useful when assessing prospects for future cash flows:

(a) if the ultimate cash flows are not closely linked to the original cost;

(b) if, because of significant variability in contractual cash flows, cost-based measurement techniques may not work because they would be unable to simply allocate interest payments over the life of such financial assets or financial liabilities; or

(c) if changes in market factors have a disproportionate effect on the value of the asset or the liability (ie the asset or the liability is highly leveraged).

Do you agree with this preliminary view? Why or why not?

ICAC agrees with the DP in this issue.

<u>Question 15</u>

Do you have any further comments on the discussion of measurement in this section?

No, we do not.

Section 7 Presentation and disclosure

<u>Question 16</u>

This section sets out the IASB's preliminary views about the scope and content of presentation and disclosure guidance that should be included in the Conceptual Framework. In developing its preliminary views, the IASB has been influenced by two main factors:

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(a) the primary purpose of the Conceptual Framework, which is to assist the IASB in developing and revising Standards (see Section 1); and

(b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 7.6–7.8), including:

(i) a research project involving IAS 1, IAS 7 and IAS 8, as well as a review of feedback received on the Financial Statement Presentation project;

(ii) amendments to IAS 1; and

(iii) additional guidance or education material on materiality.

Within this context, do you agree with the IASB's preliminary views about the scope and content of guidance that should be included in the Conceptual Framework on:

(a) presentation in the primary financial statements, including:

(i) what the primary financial statements are;

(ii) the objective of primary financial statements;

(iii) classification and aggregation;

(iv) offsetting; and

(v) the relationship between primary financial statements.

(b) disclosure in the notes to the financial statements, including:

(i) the objective of the notes to the financial statements; and

(ii) the scope of the notes to the financial statements, including the types of information and disclosures that are relevant to meet the objective of the notes to the financial statements, forward-looking information and comparative information.

Why or why not? If you think additional guidance is needed, please specify what additional guidance on presentation and disclosure should be included in the Conceptual Framework.

ICAC agrees with the proposal.

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Question 17

Paragraph 7.45 describes the IASB's preliminary view that the concept of materiality is clearly described in the existing Conceptual Framework. Consequently, the IASB does not propose to amend, or add to, the guidance in the Conceptual Framework on materiality.
However, the IASB is considering developing additional guidance or education material on materiality outside of the Conceptual Framework project.

Do you agree with this approach? Why or why not?

We agree that there is no need for changing the concept of materiality.

Question 18

The form of disclosure requirements, including the IASB's preliminary view that it should consider the communication principles in paragraph 7.50 when it develops or amends disclosure guidance in IFRSs, is discussed in paragraphs 7.48–7.52.
Do you agree that communication principles should be part of the Conceptual Framework? Why or why not?

If you agree they should be included, do you agree with the communication principles proposed? Why or why not?

ICAC agrees that communication principles should be part of the Conceptual Framework.

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Section 8 Presentation in the statement of comprehensive income—profit or loss and other comprehensive income

<u>Question 19</u>

The IASB's preliminary view that the Conceptual Framework should require a total or subtotal for profit or loss is discussed in paragraphs 8.19–8.22.
Do you agree? Why or why not?
If you do not agree do you think that the IASB should still be able to require a total or subtotal profit or loss when developing or amending Standards?

The ICAC strongly agrees with the proposal that Conceptual framework should require to present profit and loss as a total or subtotal.

<u>Question 20</u>

The IASB's preliminary view that the Conceptual Framework should permit or require at least some items of income and expense previously recognised in OCI to be recognized subsequently in profit or loss, ie recycled, is discussed in paragraphs 8.23–8.26.
Do you agree? Why or why not? If you agree, do you think that all items of income and expense presented in OCI should be recycled into profit or loss? Why or why not?
If you do not agree, how would you address cash flow hedge accounting?

ICAC believes that when it is considered appropriate to apply the fair value criteria of an asset, the subsequent changes in value should be part of the profit and loss. Only very good reasons, such as poor predictive value of the change in value relative to the cash flows of the entity in the short and medium term, could account for that difference directly in equity, outside profit and loss.

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The only exception to this approach, in addition to the above, would be cash flows hedge accounting, where we believe that recycling of the changes in value of the hedging instrument itself contributes to the goal of fairly either recognizing the change in value as an adjustment to the carrying amount of the hedged item or imputing the difference directly to income.

According to the above, from a general perspective, the ICAC is against recycling and shares all the arguments in paragraph 8.25 of the DP.

From a strict point of view recycling is not an income, but a variation of the equity items of the entity. So if, finally, it is decided to keep on recycling, we propose that reclassification will be shown in the statement of changes in equity and not in the OCI, unless CF includes what reasons justify a "qualitative " change in the assets of the entity, without changes in net assets , may be regarded as a result of exercise.

Question 21

In this Discussion Paper, two approaches are explored that describe which items could be included in OCI: a narrow approach (Approach 2A described in paragraphs 8.40–8.78) and a broad approach (Approach 2B described in paragraphs 8.79–8.94).
Which of these approaches do you support, and why?
If you support a different approach, please describe that approach and explain why you believe it is preferable to the approaches described in this Discussion Paper.

ICAC is of the view that this issue should be analyzed more, before being included in framework.

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Section 9 Other issues

Question 22

Chapters 1 and 3 of the existing Conceptual Framework

Paragraphs 9.2–9.22 address the chapters of the existing Conceptual Framework that were published in 2010 and how those chapters treat the concepts of stewardship, reliability and prudence. The IASB will make changes to those chapters if work on the rest of the Conceptual Framework highlights areas that need clarifying or amending. However, the IASB does not intend to fundamentally reconsider the content of those chapters.

Do you agree with this approach? Please explain your reasons.

If you believe that the IASB should consider changes to those chapters (including how those chapters treat the concepts of stewardship, reliability and prudence), please explain those changes and the reasons for them, and please explain as precisely as possible how they would affect the rest of the Conceptual Framework.

ICAC believes that the objective of accountability is appropriately reflected in the existing conceptual Framework.

At the contrary, ICAC is of the view that reliability and prudence should be included explicitly in the CF, so we believe that these chapters should be reviewed.

Question 23

Business model

The business model concept is discussed in paragraphs 9.23–9.34. This Discussion Paper does not define the business model concept. However, the IASB's preliminary view is that financial statements can be made more

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relevant if the IASB considers, when developing or revising particular Standards, how an entity conducts its business activities.

Do you think that the IASB should use the business model concept when it develops or revises particular Standards? Why or why not?

If you agree, in which areas do you think that the business model concept would be helpful?

Should the IASB define 'business model'? Why or why not?

If you think that 'business model' should be defined, how would you define it?

ICAC is of the view that the concept of business model is essential in financial reporting. We would like further analysis about concept and definition of business model in order to be included in CF.

<u>Question 24</u>

Unit of account

The unit of account is discussed in paragraphs 9.35–9.41. The IASB's preliminary view is that the unit of account will normally be decided when the IASB develops or revises particular Standards and that, in selecting a unit of account, the IASB should consider the qualitative characteristics of useful financial information.

Do you agree? Why or why not?

We generally agree with IASB in this issue.

<u>Question 25</u>

Going concern

Going concern is discussed in paragraphs 9.42–9.44. The IASB has identified three situations in which the going concern assumption is relevant (when

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measuring assets and liabilities, when identifying liabilities and when disclosing information about the entity).

Are there any other situations where the going concern assumption might be relevant?

We generally agree with IASB in this issue. But we think that the going concern has more to say in definition of liabilities.

Question 26

Capital maintenance

Capital maintenance is discussed in paragraphs 9.45–9.54. The IASB plans to include the existing descriptions and the discussion of capital maintenance concepts in the revised Conceptual Framework largely unchanged until such time as a new or revised Standard on accounting for high inflation indicates a need for change.

Do you agree? Why or why not? Please explain your reasons.

ICAC agrees with IASB's plans not to change the actual CF and to delay the debate until the moment in which the treatment to the inflation is reviewed.

Please do not hesitate to contact us if you would like to clarify any point of this letter.

Ana Martínez-Pina
Chairman of ICAC

Madrid, 14th January 2014

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Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
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United Kingdom

January 14, 2014

Dear Mr. Hans Hoogervorst,

The China Accounting Standards Committee (CASC) is pleased to have this opportunity to comment on the DP/2013/1 *A Review of the Conceptual Framework for Financial Reporting* ("the DP"). We appreciate the efforts made by the IASB to improve the Conceptual Framework. However, considering the important role that the Conceptual Framework plays in the IFRS setting, we expect the IASB to have more study and outreach activities before the Exposure Draft, to maintain certain stability of the revised Conceptual Framework and to avoid frequent change after a hurry publish. Our main comments are listed as the following:

Firstly, in our view, the most urgent matter for the Conceptual Framework is to clarify the definition of financial performance, OCI, and comprehensive income at conceptual level, and to define the principle of the recognition of OCI to fundamentally resolve this issue. Additionally, in principle we think all items in OCI should be allowed to be recycled into P&L.

Secondly, we suggest the IASB to keep the term "expected" in the definition of asset and liability, and to keep the requirements about possibility in the recognition principles.

Thirdly, we expect the IASB to provide more guidance on the selection of measurement bases and illustrate "unit of account" in the Framework. Additionally, as for the view of using one measure in the statement of financial position and using a different measure to determine the amounts recognised in profit or loss, we have some concerns on it and suggest the IASB to further study on the matter.

Fourthly, we suggest to re-introduce stewardship, reliability and prudence into the Chapter 1 and Chapter 3. Additionally, in our view, we suggest that limit the revision to context with inevitable necessity and keep the rest in a stable status.

Fifthly, although we agree with the purpose of the Conceptual Framework to assist the IASB to develop and revise the IFRSs, we also think that it's very important that the Conceptual

Framework may also assist parties other than the IASB: (a) to understand and interpret existing Standards; and (b) to develop accounting policies when no Standard or Interpretation specifically applies to a particular transaction or event. We suggest that these two purposes should be of equally importance.

Please see the Appendix for our detailed comments on each question in the DP and feel free to contact my colleague Ms. CHEN Yu (chenyu@mof.gov.cn) for further information.

Yours faithfully,

Yang Min
Director-General, Accounting Regulatory Department, Ministry of Finance, P.R.China
Secretary-General, China Accounting Standards Committee

Appendix

China Accounting Standards Committee
Comments on DP/2013/1 *A Review of the Conceptual Framework for Financial Reporting*

Please refer to the following as our response to all questions in the DP/2013/1.

Section 1 Introduction

> **Question 1**
>
> Paragraphs 1.25–1.33 set out the proposed purpose and status of the Conceptual Framework. The IASB's preliminary views are that:
>
> (a) the primary purpose of the revised Conceptual Framework is to assist the IASB by identifying principles that it will use consistently when developing and revising IFRSs; and
>
> (b) in rare cases, in order to meet the overall objective of financial reporting, the IASB may decide to issue a new or revised Standard that conflicts with an aspect of the Conceptual Framework. If this happens the IASB would describe the departure from the Conceptual Framework and the reasons for that departure, in the Basis for Conclusions on that Standard.
>
> Do you agree with these preliminary views? Why or why not?

Response: In general, we agree with the purpose stated.

a. Other than the status and purpose stated above, the Conceptual Framework should also assist parties other than the IASB: (a) to understand and interpret existing Standards; and (b) to develop accounting policies when no Standard or Interpretation specifically applies to a particular transaction or event. These two purposes would be of same importance as the purpose proposed.

b. As for the possible conflicts in IFRS and Conceptual Framework, we suggest that such case should be avoided under upmost circumstances.

Section 2 Elements definitions of financial statements

> **Question 2**
>
> The definitions of an asset and a liability are discussed in paragraphs 2.6–2.16. The IASB proposes the following definitions:
>
> (a) an asset is a present economic resource controlled by the entity as a result of past events.
>
> (b) a liability is a present obligation of the entity to transfer an economic resource as a result of past events.
>
> (c) an economic resource is a right, or other source of value, that is capable of producing economic benefits.
>
> Do you agree with these definitions? Why or why not? If you do not agree, what changes do you suggest, and why?

Response: In general, we agree with such proposal, especially keeping the term "past event" and “control”. However, there are following suggestions for consideration: (a) as whether to keep the term “expected”, we suggest otherwise (please refer to comments on Question 3); (b) the term “economic resource” should be further clarified to avoid possible misunderstanding; and (c) since the definition of asset is supported by a separately defined term “economic resource”, the “present obligation” in the definition of liability should also be defined.

Question 3

Whether uncertainty should play any role in the definitions of an asset and a liability, and in the recognition criteria for assets and liabilities is discussed in paragraphs 2.17–2.36. The IASB’s preliminary views are that:

(a) the definitions of assets and liabilities should not retain the notion that an inflow or outflow is ‘expected’. An asset must be capable of producing economic benefits. A liability must be capable of resulting in a transfer of economic resources.

(b) the Conceptual Framework should not set a probability threshold for the rare cases in which it is uncertain whether an asset or liability exists. If there could be significant uncertainty about whether a particular type of asset or a liability exists, the IASB would decide how to deal with that uncertainty when it develops or revises a Standard on that type of asset or liability.

(c) the recognition criteria should not retain the existing reference to probability.

Do you agree? Why or why not? If you do not agree, what do you suggest, and why?

Response: For current IFRSs, the term “expected” is vital in many accounting treatments, such as provision of litigation loss (Under current IAS 37, if it is probably that litigation will be lost, a provision will be provided based on the most likely outcome. If degree of likelihood should not affect recognition, but may affect measurement – this implies a litigation will be measured using 'expected' value no matter it is probable or not.). Such removal might mislead the financial statements users. Hence, we suggest to keep the term “expected” in the definition of asset and liability, and to keep the requirements on possibility in current IFRSs.

Question 4

Elements for the statement(s) of profit or loss and OCI (income and expense), statement of cash flows (cash receipts and cash payments) and statement of changes in equity (contributions to equity, distributions of equity and transfers between classes of equity) are briefly discussed in paragraphs 2.37–2.52.

Do you have any comments on these items? Would it be helpful for the Conceptual Framework to identify them as elements of financial statements?

Response: In our view, one of the upmost urgent missions for this revision is to clarify the definition and boundary of performance, OCI and comprehensive income.

As for cash receipts and cash payments in the statement of cash flows and transfers between classes of equity in the statement of changes in equity, those terms might not need to be defined as elements.

In addition, the current Conceptual Framework characterizes revenue element as gains and income and characterize expense element as expense (same term used as the expense element) and loss (same term as that in P&L) with separate presentation but without clear classification, which put practice in some difficulty. Hence, we suggest the Conceptual Framework or other IFRSs to clearly define those terms to avoid ambiguity.

Section 3　　Additional guidance to support the asset and liability definitions

Question 5

Constructive obligations are discussed in paragraphs 3.39–3.62. The discussion considers the possibility of narrowing the definition of a liability to include only obligations that are enforceable by legal or equivalent means. However, the IASB tentatively favours retaining the existing definition, which encompasses both legal and constructive obligations—and adding more guidance to help distinguish constructive obligations from economic compulsion. The guidance would clarify the matters listed in paragraph 3.50.

Do you agree with this preliminary view? If not, why not?

Response: We generally agree with the proposal; also we expect more guidance on constructive obligations and economic compulsion, expect a clear relation between the application of constructive obligation and the application of other aspects of the Conceptual Framework (like conditional liability, distinction between liability and equity) to resolve the current inconsistency of the applications of constructive obligation in various IFRSs.

Question 6

The meaning of 'present' in the definition of a liability is discussed in paragraphs 3.63–3.97. A present obligation arises from past events. An obligation can be viewed as having arisen from past events if the amount of the liability will be determined by reference to benefits received, or activities conducted, by the entity before the end of the reporting period. However, it is unclear whether such past events are sufficient to create a present obligation if any requirement to transfer an economic resource remains conditional on the entity's future actions. Three different views on which the IASB could develop guidance for the Conceptual Framework are put forward:

(a) View 1: a present obligation must have arisen from past events and be strictly unconditional. An entity does not have a present obligation if it could, at least in theory, avoid the transfer through its future actions.

(b) View 2: a present obligation must have arisen from past events and be practically unconditional. An obligation is practically unconditional if the entity does not have the practical ability to avoid the transfer through its future actions.

(c) View 3: a present obligation must have arisen from past events, but may be conditional on the entity's future actions.

The IASB has tentatively rejected View 1. However, it has not reached a preliminary view in favour of View 2 or View 3.

Which of these views (or any other view on when a present obligation comes into existence) do you support? Please give reasons.

Response: We prefer view 2. View 1 is too narrow to reflect business transactions; and the liability would be recognized too broadly by View 3. In addition, we suggest the IASB to provide guidance on "practical ability" in View 2.

Question 7

Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?

Response: We support to provide clearer guidance on executory contracts and onerous contracts.

Section 4 Recognition and Derecognition

Question 8

Paragraphs 4.1–4.27 discuss recognition criteria. In the IASB's preliminary view, an entity should recognise all its assets and liabilities, unless the IASB decides when developing or revising a particular Standard that an entity need not, or should not, recognise an asset or a liability because:

(a) recognising the asset (or the liability) would provide users of financial statements with information that is not relevant, or is not sufficiently relevant to justify the cost; or

(b) no measure of the asset (or the liability) would result in a faithful representation of the asset (or the liability) and of changes in the asset (or the liability), even if all necessary descriptions and explanations are disclosed.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

Response: We disagree. We suggest to retain principles about possibility in current IFRSs, since the proposal will loosen up threshold for the definition and recognition of asset and liability, and put such burden on measurement, which for assets and liabilities of larger uncertainties, will enlarge the problems of measurement (please refer to comments on Question 3).

Question 9

In the IASB's preliminary view, as set out in paragraphs 4.28–4.51, an entity should derecognise an asset or a liability when it no longer meets the recognition criteria. (This is the control approach described in paragraph 4.36(a)). However, if the entity retains a component of an asset or a liability, the IASB should determine when developing or revising particular Standards how the entity would best portray the changes that resulted from the transaction. Possible approaches include:

(a) enhanced disclosure;

(b) presenting any rights or obligations retained on a line item different from the line item that was used for the original rights or obligations, to highlight the greater concentration of risk; or

(c) continuing to recognise the original asset or liability and treating the proceeds received or paid for the transfer as a loan received or granted.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

Response: We support the control approach. In our view, when entity retains a component of an asset or a liability, the entity should consider whether the component has material change in nature to decide account for a partial disposal (no P&L for retaining component) or a full disposal with a new asset (P&L for retaining component). Specific requirements can be considered in the level of IFRS.

Section 5 Definition of equity and distinction between liabilities and equity instruments

Question 10

The definition of equity, the measurement and presentation of different classes of equity, and how to distinguish liabilities from equity instruments are discussed in paragraphs 5.1–5.59. In the IASB's preliminary view:

(a) the Conceptual Framework should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.

(b) the Conceptual Framework should state that the IASB should use the definition of a liability to distinguish liabilities from equity instruments. Two consequences of this are:

(i) obligations to issue equity instruments are not liabilities; and

(ii) obligations that will arise only on liquidation of the reporting entity are not liabilities (see paragraph 3.89(a)).

(c) an entity should:

(i) at the end of each reporting period update the measure of each class of equity claim. The IASB would determine when developing or revising particular Standards whether that measure would be a direct measure, or an allocation of total equity.

(ii) recognise updates to those measures in the statement of changes in equity as a transfer of wealth between classes of equity claim.

(d) if an entity has issued no equity instruments, it may be appropriate to treat the most subordinated class of instruments as if it were an equity claim, with suitable disclosure. Identifying whether to use such an approach, and if so, when, would still be a decision for the IASB to take in developing or revising particular Standards.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

Response: We expect a clearer definition of equity and its classification to better resolve matters of distinction of the liability and equity.

To re-measure each class of equity claims and its related transfer of wealth can be difficult in practice and we expect the IASB to provide more guidance.

Section 6 Measurement

Question 11

How the objective of financial reporting and the qualitative characteristics of useful financial information affect measurement is discussed in paragraphs 6.6–6.35. The IASB's preliminary views are that:

(a) the objective of measurement is to contribute to the faithful representation of relevant information about the resources of the entity, claims against the entity and changes in resources and claims, and about how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources;

(b) a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements;

(c) when selecting the measurement to use for a particular item, the IASB should consider what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI; and

(d) the relevance of a particular measurement will depend on how investors, creditors and other lenders are likely to assess how an asset or a liability of that type will contribute to future cash flows. Consequently, the selection of a measurement:

(i) for a particular asset should depend on how that asset contributes to future cash flows; and

(ii) for a particular liability should depend on how the entity will settle or fulfil that liability.

(e) the number of different measurements used should be the smallest number necessary to provide relevant information. Unnecessary measurement changes should be avoided and necessary measurement changes should be explained.

(f) the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.

Do you agree with these preliminary views? Why or why not? If you disagree, what alternative approach to deciding how to measure an asset or a liability would you support?

Response: In general we support the preliminary view.

As for the objective of measurement stated above, it consists of two components: first is decision usefulness on the perspective of users and second is stewardship on the perspective of management; in practice, decision made based on two perspectives might not be unified. Hence, we suggest the IASB to explain the influence of different measurement objectives. In addition, in our view, the objective of measurement should be align with the overall objective of financial reporting; since two objectives of measurement (eg. decision usefulness and stewardship) might seem overrun the sole objective of financial reporting (decision usefulness), we incline to add stewardship into the objective of financial reporting.

In addition, we think relevance, reliability and overall (not only in users view) cost/benefit balance should be considered in choosing measurement bases, and expect the IASB to provide more guidance in choosing measurement bases.

Question 12

The IASB's preliminary views set out in Question 11 have implications for the subsequent measurement of assets, as discussed in paragraphs 6.73–6.96. The IASB's preliminary views are that:

(a) if assets contribute indirectly to future cash flows through use or are used in combination with other assets to generate cash flows, cost-based measurements normally provide information that is more relevant and understandable than current market prices.

(b) if assets contribute directly to future cash flows by being sold, a current exit price is likely to be relevant.

(c) if financial assets have insignificant variability in contractual cash flows, and are held for collection, a cost-based measurement is likely to provide relevant information.

(d) if an entity charges for the use of assets, the relevance of a particular measure of those assets will depend on the significance of the individual asset to the entity.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

Response: We generally agree with the preliminary view. We expect the IASB to provide more guidance on a series of factors considered in choosing measurement bases and to provide clearer explanation of the three measurements bases. For example, measurement based on cash flow can be broad and some fair value based on market information can be concluded from the present value of future cash flows; the DP points out that the market value includes fair value but in our understanding, fair value is broader than current market value, hence such statement is in need of further clarification; the term "cost" in "cost-based measurement" should be clarified as historical cost, amortized cost, or replacement cost.

Question 13

The implications of the IASB's preliminary views for the subsequent measurement of liabilities are discussed in paragraphs 6.97–6.109. The IASB's preliminary views are that:

(a) cash-flow-based measurements are likely to be the only viable measurement for liabilities without stated terms.

(b) a cost-based measurement will normally provide the most relevant information about:

(i) liabilities that will be settled according to their terms; and

(ii) contractual obligations for services (performance obligations).

(c) current market prices are likely to provide the most relevant information about liabilities that will be transferred.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

Response: We generally agree with the preliminary views.

Question 14

Paragraph 6.19 states the IASB's preliminary view that for some financial assets and financial liabilities (for example, derivatives), basing measurement on the way in which the asset contributes to future cash flows, or the way in which the liability is settled or fulfilled, may not provide information that is useful when assessing prospects for future cash flows. For example, cost-based information about financial assets that are held for collection or financial liabilities that are settled according to their terms may not provide information that is useful when assessing prospects for future cash flows:

(a) if the ultimate cash flows are not closely linked to the original cost;

(b) if, because of significant variability in contractual cash flows, cost-based measurement techniques may not work because they would be unable to simply allocate interest payments over the life of such financial assets or financial liabilities; or

(c) if changes in market factors have a disproportionate effect on the value of the asset or the liability (ie the asset or the liability is highly leveraged).

Do you agree with this preliminary view? Why or why not?

Response: The usefulness of cost-based information is not satisfactory for derivative financial instruments and similar instruments. Although we generally agree, it should not be considered as a necessary exception from the overall principle of measurement in Conceptual Framework. All those factors should be considered when the entity chooses the measurement bases and we suggest that the IASB should consider such matter when developing guidance on measurement bases.

Question 15

Do you have any further comments on the discussion of measurement in this section?

Response: As for different measurement basis for same item (different measurement in the statement of financial position and statement of P&L), we suggest the IASB to further study on this matter, otherwise, there will be increasing number of times of asset and liability (especially in assets and liability other than those in financial instrument and insurance contract) that will take different measurement basis, resulting increasing items in OCI, and letting OCI become a "dumping ground".

As for unit account, please refer to comment on Question 24.

Section 7 Presentation and disclosure—general

Question 16

This section sets out the IASB's preliminary views about the scope and content of presentation and disclosure guidance that should be included in the Conceptual Framework. In developing its preliminary views, the IASB has been influenced by two main factors:

(a) the primary purpose of the Conceptual Framework, which is to assist the IASB in developing and revising Standards (see Section 1); and

(b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 7.6–7.8), including:

(i) a research project involving IAS 1, IAS 7 and IAS 8, as well as a review of feedback received on the Financial Statement Presentation project;

(ii) amendments to IAS 1; and

(iii) additional guidance or education material on materiality.

Within this context, do you agree with the IASB's preliminary views about the scope and content of guidance that should be included in the Conceptual Framework on:

(a) presentation in the primary financial statements, including:

(i) what the primary financial statements are;

(ii) the objective of the primary financial statements;

(iii) classification and aggregation;

(iv) offsetting; and

(v) the relationship between primary financial statements.

(b) disclosure in the notes to the financial statements, including:

(i) the objective of the notes to the financial statements; and

(ii) the scope of the notes to the financial statements, including the types of information and disclosures that are relevant to meet the objective of the notes to the financial statements, forward-looking information and comparative information.

Why or why not? If you think additional guidance is needed, please specify what additional guidance on presentation and disclosure should be included in the Conceptual Framework.

Response: In general we agree with the preliminary view. In the meantime, we expect the IASB to further study on the notes and suggest a cautious approach on forward-looking information in notes.

Question 17

Paragraph 7.45 describes the IASB's preliminary view that the concept of materiality is clearly described in the existing Conceptual Framework. Consequently, the IASB does not propose to amend, or add to, the guidance in the Conceptual Framework on materiality. However, the IASB is considering developing additional guidance or education material on materiality outside of the Conceptual Framework project.

Do you agree with this approach? Why or why not?

Response: We agree. Additionally we suggest that: (a) additional guidance on judging materiality should be developed such as how to apply materiality principle in disclosing quality and quantity information and distinguishing financial statement presentation and footnote disclosure; and (b) the materiality principle should be better coordinated with the materiality principle developed by the IAASB to gain better practice.

Question 18

The form of disclosure requirements, including the IASB's preliminary view that it should consider the communication principles in paragraph 7.50 when it develops or amends disclosure guidance in IFRSs, is discussed in paragraphs 7.48–7.52.

Do you agree that communication principles should be part of the Conceptual Framework? Why or why not?

If you agree they should be included, do you agree with the communication principles proposed? Why or why not?

Response: Theoretically we agree with communication principle, but suggest the IASB further illustrate the mechanism for the communication principle to weigh in the standard-setting process and further consider whether certain statement regarding communication principle is appropriate for the Conceptual Framework; for example, the sequence of disclosures in notes can be stated in the IAS1 instead of the Conceptual Framework.

Section 8 Profit or loss and other comprehensive income (OCI)

Question 19

The IASB's preliminary view that the Conceptual Framework should require a total or subtotal for profit or loss is discussed in paragraphs 8.19–8.22.

Do you agree? Why or why not? If you do not agree do you think that the IASB should still be able to require a total or subtotal profit or loss when developing or amending Standards?

Response: We agree with the preliminary view. For emerging economies like China, net income is still a vital index for financial performance and a regulation basis under Company Law and regulations. Additionally, we suggest the IASB to add net income as an element in financial statements and develop a definition.

Question 20

The IASB's preliminary view that the Conceptual Framework should permit or require at least some items of income and expense previously recognised in OCI to be recognised subsequently in profit or loss, ie recycled, is discussed in paragraphs 8.23–8.26.

Do you agree? Why or why not? If you agree, do you think that all items of income and expense presented in OCI should be recycled into profit or loss? Why or why not?

If you do not agree, how would you address cash flow hedge accounting??

Response: We agree with the preliminary views and suggest the IASB clarify whether OCI could be recycled. In our view, all items in OCI should be allowed to be recycled to P&L, otherwise couldn't fully reflect the financial performance if some items are left out of P&L, which will cause practical difficulties in accounting. Additionally, we suggest the IASB further study on the timing of recycling and on whether put the principles on timing of recycling in IFRS or Conceptual Framework.

Question 21

In this Discussion Paper, two approaches are explored that describe which items could be included in OCI: a narrow approach (Approach 2A described in paragraphs 8.40–8.78) and a broad approach (Approach 2B described in paragraphs 8.79–8.94).

Which of these approaches do you support, and why? If you support a different approach, please describe that approach and explain why you believe it is preferable to the approaches described in this Discussion Paper.

Response: We don't support such approaches. In our view, the Conceptual Framework should provide principles on what go into OCI rather than list several examples of OCI as principle requirement; such artificial listing is too complicated and abstract to understand and translate, and not necessary for future guidance on the recognition of OCI.

At the same time, we think the most urgent matter of the Conceptual Framework is to define the financial performance, OCI and CI at conceptual level in order to lay boundary for gains, income, loss, expense, loss, income (expense) recognized in P&L, and income (expense) recognized in OCI, in order to reach a fundamental settlement on OCI. We are worried that the items in OCI would grow so much that it ends up as a "dumping ground ".

Section 9 Other issues

Question 22

Chapters 1 and 3 of the existing Conceptual Framework

Paragraphs 9.2–9.22 address the chapters of the existing Conceptual Framework that were published in 2010 and how those chapters treat the concepts of stewardship, reliability and prudence. The IASB will make changes to those chapters if work on the rest of the Conceptual Framework highlights areas that need clarifying or amending. However, the IASB does not intend to fundamentally reconsider the content of those chapters.

Do you agree with this approach? Please explain your reasons.

If you believe that the IASB should consider changes to those chapters (including how those chapters treat the concepts of stewardship, reliability and prudence), please explain those changes and the reasons for them, and please explain as precisely as possible how they would affect the rest of the Conceptual Framework.

Response: We would like the IASB to reconsider Chapter 1and Chapter 3.

As for stewardship, in our view, under the development of capital market and modern business structure of the separation of ownership and management, the decision usefulness and stewardship can be unified, and "stewardship" is necessary to stay in the Conceptual Framework. In addition, the term "stewardship" is of long history and with no translation difficulty.

As for reliability, in our view, as a major characteristic for financial statement quality, reliability will impact on recognition, measurement and report, especially in emerging economies and transferring economies, hence such term should be taken extra attention. In the meantime, the China's Accounting Law requires the authenticity and completion of the financial which clearly indicates the requirement of information reliability, in that case the reliability is one of the basic quality features of financial statement. Additionally, we suggest that the Conceptual Framework should only revise those with inevitable necessity and retain the rest to maintain the stability of the framework.

As for prudence, in our view, the Conceptual Framework includes many items with inter-relations and similar nature (reliability, neutrality, verifiability, and prudence), hence we suggest the IASB to clarify and provide needed guidance; also, we suggest the IASB to put prudence back to the Conceptual Framework.

Question 23

Business model

The business model concept is discussed in paragraphs 9.23–9.34. This Discussion Paper does not define the business model concept. However, the IASB's preliminary view is that financial statements can be made more relevant if the IASB considers, when developing or revising particular Standards, how an entity conducts its business activities.

Do you think that the IASB should use the business model concept when it develops or revises particular Standards? Why or why not?

If you agree, in which areas do you think that the business model concept would be helpful?

Should the IASB define 'business model'? Why or why not?

If you think that 'business model' should be defined, how would you define it?

Response: We agree that the IASB should consider business model in standard-setting process and such concept has become an important guidance to determine relativity to users. We suggest the IASB to further study on the possible definition of "business model".

Question 24

Unit of account

The unit of account is discussed in paragraphs 9.35–9.41. The IASB's preliminary view is that the unit of account will normally be decided when the IASB develops or revises particular Standards and that, in selecting a unit of account, the IASB should consider the qualitative characteristics of useful financial information.

Do you agree? Why or why not?

Response: We disagree. Unit of account is an important concept in many IFRSs especially in IFRS13; the recognition principle of unit of account has been scattered among various IFRSs and in some jurisdictions, the unit of account can be hard to understand and apply. Hence, we expect the IASB could include unit of account in the Conceptual Framework and streamline all requirements in IFRSs and develop detailed application guidance.

Question 25

Going concern

Going concern is discussed in paragraphs 9.42–9.44. The IASB has identified three situations in which the going concern assumption is relevant (when measuring assets and liabilities, when identifying liabilities and when disclosing information about the entity).

Are there any other situations where the going concern assumption might be relevant?

Response: We agree with the proposed description of going concerns. In addition, we suggest the IASB to consider providing further guidance in standards on how to account for and disclose assets and liabilities of company in liquidation or ready for liquidation.

Question 26

Capital maintenance

Capital maintenance is discussed in paragraphs 9.45–9.54. The IASB plans to include the existing descriptions and the discussion of capital maintenance concepts in the revised Conceptual Framework largely unchanged until such time as a new or revised Standard on accounting for high inflation indicates a need for change.

Do you agree? Why or why not? Please explain your reasons.

Response: We generally agree. In addition, we suggest the IASB to clarify that such proposal is mostly for financial capital maintenance concept, and physical capital maintenance is used in very rare situation.

FINANCIAL REPORTING STANDARDS COUNCIL SUBMISSION ON *DP/2013/1 – A REVIEW OF THE CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING*

14 January 2014

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

Email: commentletters@ifrs.org

Dear Sir/Madam

THE FINANCIAL REPORTING STANDARDS COUNCIL RESPONSE TO *DP/2013/1 – A REVIEW OF THE CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING*

In response to your request for comments on DP/2013/1 – *A Review of the Conceptual Framework for Financial Reporting*, below please find the comments prepared by the Financial Reporting Standards Council, the body set up in terms of the South African Companies Act to take responsibility for the setting of financial reporting standards.

In preparing our comments we have considered the comments letter prepared by the Accounting Practices Committee of The South African Institute of Chartered Accountants and generally support the comments included in their submission, taking into account that it reflects different views on some issues.

We thank you for the opportunity to provide comments on this discussion paper.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

Mr Jeff van Rooyen

Chairman – Financial Reporting Standards Council

Cc: Mr Vickson Ncube – CEO of The Pan African Federation of Accountants
Mr Garth Coppin – Member of the Financial Reporting Standards Council

FINANCIAL REPORTING STANDARDS COUNCIL SUBMISSION ON *DP/2013/1 – A REVIEW OF THE CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING*

GENERAL COMMENTS

In addition to the comments provided by the Accounting Practices Committee of The South African Institute of Chartered Accountants, set out below are our comments.

1. We support the International Accounting Standards Board's (IASB) decision to proceed with completing the *Conceptual Framework for Financial Reporting* (Conceptual Framework). Having already issued certain chapters of the Conceptual Framework, we are of the view that the remaining chapters should be issued at the same time, which might require revision of the existing chapters to ensure they are consistent with the remaining chapters. This support is based on the Conceptual Framework including sections not covered by the previous Framework (Framework for the Preparation and Presentation of Financial Statements) (e.g. disclosure and derecognition) and the desire for the Conceptual Framework to be completed timeously. Accordingly we look forward to receiving an exposure draft on the Conceptual Framework in the not too distant future.

2. We continue to support the principle contained in the Conceptual Framework that there could be conflicts between the Conceptual Framework and International Financial Reporting Standards (IFRS) and that in this case IFRS takes precedence over the Conceptual Framework., Where this occurs in existing IFRSs, the IASB should be consider whether the relevant IFRSs should be changed. We believe the process of identifying any conflicts should be carried out during the process of finalising the Conceptual Framework so that ideally any necessary changes can be made to IFRS at the same time as issuing the completed Conceptual Framework.

   Where subsequent to the issue of the completed Conceptual Framework a conflict occurs between the Conceptual Framework and IFRS this should only occur where a deliberate, motivated and explained exception is made. In addition, it is believed that any conflict should ideally apply to certain specific areas and that IFRS should not contain any general overrides to the Conceptual Framework. This means the Conceptual Framework in the area where the conflict arises should still be applied in IFRS, except for the limited identified exceptions.

3. We also support the principle in the Conceptual Framework that it may need to be revised periodically. Thus we recognise that as IFRS develops over time it may indicate the need to reconsider the principles contained in the Conceptual Framework.

4. We also recognise that the Conceptual Framework is not able to be used to resolve all possible issues that could arise in IFRS. While it appears that some

have been supporting the completion of the Conceptual Framework on the basis that this is necessary to finalise certain IFRS projects, we accept that certain issues are best dealt with in individual IFRS. For example, while we support the proposed definitions of liabilities and equity in the Conceptual Framework, we realise the issue of what is the unit of account, particularly in the case of hybrid instruments, is best dealt with in IFRS. Another example is measurement where we believe that in certain cases the use of fair values is appropriate, while cost or amortised cost is appropriate in other cases and that IFRS should specify the measurement basis applicable in the various circumstances instead of the Conceptual Framework only specifying one measurement basis. Thus the Conceptual Framework can be used to specify what options are permissible, where this is appropriate, with IFRS specifying the options permissible in specific areas of accounting.

5. There may be merit for the Conceptual Framework to also specifically mention areas it doesn't cover in detail. For example, as mentioned above the issue of unit of account might be more appropriately dealt with in detail in individual IFRS, but for the Conceptual Framework to explain the issue. The use of a business model in accounting is also related to the unit of account issue and thus while the Conceptual Framework could deal with issue broadly, when it can be used seems best left to individual IFRS.

6. It seems that the proposed Conceptual Framework in attempting to deal with some issues on a conceptual basis might just be moving issues from the Conceptual Framework to IFRS. For example, with probability being removed from the definition of an asset or liability, it becomes more important to understand how probability and its related concept, prudence, is applied in IFRS. Thus when issuing the completed Conceptual Framework it may be necessary to ensure IFRS is sufficiently clear on these issues if these concepts are no longer dealt with in the Conceptual Framework.

7. The proposals dealing with the distinction between profit or loss and other comprehensive income (OCI) warrant additional consideration as they still appear to be more rule based than principle based. The discussion on this section could include a consideration as to why earnings per share (EPS) is provided in IFRS and whether it is still relevant as performance measures are considered a valid topic for a Conceptual Framework, particularly as it seems the reason to include some items in OCI is to exclude them from EPS.

8. Although the intention might not have been to remove stewardship from the Conceptual Framework, the existing wording unfortunately seems to suggest it is no longer important and accordingly we believe there is merit is ensuring the wording in the Conceptual Framework deals with it more specifically.

Zambia Institute of Chartered Accountants

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10th January 2014

International Accounting Standards Board
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Dear Sir,

COMMENTS ON DISCUSSION PAPER DP/2013/1 A REVIEW OF THE CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

The Zambia Institute of Chartered Accountants welcomes the opportunity to provide comments to the International Accounting Standards Board (IASB) on the Discussion Paper DP/2013/1- A Review of the Conceptual Framework for Financial Reporting published in July 2013, with the comment period closing on 14 January 2014.

We applaud the IASB for the decision undertaken to reinitiate the Conceptual Framework project, which had been suspended in 2010 and hope that this project would be given a priority.

The Institute generally agrees that the Conceptual Framework needs to be revised in order to incorporate new developments. We believe that the proposed Conceptual Framework for Financial Reporting would assist the IASB by identifying concepts that will be used consistently when developing and revising IFRSs.

It must be pointed out that the International Public Sector Accounting Standards Board (IPSASB) is also working on its Conceptual Framework; we propose that the IASB and IPSASB should work together; as we believe the concepts we will be similar.

The Institute deliberated the DP, as well as the accompanying draft Basis for Conclusions and our responses to your specific questions are as follows:

Question 1:

Paragraphs 1.25–1.33 set out the proposed purpose and status of the Conceptual Framework. The IASB's preliminary views are that:

(a) the primary purpose of the revised Conceptual Framework is to assist the IASB by identifying concepts that it will use consistently when developing and revising IFRSs; and

(b) in rare cases, in order to meet the overall objective of financial reporting, the IASB may decide to issue a new or revised Standard that conflicts with an aspect of the Conceptual Framework. If this happens the IASB would describe the departure from the Conceptual Framework, and the reasons for that departure, in the Basis for Conclusions on that Standard.

Do you agree with these preliminary views? Why or why not?

Comment

(a) We do agree with the preliminary view on primary purpose of the revised Conceptual Framework, this has been the case even under the current Framework i.e. the principle based system of developing standards. The conceptual framework should always be the primary conceptual source for the development and revision of IFRSs.

(b) The Conceptual Framework should be allowed to evolve over time as it is unlikely to deal with all possible future situations. Exceptional levels of departure should still be allowed in the development of standards.

Question 2:

The definitions of an asset and a liability are discussed in paragraphs 2.6–2.16. The IASB proposes the following definitions:

(a) an asset is a present economic resource controlled by the entity as a result of past events.

(b) a liability is a present obligation of the entity to transfer an economic resource as a result of past events.

(c) an economic resource is a right, or other source of value, that is capable of producing economic benefits.

Do you agree with these definitions? Why or why not? If you do not agree, what changes do you suggest, and why?

Comment

(a) We do agree with the proposed definition of an asset, there is need to focus on the present economic resource being controlled by the entity as a result of past events, rather than to focus on the future economic benefits. Further, the definition seems to be wide-ranging to cover all kinds of economic benefits of a reporting entity.

(b) Yes, we do agree with the proposed definition of a liability, the 'present obligation' should be the key criteria when defining the liability. The proposed definition of a liability is more succinct and focused; we are not expecting that the users of financial statements will have difficulties in the identifications of liabilities.

(c) We do agree that, economic resource should be a right, or other source of value, that is capable of producing economic benefits.

Question 3:

Whether uncertainty should play any role in the definitions of an asset and a liability, and in the recognition criteria for assets and liabilities, is discussed in paragraphs 2.17–2.36. The IASB's preliminary views are that:

(a) the definitions of assets and liabilities should not retain the notion that an inflow or outflow is 'expected'. An asset must be capable of producing economic benefits. A liability must be capable of resulting in a transfer of economic resources.

(b) the Conceptual Framework should not set a probability threshold for the rare cases in which it is uncertain whether an asset or a liability exists. If there could be significant uncertainty about whether a particular type of asset or liability exists, the IASB would decide how to deal with that uncertainty when it develops or revises a Standard on that type of asset or liability.

(c) the recognition criteria should not retain the existing reference to probability.

Do you agree? Why or why not? If you do not agree, what do you suggest, and why?

Comment

(a) We do agree that, the definitions should not retain the notion that an inflow or outflow is 'expected'. An asset must be capable of producing economic benefits. A liability must be capable of resulting in a transfer of economic resources.

(b) We have no comments.

(c) We do agree that, the recognition criteria should not retain the existing reference to probability.

Question 4:

Elements for the statement(s) of profit or loss and OCI (income and expense), statement of cash flows (cash receipts and cash payments) and statement of changes in equity (contributions to equity, distributions of equity and transfers between classes of equity) are briefly discussed in paragraphs 2.37–2.52.

Do you have any comments on these items? Would it be helpful for the Conceptual Framework to identify them as elements of financial statements?

Comment

We are of the view that the Conceptual Framework should identify the statement(s) of profit or loss and OCI, statement of cash flows and statement of changes in equity (contributions to equity as separate elements of financial statements. This would allow users of financial statements to interpret the information in a consistent approach and make sound economic decisions.

Question 5:

Constructive obligations are discussed in paragraphs 3.39–3.62. The discussion considers the possibility of narrowing the definition of a liability to include only obligations that are enforceable by legal or equivalent means. However, the IASB tentatively favours retaining the existing definition, which encompasses both legal and constructive obligations—and adding more guidance to help distinguish constructive obligations from economic compulsion. The guidance would clarify the matters listed in paragraph 3.50.

Do you agree with this preliminary view? Why or why not?

Comment

The Institute agrees that the existing definition of a liability which encompasses both legal and constructive obligations should be retained. We believe that, retaining the existing definition would enhance faithful representation.

Question 6:

The meaning of 'present' in the definition of a liability is discussed in paragraphs 3.63–3.97. A present obligation arises from past events. An obligation can be viewed as having arisen from past events if the amount of the liability will be determined by reference to benefits received, or activities conducted, by the entity before the end of the reporting period. However, it is unclear whether such past events are sufficient to create a present obligation if any requirement to transfer an economic resource remains conditional on the entity's future actions. Three different views on which the IASB could develop guidance for the Conceptual Framework are put forward:

(a) View 1: a present obligation must have arisen from past events and be strictly unconditional. An entity does not have a present obligation if it could, at least in theory, avoid the transfer through its future actions.

(b) View 2: a present obligation must have arisen from past events and be practically unconditional. An obligation is practically unconditional if the entity does not have the practical ability to avoid the transfer through its future actions.

(c) View 3: a present obligation must have arisen from past events, but may be conditional on the entity's future actions.

The IASB has tentatively rejected View 1. However, it has not reached a preliminary view in favour of View 2 or View 3.

Which of these views (or any other view on when a present obligation comes into existence) do you support? Please give reasons.

Comment

We support view 2, a present obligation must have arisen from past events and be practically unconditional. However, we do recommend that the term "practically unconditional" needs to be clarified in order to avoid inconsistency and further guidance needs to be provided.

Question 7:

Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?

Comment

The Institute has no further comments.

Question 8:

Paragraphs 4.1–4.27 discuss recognition criteria. In the IASB's preliminary view, an entity should recognise all its assets and liabilities, unless the IASB decides when developing or revising a particular Standard that an entity need not, or should not, recognise an asset or a liability because:

(a) recognising the asset (or the liability) would provide users of financial statements with information that is not relevant, or is not sufficiently relevant to justify the cost; or

(b) no measure of the asset (or the liability) would result in a faithful representation of both the asset (or the liability) and the changes in the asset (or the liability), even if all necessary descriptions and explanations are disclosed.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

Comment

Yes, we do agree with the IASB's preliminary view; an entity should recognise all its assets and liabilities, unless the IASB decides when developing or revising a particular Standard that an entity need not, or should not, recognise an asset or a liability, as provided for in the discussion paper.

Question 9:

In the IASB's preliminary view, as set out in paragraphs 4.28–4.51, an entity should derecognise an asset or a liability when it no longer meets the recognition criteria. (This is the control approach described in paragraph 4.36(a)). However, if the entity retains a component of an asset or a liability, the IASB should determine when developing or revising particular Standards how the entity would best portray the changes that resulted from the transaction. Possible approaches include:

(a) enhanced disclosure;

(b) presenting any rights or obligations retained on a line item different from the line item that was used for the original rights or obligations, to highlight the greater concentration of risk; or

(c) continuing to recognise the original asset or liability and treating the proceeds received or paid for the transfer as a loan received or granted.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

Comment

We do agree with the IASB's preliminary view and support approach (b), disclosure should not be substituted for the recognition of an asset and liability, if the entity retains a component of an asset or a liability. Further guidance should also be provided to distinguish modification from derecognition of asset or liability.

Question 10:

The definition of equity, the measurement and presentation of different classes of equity, and how to distinguish liabilities from equity instruments are discussed in paragraphs 5.1–5.59. In the IASB's preliminary view:

(a) the Conceptual Framework should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.

(b) the Conceptual Framework should state that the IASB should use the definition of a liability to distinguish liabilities from equity instruments. Two consequences of this are:

(i) obligations to issue equity instruments are not liabilities; and

(ii) obligations that will arise only on liquidation of the reporting entity are not liabilities (see paragraph 3.89(a)).

(c) an entity should:

(i) at the end of each reporting period update the measure of each class of equity claim. The IASB would determine when developing or revising particular Standards whether that measure would be a direct measure, or an allocation of total equity.
(ii) recognise updates to those measures in the statement of changes in equity as a transfer of wealth between classes of equity claim.

(d) if an entity has issued no equity instruments, it may be appropriate to treat the most subordinated class of instruments as if it were an equity claim, with suitable disclosure. Identifying whether to use such an approach, and if so, when, would still be a decision for the IASB to take in developing or revising particular Standards.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

Comment

(a) We do agree that the Conceptual Framework should retain the existing definition of equity as the residual interest, rather than coming up with new definition.

(b) We do agree

(c) We have no comments.

(d) We do not agree with the IASB's preliminary view, if no equity has been issued, there is no need to designate a debt instrument as equity.

Question 11:

How the objective of financial reporting and the qualitative characteristics of useful financial information affect measurement is discussed in paragraphs 6.6–6.35. The IASB's preliminary views are that:

(a) the objective of measurement is to contribute to the faithful representation of relevant information about:

(i) the resources of the entity, claims against the entity and changes in resources and claims; and

(ii) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources.

(b) a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements;

(c) when selecting the measurement to use for a particular item, the IASB should consider what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI;

(d) the relevance of a particular measurement will depend on how investors, creditors and other lenders are likely to assess how an asset or a liability of that type will contribute to future cash flows. Consequently, the selection of a measurement:

(i) for a particular asset should depend on how that asset contributes to future cash flows; and
(ii) for a particular liability should depend on how the entity will settle or fulfil that liability.

(e) the number of different measurements used should be the smallest number necessary to provide relevant information. Unnecessary measurement changes should be avoided and necessary measurement changes should be explained; and

(f) the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.

Do you agree with these preliminary views? Why or why not? If you disagree, what alternative approach to deciding how to measure an asset or a liability would you support?

Comment

Yes, we do agree with the preliminary views. There should be different measurement bases depending on the particular characteristics of the asset or liability being measured and practicality of obtaining a measurement base.

Question 12:

The IASB's preliminary views set out in Question 11 have implications for the subsequent measurement of assets, as discussed in paragraphs 6.73–6.96. The IASB's preliminary views are that:

(a) if assets contribute indirectly to future cash flows through use or are used in combination with other assets to generate cash flows, cost-based measurements normally provide information that is more relevant and understandable than current market prices.

(b) if assets contribute directly to future cash flows by being sold, a current exit price is likely to be relevant.

(c) if financial assets have insignificant variability in contractual cash flows, and are held for collection, a cost-based measurement is likely to provide relevant information.

(d) if an entity charges for the use of assets, the relevance of a particular measure of those assets will depend on the significance of the individual asset to the entity.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

Comment
We do agree with your view.

Question 13:

The implications of the IASB's preliminary views for the subsequent measurement of liabilities are discussed in paragraphs 6.97–6.109. The IASB's preliminary views are that:

(a) cash-flow-based measurements are likely to be the only viable measurement for liabilities without stated terms.

(b) a cost-based measurement will normally provide the most relevant information about:

(i) liabilities that will be settled according to their terms; and

(ii) contractual obligations for services (performance obligations).

(c) current market prices are likely to provide the most relevant information about liabilities that will be transferred.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

Comment
Yes, we do agree with the preliminary views

Question 14:

Paragraph 6.19 states the IASB's preliminary view that for some financial assets and financial liabilities (for example, derivatives), basing measurement on the way in which the asset contributes to future cash flows, or the way in which the liability is settled or fulfilled, may not provide information that is useful when assessing prospects for future cash flows. For example, cost-based information about financial assets that are held for collection or financial liabilities that are settled according to their terms may not provide information that is useful when assessing prospects for future cash flows:

(a) if the ultimate cash flows are not closely linked to the original cost;

(b) if, because of significant variability in contractual cash flows, cost-based measurement techniques may not work because they would be unable to simply allocate interest payments over the life of such financial assets or financial liabilities; or

(c) if changes in market factors have a disproportionate effect on the value of the asset or the liability (i.e. the asset or the liability is highly leveraged).

Do you agree with this preliminary view? Why or why not?

Comment

We do agree and believes that current market price would be relevant where it is available.

Question 15:

Do you have any further comments on the discussion of measurement in this section?

Comment

We do not have any further comments on the discussion of measurement.

Question 16:

This section sets out the IASB's preliminary views about the scope and content of presentation and disclosure guidance that should be included in the Conceptual Framework. In developing its preliminary views, the IASB has been influenced by two main factors:

(a) the primary purpose of the Conceptual Framework, which is to assist the IASB in developing and revising Standards (see Section 1); and

(b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 7.6 7.8), including:

(i) a research project involving IAS 1, IAS 7 and IAS 8, as well as a review of feedback received on the Financial Statement Presentation project;

(ii) amendments to IAS 1; and

(iii) additional guidance or education material on materiality.

Within this context, do you agree with the IASB's preliminary views about the scope and content of guidance that should be included in the Conceptual Framework on:

(a) presentation in the primary financial statements, including:

(i) what the primary financial statements are;

(ii) the objective of primary financial statements;

(iii) classification and aggregation;

(iv) offsetting; and

(v) the relationship between primary financial statements.

(b) disclosure in the notes to the financial statements, including:

(i) the objective of the notes to the financial statements; and

(ii) the scope of the notes to the financial statements, including the types of information and disclosures that are relevant to meet the objective of the notes to the financial statements, forward-looking information and comparative information.

Why or why not? If you think additional guidance is needed, please specify what additional guidance on presentation and disclosure should be included in the Conceptual Framework.

Comment

We do not think additional guidance is needed. In the framework there is no basis for considering presentation and disclosure issues, these two issues should be addressed in IAS 1 as well as in the specific standards regarding the disclosure requirements.

Question 17:

Paragraph 7.45 describes the IASB's preliminary view that the concept of materiality is clearly described in the existing Conceptual Framework. Consequently, the IASB does not propose to amend, or add to, the guidance in the Conceptual Framework on materiality.

However, the IASB is considering developing additional guidance or education material on materiality outside of the Conceptual Framework project.

Do you agree with this approach? Why or why not?

Comment

We do agree that the current Conceptual Framework definition of materiality is adequate and the IASB's proposal to issue additional guidance on the concept of materiality would be useful.

Question 18:

The form of disclosure requirements, including the IASB's preliminary view that it should consider the communication principles in paragraph 7.50 when it develops or amends disclosure guidance in IFRSs, is discussed in paragraphs 7.48–7.52.

Do you agree that communication principles should be part of the Conceptual Framework?
Why or why not?

If you agree they should be included, do you agree with the communication principles proposed?

Why or why not?

Comment

We do agree that the communication principles should be part of the Conceptual Framework and we do further agree with the proposed communication principles.

Question 19:

The IASB's preliminary view that the Conceptual Framework should require a total or subtotal for profit or loss is discussed in paragraphs 8.19–8.22.

Do you agree? Why or why not?

If you do not agree do you think that the IASB should still be able to require a total or subtotal profit or loss when developing or revising particular Standards?

Comment

We agree that the Conceptual Framework should require a total or subtotal for profit or loss to be shown, this would enhance transparent on how entity's resources have been used. We also support the view to differentiate between the total of profit and loss and the total of other comprehensive income.

Question 20:

The IASB's preliminary view that the Conceptual Framework should permit or require at least some items of income and expense previously recognised in OCI to be recognized subsequently in profit or loss, i.e. recycled, is discussed in paragraphs 8.23–8.26.

Do you agree? Why or why not? If you agree, do you think that all items of income and expense presented in OCI should be recycled into profit or loss? Why or why not?

If you do not agree, how would you address cash flow hedge accounting?

Comment We do not support the principle of recycling other comprehensive income into profit or loss. Recycling would distort the financial performance and may promote earnings management.

Question 21:

In this Discussion Paper, two approaches are explored that describe which items could be included in OCI: a narrow approach (Approach 2A described in paragraphs 8.40–8.78) and a broad approach (Approach 2B described in paragraphs 8.79–8.94).

Which of these approaches do you support, and why?

If you support a different approach, please describe that approach and explain why you believe it is preferable to the approaches described in this Discussion Paper.

Comment We have no comments.

Question 22:

Chapters 1 and 3 of the existing Conceptual Framework

Paragraphs 9.2–9.22 address the chapters of the existing Conceptual Framework that were published in 2010 and how those chapters treat the concepts of stewardship, reliability and prudence. The IASB will make changes to those chapters if work on the rest of the Conceptual Framework highlights areas that need clarifying or amending. However, the IASB does not intend to fundamentally reconsider the content of those chapters.

Do you agree with this approach? Please explain your reasons.

If you believe that the IASB should consider changes to those chapters (including how those chapters treat the concepts of stewardship, reliability and prudence), please explain those changes and the reasons for them, and please explain as precisely as possible how they would affect the rest of the Conceptual Framework.

Comment

We are of the view that the entire conceptual framework should be reviewed. The IASB should undertake a fundamental and comprehensive review of the conceptual framework, rather than merely using a quick fix solution 'firefighting approach'.

Question 23:

Business model

The business model concept is discussed in paragraphs 9.23–9.34. This Discussion Paper does not define the business model concept. However, the IASB's preliminary view is that financial statements can be made more relevant if the IASB considers, when developing or revising particular Standards, how an entity conducts its business activities.

Do you think that the IASB should use the business model concept when it develops or revises particular Standards? Why or why not?

If you agree, in which areas do you think that the business model concept would be helpful?

Should the IASB define 'business model'? Why or why not?

If you think that 'business model' should be defined, how would you define it?

Comment

If this concept is reasonably pervasive, it should be defined at some level in the framework. Specific examples can then be amplified in the affected standards.

Question 24:

Unit of account

The unit of account is discussed in paragraphs 9.35–9.41. The IASB's preliminary view is that the unit of account will normally be decided when the IASB develops or revises particular Standards and that, in selecting a unit of account, the IASB should consider the qualitative characteristics of useful financial information.

Do you agree? Why or why not?

Comment

We do agree that the unit of account should be based on the qualitative characteristics of useful financial information.

Question 25:

Going concern

Going concern is discussed in paragraphs 9.42–9.44. The IASB has identified three situations in which the going concern assumption is relevant (when measuring assets and liabilities, when identifying liabilities and when disclosing information about the entity).

Are there any other situations where the going concern assumption might be relevant?

Comment

We are not aware of other situations.

Question 26:

Capital maintenance

Capital maintenance is discussed in paragraphs 9.45–9.54. The IASB plans to include the existing descriptions and the discussion of capital maintenance concepts in the revised Conceptual Framework largely unchanged until such time as a new or revised Standard on accounting for high inflation indicates a need for change.

Do you agree? Why or why not? Please explain your reasons.

Comment

The concept Capital maintenance is critical and determines all recognition and measurement principles that are currently in existence.

The Institute will be ready to respond to any matters arising from the above comments.

Yours faithfully

Modest Hamalabbi
Technical and Standards Manager

Accounting Standards Board
AcSB
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Conseil des normes comptables

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January 14, 2014

Submitted electronically via www.ifrs.org

International Accounting Standards Board
30 Cannon Street, 1st Floor
London EC4M 6XH
United Kingdom

Dear Sirs:

Re: A Review of the Conceptual Framework for Financial Reporting (DP/2013/1)

This letter is the response of the Canadian Accounting Standards Board (AcSB) to the Discussion Paper, *A Review of the Conceptual Framework for Financial Reporting*, issued in July, 2013.

The AcSB is Canada's national accounting standard setting body, which has adopted a strategy of importing IFRSs into Canada for publicly accountable enterprises. The AcSB consists of members from a variety of backgrounds, including financial statement users, preparers, auditors and academics. Additional information about the AcSB can be found at www.frascanada.ca.

The AcSB consulted widely on the Discussion Paper, including with its Conceptual Framework Discussion Group, User Advisory Council and Academic Advisory Council, as well as outreach to Canadian stakeholders, individual members of the AcSB and its staff. The Conceptual Framework Discussion Group included preparers, auditors, users and academics and discussed the full proposals over multiple meetings. The outreach activities included holding, in conjunction with the IASB, a roundtable with Canadian stakeholders. This letter represents the views of the AcSB after considering the input received from these consultations. These views are not formal positions of the AcSB, which are developed only through due process.

In our response to the 2011 Agenda Consultation, we strongly supported a project to complete the IASB's *Conceptual Framework*. We are therefore pleased that the IASB reactivated the conceptual framework project and developed a Discussion Paper. We agree that the project should focus on "updating, improving and filling in gaps rather than fundamentally reconsidering all aspects of the *Conceptual Framework*". Focusing on the items listed in paragraph 1.7 of the Discussion Paper, bringing forward the exposure draft on "reporting entity" and not reopening Chapters 1 and 3 of the current *Conceptual Framework* are consistent with this approach.

Understandably, the Discussion Paper includes much material that is not conceptual, in order to clarify the implications of alternatives and differences between them as well as to describe current practices. As a result it is unclear what material from the Discussion Paper the IASB intends to include in the *Conceptual Framework*. For some parts of the Discussion Paper, this has made it difficult to determine how best to provide constructive comments. We think it is important that the *Conceptual Framework* be focused at the conceptual level and include only concepts that have a sound theoretical basis. This will provide an integrated set of concepts that is useful to the IASB in developing standards and to preparers, auditors and others in determining accounting policies for transactions and events not specifically addressed by a standard. For the reasons identified in our response to Question 1, we think that assisting preparers, auditors and other stakeholders is an equally important purpose of the *Conceptual Framework*. Our detailed comments specify the conceptual principles that we think should be part of the *Conceptual Framework* and the other material that, where relevant, should be dealt with outside of the *Conceptual Framework*.

The IASB intends to complete the *Conceptual Framework* by the end of 2015. We think that certain of the Discussion Paper topics are well advanced and could be completed in this timeframe. Specifically, this would include most of the topics in Sections 2, 3 and 4 on asset and liability definitions, recognition and derecognition. However, we think that the topics in Sections 5 to 8 on liabilities and equity, measurement, presentation and disclosure and other comprehensive income require significant further development before being ready for an exposure draft. Parts of these chapters look more like an amalgam of current practice, rules and application guidance rather than concepts level material, which is not appropriate in a *Conceptual Framework*. (Specific comments on each of these sections of the Discussion Paper are provided in the Appendix to this letter.)

We recommend that the IASB proceed on the proposed schedule with the first group of topics. Addressing these topics would be of significant benefit in resolving a number of issues that arise in relation to current standards and would help some important standard-setting projects to move forward.

For the second group of topics we recommend that additional targeted research as proposed in the Appendix start as soon as possible. We think that this research should include the concepts associated with unit of account to ensure that future standards address this fundamental and pervasive issue in a systematic and consistent manner. Our response to Question 24 identifies some aspects of unit of account that should be considered. We recognize that this additional research will delay completion of the *Conceptual Framework* but, as noted above, we think it is critical that the *Conceptual Framework* be focused on concepts and that these have a sound theoretical basis.

Consistent with a focus on concepts, we do not believe the *Conceptual Framework* should contain exceptions. A conceptual framework should be aspirational in nature, stating clearly the concepts the IASB thinks should ideally underlie accounting standards. We recognize that in certain circumstances it may not be possible to fully apply the *Conceptual Framework* but these decisions should be dealt with explicitly at a standards level, not in the *Conceptual Framework*. As identified in our response to Question 1, we think that Chapter 3 of the *Conceptual Framework* already provides criteria for such decisions.

The Appendix to this letter responds to the questions posed in the Discussion Paper and provides some additional comments at the end.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me or, alternatively, Peter Martin, Director, Accounting Standards (+1 416 204-3276 or email pmartin@cpacanada.ca) or Rebecca Villmann, Principal, Accounting Standards (+1 416 204-3464 or email rvillmann@cpacanada.ca).

Yours truly,

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APPENDIX

Section 1 Introduction

Purpose and status – Question 1

1. We agree that the long list of possible uses in the current *Conceptual Framework* is unhelpful when developing a revised conceptual framework. However, we are concerned that the Discussion Paper does not reflect the importance of the *Conceptual Framework* to preparers, auditors and other stakeholders that need to determine the appropriate accounting for a transaction or event that is not addressed in a standard. Preparers and their professional advisors are usually the first to have to deal with new accounting issues as they enter into new types of transactions that are not addressed by the standards. The *Conceptual Framework* is important to them for this reason. Other stakeholders have expressed similar views on the importance of the Framework to them. Therefore we think that the secondary purpose in paragraph 1.28 of the Discussion Paper should be equal in importance to assisting the IASB in developing and revising IFRSs.

2. Consistent with the above, we do not agree with the statement in paragraph 1.29 that some aspects of the *Conceptual Framework* should not be used by parties other than the IASB. If a concept is valid and appropriately expressed it should be available to anyone, whether it is the IASB developing a new or revised standard or a preparer or auditor considering what an appropriate accounting policy should be in the absence of a standard that applies to a specific transaction or event.

3. We agree that the IASB will sometimes need to issue a new or revised standard that conflicts with some aspect of the *Conceptual Framework*. This will often be the result of the need to make a trade-off between different requirements rather than simply a conflict with one specific part of the *Conceptual Framework*. The possibility of departures from full compliance with all aspects of the *Conceptual Framework* is already acknowledged in Chapter 3. For example, paragraph QC 34 already states that "sometimes one enhancing qualitative characteristic may have to be diminished to maximize another qualitative characteristic". Paragraphs QC 35 – 39 discuss the cost constraint. A decision to issue a standard that conflicts with some aspect of the *Conceptual Framework* should be made only after careful consideration of the qualitative characteristics and the costs and benefits of alternatives.

4. We think that the *Conceptual Framework* should not address this issue to any greater extent than already exists in Chapter 3. The *Conceptual Framework* should focus on the concepts that should ideally underlie accounting standards. Any departure from the *Conceptual Framework* should be a standards level decision. This is a due process issue that should be addressed in the Due Process Handbook issued by the IFRS Foundation. We agree that due process should require an explanation of a departure from some aspect of the *Conceptual Framework* in the Basis for Conclusions for that standard.

Section 2 Elements of financial statements

Definitions – Question 2

5. We support these definitions and think they represent a significant improvement that will address the primary problems experienced in practice with the existing definitions. We suggest no further changes.

6. We note that the phrase "as a result of past events" in the definitions could be included in the supporting guidance to the definitions instead. This phrase is problematic to some who think that retaining it in the definitions creates a requirement to search for and identify the past event that gave rise to an asset or liability. We think it is not necessary to identify the past event in order to determine whether an asset or a liability exists and struggle to understand how a present asset or liability can exist without a past event. However, we acknowledge that the reference to past events in the definitions may be helpful to some. In particular, looking at which past event gave rise to an asset or a liability in practice is useful to determine how to portray that event in financial statements, as explained in paragraph 2.16(c) of the Discussion Paper. We recommend that the Exposure Draft explain the IASB's rationale for retaining this phrase in the definitions.

Uncertainty and probability threshold – Question 3

7. We agree that removing the word "expected" from the definitions and replacing it with the notion of "capable" represents an improvement. Although some stakeholders question whether capable still contains an implicit probability threshold, we acknowledge that a better word hasn't been found.

8. Overall, we agree with the IASB's preliminary views on uncertainty in paragraphs 2.35 and 2.36 of the Discussion Paper. Specifically, we agree that:

   (a) A probability threshold should not be part of the element definitions, for the reasons discussed in paragraph 2.35(a).

   (b) Existence uncertainty is rare when considering types of assets or liabilities. The most obvious example is litigation as a low-probability/high-severity event. The IASB should decide at a standards level how to deal with assets and liabilities with significant existence uncertainty, as explained in paragraph 2.35(b).

   (c) A probability threshold should not be included in the recognition criteria. Uncertainty should not, by itself, determine whether an asset or liability is recognized. Instead, uncertainty should affect the measurement, as explained in paragraphs 2.35(c) and 2.36.

Elements for other statements – Question 4

9. We think that the *Conceptual Framework* should be complete and include definitions of elements of all financial statements, including the statement of cash flows and statement of changes in equity, as identified in paragraph 2.52 of the Discussion Paper. We agree that there have not been significant problems in practice with the existing framework material in the definitions of income and expenses (including gains, revenue, losses and expenses). Therefore we agree with the IASB's approach to carry forward the existing material unchanged, as described in paragraphs 2.37 to 2.46.

Section 3 Additional guidance to support the asset and liability definitions

Constructive obligations – Question 5

10. We agree that the revised *Conceptual Framework* should retain a definition that encompasses both legal and constructive obligations. However, we think paragraph 4.15 of the existing framework that states that obligations may also arise "from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner" should be revised because this statement is too broad and vague.

11. The notion of a constructive obligation is particularly confusing under different legal frameworks. In the context of some legal frameworks, there may be no need to separately identify a constructive obligation and doing so causes confusion. Some stakeholders think that constructive obligations are one type of liability that could result from applying the more general liability definition. However, we accept that a broader definition that encompasses constructive obligations is necessary because obligations in other jurisdictions may be enforceable by religious strictures or local customs rather than by law.

12. We agree that the additional guidance in paragraph 3.50 of the Discussion Paper could be helpful to clarify the distinction between a constructive liability and economic compulsion. Conceptually, if an entity has an obligation, generally, another party (or the public at large) should have a corresponding right. Looking at the concept from this perspective may be useful in determining whether a present obligation exists.

Meaning of "present" – Question 6

13. We agree with the IASB's tentative decision to reject View 1 for the reasons stated in paragraph 3.96 of the Discussion Paper.

14. We think that paragraphs 3.63 to 3.97 are the one exception to our previous statement that Sections 2 to 4 are well advanced. We think that the concepts underlying Views 2 and 3 need further work. In particular, the implications of the two views on royalties and executory contracts need to be considered. Also, rather than focusing on the notion that conditions may remain, we think any further work on View 3 should focus on the concept

in paragraph 3.85 that "[a]s soon as the entity has received the resource or conducted the activity, it no longer has complete discretion to avoid a future transfer." Given that we agree with neutrality, we struggle with View 3 when thinking about whether another party has a corresponding right that qualifies as an asset. Further, we think that View 3 needs to be better articulated and examples need to be provided that better distinguish the two views. If it is not possible to do so, we think that View 3 is not a sufficiently robust concept and should be discarded.

Other comments – Question 7

15. We have no other comments.

Section 4 Recognition and derecognition

Recognition – Question 8

16. We agree that all assets and liabilities should be recognized (with limited exceptions being addressed at a standards level). If the definitions of the elements are valid, there must be a presumption to recognize all items that meet those definitions.

17. We think that Chapter 3 of the existing *Conceptual Framework* provides the basis for the IASB to determine and explain any departures from concepts in the *Conceptual Framework*. However, such departures should be standard level decisions. Although it might be helpful to remind stakeholders of how the concepts in Chapter 3 could be applied at a standards level by specifying recognition criteria, an explicit exception in the *Conceptual Framework* is unnecessary and may suggest to some that the concepts in Chapters 3 can only be applied when explicitly referenced.

18. As we have stated elsewhere in this response, we think exceptions should not be included in the *Conceptual Framework* but considered and justified at a standards level. We think that recognition criteria could be introduced at a standards level when necessary without requiring an exception in the *Conceptual Framework*. We think that the material for the Exposure Draft should be phrased to include a broad explanation that allows for the IASB to specify recognition criteria at a standards level when necessary.

19. Should the IASB not agree with our view, we offer the following comments with regards to the exceptions noted in paragraph 4.25 of the Discussion Paper. We find it difficult to envision how recognizing an item that meets the definition of an asset or liability could provide information that has no relevance to a user (i.e., the first half of (a) in paragraph 4.25). However, we agree that two reasons the IASB may decide at a standards level that an asset or liability should not be recognized are if recognition does not provide users with sufficiently relevant information to justify the cost (i.e., the second half of (a)) or no measure would faithfully represent the asset or liability (i.e., (b) in paragraph 4.25).

20. Further, we think a distinction needs to be made at a standards level between recognition (and derecognition) and a nil carrying amount.

Derecognition – Question 9

21. We agree that an entity should derecognize an asset or liability when it no longer meets the recognition criteria and support the control approach described in paragraph 4.36(a) of the Discussion Paper. However, as noted above, we think a distinction needs to be made at a standards level between derecognition and a nil carrying amount.

22. We struggle with the notion of an entity retaining a component of an asset or liability because the element definitions focus on rights and obligations. We think this discussion implies a different unit of account and demonstrates that unit of account should be addressed in the framework as explained further in our response to question 24 below (see paragraphs 100-106). If unit of account is only addressed at a standards level, we agree that the IASB must also determine at a standards level how to portray the changes when an entity retains only some of the rights (obligations) of a previously recognized group of rights (obligations).

Section 5 Definition of equity and distinction between liabilities and equity instruments

23. The majority of proposals in Section 5 of the Discussion Paper (other than question 10(a) and part of question 10(b)) cover a range of accounting issues from the application of the definitions to measurement and presentation. We think that it would be more appropriate to deal with these issues at a standards level rather than in the *Conceptual Framework*.

24. We found this section challenging to assess because we could not identify what parts would be included in the *Conceptual Framework* from material that was provided to explain the proposals and implications of the alternatives. As a result, it was very difficult for us to provide constructive responses to the questions asked. Therefore, we have responded to the questions primarily to assist the eventual consideration of the issues at a standards level.

Equity definition – Question 10(a)

25. We agree with the IASB's preliminary view that the *Conceptual Framework* should retain the existing definition of equity as "the residual interest in the assets of the entity after deducting all its liabilities".

Consequences of the liability definition – Question 10(b)

26. We agree with the concept that the IASB should use the definition of a liability to distinguish liabilities and equity instruments. However we think the two consequences of that view, that obligations to issue equity instruments are not liabilities and that obligations that will arise only on liquidation of the reporting entity are not liabilities, is guidance that the IASB should consider at a standards level rather than identified as concepts in the *Conceptual Framework*.

27. Several practitioners we consulted indicated that they spend a significant amount of time distinguishing liabilities from equity instruments given the complex nature of these instruments. Some users of financial statements expressed the need for better information about, and improved classification of, claims that identify the priority in which they will be settled. We think that they are asking for this information given the numerous and complex exceptions in IAS 32 *Financial Instruments: Presentation*.

28. Several academics, however, emphasized the importance of considering the choices an entity can make when issuing derivative contracts, including whether the entity has the ability to issue a derivative contract to settle an obligation or whether the entity has choices on how it can settle the contract. When an entity can decide whether to settle in cash or equity, it will report fewer liabilities. Some academics think such reporting does not provide relevant information or faithfully represent arrangements that are to finance operations or are likely to result in cash payments. Such classifications reduce reported leverage and can affect decisions made by financial statement users.

29. We think that using the liability definition to distinguish liabilities and equity instruments is the first step or guiding concept to determine how to classify an instrument. That proposed classification then needs to be assessed through the application of the qualitative characteristics (i.e. does the classification provide relevant information, is the depiction of claim represented faithfully and how can the usefulness of the information be enhanced) and the cost constraint. That analysis, including assessing implications of those classifications, needs to be fully assessed at a standards level.

30. We recommend that the IASB propose a targeted standards level project to remove or reduce the inconsistencies within IAS 32 as part of its next agenda consultation.

Subsequent measurement of equity – Question 10(c)

31. We agree that the *Conceptual Framework* should not prescribe a specific format for the statement of changes in equity. Redesigning the statement of changes in equity to display updated measurements of equity claims is a new and innovative idea. "Wealth transfer" misrepresents the nature of the change being reported. When the market value of a share in an entity changes, the value of shares owned by existing shareholders and written options both change. Thus, the existing shareholders are no worse off and did not transfer anything to the option holder as no exchange occurred between two parties.

32. Many stakeholders we consulted challenged the need for the proposal given that:

> "General purpose financial reports are not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders and other creditors to estimate the value of the reporting entity." (Paragraph OB7 of Chapter 1).

33. They question reporting fair value changes in written options, warrants and other similar instruments classified as equity given the uncertainty of whether those instruments may be exercised. Others objected to updating the measurement of some but not all equity claims because it is incomplete and potentially misleading.

34. Some stakeholders thought that more work at a conceptual level could develop a simplified approach to when and how measurements of equity claims are updated. For example, the measurement of written options could be updated only when the option is exercised with the difference between that market price and the total consideration received for the instrument (i.e. the premium received plus the exercise price) reported in the statement of changes in equity. Such an approach would be consistent with the requirements in IFRS 3 *Business Combinations* and IAS 32 (although not stated explicitly) when shares are used as consideration.

35. Several stakeholders expressed support for reallocating the total net assets of the entity among all equity claims. The statement of changes in equity would report a revised carrying value of each equity class by allocating the carrying value of the net underlying assets to each class. In essence, it would provide a hypothetical liquidation value of an entity, rather than revised assessments of the value of some of the claims.

36. Stakeholders we consulted thought that updating the measurement of equity claims, i.e. using a current measurement or an allocation approach, would not likely reduce the challenges and concerns with distinguishing liabilities from equity instruments. Several preparers, auditors and academics questioned whether the benefits of the information to financial statement users would exceed the cost of updating the measurement of equity instruments. The views of financial statement users varied. Lenders saw little merit to the additional information, while equity investors thought it may be helpful.

37. On balance, we think that the idea of updating measurements of equity is worth further consideration. It is a proposal that we include in the second group of topics that warrant further research. We think that the IASB needs to conduct a more detailed assessment of the need for, and benefits of, this proposal before proceeding.

Most subordinated class of instruments – Question 10(d)

38. Permitting an entity that has not issued any equity instruments to treat the most subordinated class of instruments as if it were an equity claim would be an exception. As we have stated previously, the *Conceptual Framework* should only set out concepts that are to be applied when developing standards. Exceptions to those concepts should only

be considered at a standards level after applying the qualitative characteristics and the cost constraint.

39. We think that more research and analysis is needed at a standards level. The follow-on consequences of classifying the most subordinated class of instruments as equity would need to be assessed and agreed upon, such as whether the entity would report earnings per share, before deciding to provide this exception.

Section 6 Measurement

Take a two-step approach

40. We think that the measurement section should clearly articulate concepts and principles that set out necessary and sufficient criteria to determine the measurement basis for categories of assets and liabilities. This section currently proposes guidelines for improving measurement practices in IFRSs and makes general statements of when specific measurement bases will "normally" or are "likely" to be used based on past practices. Including these guidelines and statements in the *Conceptual Framework* would ingrain current practices without rigorous analysis, discussion of the rationale or consideration of the consistency of those positions. This could impede development of the underlying concepts and principles that are the essence of a conceptual framework.

41. In particular, we think it essential that the framework deal explicitly with the risk that an entity's bias could affect a measurement, either through making optional changes (as noted in paragraph 6.24 of the Discussion Paper) or determining estimates when there is uncertainty. In academe, moral hazard is a term used to describe situations when a party has the opportunity to take risks or act with "self-interest-seeking with guile", to the detriment of another. A faithful representation of a measurement requires that it be neutral or unbiased. The attributes of some measurement bases could reduce the opportunity for bias to be exercised. The failure to deal explicitly with moral hazard would seriously undermine the credibility of the *Conceptual Framework* particularly as it relates to measurement.

42. For example, when there is wide range of possible outcomes for a liability, requiring a best estimate to be determined by using a probability-weighted expected cash-flow measure would enable the entity to be more objective than requiring the selection of the single most likely outcome that it expects to pay. In other situations, when the uncertainty is so high that a cash-flow measurement would be too subjective, it may be necessary to consider whether the item should be recognized, if recognized whether it should be measured at cost and whether it should be remeasured at subsequent dates, or whether information about the nature and uncertainty of the item should be disclosed. Some of these situations may be considered when determining whether a measurement will provide a faithful representation of relevant information about the item or require the use of more verifiable inputs. Academics and other stakeholders we consulted were very concerned

that the Discussion Paper did not identify explicitly the need to consider the risk of bias when there is subjectivity in measurements.

43. A significant amount of thought, analysis and discussion is needed to develop measurement concepts and principles that will be useful and effective for developing principle-based measurement requirements in new and amended standards. Therefore, we recommend that the IASB undertake a two-step approach to improve the measurement guidance in the *Conceptual Framework*.

First Step – develop interim guidance

44. As part of this project and on the same timeline, the IASB should develop revised but limited measurement guidance that can be included in the *Conceptual Framework* until rigorous measurement concepts and principles can be developed. This measurement guidance could include:

(a) the objective of measurement as proposed (see response to question 11(a) or paragraphs 51-52);

(b) the requirement that the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost (see response to question 11(f) or paragraph 65);

(c) descriptions of the measurement bases or categories that should be considered when determining how to measure an asset or a liability; and

(d) the attributes of the information the different measurement bases or categories portray about an item, which should be assessed in standards level projects when determining the measurement basis that would provide the most relevant information to financial statement users.

45. This first step would describe the measurement bases and identify the information attributes about measurements that would provide a common starting point for assessing how to measure an item at a standards level. We think that such revised yet brief conceptual measurement guidance could be developed without significant effort by evaluating and revising existing descriptions of measurements bases, as needed. For example, the IASB could make use of the descriptions of measurement bases set out in past published research on measurement, such as:

(a) the Institute of Chartered Accountants in England and Wales "Measurement in Financial Reporting: Information for Better Markets Initiative" issued in 2006;

(b) the IASB Discussion Paper "Measurement Bases for Financial Accounting – Measurement on Initial Recognition" (prepared by staff of the Canadian AcSB) issued in 2005; and

(c) the International Public Sector Accounting Standards Board "Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities:

Measurement of Assets and Liabilities in Financial Statements" issued November 2012.

Thus, the focus of the first step would be on explaining how, and to what extent, the different measurement bases convey relevant information about the amount, timing and uncertainty of the cash flows associated with the asset or liability, including market risks like interest rate risk and price risk.

46. The revised guidance should not include:

    (a) many of the IASB's preliminary views that are guidelines for improving measurement practices in IFRSs (such as not using a single measurement for all assets and liabilities), because they describe an intended result rather than identifying when one measurement basis should be used instead of another basis.

    (b) general statements of when specific measurement bases may be used because common practices do not belong in a conceptual framework.

    (c) the description of present value in the current *Conceptual Framework* because present value is a measurement technique rather than a measurement basis.

Second Step – develop measurement concepts

47. We recommend that research on measurement be the first topic that the IASB undertakes as part of its new research program. In-depth research is needed into what the conceptual underpinnings should be for measurement.

48. This research will take time and resources. We think that it would not be possible to make significant progress in this area within the IASB's current project timeline. Accordingly, we recommend that this research be undertaken separately over a longer period of time.

49. This research should:

    (a) identify the information needs of different users of financial statements and how they use information;

    (b) assess the usefulness of reported information in predicting future cash flows and identify the measurement basis or bases that provide the most useful information about different assets and liabilities;

    (c) identify the other qualitative characteristics, including the cost constraint and possibly other factors, that should be considered when selecting a measurement basis and the inter-relationships of those factors;

    (d) involve rigorous evaluation of each measurement family based on the qualitative characteristics, including the cost constraint;

    (e) develop concepts that would result in identifying characteristics that are necessary and sufficient to portray the measurement of assets and liabilities with similar attributes in a consistent manner;

(f) assess the effect of moral hazard in measurement and how the selection of a measurement basis could reduce the opportunity for bias in measurements;

(g) develop conceptual rationale for when assets and liabilities should be remeasured and whether and how they should be assessed for impairment when they are not remeasured; and

(h) generate discussion, debate and a better understanding of views between the IASB and its stakeholders in order to advance thought about measurement in financial reporting.

50. We also think that an explicit discussion of moral hazard may be more effective than reinstating prudence or the need to exercise a "degree of caution" when setting standards. It may also resonate with stakeholders who think stewardship requires a higher profile (see overall response to question 11 or paragraphs 41-42).

Objective of measurement – Question 11(a)

51. We agree that the objective of measurement should be based on the objective of financial reporting. We support the IASB's preliminary view that a measurement basis should be selected based on the usefulness of the information to investors, lenders and other creditors in making decisions about providing the entity with resources. The usefulness of the information should be assessed based on the relevance of a measurement that faithfully represents information about:

(a) the resources of the entity, claims against the entity and changes in resources and claims; and

(b) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources.

52. We think that including the objective of measurement in the *Conceptual Framework* would be a significant improvement.

Single measurement basis – Question 11(b)

53. We agree that a single measurement basis for all assets and liabilities may not necessarily provide the most relevant information for users of financial statements. Different measurement bases portray or quantify information about assets and liabilities differently. We think that a measurement basis should be selected through determining how to convey relevant information about the amount, timing and uncertainty of the cash flows associated with a given asset or liability.

54. We think that the preliminary view as expressed is an acknowledgement of the IASB's intention that it "may" not require a single measurement basis for all assets and liabilities. Such a statement does not require or limit future measurement decisions the IASB may

make. As outlined previously, we recommend that the *Conceptual Framework* should instead set out:

(a) the measurement bases or categories that should be considered when determining how to measure an asset or a liability; and

(b) the attributes of the information the different measurement bases portray about an item that should be assessed as part of determining the measure that would provide the most relevant information to financial statement users.

55. The basis for conclusions for the measurement chapter of the *Conceptual Framework* could explain that the IASB included multiple measurement bases or categories because the IASB recognizes that different measurement bases can provide relevant information. Further research is required to determine which measurement basis or bases best serve the needs of financial statement users for various categories of assets and liabilities.

Information on the statement of financial position and the statement(s) of profit or loss and OCI – Question 11(c)

56. We agree that the information a measurement would provide in both the statement of financial position and the statement(s) of profit or loss and other comprehensive income (OCI) should be considered when selecting how a particular item should be measured. Considering the information a measurement provides at a point in time and changes over time adds discipline to the process of deciding what measurement basis provides users of financial statements with the most relevant information. For example, the information attributes that measurement bases portray in the statement of financial position (at a point in time) and in the statement of performance (changes over time) could be described in the framework.

57. This preliminary view acknowledges one important consideration that should be assessed when determining how to measure an asset or liability. Yet, there are other factors that should be considered that could result in selecting a different measurement basis, such as the ability to represent information faithfully, that were not discussed adequately in the Discussion Paper. Thus, we recommend that the IASB conduct research to identify all the various considerations or factors that should be assessed (see the second step of the proposed two-step approach in the overall response to question 11 or paragraphs 47-50).

58. We think that this preliminary view also implies that it may be acceptable to measure an item using different bases in each statement when the information in those statements would provide more relevant information to users of financial statements. In concept, we think that changes in assets and liabilities result in income and expenses that represent an entity's performance. The reference to reporting information in profit or loss and OCI would permit presenting some changes in assets and liabilities in OCI.

59. We support the use of OCI from a practical perspective because it has enabled some assets and liabilities to be measured using a more relevant basis on the statement of

financial position and the changes, or a portion of those changes, to be presented in the statement of OCI (see responses to questions 20 and 21 or paragraphs 82-92). Therefore, we recommend that this view be expressed in terms of how changes in assets and liabilities are reported but should not be included in the *Conceptual Framework* because the preliminary view is not a concept. We think that material on the use of OCI, including this view, should be provided outside the *Conceptual Framework*. For example, the IASB could acknowledge in the basis for conclusions that it may decide when developing new and amended standards that some changes may be reported in OCI.

Relevance of a measurement – Question 11(d)

60. We think that the IASB should not form a view on how to assess the relevance of a particular measurement without additional research.

61. The IASB's preliminary view narrows the focus for assessing the usefulness of financial reporting from "assess[ing] the prospects for future net cash inflows to an entity" (paragraph OB3) to determining how "an asset or a liability contributes to those future cash flows". Yet, when applying this proposed overarching view to determining how to measure financial assets and financial liabilities (see paragraph 6.19 of the Discussion Paper), the IASB acknowledges that this overarching view "may not provide information that is useful when assessing prospects for future cash flows." Having to propose an exception demonstrates that this preliminary view requires further thought.

62. We also question the merits of further extending this view in the context of all assets and liabilities because the preliminary view is not complete. It does not identify how the selection of the measurement would consider whether that relevant measurement could be represented faithfully.

Number of different measurement bases and unnecessary changes – Question 11(e)

63. We agree that the number of different measurements used in financial statements should be the smallest number necessary to provide relevant information. We also agree that unnecessary measurement changes should be avoided and necessary measurement changes should be explained.

64. We think that this preliminary view is a goal that the IASB is striving to achieve. Without clear descriptions of each measurement category and assessment of the information attributes of each measurement category, there is no basis for achieving this goal. We think that goal can be achieved through the development of rigorous measurement concepts. Therefore, we recommend that this preliminary view be expressed in the Basis for Conclusions rather than in the *Conceptual Framework*.

Benefits versus costs – Question 11(f)

65. We agree that the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost. Including this preliminary view in the *Conceptual Framework* would make explicit the need to consider the cost constraint when determining how to measure an item.

Subsequent measurement – Questions 12 through 14

66. We recommend that the IASB not further develop these preliminary views but instead undertake a two-step approach to work towards developing more robust measurement concepts (see overall response to question 11 or paragraphs 40-50).

67. The IASB's preliminary views propose common ways to measure different types of assets and liabilities in a manner similar to the existing material in the *Conceptual Framework* for assets and liabilities in general. Overall, the material accommodates all measurements rather than removing options, is vague and does not restrain or guide a standard-setter in any way. While some statements may seem plausible, there is no supporting conceptual explanation for them. We and most, if not all, stakeholders we consulted are concerned that including these statements in the *Conceptual Framework* would enshrine current practices and make it difficult to develop measurement concepts.

68. We are also disappointed that the Discussion Paper did not outline or refer to the results of the IASB's past research and public consultations, especially in the context of how to measure derivative instruments.

69. For these reasons, we disagree with the IASB's preliminary views regarding subsequent measurement of assets, liabilities, financial assets and financial liabilities.

Other comments – Question 15

70. We think that the IASB should replace the material on measurement in the existing *Conceptual Framework*. We recommend a two-step approach. The IASB should consider including interim guidance that provides a common starting point for assessing how to measure an item and undertake research to develop measurement concepts (see overall response to question 11 or paragraphs 40-50, including suggestions on what the interim guidance could contain in paragraph 44).

Section 7 Presentation and disclosure

Scope and content of presentation and disclosure guidance – Question 16

71. While recognition and measurement focus on the determination of what information should be included in financial statements, presentation and disclosure focus on the important issue of how that information should be communicated to investors, lenders and other users of financial statements. Improving the quality of this communication, especially the notes to the financial statements, is important and we welcome recent initiatives by the IASB in that regard. These various IASB initiatives, including the relevant content of the *Conceptual Framework*, must be well co-ordinated so the resulting guidance supports disclosures that are consistent and meet user needs in a cost efficient manner. It was difficult to understand from the Discussion Paper what is intended to be included in the *Conceptual Framework* on presentation and disclosure and how that would relate to other steps the IASB is planning regarding presentation and disclosure. Some of the content of this chapter clearly does not belong in a conceptual framework, such as the discussion of financial statements in an electronic format. The other material is not consistent with our view that the *Conceptual Framework* should focus on concepts.

72. Overall, we think that this section of the Discussion Paper is not sufficiently developed to form part of the *Conceptual Framework*. Significant conceptual issues that are not addressed in the Discussion Paper include:

    (a) The scope of information that should be included in financial statements.

    (b) The type of information that should be required to be included in the primary statements versus in the notes. This includes the extent of disaggregation of information in the primary financial statements.

    (c) A framework of user needs that standard setters (and preparers) should focus on (including key categories of user needs).

    (d) Guidance on how the cost constraint applies to disclosure so as to prevent or minimize disclosure overload.

    (e) A discussion about whether there should be any other constraints on disclosure (e.g. competitive harm).

73. We agree that the primary financial statements are the statement of financial position, the statement of profit or loss and the statement of OCI, the statement of changes in equity and the statement of cash flows. We also agree with the objective of primary financial statements in paragraph 7.17 of the Discussion Paper but note that this definition is not useful without more consideration of how information should be summarized.

74. The material on classification and aggregation in paragraphs 7.20 to 7.28 is largely descriptive in nature. The only material that discusses how information should be classified in the primary financial statements is paragraph 7.26 which provides examples of how information might be classified (function, nature, measurement basis). This would

be of little use to the IASB or a preparer or auditor in making specific decisions on the degree or method of summarization.

75. We agree that, conceptually, offsetting should not be permitted in financial statements. As we have stated elsewhere in this response, we do not think exceptions should be included in the *Conceptual Framework.* Exceptions should be considered and justified at a standards level. We also agree that no primary financial statement should have primacy over other primary statements.

76. We agree with the objective of the notes to the financial statements as expressed in paragraph 7.33. However paragraph 7.34 goes on to refer to understanding how actions taken by management protect the entity's assets from unfavourable effects of economic factors such as price and technical change. This is a very broad statement and demonstrates the need to identify the boundaries of the information that is within the scope of financial statements. Paragraph 7.35 addresses the scope of the notes. However, it is a list of some things the IASB would "normally consider" and includes "information about the reporting entity as a whole, to the extent necessary to understand… how effectively the entity's management and governing board have discharged their responsibilities to use the entity's assets" as well as "the nature and extent of risks arising from the entity's assets and liabilities". This does not address the scope of the notes in a meaningful way – indeed these statements open the door to disclosures that many would consider well beyond the scope of financial statements. The other items listed in paragraph 7.35 are more specific, but there is no link provided to show how they relate to the objective of the notes or any evidence that this list is comprehensive. A conceptual framework should clearly show how the more detailed aspects flow from the objectives and higher level concepts.

Materiality – Question 17

77. We agree that materiality is well discussed in Chapter 3 of the existing *Conceptual Framework* and that there is no need for the IASB to amend or add to that guidance in the *Conceptual Framework*. Materiality is a pervasive consideration that applies to all aspects of financial reporting. Including it in the section of the *Conceptual Framework* that addresses presentation and disclosure could imply that it is less relevant to other parts of the *Conceptual Framework.*

78. We agree that the application of materiality to presentation and disclosure is not always well understood. Consistent with our view that the *Conceptual Framework* should focus on concepts, any additional guidance or educational material on this topic should be outside of the *Conceptual Framework.*

Communication principles – Question 18

79. We think the IASB can support effective presentation and disclosure by the way in which presentation and disclosure requirements are specified in standards. Standards should not impede effective communication. We agree with the communications principles in paragraph 7.50 of the Discussion Paper and think that they would be helpful in developing requirements at a standards level that support improved presentation and disclosure in financial statements.

Section 8 Presentation in the statement of comprehensive income—profit or loss and other comprehensive income

Require a total or subtotal for profit or loss – Question 19

80. Generally speaking, the *Conceptual Framework* should not require specific totals or subtotals in financial statements because they are not a fundamental concept or element of financial statements. Although profit or loss is a total or subtotal, it is a residual measure similar to the concept of equity. Lenders, equity investors, regulators, preparers and auditors we consulted all agree strongly that the total or subtotal for profit or loss is one of the most widely used pieces of financial information. Its importance is reinforced by its use to derive earnings per share and other performance metrics.

81. Therefore, we think that the *Conceptual Framework* should acknowledge that a total or subtotal of profit or loss can provide decision useful information. The determination of items to be included in profit or loss (or other totals or subtotals) should, however, be a standards level decision.

Permit or require recycling – Question 20

82. We do not agree with the IASB's preliminary view that some items of income or expense previously recognised in OCI should be permitted or required to be recognised subsequently in profit or loss, i.e. recycled. We think that the IASB should require all items to be recycled if they are recognized in OCI.

83. In the long term, we think that there should be one overall performance measure that does not present some income and expenses in profit or loss and others in OCI. This aspirational view is based on the fundamental principle that "changes in a reporting entity's economic resources and claims result from that entity's financial performance" (paragraph OB15) other than changes resulting from transactions with equity investors (paragraph OB21). Academics we consulted supported that view based on the principle of "clean surplus", a theory that links accounting and finance practices[1].

1 "Valuation and Clean Surplus Accounting for Operating and Financial Activities" study by Gerald Feltham and James Ohlson in 1995 sets out the clean surplus theory. The theory illustrates a way of calculating the

84. However, we think that the use of OCI is a practical decision rather than a conceptual matter. We acknowledge that standard setting involves considering conflicting objectives of different stakeholders and developing generally accepted standards. In some circumstances, we accept that it might be necessary for the IASB to decide to report some income or expenses in OCI at a standards level in order to make improvements in financial reporting. For example, we support the use of OCI when it would enable some assets and liabilities to be measured using a more relevant basis on the statement financial position, and the changes in those assets or liabilities, or a portion of those changes, to be presented in the statement of OCI.

85. When assessing whether to report some income and expenses in OCI, we think that the IASB should consider an entity's ability to make decisions that result in recycling a gain or loss in profit or loss in order to report a more favourable position. If the use of OCI is considered on balance to provide the more relevant information to financial statement users, the IASB should consider presentation and disclosure requirements to identify and explain gains and losses that have been recycled from OCI. Such information could help to reduce or detect opportunistic behaviour.

86. In time, we think that the information value of items reported in OCI will be better understood and considered when assessing an entity's overall performance. In part, our view is based on the importance that some financial statement users place on assessing income and expenses reported in OCI to understand an entity's past performance and better predict its future cash flows. Therefore, we think that recycling all items reported in OCI is important. While recycling may be complex, recycling is a necessary consequence that arises from using OCI.

Use of OCI – Question 21

Defining "financial performance" or OCI

87. All stakeholders we consulted were disappointed that the Discussion Paper did not propose to define "financial performance" or identify the necessary and distinguishing characteristics of income and expenses that could be reported in OCI. Instead, the Discussion Paper developed rationale to identify the types of income and expenses the IASB may consider reporting in OCI.

88. Given our view that the use of OCI is a practical approach used to improve financial reporting and the wide range of views of how best to report an entity's performance, we think the IASB should not undertake work to define financial performance or describe OCI at this time. The IASB should use its resources to further develop other areas of the *Conceptual Framework.*

market value of a firm, and ultimately the security returns, by means of balance sheet and income statement components and how these statements reconcile in order to anticipate future earnings.

89. The proposals provide a practical and systematic approach that will help the IASB when deciding whether to report items in OCI when developing standards. We think that the discussion of OCI and this guidance should not be included in the *Conceptual Framework* because the use of OCI is not a concept in financial reporting but an exception to a concept. We recommend that the material be issued outside of the *Conceptual Framework*.

90. In addition, we also agree that only the IASB should decide when OCI should be used. Issuing the material outside the *Conceptual Framework* would enable the *Conceptual Framework* to assist the IASB and other parties equally.

Narrow or broad approach

91. We support the broad approach 2B but think that transitory remeasurements should be required to be recycled (see response to question 20 or paragraphs 82-86).

92. We also recommend reassessing the name and description of "mismatched remeasurements" to avoid using the notion of matching as a basis for using OCI. We are concerned that the matching logic could be used to defer expensing items in profit or loss and result in a broader use of OCI. The IASB could consider describing this category as "linked items", as the income and expenses on a linked set of assets and liabilities are not always remeasured in profit or loss in the same period, absent the application of a linking notion. Thus, reporting these items together would faithfully represent the linked nature of these items. We think that further thought is needed to identify the type of linked arrangements that would or would not qualify.

Section 9 Other issues

Chapters 1 and 3 of the existing Conceptual Framework – *Question 22*

93. We agree that the IASB should not reconsider Chapters 1 and 3 of the existing *Conceptual Framework.* These chapters were completed only three years ago and were subject to full and extensive due process. The issues of stewardship, reliability and prudence were fully considered by the IASB with input from those supporting the changes and those opposing them. At that time we supported the changes for the reasons explained in the Basis for Conclusions on Chapter 3. We are not aware of anything that has occurred since that time that might change our view or that should change the IASB's view.

94. We are particularly concerned about re-introducing prudence into the *Conceptual Framework* for the reasons stated in the Basis for Conclusions on Chapter 3 and reproduced in paragraph 9.18 of the Discussion Paper. Specifically, we are concerned that prudence is often understood to require different recognition thresholds for assets and liabilities. This can result in recognizing liabilities that have a lower degree of certainty than is required to recognise assets. We fail to see how this can be consistent with neutrality, which is one of the three enhancing characteristics of the fundamental

qualitative characteristic of faithful representation. We think that neutrality is an essential aspect of the credibility of financial statement information and are concerned that re-introducing the concept of prudence into the *Conceptual Framework* would endorse bias.

95. Paragraph 9.19 notes that some support the need for prudence "to counteract the effect of over-optimistic management estimates". This argument raises the issue of moral hazard. Although the concept of moral hazard associated with financial reporting is well accepted and supported by extensive academic literature, it is not addressed in the Discussion Paper. As noted in our responses to earlier questions, we agree that all assets and liabilities should be recognized (with limited exceptions being addressed at a standards level and after assessing materiality and the cost constraint). Consequently, we think moral hazard needs to be explicitly addressed in the context of measurement (see overall response to question 11 or paragraphs 41-42).

Business model – Question 23

96. The Discussion Paper does not define "business model". One view might be that the business model is a choice made by management on how to manage the entity's assets and operations. We would be concerned if the accounting for assets (and liabilities) could be determined based on management intent. This would permit an entity to decide to manage assets in a certain manner in order to achieve a desired accounting result. It would also affect comparability between similar entities if the respective managements chose different business models.

97. We think that the type of business may determine the most appropriate accounting. Examples in current IFRSs are broker-dealers, investment companies and investment properties. The determining factor here is the business the entity is engaged in, which is a matter of fact rather than of management intent.

98. Whether an item is recognised as an asset (or liability), or when it is recognized, should not be affected by the type of business or the business model selected by management. We agree that the type of business might affect the choice of the basis of measurement. The examples in the previous paragraph primarily relate to measurement. However, we think that this will be rare and should be driven by the concepts in the *Conceptual Framework* for the determination of the measurement basis.

99. The business model may play a role in presentation and disclosure. The business model will often reflect management's views of the risks associated with different assets. Differences in risk affect aggregation/disaggregation in the financial statements and the level of detail provided in the notes to the financial statements. For example, the management approach underlying segment reporting is based on management's business model.

Unit of account – Question 24

100. Unit of account is a fundamental and pervasive issue in standard setting. While we agree that the unit of account will be determined at a standards level, we think it is important that the *Conceptual Framework* address the concepts associated with unit of account to ensure that new and revised standards address unit of account in a systematic, rational and consistent manner. The following paragraphs outline some aspects of unit of account that we believe need to be considered.

101. We think a key concept is that there are four inter-related unit of account issues. These are the unit of recognition, the unit of measurement, the unit of presentation and the unit of disclosure.

102. The unit of recognition (and derecognition) defines the boundaries of an element. The unit of account for initial recognition usually coincides with the physical or contractual boundaries of whatever is transferred. However, this may not be true when different portions of the item transferred contribute to the future cash flows of the reporting entity in different ways. For example cash flows associated with different parts of an item may be fixed, variable or contingent and other factors may also affect the timing and uncertainty of future cash flows. The unit of account changes as the item is used in the entity's value-producing process so context needs to be considered.

103. The unit of measurement is not necessarily the same as the unit of recognition. In certain circumstances, measurement may only be possible at a group level. For example, asset impairment may have to be carried out for a cash-generating unit rather than for individual assets. As a practical matter, grouping for measurement is also appropriate when the item is economically indistinguishable from other similar items, either because items are fungible or individually insignificant. However, such aggregation of individual items would generally not affect the total amount at which the items are measured.

104. The unit of presentation is generally at a more aggregated level than the unit of recognition or the unit of measurement. Offsetting is a unit of presentation issue as is the debate about presentation by nature or by function.

105. There are two unit-of-account issues in determining disclosures. Disclosures are sometimes used to provide an alternative view to information presented on the face of the statements. For example, risk disclosures aggregate portions of a number of similar and dissimilar elements. Risk exposures are a separate unit of account for disclosure purposes. In other cases, disclosures provide more granular information than considered appropriate for presentation.

106. We think that more research is needed to develop concepts level thinking on unit of account that could be included in the *Conceptual Framework* and that this should be undertaken as part of the coordinated research on conceptual framework topics that we propose elsewhere in this response.

Going concern – Question 25

107. We are not aware of any other situations where the going concern assumption might be relevant.

Capital maintenance – Question 26

108. We agree that the IASB should include the existing descriptions and the discussion of capital maintenance concepts in the revised *Conceptual Framework*, largely unchanged, at this time. The difference between financial capital maintenance and physical capital maintenance can be substantial. However, the quite limited material on capital maintenance concepts in the current *Conceptual Framework* is not an aspect that is currently causing difficulty. The IASB's resources should be focused on other aspects of the *Conceptual Framework* as discussed elsewhere in our response.

Additional Comments

Transition

109. The Discussion Paper notes that a new conceptual framework would not override existing standards but would be used in the development of new standards. It does not otherwise discuss transition issues. We think that issuing a new conceptual framework with significant differences from the existing *Conceptual Framework* could raise transition issues for preparers, auditors and other stakeholders.

110. The *Conceptual Framework* is used in determining how to account for a transaction in the absence of a standard that specifically applies to the transaction or event. Certain standards also use terms that are only defined in the *Conceptual Framework.* The transition question arising is whether the new *Conceptual Framework* should be used in conjunction with a standard developed using the current *Conceptual Framework* – or should one be required to look back to the *Conceptual Framework* in place when the standard was developed. This issue becomes more complicated if a standard developed under the current *Conceptual Framework* is amended after the new *Conceptual Framework* is issued. A related question is whether an accounting policy developed using the existing *Conceptual Framework* would have to be reconsidered if it is not consistent with the new *Conceptual Framework.*

111. We think the IASB should identify significant conflicts between the new *Conceptual Framework* and existing standards as a first step to determining whether and what transition guidance will be required.

Professional judgment

112. In developing a standard the IASB must decide how much detailed guidance to include. Implicit in this decision is a view of the professional judgment that preparers, auditors and other stakeholders can be expected to apply. It is also important for preparers, auditors and other stakeholders to understand the level of guidance generally included in an IFRS and the IASB's expectations of them in terms of applying professional judgment. We therefore think that the *Conceptual Framework* should address professional judgment.

23 January 2014

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Hans

AOSSG comments on IASB Discussion Paper DP/2013/1
A Review of the Conceptual Framework for Financial Reporting

The Asian-Oceanian Standard-Setters Group (AOSSG) is pleased to provide comments on the IASB DP/2013/1 *A Review of the Conceptual Framework for Financial Reporting* (DP). In formulating its views, the AOSSG sought the views of its constituents within each jurisdiction.

The AOSSG currently has 26 member standard-setters from the Asia-Oceania region: Australia, Brunei, Cambodia, China, Dubai, Hong Kong, India, Indonesia, Iraq, Japan, Kazakhstan, Korea, Macao, Malaysia, Mongolia, Nepal, New Zealand, Pakistan, Philippines, Saudi Arabia, Singapore, Sri Lanka, Syria, Thailand, Uzbekistan and Vietnam.

To the extent feasible, this submission to the IASB reflects in broad terms the collective views of AOSSG members. Each member standard-setter may also choose to make a separate submission that is consistent or otherwise with aspects of this submission. The intention of the AOSSG is to enhance the input to the IASB from the Asia-Oceania region and not to prevent the IASB from receiving the variety of views that individual member standard-setters may hold. This submission has been circulated to all AOSSG members for their feedback after having initially been developed through the AOSSG Conceptual Framework Working Group.

The AOSSG strongly supports the IASB's efforts in issuing the DP and the high priority it has given to reviewing *The Conceptual Framework for Financial Reporting* (the Conceptual Framework). The AOSSG identified the review of the Conceptual Framework as the highest priority project in its response to the IASB's Request for Views *Agenda Consultation 2011*, because the AOSSG believes that the Conceptual Framework is the cornerstone for the IASB's work in developing or revising Standards, and that the development of a robust Conceptual Framework will contribute greatly to the development of high quality and internally consistent accounting standards.

In general, the AOSSG finds that the DP is written quite well given the very short period of preparation time. However, AOSSG members have strong concerns about the following general matters:

- Some of the preliminary views presented in the DP would not be adequate to assist the IASB to develop high quality and internally consistent accounting standards, for example, in relation to the recognition criteria for assets and liabilities (refer our comments on Question 8);

- Some of the preliminary views seem to be based on current accounting conventions rather than having been arrived at on the basis of conceptual merits (for example, discussion of liabilities and equities, and recycling of other comprehensive income (OCI) (refer our comments on Questions 10 and 21);

- The presentation and disclosure section of the DP seems to merely document the accounting constructs currently employed, and it is questionable that it would satisfy the demands of financial statement users for a meaningful presentation and disclosure framework that can help streamline excessive disclosure and make information more relevant (refer our comments on Question 16); and

- Some areas (for example, the unit of account) remain almost untouched but would be of significant and pervasive importance in the standard-setting process, and warrant consideration (refer our comments on Questions 2, 7, 9, 15 and 24)

In particular, AOSSG members have found the following areas to be controversial, yet fundamental to the Conceptual Framework project:

- Whether to directly remeasure secondary equity claims (refer our comments on Question 10);

- How to determine relevant measurement bases (refer our comments on Questions 11-15);

- Whether recycling of OCI items should be required or permitted (refer our comments on Questions 19-21); and

- Whether the concepts of prudence, reliability and stewardship should be revisited (refer our comments on Question 22).

Finally, having regard to the critical importance of this project, AOSSG members strongly encourage the IASB to reach out to national standard-setters and other stakeholders before developing the Exposure Draft. This would enhance the IASB's understanding of the views and reasons expressed in comment letters, and would assist the IASB in thoroughly analysing alternative approaches. The AOSSG is willing to provide assistance in making arrangements for the IASB members and staff to interact with key stakeholders from the Asia-Oceania region.

Our views in relation to the preliminary views in DP/2013/1 are explained in more detail in the Appendix.

If you have any questions regarding any matters in this submission, please contact either one of us.

Yours sincerely,

Clement Chan
AOSSG Chair

Ikuo Nishikawa
AOSSG Conceptual Framework Working Group Leader

APPENDIX – Detailed comments on DP/2013/1

Section 1 Introduction

Question 1

Paragraphs 1.25–1.33 set out the proposed purpose and status of the *Conceptual Framework*. The IASB's preliminary views are that:

(a) the primary purpose of the revised *Conceptual Framework* is to assist the IASB by identifying concepts that it will use consistently when developing and revising IFRSs; and

(b) in rare cases, in order to meet the overall objective of financial reporting, the IASB may decide to issue a new or revised Standard that conflicts with an aspect of the *Conceptual Framework*. If this happens the IASB would describe the departure from the *Conceptual Framework*, and the reasons for that departure, in the Basis for Conclusions on that Standard.

Do you agree with these preliminary views? Why or why not?

Comments on Question 1

Role of the Conceptual Framework

1. AOSSG members generally support the preliminary view in the DP that the primary purpose of the Conceptual Framework is to assist the IASB by identifying the concepts that can be used consistently when developing and revising IFRSs. However, AOSSG members offer the following comments:

    (1) The IASB should emphasise that the Conceptual Framework is a 'living document' and is subject to change based on experience (or feedback) gained from the standard-setting process.

    (2) The Conceptual Framework is useful for all those involved in the standard-setting process, not just the IASB, as it facilitates communication among stakeholders in the 'same language'.

    (3) Some AOSSG members suggest it might be helpful for the IASB to consider whether the reference to the *Framework* in paragraph 11(b) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* is still necessary, considering that the IASB has added a large number of requirements as well as application materials to IFRSs since that reference was included. If the IASB decides that such a reference is still necessary, the Conceptual Framework should more explicitly state that the Conceptual Framework also assists parties other than the IASB to: (i) understand and interpret existing standards; and (ii) develop accounting policies when no standard or interpretation specifically applies to a particular transaction or event consistent with paragraph 11(b) of IAS 8.

Departure from the Conceptual Framework

2. AOSSG members generally support the preliminary view in the DP that, in rare cases, in order to meet the overall objective of financial reporting, the IASB may decide to issue a new or revised Standard that conflicts with an aspect of the Conceptual Framework.

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3. However, some AOSSG members consider that the IASB should not use the possibility of departure only in rare cases as a justification for developing potentially weak principles in the Conceptual Framework. In this regard, these AOSSG members think that 'rare' is too specific and could restrict the frequency of departures from the Conceptual Framework when developing IFRSs. If the IASB commits to depart from the Conceptual Framework only in rare circumstances, the IASB might lean towards developing a more pragmatic Conceptual Framework, rather than ideal principles to accommodate evolving transactions and accounting treatments in foreseeable new or revised IFRSs. On a positive note, some AOSSG members consider the possibility of departure from the Conceptual Framework as an indication that there will be a need to revisit the Conceptual Framework regularly over time.
4. Some AOSSG members recommend that the IASB explain when and how a departure from the Conceptual Framework is made especially if the departure is not due to cost-benefit reasons.

Section 2 Elements of financial statements

Question 2

The definitions of an asset and a liability are discussed in paragraphs 2.6–2.16. The IASB proposes the following definitions:

(a) an asset is a present economic resource controlled by the entity as a result of past events.

(b) a liability is a present obligation of the entity to transfer an economic resource as a result of past events.

(c) an economic resource is a right, or other source of value, that is capable of producing economic benefits.

Do you agree with these definitions? Why or why not? If you do not agree, what changes do you suggest, and why?

Comments on Question 2

5. Most AOSSG members generally support the proposed definitions of an asset, a liability, and an economic resource stated in the DP.

Definition of a 'liability'

6. Some AOSSG members believe that the definition of a liability should be modified to address issues that have arisen from certain instruments that oblige an entity to transfer economic resources only because they have redemption features or embedded put options but otherwise exhibit the common characteristics of equity instruments, and to capture in-substance liabilities in the absence of an obligation to transfer economic resources, such as obligations to be fulfilled by the issuance of an entity's own equity instruments as 'currency'. Paragraph 36 of this submission provides more detail.

Definition of an 'economic resource'

7. Some AOSSG members offer the following comments:

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(1) The definition of an economic resource should be considered in combination with the concept of the 'unit of account'. If the IASB were to clarify that an economic resource is a right, or other source of value, that is capable of producing economic benefits (rather than, for example, a physical asset itself), it would be significantly difficult to determine whether a bundle of rights should be accounted for together (or separately) without a robust discussion about the 'unit of account'.

(2) Having witnessed the various interpretations provided by respondents to the IASB ED/2012/5 *Clarification of Acceptable Methods of Depreciation and Amortisation*, the IASB should consider clarifying the term 'economic benefits' in the Conceptual Framework.

(3) It is not sufficiently clear whether the 'right' and 'other source of value' are meant to be used interchangeably or have different meanings. It would be helpful if the IASB clarifies whether, and if so, how they are different.

Question 3

Whether uncertainty should play any role in the definitions of an asset and a liability, and in the recognition criteria for assets and liabilities, is discussed in paragraphs 2.17–2.36. The IASB's preliminary views are that:

(a) the definitions of assets and liabilities should not retain the notion that an inflow or outflow is 'expected'. An asset must be capable of producing economic benefits. A liability must be capable of resulting in a transfer of economic resources.

(b) the Conceptual Framework should not set a probability threshold for the rare cases in which it is uncertain whether an asset or liability exists. If there could be significant uncertainty about whether a particular type of asset or a liability exists, the IASB would decide how to deal with that uncertainty when it develops or revises a Standard on that type of asset or liability.

(c) the recognition criteria should not retain the existing reference to probability.

Do you agree? Why or why not? If you do not agree, what do you suggest, and why?

Comments on Question 3

Deleting the term 'expected' from definitions of an asset and a liability

8. AOSSG members generally support the preliminary view in the DP that the definitions of assets and liabilities should not retain the notion that an inflow or outflow is 'expected'.

Existence uncertainty

9. AOSSG members generally support the preliminary view in the DP that the Conceptual Framework should not set a probability threshold for the rare cases in which it is uncertain whether an asset or liability exists. AOSSG members generally feel that such rare circumstances could be better dealt with at a Standards level.

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Recognition criteria

10. For various reasons, most AOSSG members strongly disagree with the preliminary view in the DP that the recognition criteria should not retain the existing reference to 'probability'. The reasons include the following:

    (1) If the probable threshold were to be eliminated, virtually all litigation claims could be measured using an expected value, which would be very misleading to financial statement users. Accordingly, the probable threshold in the existing Conceptual Framework should be retained in the recognition criteria. In connection with this, some AOSSG members recommend that 'probable' is defined as 'more likely than not', while other members are of the view that it is not appropriate to define the term in the Conceptual Framework.

    (2) It may not *always* be appropriate to use a 'probability' notion as part of recognition criteria, including the case where the distribution of the probabilities of something occurring is not known to third parties (for example, a written option). Nevertheless, in many cases, including litigation, the probable threshold would be appropriate because it would filter out liabilities the measurement of which on an expected value basis, would usually differ from the ultimate cash outflows.

    (3) Recognising items arising from outcomes with a remote chance of occurring would detract from the other recognised items in financial statements. In addition, recognising all rights and obligations regardless of the probability of outcomes might require entities to search 'endlessly' for potential rights and obligations.

    (4) The IASB's concerns with retaining a 'probable' criterion for recognition seem, at least in part, to focus on the range of assets and liabilities in respect of which it might be less than probable that an 'ultimate inflow or outflow' of economic benefits will occur (and that, consequently, would not qualify for recognition if that criterion were used) (refer paragraph 2.35(c) of the DP). However, focusing on whether it is probable that an 'ultimate inflow or outflow' of economic benefits will occur seems much more restrictive than the 'probable' criterion in paragraph 4.38(a) of the existing Conceptual Framework, which refers to whether "it is probable that *any future economic benefit associated with the item* will flow to or from the entity" (emphasis added). Focusing only on the probability of an 'ultimate inflow or outflow' of economic benefits and disregarding a probable inflow or outflow of economic benefits that would result from receiving or providing a service of standing ready (for example, standing ready to meet any insurance claim or warranty claim that may arise under a contract with a customer) might lead to non-recognition of assets and liabilities that would qualify for recognition if the 'probable' criterion in paragraph 4.38(a) of the existing Conceptual Framework were applied. Therefore, the DP seems to overstate the range of assets and liabilities that would be filtered from recognition by the existing 'probable' criterion.

Question 4

Elements for the statement(s) of profit or loss and OCI (income and expense), statement of cash flows (cash receipts and cash payments) and statement of changes in equity (contributions to equity, distributions of equity and transfers between classes of equity) are briefly discussed in paragraphs 2.37–2.52.

asian-oceanian standard-setters group

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Do you have any comments on these items? Would it be helpful for the Conceptual Framework to identify them as elements of financial statements?

<u>Comments on Question 4</u>

Elements for statements of profit or loss and OCI

11. Many AOSSG members believe that terms such as 'profit or loss' and 'OCI' should be defined as elements of financial statements. These members believe that defining 'profit or loss' as an element is important, because presentation of the item is essential to meet the objective of financial reporting.

12. However, other AOSSG members do not regard 'profit or loss' as a separate element of financial statements, although they have no problem with presenting 'profit or loss' as one of various possible metrics in financial statements. In other words, they regard 'profit or loss' as one of the sub-totals of particular items of other elements (income and expenses), and therefore a matter of presentation rather than definition.

Elements for statements of cash flows

13. Some AOSSG members believe that terms such as 'cash receipts' and 'cash payments' should not be defined as elements of financial statements for the following reasons:

    (1) The proposed definitions would be inconsistent with the presentation of the statements of cash flows under the indirect method, and would give rise to a misunderstanding that the IASB still wishes to adopt the 'direct method' for the statement of cash flows.

    (2) Considering that cash is a sub-set of another element (that is, assets), defining cash flows as elements would imply defining other sub-sets of assets (such as 'current assets'), or movements therein, as separate elements. These members consider that this would be inappropriate.

Elements of statements of changes in equity

14. Some AOSSG members believe that it is unnecessary to define 'transfers between classes of equity' as a possible element of the statement of changes in equity, considering the discussion in Section 5 of the DP.

Section 3 Additional guidance to support the asset and liability definitions

Question 5

Constructive obligations are discussed in paragraphs 3.39–3.62. The discussion considers the possibility of narrowing the definition of a liability to include only obligations that are enforceable by legal or equivalent means. However, the IASB tentatively favours retaining the existing definition, which encompasses both legal and constructive obligations—and adding more guidance to help distinguish constructive obligations from economic compulsion. The guidance would clarify the matters listed in paragraph 3.50.

Do you agree with this preliminary view? If not, why not?

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Comments on Question 5

15. Most AOSSG members agree with the preliminary view in the DP to retain the existing definition of a liability, which encompasses both legal and constructive obligations. This is primarily because if the definition of a liability is limited only to obligations that are enforceable by legal or equivalent means, such a definition will not be able to capture the obligations for which an entity has no practical ability to avoid. Having said that, some AOSSG members offer the following comments:

    (1) The interaction and difference between the concepts of 'economic compulsion' and 'constructive obligation' should be explained in the Conceptual Framework, especially regarding whether both concepts can be used for financial and non-financial liabilities.

    (2) The interaction between the concepts of 'constructive obligation' and 'conditional obligation' should be explained in the Conceptual Framework. For example, if a constructive obligation to pay a bonus to employees is determined to exist for an entity based on the entity's past pattern of paying bonuses, and such a bonus would become payable only when employees have worked for a five-year period, that constructive obligation is conditional until that period is completed. The DP does not explain how such a situation should be accounted for.

    (3) The interaction between the concepts of 'constructive obligation' and 'practically unconditional' under View 2 in the DP should be explained in the Conceptual Framework, if the IASB were to retain the concept stated as View 2 in the revised Conceptual Framework. For example, a constructive obligation is likely to exist for past services rendered since employees could *reasonably rely* on the entity to pay the special bonus as a result of its past actions. However, one could consider that the entity has a *practical ability to avoid* payment, and hence conclude a present obligation does not exist.

    (4) Further analysis should be considered such as whether a constructive obligation could also exist when circumstances other than an entity's past actions have caused other parties to reasonably rely on the entity to act in a certain way, such that those parties would benefit (or would not suffer loss or harm) and, as a result, created a duty or responsibility on the entity to undertake that particular action. This includes the case where the industry practice (not necessarily the entity's past practice) creates a reasonable expectation that a bonus will be paid to employees when certain conditions are met.

16. In contrast to the comments in paragraph 15 above, some other members believe that a present obligation must be enforceable against the entity, and unenforceable 'constructive obligations' should be excluded from the definition of a liability. This is because an entity cannot be obliged to transfer an economic resource if the obligations are unenforceable. In this context, these members believe that 'enforceable' does not only mean 'legally enforceable' (as 'enforceable' is sometimes interpreted). It includes implicit obligations and equitable obligations that are enforceable, and obligations enforceable through religious customs or sanctions. These AOSSG members are concerned that unenforceable obligations are inherently indistinguishable from economic compulsion. If economic compulsion were implicitly treated as being, of itself, sufficient for a present obligation to exist, it would be logical for present obligations to be identified in respect of intentions to pay salaries for future

services by employees, intentions to repair or replace assets essential to the entity's future operations, and intentions to undertake staff training to comply with industry regulations.

17. Furthermore, some AOSSG members offer the following comments:

    (1) Paragraph 3.5(b) of the DP acknowledges that economic resources include rights arising from a constructive obligation of another party (these could be referred to as 'constructive rights'), but there is barely any further discussion of this type of economic resource. Further discussion in this regard would be helpful to address potential tension between the 'constructive' concept and the 'control' notion in the asset definition.

    (2) It would be useful to clarify what role the concept of 'economic compulsion' would play in determining whether a liability exists. For example, much of the discussion relating to Views 1 to 3 could alternatively be explained by addressing the concept (refer our comments on economic compulsion in paragraphs 15(1) and 16 above).

Question 6

The meaning of 'present' in the definition of a liability is discussed in paragraphs 3.63–3.97. A present obligation arises from past events. An obligation can be viewed as having arisen from past events if the amount of the liability will be determined by reference to benefits received, or activities conducted, by the entity before the end of the reporting period. However, it is unclear whether such past events are sufficient to create a present obligation if any requirement to transfer an economic resource remains conditional on the entity's future actions. Three different views on which the IASB could develop guidance for the Conceptual Framework are put forward:

(a) View 1: a present obligation must have arisen from past events and be strictly unconditional. An entity does not have a present obligation if it could, at least in theory, avoid the transfer through its future actions.

(b) View 2: a present obligation must have arisen from past events and be practically unconditional. An obligation is practically unconditional if the entity does not have the practical ability to avoid the transfer through its future actions.

(c) View 3: a present obligation must have arisen from past events, but may be conditional on the entity's future actions.

The IASB has tentatively rejected View 1. However, it has not reached a preliminary view in favour of View 2 or View 3.

Which of these views (or any other view on when a present obligation comes into existence) do you support? Please give reasons.

<u>Comments on Question 6</u>

18. Among the three options, most AOSSG members prefer View 2 for the following reasons:

    (1) Although View 1 is conducive to improving the comparability of financial statements across entities, it is likely to fail to faithfully represent transactions and events, as the scope of a liability would be too narrow. In addition, it may give rise to structuring opportunities through incorporation of artificial conditions in contracts.

    (2) View 2 is more consistent with the control model introduced in IFRS 10 *Consolidated Financial Statements*, which requires that the practical ability should be considered to

ascertain substantive rights in assessing whether control exists. However, the use of the 'going concern' concept would not be appropriate in determining whether there is a practical ability for an entity. This is because an entity may have various operations and, even if an entity were to cease operation in its major business line (for example, railways operation), it can still survive by continuing operations in other business lines (also refer our comments in paragraph 97 of this submission).

19. In addition to the comments stated in the previous paragraph, some AOSSG members suggest considering the following possible alternative approaches (besides those suggested in the DP):

(1) An approach based on the principle that a present obligation must be enforceable against the entity (as mentioned in paragraph 16 above).

(2) An approach that is broader than View 3. Under this approach, for a liability to be recognised, a present obligation must have arisen from a past event, but such an event may be conditional on future actions of the entity or of *others*, or *on the resolution of some events*.

(3) An approach that focuses on determining whether or not there is a present claim on the entity's assets (rather than whether or not future cash outflows are expected to occur or must occur):

(i) View 1A: A present claim against the assets must exist at balance sheet date, irrespective of whether or not it is probable or certain that the entity will settle the claim in the future.

(ii) View 2A: A present legal or constructive obligation must be practically unconditional and exclude amounts that are wholly (or substantially) based on future activities of the entity, such as future revenues or profits.

(4) An approach that uses a threshold that corresponds to the 'reasonably rely' threshold for 'unconditional' constructive obligations, such as 'no reasonable ability to avoid'. Arguably, such a threshold would consider an entity's likelihood of acting upon or abstaining from the future action more realistically than the three views in the DP, thereby resulting in an outcome that better reflects the underlying economic reality. Furthermore, there are conceptual merits in applying similar principles to all in-substance similar obligations, whether they are legal or constructive obligations that depend on an entity's future actions or 'unconditional' constructive obligations, for all such obligations in respect of which the entity has the unilateral right (whether or not through its future actions) to avoid the transfer of economic resources.

20. Regardless of which view to take, some members are concerned with the insufficiently robust discussions and potential tension points as to which activity would result in a 'past event'. This issue is particularly important when an obligation to transfer an economic resource is incurred as a result of an entity conducting *more than one activity* at different points in time. For example, a government may impose a levy on entities that supply electricity to a domestic energy market on 31 December each year, and the levy is determined as a percentage of the operator's revenue during the year. In this example, the 'past event' may be interpreted to mean the occurrence of:

(1) The entity operating in the electricity market on 31 December, which is based on the interpretation that a past event refers to *a specified activity* for which another party can seek payment from the entity (refer paragraph 3.65 of the DP);

(2) The entity having generated revenue during the year, which is based on the interpretation that a past event refers to *any activity* that contributes to other party's right to seek payment from the entity (refer paragraph 3.65 of the DP); or

(3) The entity having generated revenue during the year and the entity operating in the electricity market on December 31 of that year, which is based on the interpretation that a past event refers to *an activity that determines the amount of a liability* (refer paragraph 3.66 of the DP).

These members recommend that the Conceptual Framework should include clearer principles to address the above issues.

Question 7

Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?

Comments on Question 7

21. Paragraph 3.110(a) of the DP explains that, in principle, a net asset or a net liability arises under an executory contract if the contract is enforceable. In addition, paragraph 3.110 (c) of the DP explains that, depending on the circumstances, the purchaser may have either: (i) a single net right or net obligation to exchange the underlying asset and the purchase price simultaneously; or (ii) a separate gross right to receive the asset and a separate gross obligation to pay the purchase price. However, the DP does not provide guidance on when 'a net single right or obligation' (as opposed to a gross right and obligation) arises under such a contract.

22. Some AOSSG members think this has important implications for the use of judgment in the standard-setting process, having witnessed the different views in relation to when a separate right and obligation should be accounted for as a single 'unit of account' in the IASB's standard-setting. Therefore, these AOSSG members encourage the IASB to explore the 'unit of account' further in the Conceptual Framework project (refer our comments on Question 24).

Section 4 Recognition and derecognition

Question 8

Paragraphs 4.1–4.27 discuss recognition criteria. In the IASB's preliminary view, an entity should recognise all its assets and liabilities, unless the IASB decides when developing or revising a particular Standard that an entity need not, or should not, recognise an asset or a liability because:

(a) recognising the asset (or the liability) would provide users of financial statements with information that is not relevant, or is not sufficiently relevant to justify the cost; or

(b) no measure of the asset (or the liability) would result in a faithful representation of the asset (or the liability) and of changes in the asset (or the liability), even if all necessary descriptions and explanations are disclosed.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

<u>Comments on Question 8</u>

23. As stated in our response to Question 3, for various reasons, most AOSSG members strongly disagree with the preliminary view in the DP that the recognition criteria should not retain the existing reference to 'probability'. Refer paragraph 10 for more details.

24. Some AOSSG members agree with the IASB's preliminary view that a probability threshold should be eliminated, and that all assets and liabilities should be recognised unless the conditions for non-recognition in paragraph 4.25 of the DP are satisfied. Therefore, they suggest that these conditions should be stipulated in the revised Conceptual Framework (rather than to be determined by the IASB at the Standards level). This is because, unless such conditions are explicitly stated in the Conceptual Framework, there is a greater risk that the IASB would not specify such conditions in a Standard; thereby an entity would be required to search extensively for potential rights and obligations that would otherwise meet the proposed non-recognition criteria. Some AOSSG members feel that insufficient discipline is provided in paragraphs 4.25 and 4.26 of the DP for the following reasons:

   (1) Paragraph 4.25 of the DP states that the IASB *might* decide that an entity need not, or should not, recognise an asset or a liability, when the information does not pass the tests of 'relevance' and 'faithful representation'. However, it would seem that the IASB *must* prohibit an entity from recognising the asset or the liability, when such tests are not met, because information would not be useful unless these tests are met.

   (2) The proposed recognition criteria are not sufficiently robust. They could be interpreted to justify an argument that an asset or a liability should be recognised as long as it meets the definition. This is because the concepts of 'relevance' and 'faithful representation' are likely to be neglected in the standard-setting process due to their very subjective nature.

25. Furthermore, some AOSSG members believe that 'relevance' should be a qualitative characteristic of the information produced as a result of the measurement basis used to measure a recognised asset rather than an attribute of recognition (that is, the question of relevance is not about whether or not to recognise an asset, it is rather about how to measure the recognised asset in a way that results in information relevant to users' decisions). Therefore, these members support retaining the 'probability of outcome' as a recognition criterion. In addition, these members disagree with the DP in its use of internally generated goodwill as an example of an unrecognised asset because it lacks relevance (paragraph 4.9(c) of the DP). In their view, internally generated goodwill fails both of the recognition criteria in the existing Conceptual Framework (that is, probability of the flow of economic benefits and reliability of the measurement).

Question 9

In the IASB's preliminary view, as set out in paragraphs 4.28–4.51, an entity should derecognise an asset or a liability when it no longer meets the recognition criteria. (This is the control approach described in paragraph 4.36(a)). However, if the entity retains a

component of an asset or a liability, the IASB should determine when developing or revising particular Standards how the entity would best portray the changes that resulted from the transaction. Possible approaches include:

(a) enhanced disclosure;

(b) presenting any rights or obligations retained on a line item different from the line item that was used for the original rights or obligations, to highlight the greater concentration of risk; or

(c) continuing to recognise the original asset or liability and treating the proceeds received or paid for the transfer as a loan received or granted.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

<u>Comments on Question 9</u>

26. AOSSG members generally agree with the preliminary view in the DP that an entity should derecognise an asset or a liability when it no longer meets the recognition criteria (that is, to adopt the 'control approach').

27. Some AOSSG members understand the challenges in formulating explicit principles for derecognition of assets and liabilities, and agree with the IASB's preliminary view in the DP that if the entity retains a component of an asset or a liability, the IASB should determine when developing or revising particular Standards how the entity should best portray the changes that resulted from the transaction.

28. However, other members are not convinced with the IASB's preliminary view, and consider that the Conceptual Framework should contain robust overarching derecognition principles because that preliminary view relies too much on judgement at an individual standard level. These members believe that development of a principle about how to determine the unit of account is the key to developing a robust derecognition principles.

29. In addition, some AOSSG members offer the following comments:

    (1) Principles as to whether to follow a 'control approach' or a 'risk-and-rewards approach' and how they relate to each other should be more clearly articulated in the Conceptual Framework. In doing so, application of the 'unit of account' concept should be explored in parallel.

    (2) Rather than relying on enhanced disclosures and separate presentation, for a transaction involving derecognition of some components of an asset or a liability:

        (i) The partial derecognition approach should be applied in respect of any components of an asset or a liability that are retained by the entity (a component of an asset or a liability should not be treated as being retained if its character has changed significantly); and

        (ii) The full derecognition approach should be applied to all other components, with initial recognition of the new or substantially different rights or obligations arising from the transaction.

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Section 5 Definition of equity and distinction between liabilities and equity instruments

Question 10

The definition of equity, the measurement and presentation of different classes of equity, and how to distinguish liabilities from equity instruments are discussed in paragraphs 5.1–5.59. In the IASB's preliminary view:

(a) the Conceptual Framework should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.

(b) the Conceptual Framework should state that the IASB should use the definition of a liability to distinguish liabilities from equity instruments. Two consequences of this are:

(i) obligations to issue equity instruments are not liabilities; and

(ii) obligations that will arise only on liquidation of the reporting entity are not liabilities (see paragraph 3.89(a)).

(c) an entity should:

(i) at the end of each reporting period update the measure of each class of equity claim. The IASB would determine when developing or revising particular Standards whether that measure would be a direct measure, or an allocation of total equity.

(ii) recognise updates to those measures in the statement of changes in equity as a transfer of wealth between classes of equity claim.

(d) if an entity has issued no equity instruments, it may be appropriate to treat the most subordinated class of instruments as if it were an equity claim, with suitable disclosure. Identifying whether to use such an approach, and if so, when, would still be a decision for the IASB to take in developing or revising particular Standards.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

<u>Comments on Question 10</u>

Overall comments

30. While the emphasis given varies, most AOSSG members disagree with the preliminary views in the DP for various reasons, including the following:

(1) The focus given to determining how to separate the claim against an entity (that is to show: (i) the *solvency* of an entity; and (ii) the *effect of dilution* to the primary equity claim) is not appropriate (refer also paragraph 32 below).

(2) A proposal to retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities does not work well to address the concerns stated in the DP.

(3) The notion of 'wealth transfer' and need for remeasuring secondary equity claims are questionable.

31. Regardless of the preferred approaches, most AOSSG members strongly disagree with directly remeasuring secondary equity claims, because:

    (1) It is unclear what the residual amounts (that is, primary equity claims) would represent after deducting the current value of the secondary equity claims.

    (2) Remeasuring equity warrants may give rise to an outcome that does not reflect economic reality, because the residual amount of equity (that is, primary equity claims) would decrease when the share price increases due to the surge in the value of equity warrants (however, in that case, the value attributed to holders of ordinary shares should have increased). This concern could only be overcome by remeasuring all equity interests to their current market value, the sum of which would not equal the entity's recognised net assets, which AOSSG members do not advocate.

    (3) The objectives of financial information stated in paragraphs OB2-OB4 of the Conceptual Framework do not necessitate showing the effect of dilution in the equity section.

    (4) There are significant practical difficulties on how to remeasure some parts of equity, and the benefits from remeasuring some parts of equity do not outweigh the cost of doing so.

    (5) It conflicts with the general principle that an entity's financial statements depict economic phenomena affecting the entity, and not economic phenomena affecting other parties only. No changes in the entity's assets or liabilities, or future cash flows, occur as a result of changes in the value of its equity instruments to equity holders.

32. Some members disagree with the preliminary views stated in paragraphs (a)-(c) of Question 10, because they believe that claims against the entity should be separated in light of: (i) determining *whether a transaction should give rise to income or expense* (rather than being accounted for as changes in equity); and (ii) assessment of the *solvency* of an entity, giving particular focus to the former. In contrast, the preliminary view in the DP seems to give particular focus on showing: (i) the *solvency* of an entity; and (ii) the *effect of dilution* on the primary equity claim. These members suggest that a combination of the 'narrow equity approach' and the 'strict obligation approach' would be helpful, because the former approach is conducive to the determination of whether a transaction should give rise to income or expense, while the latter approach is conducive to the assessment of solvency. Yet this approach would result in the three 'categories' for the presentation of claims, consisting sections for liabilities, mezzanine claims and equities.

Specific comments

33. Many AOSSG members agree with the preliminary view stated in paragraph (b)(ii) of Question 10 that the requirement to make payments that would arise only on liquidation would not meet the definition of a present obligation. This is because, as paragraph 3.89(a) of the DP explains, financial statements are normally presented on the assumption that an entity is a going concern, and will continue to operate for the foreseeable future.

34. On the contrary, some other members disagree with the preliminary view in the DP that obligations that will arise only on liquidation of the reporting entity are not liabilities. Those members argue that the central point in defining a liability is the existence of an obligation at the reporting date that arises from past events, and these members believe that the timing of payment is not relevant to the definition as long as there will be a payment in the future. In addition, those members are of the view that using the example of payment to ordinary

shareholders is not appropriate since the payment to ordinary shareholders on liquidation is the application of the notion of 'residual interest' as opposed to 'obligation'.

35. Members' views were mixed regarding the preliminary view in paragraph 5.57 of the DP that the revised Conceptual Framework should indicate that an entity should treat some obligations that oblige the issuer to deliver economic resources as if they were equity instruments. Some members believe that this clarification is helpful. However, others disagree with the preliminary view and feel that unless an instrument can only be exercised upon liquidation of the entity, the conceptual alternatives that should be considered are either:

    (1) bifurcation into its liability and equity components; or

    (2) a dual approach under which the instrument is either classified entirely as equity if the option is puttable at fair value, or bifurcated into liability and equity components if the option is not puttable at fair value.

36. Some AOSSG members think that, building on the notion that equity is a residual element in the statement of financial position, equity could arguably exhibit characteristics such as participation in net assets (for example pro-rata share of net assets and net income/expense) and loss absorption features. As such, certain instruments that oblige an entity to transfer economic resources only because of redemption features (mandatorily or at the option of holders) or embedded put options would have characteristics that are otherwise consistent with a residual interest. Therefore, the definition of liability should be refined to address possible classification issues relating to redeemable or puttable instruments that would otherwise exhibit the common characteristics of equity instruments. These members also consider that the definition of s liability should be refined to capture in-substance liabilities in the absence of an obligation to transfer economic resources, such as obligations to be fulfilled by the issuance of an entity's own equity instruments as 'currency'.

Section 6 Measurement

Question 11

How the objective of financial reporting and the qualitative characteristics of useful financial information affect measurement is discussed in paragraphs 6.6–6.35. The IASB's preliminary views are that:

(a) the objective of measurement is to contribute to the faithful representation of relevant information about (i) the resources of the entity, claims against the entity and changes in resources and claims, and (ii) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources;

(b) a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements;

(c) when selecting the measurement to use for a particular item, the IASB should consider what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI;

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(d) the relevance of a particular measurement will depend on how investors, creditors and other lenders are likely to assess how an asset or a liability of that type will contribute to future cash flows. Consequently, the selection of a measurement:

(i) for a particular asset should depend on how that asset contributes to future cash flows; and

(ii) for a particular liability should depend on how the entity will settle or fulfil that liability.

(e) the number of different measurements used should be the smallest number necessary to provide relevant information. Unnecessary measurement changes should be avoided and necessary measurement changes should be explained; and

(f) the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.

Do you agree with these preliminary views? Why or why not? If you disagree, what alternative approach to deciding how to measure an asset or a liability would you support?

Comments on Question 11

Overall comments

37. Many AOSSG members generally support the IASB's preliminary views stated in paragraphs (a)-(f) of Question 11, including the statement in principle (b) that a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements. In addition, these members generally feel that principles (c) and (d) are helpful in determining relevant measurement bases for assets and liabilities.

38. However, some members strongly disagree with principle (b) because they believe that the Conceptual Framework should include measurement concepts that would result in measurements possessing the following qualities:

(1) The amounts can meaningfully be added, subtracted and compared; and

(2) Their economic significance, individually and collectively, is capable of being understood.

39. To achieve the goals in (1) and (2) immediately above, these members believe that measurements must have a common property and that this would require identifying an ideal concept of wealth. These members are of the view that the ideal measurement basis for a particular asset would not depend on how investors, creditors and other lenders are likely to assess how an asset of that type will contribute to future cash flows (that is, whether it will contribute *directly or indirectly* to future cash flows), and disagree with principle (d)(i).

Objective of measurement

40. The IASB's preliminary view is that the objective of measurement is to contribute to the faithful representation of relevant information about (i) the resources of the entity, claims against the entity and changes in resources and claims; and (ii) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources. While some AOSSG members agree with this preliminary view, some other AOSSG members believe that the Conceptual Framework should specify separate and distinct measurement objectives for the statement of financial position and the statement of profit or loss and OCI.

41. Some AOSSG members note that the relevance of a particular measurement will also depend on whether it allows investors, lenders and other creditors to assess how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources. For example, if an entity decides to acquire real estate for investment purposes, then investors, lenders and other creditors would benefit from learning the fair value of the property not only for the sake of knowing how the asset will contribute to future cash flows, but also to be able to assess whether management made the right decision in acquiring the property (that is, an increase in the fair value of the property could be interpreted as a good management decision).

42. In addition, some members believe that further consideration should be given to whether the two objectives of measurement (that is, decision usefulness for users and fulfilling the accountability of management) have an equal priority. If that is the case, the IASB may want to reconsider the hierarchy of 'stewardship (or accountability)' in the objective section of the Conceptual Framework.

Relevance of a particular measurement

43. The DP states as the IASB's preliminary view that the selection of a measurement basis (i) for a particular asset should depend on how that asset contributes to future cash flows; and (ii) for a particular liability should depend on how the entity will settle or fulfil that liability. Some members believe that the concept of the 'business model' can play a role in determining how a particular asset contributes to future cash flows or how an entity will settle or fulfil that liability (including when an asset contributes to future cash flows or a liability will be settled or fulfilled *in more than one way*); thereby providing a foundation to identify an appropriate measurement basis (or appropriate measurement bases) that best reflects the economic reality of an asset or a liability vis-à-vis the operations of the reporting entity.

Number of different measurements used

44. The DP states as the IASB's preliminary view that the number of different measurement bases used should be the smallest number necessary to provide relevant information. Although it is desirable not to use too many different measurement bases, AOSSG members believe that setting any arbitrary goal regarding the number of measurement bases is undesirable. If the IASB were to develop a robust decision framework that helps in determining the appropriate measurement bases for assets and liabilities, by definition there would not be too large a number of measurement bases used.

Question 12

The IASB's preliminary views set out in Question 11 have implications for the subsequent measurement of assets, as discussed in paragraphs 6.73–6.96. The IASB's preliminary views are that:

(a) if assets contribute indirectly to future cash flows through use or are used in combination with other assets to generate cash flows, cost-based measurements normally provide information that is more relevant and understandable than current market prices.

(b) if assets contribute directly to future cash flows by being sold, a current exit price is likely to be relevant.

(c) if financial assets have insignificant variability in contractual cash flows, and are held for collection, a cost-based measurement is likely to provide relevant information.

(d) if an entity charges for the use of assets, the relevance of a particular measure of those assets will depend on the significance of the individual asset to the entity.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

<u>Comments on Question 12</u>

45. Most AOSSG members support the IASB's preliminary views regarding how to determine relevant measurement bases of assets. These members believe that considering how an asset will contribute to future cash flows is relevant to the objective of assessing the amount, timing and uncertainty of future net cash inflows to an entity (paragraph OB3 of the Conceptual Framework).

46. However, some other members strongly disagree with the IASB's preliminary views, primarily because:

    (1) Identifying an ideal concept of wealth would not involve measuring assets according to whether they are expected to contribute directly or indirectly to future cash flows; and

    (2) An entity's capacity to provide cash to investors and creditors is not limited to its economic resources that directly generate cash inflows.

47. Furthermore, some AOSSG members believe that a stronger linkage should be created between the discussion about measurement and profit or loss/OCI. In doing so, these members believe that the IASB should acknowledge that differences may exist between measurement bases relevant for the statement of financial position and those relevant for the statement of profit or loss and OCI, although in most cases they would be the same.

48. Additionally, some AOSSG members offer the following comments:

    (1) In relation to category (b) in Question 12: The scoping of this category should be clarified, such that it only applies to assets held for trading purposes.

    (2) In relation to category (c) in Question 12: The description of this category should be modified to acknowledge the situations where: (i) an entity holds assets for collection or for sale; and (ii) an entity may charge for the use of assets or sell them (that is, assets with hybrid purposes). In such situations, the use of a current measure would be relevant for the statement of financial position, but a cost-based measure would be relevant for the statement of profit or loss and OCI; therefore, the use of OCI would be necessary.

    (3) In relation to category (d) in Question 12: The discussion is rather weak, and should be reconsidered. Since the manner in which the charge-for-use assets contribute to future cash flows is the same regardless of whether such items are significant, there appears no conceptual basis for using a different measurement between high-value and low-value items.

Question 13

The implications of the IASB's preliminary views for the subsequent measurement of liabilities are discussed in paragraphs 6.97–6.109. The IASB's preliminary views are that:

(a) cash-flow-based measurements are likely to be the only viable measurement for liabilities without stated terms.

(b) a cost-based measurement will normally provide the most relevant information about:

(i) liabilities that will be settled according to their terms; and

(ii) contractual obligations for services (performance obligations).

(c) current market prices are likely to provide the most relevant information about liabilities that will be transferred.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

<u>Comments on Question 13</u>

49. For reasons similar to those expressed in paragraph 45 of this submission, AOSSG members generally support the IASB's preliminary views for determining relevant measurement bases for liabilities.

50. However, some AOSSG members disagree with the IASB's preliminary view for similar reasons to those expressed in paragraph 46(1) of this submission.

51. For liabilities with stated terms but highly uncertain settlement amounts that have not yet been determined, some AOSSG members think that the explanation should be modified to acknowledge that there are situations in which different measurement bases should be used for the statement of financial position and the statement of profit or loss and OCI (the difference may be whether inputs should be updated or not at each reporting date).

Question 14

Paragraph 6.19 states the IASB's preliminary view that for some financial assets and financial liabilities (for example, derivatives), basing measurement on the way in which the asset contributes to future cash flows, or the way in which the liability is settled or fulfilled, may not provide information that is useful when assessing prospects for future cash flows. For example, cost-based information about financial assets that are held for collection or financial liabilities that are settled according to their terms may not provide information that is useful when assessing prospects for future cash flows:

(a) if the ultimate cash flows are not closely linked to the original cost;

(b) if, because of significant variability in contractual cash flows, cost-based measurement techniques may not work because they would be unable to simply allocate interest payments over the life of such financial assets or financial liabilities; or

(c) if changes in market factors have a disproportionate effect on the value of the asset or the liability (ie the asset or the liability is highly leveraged).

Do you agree with this preliminary view? Why or why not?

<u>Comments on Question 14</u>

52. Most AOSSG members agree with the preliminary view in the DP that for some financial assets and financial liabilities (for example, derivatives), basing measurement on the way in which the asset contributes to future cash flows, or the way in which the liability is settled or

fulfilled, may not provide information that is useful when assessing prospects for future cash flows.

53. However, some members disagree with paragraph 6.19 of the DP, because they believe that some exceptions discussed in the DP are not necessarily exceptions to the general principle. For example, derivatives (except for those held for hedging purposes) are presumed to be held with a view to benefiting from an appreciation in their fair value, and the current market price is considered to be relevant in light of reporting information about financial performance and financial condition.

54. Yet some other members disagree with paragraph 6.19 of the DP for reasons similar to those stated in paragraph 46 of this submission. They agree that historical cost-based information would not be useful (compared with current market prices) for assessing cash flow prospects for the financial assets and financial liabilities referred to in paragraph 6.19 of the DP, but hold this view in relation to all assets and liabilities.

Question 15

Do you have any further comments on the discussion of measurement in this section?

Comments on Question 15

55. Some AOSSG members note that the 'unit of account' is a very important concept in determining how measurement bases of assets and liabilities should be determined. These members recommend that the IASB consider how the unit of account should be determined when developing the Exposure Draft.

56. Some other AOSSG members note that the DP does not address when and how the various factors of cash-flow-based measurements should be considered for inclusion in such measurements. In the absence of broad principles in the Conceptual Framework, differences across Standards would continue to exist and diversity in practice could emerge for transactions that are not dealt with by specific IFRSs. The loosely defined 'cash-flow-based measurement' and the existing variants also bring into question whether removing any component(s) of a cash-flow-based measurement would still result in a 'meaningful, understandable and clearly describable' measure under Approach 2A to OCI discussed in section 8 of the DP, and allow the removed component(s) to be presented in OCI as a bridging item. These members therefore recommend that the IASB establishes principles in the Conceptual Framework on when and how the various factors should be considered when determining an appropriate cash-flow-based measurement.

57. In addition, some other AOSSG members recommend that the Conceptual Framework discusses the issue of foreign currency translation because some countries that are exposed to a great deal of foreign currency risk share the idea that changes in the existing foreign currency translation accounting are needed. However, more in-depth discussion regarding the issue has not been easy due to the fact that the measurement attributes of translations are not clearly articulated in IFRSs. Therefore, these members believe that it would be helpful if the Conceptual Framework clearly describes the nature of the foreign currency translation accounting (at least, whether it is part of remeasurement or not). If foreign currency translation accounting is not part of measurement, the Conceptual Framework may identify the attribute of foreign currency translation as a 'simple denomination'.

58. Furthermore, as part of their research initiative, these members identified three potential views about the nature of foreign currency translation. Those views and their possible consequences are:

   (1) **View 1:** Foreign currency translation is a mechanical conversion, separate from measuring a foreign currency transaction in a foreign currency. If View 1 is taken, exchange differences should not be recognised in profit or loss because exchange differences would not represent any result from an entity's financial performance.

   (2) **View 2:** Foreign currency translation is a measurement, separate from measuring a foreign currency transaction in a foreign currency. If View 2 is taken, the standard on foreign currency translation needs to be aligned with IFRS 13 *Fair Value Measurement* since foreign currency translation is considered to be fair value measurement of an exposure to foreign currency risk.

   (3) **View 3:** Foreign currency translation is a measurement, inseparable from measuring a foreign currency transaction in a foreign currency. If View 3 is taken, the measurement basis used in the functional currency should be the same as that used in a foreign currency because it is a single measurement process. For example, foreign currency items measured at historical cost should accordingly, be translated using the historical exchange rate, whereas those measured at fair value should be translated using the spot rate.

Section 7 Presentation and disclosure—general

Question 16

This section sets out the IASB's preliminary views about the scope and content of presentation and disclosure guidance that should be included in the Conceptual Framework. In developing its preliminary views, the IASB has been influenced by two main factors:

(a) the primary purpose of the Conceptual Framework, which is to assist the IASB in developing and revising Standards (see Section 1); and

(b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 7.6–7.8), including:

   (i) a research project involving IAS 1, IAS 7 and IAS 8, as well as a review of feedback received on the Financial Statement Presentation project;

   (ii) amendments to IAS 1; and

   (iii) additional guidance or education material on materiality.

Within this context, do you agree with the IASB's preliminary views about the scope and content of guidance that should be included in the Conceptual Framework on:

(a) presentation in the primary financial statements, including:

   (i) what the primary financial statements are;

   (ii) the objective of the primary financial statements;

   (iii) classification and aggregation;

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(iv) offsetting; and

(v) the relationship between primary financial statements.

(b) disclosure in the notes to the financial statements, including:

(i) the objective of the notes to the financial statements; and

(ii) the scope of the notes to the financial statements, including the types of information and disclosures that are relevant to meet the objective of the notes to the financial statements, forward-looking information and comparative information.

Why or why not? If you think additional guidance is needed, please specify what additional guidance on presentation and disclosure should be included in the Conceptual Framework.

Comments on Question 16

General comments

59. Some AOSSG members believe that this section of the DP merely documents the accounting constructs currently employed, and would be unlikely to satisfy the demands of users of financial reports for a meaningful disclosure and presentation framework and their demands to streamline excessive disclosure and make information more relevant. These members believe it is important to explain how to determine disclosures that more directly and efficiently link with the objective of financial reporting. Additionally, they believe it is difficult to gain an overview of the principles that might complement this section until the IASB's future work on its 'Disclosure Initiative' is substantially progressed.

60. Some AOSSG members believe that the global adoption of IFRS is creating challenges regarding how to meet the information needs of the primary users since the primary users in different jurisdictions might have different information needs that are linked to their cultural values and substantially affect their decision making. To meet such a challenge, these members suggest that the Conceptual Framework should explicitly acknowledge that meeting the objective of financial reporting may require additional disclosures that fulfil the information needs of primary users in specific jurisdictions.

Presentation in the primary financial statements

61. With regard to presentation in the primary financial statements, many AOSSG members generally agree with the IASB's preliminary views stated in Question 16. However, some members offer the following comments:

(1) The concept of 'linked-presentation' should be discussed in the Conceptual Framework, because it would help an entity to present the economic relationship between some transactions (for example, hedging relationships) as well as management intentions more clearly.

(2) It should be clarified that the statement of cash flows does not have equal priority with the statement of financial position and the statement of profit or loss and OCI, because paragraph OB 17 of the Conceptual Framework already explains that financial performance reflected by accrual accounting provides a better basis for assessing the entity's past and future performance than information solely based on cash receipts and payments during the period.

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Disclosure in the notes to the financial statements

62. With regard to disclosure in the notes to financial statements, many AOSSG members generally agree with the IASB's preliminary views stated in Question 16. However, some members offer the following comments:

    (1) What should be included in the notes to financial statements should be analysed in more detail, by breaking down into types of disclosure at a more granular level. It may be possible to classify them, taking into account the following factors:

        (i) Whether relevant transactions or events are recognised in the primary financial statements;

        (ii) Whether relevant transactions or events occur before the end of financial reporting period; and

        (iii) Whether an estimate is required in measurement.

    (2) It may be helpful to clarify that the nature and extent of disclosure should differ, depending on the extent of outcome uncertainties.

    (3) Cost-benefit considerations should be included in the Disclosure chapter, if the IASB decides to make cost-benefit considerations explicit in other chapters.

    (4) Some of the discussion, including a catalogue of disclosure items, is too detailed to be included in the Conceptual Framework, and they may well be placed outside the Conceptual Framework.

Other comments

63. The DP does not include discussion about the management commentary, because it focuses on discussion about information presented in financial statements. Some AOSSG members believe that the scope of discussion should be expanded to cover this sort of financial report, because management commentary is one of the most important ways to communicate information about the entity to financial statement users.

Question 17

Paragraph 7.45 describes the IASB's preliminary view that the concept of materiality is clearly described in the existing Conceptual Framework. Consequently, the IASB does not propose to amend, or add to, the guidance in the Conceptual Framework on materiality. However, the IASB is considering developing additional guidance or education material on materiality outside of the Conceptual Framework project.

Do you agree with this approach? Why or why not?

<u>Comments on Question 17</u>

64. AOSSG members generally agree with the IASB's preliminary view that the concept of 'materiality' is clearly described in the Conceptual Framework.

65. However, it would be helpful if the IASB could in cooperation with the International Auditing and Assurance Standards Board (IAASB) and the International Organisation of Securities Commissions (IOSCO) develop educational material regarding the concept of 'materiality', because it is commonly used in preparing and auditing financial statements.

66. In particular, it would be helpful if the educational material explains how to apply the concept of materiality to qualitative (or non-quantitative) disclosures. In addition, it might be helpful to clarify whether, and if so how, different materiality thresholds could be applied to items presented in primary financial statements and those disclosed in the notes to the financial statements. That said, AOSSG members caution that educational material should avoid the risk of illustrating quantitative thresholds that could be construed as bright lines.

Question 18

The form of disclosure requirements, including the IASB's preliminary view that it should consider the communication principles in paragraph 7.50 when it develops or amends disclosure guidance in IFRSs, is discussed in paragraphs 7.48–7.52.

Do you agree that communication principles should be part of the Conceptual Framework? Why or why not?

If you agree they should be included, do you agree with the communication principles proposed? Why or why not?

<u>Comments on Question 18</u>

67. AOSSG members generally agree that the proposed communication principles provide helpful reference, but believe that some of the principles should not be part of the Conceptual Framework.

68. Some AOSSG members offer the following additional comments:

    (1) Paragraph 7.50(a) states that disclosure should be 'entity-specific.' Although this is important for promoting high quality financial reporting, this is an application issue that reporting entities and regulators should address, rather than a standards issue that standard-setters should address.

    (2) Paragraph 7.50(c) says disclosure guidance should enable an entity to determine the preferable order of disclosures in the financial statements. Although this is important, this may be better dealt within IAS 1 *Presentation of Financial Statements*.

Section 8 Profit or loss and other comprehensive income (OCI)

Question 19

The IASB's preliminary view that the Conceptual Framework should require a total or subtotal for profit or loss is discussed in paragraphs 8.19–8.22.

Do you agree? Why or why not? If you do not agree do you think that the IASB should still be able to require a total or subtotal profit or loss when developing or revising particular Standards?

<u>Comments on Question 19</u>

General comments

69. AOSSG members believe that there should be a clear principle with robust reasoning for the presentation of 'profit or loss' and the use of 'OCI'.

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70. Most AOSSG members believe that 'profit or loss' should be presented in the statement of profit or loss and OCI, and that 'profit or loss' should also be defined as one of the elements of financial statements.

71. Some AOSSG members suggest that 'profit or loss' should be defined as follows:

> **Profit or loss** is the change in net assets during a period except those changes resulting from transactions with owners in their capacity as owners, whereby the recognised assets and liabilities comprising the net assets are measured using measurement bases that are relevant from the perspective of reporting the entity's *financial performance*.

72. In this context, comprehensive income can be defined consistently with 'profit or loss', but its definition can be modified to read "Comprehensive income is the change in net assets during a period except those changes resulting from transactions with owners in their capacity as owners, whereby the recognised assets and liabilities comprising the net assets are measured using measurement bases that are relevant from the perspective of reporting changes in the entity's *financial position*". In connection with the above definition, it may be explained that OCI is the '*linkage factor*' between 'profit or loss' and 'comprehensive income'.

73. Some other AOSSG members also suggest another approach to OCI by developing an appropriate, robust and operational definition of profit or loss in terms of financial performance, which would then logically guide the recognition of OCI items and the timing of OCI recycling. In their view, the current thinking in the DP that profit or loss, is the primary indicator of the return made on resources, and the use of the 'business model' concept to determine what information should be included in profit or loss (based on how resources have been used under the business model during the period) could be a plausible starting point for further work on this area.

74. However, some other members disagree with the preliminary view that the Conceptual Framework should require a total or subtotal for profit or loss as providing the primary source of information about an entity's return on its economic resources. These members believe that, rather than adopting a binary classification of comprehensive income, a multi-faceted disaggregation of comprehensive income should be adopted, based on differentiated implications for the predictive ability of future cash flows.

Other comments

75. Some AOSSG members, in addition to considering it necessary to define 'profit or loss' and OCI, would like to see the IASB paying more attention to the effect of translation of the terminology. For example, terms such as profit or loss and OCI are difficult to link linguistically to, and be combined in 'total comprehensive income'.

Question 20

The IASB's preliminary view that the Conceptual Framework should permit or require at least some items of income and expense previously recognised in OCI to be recognised subsequently in profit or loss, ie recycled, is discussed in paragraphs 8.23–8.26.

Do you agree? Why or why not? If you agree, do you think that all items of income and expense presented in OCI should be recycled into profit or loss? Why or why not?

If you do not agree, how would you address cash flow hedge accounting?

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<u>Comments on Question 20</u>

76. AOSSG members that support recycling believe the IASB should develop a clear principle as to when and why OCI should be recycled.

77. Many AOSSG members believe that 'OCI' should be recycled in all instances, and that the Conceptual Framework should require recycling. Many believe that requiring recycling in all instances would be important to ensure the 'all-inclusive' nature of profit or loss. This is primarily because:

    (1) Many financial statement users have stated that 'profit or loss' is a very (or perhaps, the most) important performance indicator for the assessment of future net cash inflows into an entity, but its usefulness would be significantly decreased if the integrity of profit or loss information is not supported by the consistency between the total amount of profit or loss and the total amount of cash flows over the long term.

    (2) The 'all-inclusive' nature of profit or loss is important in light of providing information to help financial statement users assess how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources (in other words, for management to fulfil its 'accountability'.)

    (3) OCI can be viewed solely as a communication medium that updates the users with unrealised changes in net assets that are expected to be realised as a consequence of management actions. Accordingly, recycling can be viewed as a depiction of the effect of management actions on the entity's performance.

78. However, some other members strongly disagree with the IASB's preliminary view that the Conceptual Framework should permit or require at least some items of income and expense previously recognised in OCI to be recycled in profit or loss in a later period because:

    (1) subsequent recycling of items into profit or loss does not faithfully represent income and expense (as defined), because changes in assets or liabilities do not occur when recycling occurs.

    (2) the DP does not establish coherent principles for determining when it is more relevant to present an item in OCI rather than profit or loss, and when it would provide more relevant information to recycle a previously-recognised item of OCI to profit or loss.

79. Some believe that recycling of OCI should be determined according to whether or not to require the format of one-statement or two-statements for the statement of comprehensive income.

Question 21

In this Discussion Paper, two approaches are explored that describe which items could be included in OCI: a narrow approach (Approach 2A described in paragraphs 8.40–8.78) and a broad approach (Approach 2B described in paragraphs 8.79–8.94).

Which of these approaches do you support, and why? If you support a different approach, please describe that approach and explain why you believe it is preferable to the approaches described in this Discussion Paper.

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Comments on Question 21

80. AOSSG members believe that the IASB should develop a clear principle as to whether OCI should be recycled. However, most members disagree with using either of the approaches explained in the DP.

81. Although the reasons for the conclusion vary, AOSSG members do not believe that 2B would adequately address existing concerns about OCI, including the perception that OCI has become a 'dumping ground' for anything controversial. This is because Approach 2B merely justifies how OCI is accounted for under the existing IFRSs, and does not provide sufficient rationale as to when and why recycling is necessary. Accordingly, under that approach, 'profit or loss' does not necessarily reflect a clearly describable measure, and any effects arising from recycling similarly would not reflect an understandable measure.

82. In addition, although many AOSSG members believe that recycling is necessary and the principles stated in Approach 2A are helpful, especially considered together with the concept of 'business model', these members believe that Approach 2A is inappropriate in its scoping of OCI. This is because these members find many other instances that warrant the use of OCI, and can be identified when following the approach explained in paragraphs 71 and 72 of this submission. For example, items where OCI is used in the existing IFRS 9 *Financial Instruments* are considered to be items requiring recycling, following the notion of the 'linkage factor'.

83. However, some other members believe that recycling is inappropriate for the reasons stated in paragraph 78 of this submission.

Section 9 Other issues

Question 22

Chapters 1 and 3 of the existing Conceptual Framework

Paragraphs 9.2–9.22 address the chapters of the existing Conceptual Framework that were published in 2010 and how those chapters treat the concepts of stewardship, reliability and prudence. The IASB will make changes to those chapters if work on the rest of the Conceptual Framework highlights areas that need clarifying or amending. However, the IASB does not intend to fundamentally reconsider the content of those chapters.

Do you agree with this approach? Please explain your reasons.

If you believe that the IASB should consider changes to those chapters (including how those chapters treat the concepts of stewardship, reliability and prudence), please explain those changes and the reasons for them, and please explain as precisely as possible how they would affect the rest of the Conceptual Framework.

Comments on Question 22

Stewardship

84. AOSSG members' views are mixed regarding the concept of 'stewardship (or accountability)'.

85. Some members believe that changes should be made to Chapter 1 of the Conceptual Framework because:

(1) stewardship is a very important concept for financial reporting and, accordingly, it should be clearly stated in the Conceptual Framework in light of the global financial crisis.

(2) though it is not the most important objective of financial reporting, stewardship is considered to be as important as the objective of providing useful information for users to assess future net cash inflows into an entity.

86. Others believe that it is unnecessary to reopen Chapter 1 of the Conceptual Framework, because:

(1) The concept of 'stewardship' is already stated in the existing Conceptual Framework (implicitly in Chapter 1 and explicitly in the Basis for Conclusions thereon), and giving priority to specific shareholders may not meet the objective of general purpose financial reporting.

(2) Management should be accountable for all assets and liabilities (not just the assets and liabilities held for use). Similarly, management should be accountable for changes in the value of assets and liabilities, not just for transactions. Therefore, information about management's 'stewardship' would be similar to (or the same as) information useful for assessing the prospects of future net cash inflows to an entity.

(3) 'Stewardship' and 'accountability' are considered as subordinated notions compared to the assessment of the prospects of future net cash inflows into an entity.

(4) It is unclear how giving greater prominence to the concept of 'stewardship' would change the economic phenomena identified by the Conceptual Framework for reporting information in respect of those economic phenomena to users of financial reports to meet their common information needs.

87. Some AOSSG members think that 'stewardship' is often used to mean the effective and efficient use of economic resource of an entity, and that the term 'accountability' would better serve the purpose of financial reporting.

Reliability

88. AOSSG members' views are mixed regarding the concept of 'reliability'.

89. Some AOSSG members are of the view that it is important to reinstate the concept of 'reliability' in the Conceptual Framework, both as a qualitative characteristic and as part of the recognition criteria. In addition, some of these members consider that 'verifiability' should be referred as one of the essential qualitative characteristics for financial statements (although it would not be essential for financial information in financial reports as a whole)[1].

90. Other members consider that the term and discussions in the Conceptual Framework on 'faithful representation' (in place of reliability) are sufficiently broad and clear, and accordingly, it is unnecessary to make changes. These members are of the view that nothing has been lost as a result of the 2010 amendments to the *Framework*. Nevertheless, some of these members consider that, if helpful to the understanding of a wider audience, the IASB could consider clarifying in the Basis for Conclusions the relationship between the concepts of 'relevance' and 'faithful representation'.

1 Paragraph BC3.35 of the Basis for Conclusions on the 2010 Conceptual Framework indicates verifiability was implicitly part of the concept of reliability in the superseded Framework.

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Prudence

91. Some members believe that the concept of 'prudence' should not be reinstated because it would contradict the concept of 'neutrality' and has no commonly understood meaning.

92. However, many AOSSG members believe it would be helpful to emphasise the importance of the 'exercise of caution'. These members are of the view that the concept of 'prudence' is actually used in the standard-setting process, and drawing a clear line between 'a bias towards conservatism' and 'the exercise of caution when making estimates and judgments under conditions of uncertainty' in the Conceptual Framework would contribute to better financial reporting.

Question 23

Business model

The business model concept is discussed in paragraphs 9.23–9.34. This Discussion Paper does not define the business model concept. However, the IASB's preliminary view is that financial statements can be made more relevant if the IASB considers, when developing or revising particular Standards, how an entity conducts its business activities.

Do you think that the IASB should use the business model concept when it develops or revises particular Standards? Why or why not?

If you agree, in which areas do you think that the business model concept would be helpful?

Should the IASB define 'business model'? Why or why not?

If you think that 'business model' should be defined, how would you define it?

Comments on Question 23

93. AOSSG members agree that the concept of the 'business model' is very important when the IASB develops or revises particular Standards. As stated in paragraph 6.75 of the DP, measures based on how the value of the asset is likely to be realised can be indicated by current activities (including the business model). Yet there is a mixed view as to whether the concept *can* be practically defined in the Conceptual Framework. The IASB could consider: (i) describing the concept of the business model as 'how an entity conducts its business activities', (ii) explaining how such a notion would enhance the achievement of the qualitative characteristics of useful financial information; and (iii) incorporating the notion in relevant chapters of the Conceptual Framework, most notably, the Measurement chapter (refer our comments in paragraph 43 above).

94. Some AOSSG members think the role of the business model concept should, at least in part, be determined or heavily influenced by other concepts – for example, by an identified ideal concept of wealth, in relation to measurement. Arguably, an entity's operating capability, which represents the entity's ability to carry out its activities at the scale determined by its then-existing resources, is the ideal concept of wealth that should be adopted in financial statements, on the basis that it provides the most useful information for helping users to predict an entity's future cash flows. These members believe that applying that concept of wealth would provide insights into the consequences of the entity's business model (for example, management's decision to acquire specialised resources to provide bespoke goods or services would be reflected in the measurement of those specialised resources at current

market buying prices, rather than, for example, at current exit prices – this is significant because current exit prices might not reflect the value of those resources to the reporting entity in particular for generating future cash flows). However, an ideal concept of wealth – rather than management's intentions or practices – would determine whether assets and liabilities are measured at current values. For example, the measurement basis for receivables would not depend on whether those receivables are managed for collection of contractual cash flows.

Question 24

Unit of account

The unit of account is discussed in paragraphs 9.35–9.41. The IASB's preliminary view is that the unit of account will normally be decided when the IASB develops or revises particular Standards and that, in selecting a unit of account, the IASB should consider the qualitative characteristics of useful financial information.

Do you agree? Why or why not?

Comments on Question 24

95. AOSSG members believe that the 'unit of account' is such an important concept that it should be explained in more detail in the Conceptual Framework, because it has implications across various aspects of financial reporting (including recognition, derecognition, measurement, presentation and disclosures).

96. When considering the unit of account, AOSSG members suggest that the first action the IASB should undertake is to inventory the existing standards. In addition, in establishing the broad principles on the unit of account, the IASB may want to consider the factors including: (i) the economic characteristics of an asset or a liability, having regard to, in the case of assets, the various rights comprising the economic resource, as described in paragraph 3.8 of the DP; (ii) the business model under which such an asset or a liability is held; (iii) the most relevant measurement basis for the asset or liability; and (iv) the interaction with the notion of 'control' and 'risks and rewards'.

Question 25

Going concern

Going concern is discussed in paragraphs 9.42–9.44. The IASB has identified three situations in which the going concern assumption is relevant (when measuring assets and liabilities, when identifying liabilities and when disclosing information about the entity).

Are there any other situations where the going concern assumption might be relevant?

Comments on Question 25

97. AOSSG members do not find other situations in which the going concern assumption is strongly relevant. However, some AOSSG members find that classification of assets and liabilities as current and non-current is one result of applying this assumption and hence affects an entity's financial statements and how users assess the entity's short term liquidity. In addition, some AOSSG members are of the view that the reference to the going concern assumption is inappropriate when identifying liabilities (refer paragraph 18 of this submission).

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98. Furthermore, some AOSSG members consider that it is unclear from the discussion in the DP as to whether the IASB intends to provide guidance in the revised IASB Conceptual Framework on the development of IFRSs for situations where the going concern assumption is inappropriate. These members are of the view that the existing Conceptual Framework is also unclear on this matter. These members recommend that the Conceptual Framework should provide more clarity on this matter and establish broad principles to guide the development of IFRSs for situations where the going concern assumption is inappropriate, if the Conceptual Framework is intended to cover such situations.

Question 26

Capital maintenance

Capital maintenance is discussed in paragraphs 9.45–9.54. The IASB plans to include the existing descriptions and the discussion of capital maintenance concepts in the revised Conceptual Framework largely unchanged until such time as a new or revised Standard on accounting for high inflation indicates a need for change.

Do you agree? Why or why not? Please explain your reasons.

Comments on Question 26

99. Many AOSSG members generally agree with the preliminary view in the DP that the discussion of capital maintenance concepts should remain largely unchanged until such time as a new or revised Standard on accounting for high inflation indicates a need for change.

100. However, some members strongly disagree with the IASB's preliminary view because:

(1) Concepts of capital maintenance are highly important and implicitly pervasive in standard-setting, and should be dealt with at a conceptual level, in conjunction with the identification of an ideal concept of capital (wealth).

(2) The existing Conceptual Framework is descriptive and does not indicate which concept of capital maintenance is conceptually ideal.

101. In addition, some AOSSG members believe that the revaluation model embodied in IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* reflects a particular (but implicit) capital maintenance concept, and it would be a valuable improvement if such revaluation gains or losses for such assets were accounted for as changes in equity (rather than in OCI) on the basis of an explicitly stated capital maintenance concept.

3 February 2014

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir/Madam,

Re: *A Review of the Conceptual Framework for Financial Reporting*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (the 'DP').

EFRAG welcomes that the IASB has initiated a project on improving its Conceptual Framework. European constituents, including EFRAG, have over the years repeatedly called for this revision to take place, before any fundamental change to the underlying IFRS accounting model would be made. The view that the Conceptual Framework was the most important project the IASB should undertake culminated in the response to the 2011 IASB Agenda Consultation. We therefore agree with the high priority the IASB has given to this project and with the aim of completing the project within a few years. We appreciate the work that the IASB has done in analysing areas that have proven problematic in the past and we support the practical approach taken in the project. We also agree with excluding other forms of financial reports and explicitly limiting the scope of the project to financial statements.

While we broadly agree with the issues selected for the DP, we do not agree with all of the proposed solutions and think that some of the issues should be addressed on a more conceptual basis. This may partly be because many of the principles proposed have been generated from requirements in current Standards without their justification being debated conceptually. The revised Conceptual Framework should be based on the understanding of how clear objectives of financial reporting should be met in practice.

Our detailed comments and responses to the questions in the DP are set out in Appendix 1. In the following paragraphs we would like to provide some high-level comments in relation to:

- Amendments to Chapters 1 and 3 of the existing Conceptual Framework
- The role of the business model in financial reporting
- Elements of financial statements and recognition
- Distinction between liability and equity elements
- Disclosure
- Implications on existing Standards of amending the Conceptual Framework.

Amendments to Chapters 1 and 3 of the existing Conceptual Framework

The DP proposes not to undertake a fundamental reconsideration of the chapters of the Conceptual Framework that were published in 2010. Accordingly, the IASB will only make changes to these chapters if work on the rest of the Conceptual Framework highlights areas that need clarifying or amending. We disagree with this approach as we do not support how the existing chapters deal with stewardship, reliability and prudence.

The existing Chapter 1 seems to state that providing information to help existing and potential investors assess the prospects for future net cash inflows is the primary objective of financial reporting. Providing information that is useful for assessing stewardship is in our view equally essential. As the same information may not be the most useful for considering stewardship and evaluating prospects for future cash flows, the objective of assessing stewardship needs to be presented as a separate objective in Chapter 1 of the Conceptual Framework. Including this objective means that Standards should require, and financial statements include, sufficient information for assessing both stewardship and the prospects for future cash flows.

When the Conceptual Framework was amended in 2010, the term 'reliability' was replaced by 'faithful representation'. We disagree with that change. To meet the objective of providing useful information we think that 'reliability' should replace 'faithful representation' as a fundamental qualitative characteristic. The Conceptual Framework describes 'faithful representation' as something that can be achieved by disclosures. Before the 2010 amendments it was, on the other hand, acknowledged that there could be a trade-off in recognised amounts between relevance and reliability. In addition to reintroducing 'reliability', we think that verifiability should form part of reliability instead of just being considered an enhancing, and therefore unnecessary, qualitative characteristic.

Similarly, we believe that the concept of prudence should be reintroduced and explained in the Conceptual Framework. Prudence is evidently reflected both in Standards in force today and those being developed. We therefore believe that it is essential to articulate the concept of prudence clearly in the Conceptual Framework in order to ensure that it is applied consistently across both current and future Standards. In our view, prudence represents a degree of caution that generally recognises downside risks and strongly questions whether upside potential inherent in uncertain future events should be recognised. To highlight that prudence should be applied in standard setting in a manner that would not conflict with neutrality, the concept should be explained after neutrality (with both notions being defined and displayed, similarly to how it was done in the pre-2010 Conceptual Framework).

The role of the business model in financial reporting

We appreciate that the DP presents the preliminary views that financial statements can be made more relevant if the IASB considers how an entity conducts its business activities. We agree with this and think it is important that no Standard ends up preventing entities from reflecting their business models. We therefore also welcome the approach to measurement proposed in the DP, which we believe forms a sound basis for having an entity's business model reflected in measurement.

However, measurement cannot be considered in isolation. In order to achieve useful performance reporting, it is essential to consider how remeasurements are presented in the financial statements. For example, information may be most useful if some non-operational items are measured at a current value, but only if corresponding remeasurements are presented in other comprehensive income.

A definition/description of profit or loss

In relation to a general discussion on what is best presented in profit or loss and what is best included in other comprehensive income, we think that the Conceptual Framework should provide a definition/description of what profit or loss should depict, so that it plays its role of primary performance metric that is meaningful in financial communication. This definition/description would facilitate the distinction between profit or loss and other comprehensive income (OCI) and clarify when and how recycling should take place. In EFRAG's view an entity's business model should play a role in defining this primary performance.

Elements of financial statements and recognition

As noted above, we appreciate that the DP is dealing with issues that have been identified to result in problems. We also agree with the DP that the current definitions of assets and liabilities are interpreted inconsistently. We therefore appreciate that the IASB is trying to address this issue and we generally agree with the proposed new definitions. However, in order to ensure that the proposed definitions are interpreted in a consistent manner, we recommend that the IASB tests possible interpretations.

Although we generally support the proposed definitions, we think that constructive obligations are defined too narrowly in the proposals. We do not agree with the DP that a constructive obligation only exists when an entity has a duty or responsibility to another party or parties that will benefit from the entity fulfilling its duty or responsibility. We favour an approach for liabilities where an obligation is present when it has arisen from past events and is practically unconditional. We think, however, that the term 'practically unconditional' should be replaced by 'no realistic alternative'.

We agree with the proposed definition of an asset but note that it may result in more assets being identified than under some interpretations of the current definition. We therefore think that probability thresholds for recognition should be considered on a standards level. The Conceptual Framework should provide guidance on how probability thresholds/recognition criteria should be constructed on a standards level by explaining how uncertainty affects reliability and relevance of recognising items.

Distinction between liability and equity elements

Another issue that the IASB has rightly identified as causing problems in practice is the distinction between liability and equity elements. We therefore welcome that the DP addresses this issue. We also support equity being defined as a residual, but do not support either of the approaches as described in the DP.

Both the strict obligation approach and the narrow equity approach have significant problems that we do not feel have been adequately investigated and were not identified in the DP.

In EFRAG's view the difficulties inherent in making the equity/liability distinction are such that any conceptual basis needs to be tested in how it could materialise and operate at standards level. Therefore, EFRAG recommends that the IASB does not attempt to provide the conceptual basis for a distinction as part of the current revision of the Conceptual Framework. Instead, the IASB should in parallel with the Conceptual Framework project undertake a more comprehensive discussion on what this distinction means and is attempting to portray.

Disclosure

There is a strong consensus in the financial community that disclosures in the notes to the financial statements have become unwieldy. The increasing length of the notes has done little to improve the quality of information; quality may have even decreased because of information overload. We therefore appreciate that the IASB is addressing disclosures in the DP. We also think that the proposals included in the DP are pointing in the right direction and acknowledge that the IASB will also address the issue in other projects. However, we think that the Conceptual Framework could go further than proposed in the DP in order to provide guidance that could introduce discipline on the issues in relation to the IASB's standard setting. The EFRAG, ANC and FRC Discussion Paper *Towards a Disclosure Framework for the Notes* and related feedback statements should be useful to this purpose

Implications on existing Standards of amending the Conceptual Framework

The DP proposes that in rare cases, in order to meet the overall objective of financial reporting, the IASB may decide to issue a new or revised Standard that conflicts with an aspect (specific definition or principle) of the revised Conceptual Framework. If this happens the IASB should describe the departure from the Conceptual Framework and the reasons for that departure in the Basis for Conclusions on that Standard.

We agree with this, but note that it is likely that the principles of the revised Conceptual Framework will conflict with some requirements in existing IFRS. We believe that these conflicts should be identified at the level of the Exposure Draft, so that constituents have a clearer understanding of the possible outcomes of the proposed changes. Conflicts between Standards and the revised Conceptual Framework could indicate flaws in those Standards. However, projects to amend individual Standards should only be undertaken if there is evidence that they do not work appropriately and the projects should follow the procedure for the IASB's agenda consultation.

Conflicts between Standards and the revised Conceptual Framework would also create uncertainty on how to apply the hierarchy described in paragraph 11 of IAS 8 (i.e. sources to consider in the absence of an IFRS that specifically applies to a transaction, other event or condition). The IASB should therefore explain how the revised Conceptual Framework should be used, or not used, in these cases.

Although amending the Conceptual Framework will not have any immediate consequences for how financial statements are prepared, it should have implications in the long-term.

If you would like to discuss our comments further, please do not hesitate to contact Rasmus Sommer, Benjamin Reilly, Aleš Novak or me.

Yours faithfully,

Françoise Flores

EFRAG Chairman

APPENDIX 1

SECTION 1 INTRODUCTION

Question 1

Paragraphs 1.25–1.33 of the DP set out the proposed purpose and status of the Conceptual Framework. The IASB's preliminary views are that:

(a) the primary purpose of the revised Conceptual Framework is to assist the IASB by identifying concepts that it will use consistently when developing and revising IFRSs; and

(b) in rare cases, in order to meet the overall objective of financial reporting, the IASB may decide to issue a new or revised Standard that conflicts with an aspect of the Conceptual Framework. If this happens the IASB would describe the departure from the Conceptual Framework, and the reasons for that departure, in the Basis for Conclusions on that Standard.

Do you agree with these preliminary views? Why or why not?

EFRAG's response

EFRAG generally agrees with the proposal on the purpose and status of the Conceptual Framework but does not understand why parts of the Conceptual Framework should be for the IASB's use only. EFRAG agrees with the proposal that the IASB could introduce requirements in Standards that could conflict with specific definitions or principles in the revised Conceptual Framework but EFRAG believes that future conflicts as well as existing conflicts should be identified and explained.

1 EFRAG thinks that it is important that the IASB has a Conceptual Framework to guide its standard setting activities. EFRAG believes that for financial reporting information to be useful, the guidance under which financial reports are based should be founded on clear general principles. Guidance that is not based on articulated general principles could be inconsistent and could result in financial reporting information not being understandable and comparable.

2 The DP proposes that some parts of the Conceptual Framework could only be used by the IASB. For example, it is intended that only the IASB should/could use the proposed guidance on when an item of income or expense could be presented in OCI. EFRAG understands that the IASB, by this restriction, tries to reflect the requirement of paragraph 88 of IAS 1 *Presentation of Financial Statements*, which states that an entity shall recognise all items of income and expense in a period in profit or loss unless an IFRS requires or permits otherwise. In other words, an entity is only allowed and required to recognise items of income and expense in OCI in the specific cases where the IASB has decided on that in a Standard. It thus seems to EFRAG that the IASB is afraid that the Conceptual Framework could be used to override requirements in Standards.

3 EFRAG does, however, not understand why it is necessary to limit the use of parts of the Conceptual Framework to the IASB in order to avoid the Conceptual Framework being used to override requirements in Standards. IAS 1 clearly specifies that only in the extremely rare circumstances in which management concludes that compliance with a requirement in an IFRS would be so misleading that it would conflict with the objective of financial statements, the entity can and shall depart from that requirement if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.

4 EFRAG believes that all parts of the Conceptual Framework could be useful for preparers or the IFRS Interpretations Committee in the absence of an IFRS that specifically applies to a transaction, another event or condition or of a possible analogy to an existing requirement. Limiting the use of parts of the Conceptual Framework to the IASB may

confuse constituents, result in the Conceptual Framework being less understandable and may result in inconsistencies.

5 EFRAG agrees with the DP that the IASB, in a limited number of cases, would have to issue an IFRS that conflicts with specific definitions or principles in the revised Conceptual Framework, when this has been finalised. For example, in order to produce the most useful information it may be necessary to recognise a liability for deferred income although such item would not meet the definition of a liability.

6 EFRAG similarly agrees with the DP that departures from the revised Conceptual Framework should be thoroughly justified in the Basis for Conclusions to the relevant Standard or amendment. EFRAG would even go a step further as it thinks that the relationship between the Conceptual Framework and the main or controversial parts of a Standard should always be explained in the Basis for Conclusions of that Standard – even when there are no departures from the revised Conceptual Framework.

7 In addition to thoroughly justifying departures from the revised Conceptual Framework, the IASB should pay attention to departures as they could indicate deficiencies in the principles included in the Conceptual Framework.

8 Conflicts between Standards and the Conceptual Framework will not only arise as the IASB develops new or revised Standards. It is likely that the principles of the revised Conceptual Framework will conflict with some requirements in existing IFRS.

9 As a first step, EFRAG thinks that the IASB should explain (to the extent possible) the conflicts between existing Standards and the forthcoming Exposure Draft on the Conceptual Framework. This will enable the IASB's constituents to assess better the impact of the proposed principles (although changes in the Conceptual Framework will not affect existing Standards directly).

10 As a second step, when the revised Conceptual Framework has been finalised, the IASB should identify conflicts with Standards in force (to the extent possible). These conflicts could indicate flaws in IFRS. Accordingly, the IASB may choose to initiate a project to deal with any flaws. However, as noted in relation to the 2011 IASB Agenda Consultation, EFRAG thinks that projects to amend IFRS should only be undertaken if there is evidence that current Standards do not work appropriately (the mere existence of a conflict with the Conceptual Framework is not sufficient). In addition, any projects following from identified conflicts should follow the procedure for the IASB's agenda consultations.

11 Conflicts between Standards and the revised Conceptual Framework would also create uncertainty on what sources to consider in the absence of a Standard that specifically applies to a transaction, other event or condition or a Standard dealing with similar and related issues (paragraph 11 of IAS 8). The IASB should therefore provide some clear guidance on how the revised Conceptual Framework should be used, or not used, in these cases. For example, it may not be appropriate to draw upon the revised Conceptual Framework for guidance, but to base interpretations on the principles that drove the development of particular requirements.

SECTION 2 ELEMENTS OF FINANCIAL STATEMENTS

Question 2

The definitions of an asset and a liability are discussed in paragraphs 2.6–2.16 of the DP. The IASB proposes the following definitions:

(a) an asset is a present economic resource controlled by the entity as a result of past events.

(b) a liability is a present obligation of the entity to transfer an economic resource as a result of past events.

(c) an economic resource is a right, or other source of value, that is capable of producing economic benefits.

Do you agree with these definitions? Why or why not? If you do not agree, what changes do you suggest, and why?

EFRAG's response

EFRAG believes that the proposed definitions may be easier to understand than the current ones, but the IASB should perform field tests to ensure that this is the case.

12 EFRAG notes that some would consider the changes made to the definitions of an asset and a liability to be more than just clarifications as stated in the DP. In any case, as the current definitions have been interpreted differently, the proposed changes may have an impact on what users of the Conceptual Framework consider to be assets and liabilities. EFRAG considers that many items will meet the proposed definition of an asset, including items that some people would not consider to meet the current definition. Items such as a workforce and an improved market position (resulting from marketing efforts) seem to meet the proposed definition of an asset.

13 EFRAG believes that the proposed definitions may result in more consistent interpretations than the current ones, as EFRAG thinks that the proposed definitions are easier to understand. EFRAG welcomes the changes in this respect. For example, EFRAG considers that under the proposed definitions a reduction in future outflows would meet the definition of an asset. This is less evident under the current definition as it refers to economic benefits to flow to an entity.

14 Although EFRAG believes that the proposed definitions are easier to understand, we think that it should be further tested whether the proposed definitions are generally interpreted consistently or whether ambiguous wording in one area is just replaced by ambiguity in another area. For example, the test should ensure that replacing 'expected' in the definition of an asset with 'capable' in the definition of a resource does not just move a problem. EFRAG acknowledges that the DP includes some examples of items that meet the definitions of an asset and a liability and further examples of what an economic resource is. However, before publishing an Exposure Draft, EFRAG considers that the IASB should publish for comments a list of items it considers would meet the proposed definitions of an asset or a liability to test the consistency of interpretations. The IASB could in this regard consider the list of items assessed in the EFRAG/ANC staff paper on the definition of an asset published in 2010.

15 EFRAG agrees with the proposals that the definition of an asset (and a liability) should include the link to the entity. That is, the items defined should be assets and liabilities of an entity. We do not think it would be efficient first to define assets and liabilities without such a link and then establish the link to the entity afterwards. Accordingly, EFRAG does not think that fish in the open sea should meet the definition of an asset. Only when they are caught are they assets of a particular entity. For assets the link between the economic resource and the entity is established in the DP by stating that the economic

resource should be 'controlled by the entity'. For liabilities the link is established by stating that a liability is a present obligation 'of the entity'.

Question 3

Whether uncertainty should play any role in the definitions of an asset and a liability, and in the recognition criteria for assets and liabilities, is discussed in paragraphs 2.17–2.36 of the DP. The IASB's preliminary views are that:

(a) the definitions of assets and liabilities should not retain the notion that an inflow or outflow is 'expected'. An asset must be capable of producing economic benefits. A liability must be capable of resulting in a transfer of economic resources.

(b) the Conceptual Framework should not set a probability threshold for the rare cases in which it is uncertain whether an asset or a liability exists. If there could be significant uncertainty about whether a particular type of asset or liability exists, the IASB would decide how to deal with that uncertainty when it develops or revises a Standard on that type of asset or liability.

(c) the recognition criteria should not retain the existing reference to probability.

Do you agree? Why or why not? If you do not agree, what do you suggest, and why?

EFRAG's response

EFRAG thinks that the definitions of assets and liabilities should not include probability thresholds. As explained in our answer to Question 8, EFRAG thinks that uncertainty related to inflows and outflows should be considered when making recognition decisions.

16 EFRAG agrees with the DP that the definitions of assets and liabilities should not include probability thresholds.

17 EFRAG thinks that it could be useful from a standard-setting perspective to distinguish between uncertainty in relation to existence and uncertainty in relation to outcome. In practice, however, EFRAG thinks that there can be cases where it is difficult to distinguish between the two types of uncertainties. One of the reasons is that the distinction may depend on the unit of account that is chosen. For example, if tax authorities disagree with an entity that a part of revenue is not tax free as the entity has claimed, it is not clear whether the uncertainty relates to the outcome of the total tax liability or to existence of a tax liability for the particular revenue.

18 While we agree with the DP that it can be useful to distinguish between uncertainty in relation to existence and uncertainty in relation to outcome, we do not think that the IASB should make statements in the Conceptual Framework about how frequent the different types of uncertainties would arise in practice. Therefore we disagree with stating that existence uncertainty only exists in 'rare cases' (paragraph 2.20 of the DP).

Question 4

Elements for the statement(s) of profit or loss and OCI (income and expense), statement of cash flows (cash receipts and cash payments) and statement of changes in equity (contributions to equity, distributions of equity and transfers between classes of equity) are briefly discussed in paragraphs 2.37–2.52 of the DP.

Do you have any comments on these items? Would it be helpful for the Conceptual Framework to identify them as elements of financial statements?

EFRAG's response

EFRAG supports that income and expenses are defined on the basis of changes in assets and liabilities. EFRAG believes it would be useful to define contributions to equity, and distributions of equity. However, EFRAG does not see any particular benefits in defining cash receipts and cash payments. Instead the IASB should consider what the statement of cash flows should communicate.

19 EFRAG believes that no primary financial statement should have primacy over the other primary statements. This means that the statement of financial position should not have primacy over the statement(s) of profit or loss and OCI. EFRAG is aware that some believe that defining income and expenses based on changes in assets and liabilities results in the statement(s) of profit or loss and other comprehensive income being secondary to the statement of financial position. EFRAG does not share this view, as further explained in the Bulletin on the asset/liability approach[1]. Defining income and expenses based on changes in assets and liabilities does not conflict with the objective of producing useful performance figures and it does not mean that the statement of financial position is more important than the statement(s) of profit or loss and other comprehensive income.

20 As further explained in the Bulletin on the asset/liability approach, EFRAG thinks that the asset/liability approach has some merits compared to a matching approach. Focusing on changes in assets and liabilities, in EFRAG's view, provides greater clarity for the development of accounting Standards.

21 While EFRAG agrees that income and expenses should be defined on the basis of changes in assets and liabilities, we note that the definitions may have to be amended to reflect the decisions to be made by the IASB on recycling and distinguishing OCI from profit or loss.

22 EFRAG believes it would be useful to define contributions to equity and distributions of equity (and transfers between classes of equity instruments if the IASB decides that these should be shown). EFRAG notes that it is currently not always clear whether, for example, certain transactions with shareholders should be considered equity transactions or not.

23 On the other hand, EFRAG does not see any particular benefits in defining cash receipts and cash payments. Instead EFRAG thinks the IASB should consider what the statement of cash flows should communicate. In 2010, EFRAG performed outreach activities in relation to the staff draft of the Exposure Draft *Financial Statement Presentation*. Feedback from these activities suggested that cash flow statements, as currently defined, are of little value to the users of the financial statements of financial institutions, including insurance entities. The IASB may therefore need to reflect, on a conceptual level, on what information should be conveyed in these statements, including whether the information presented should be of the same type for all types of entities.

24 EFRAG's comments in relation to income and expense reported in profit or loss versus income and expense reported in OCI are provided in response to the questions relating to Section 8 of the DP.

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[1] The Bulletin was issued by EFRAG together with the French Autorité des Normes Comptables (ANC), the Accounting Standards Committee of Germany (ASCG), the Organismo Italiano di Contabilità (OIC) and the UK Financial Reporting Council (FRC). Not all the partners issuing the Bulletin share the preliminary view of EFRAG on this issue. The different views are explained in the Bulletin.

SECTION 3 ADDITIONAL GUIDANCE TO SUPPORT THE ASSET AND LIABILITY DEFINITIONS

Question 5

Constructive obligations are discussed in paragraphs 3.39–3.62 of the DP. The discussion considers the possibility of narrowing the definition of a liability to include only obligations that are enforceable by legal or equivalent means. However, the IASB tentatively favours retaining the existing definition, which encompasses both legal and constructive obligations – and adding more guidance to help distinguish constructive obligations from economic compulsion. The guidance would clarify the matters listed in paragraph 3.50 of the DP.

Do you agree with this preliminary view? Why or why not?

EFRAG's response

EFRAG agrees with the DP that the IASB should retain the existing definition of a liability which encompasses both legal and constructive obligations. However, EFRAG thinks that constructive obligations should be defined more broadly than what is proposed in the DP.

25 EFRAG agrees that the IASB should retain the existing definition of a liability which encompasses both legal and constructive obligations. EFRAG agrees with the arguments presented in the DP that excluding some constructive obligations could provide less relevant information to users of financial statements about the entity's future cash flows relating to past activities. In addition, EFRAG considers that excluding some constructive obligations would not result in a faithful representation.

26 However, EFRAG does not agree with the DP on how to consider constructive obligations. EFRAG agrees that a constructive obligation exists in cases where the criteria in paragraph 3.50 of the DP are met. EFRAG also acknowledges that the criteria in paragraph 3.50 reflect how some regard constructive obligations. EFRAG, however, thinks that constructive obligations could also arise in other circumstances where the entity has no realistic alternative than to incur future costs (that are not outweighed by accompanying benefits). According to the DP, the IASB has concluded that an entity does not have a constructive obligation to restructure a business, even if it has announced, or started to implement a detailed restructuring plan. The IASB explains that this is because the entity has no obligation to others and is not bound by its plan. However, EFRAG considers that if an entity has no realistic alternative to a restructuring plan, obligations following from this plan should be recognised as liabilities. Guidance on when an entity would have no realistic alternative would follow the guidance proposed in paragraph 3.79 of the DP on when an obligation is practically unconditional. Accordingly, an entity may not have realistic alternatives, if the alternative would involve the entity ceasing to operate as a going concern, significantly curtailing operations or leaving specific markets.

27 EFRAG also notes that the criterion in paragraph 3.50 (c) states that as a result of the entity's past actions, the other party or parties can reasonably rely on the entity to discharge its duty or responsibilities. Although the reference to an entity's past history can be used in Standards to operationalise the principle that another party or parties can reasonably rely on the entity to discharge its duty or responsibility, EFRAG does not think that the principle itself should refer to the entity's past history.

28 The DP mentions that if a liability exists for one party, an asset always exists for another party or parties, except perhaps for some obligations to clean up damage to the environment. We believe that a liability can exist even when a counterparty cannot be identified.

29 The question on the role of economic compulsion is closely related to the issue of constructive obligations. EFRAG provides some comments on this topic in its answer to Question 7.

Question 6

The meaning of 'present' in the definition of a liability is discussed in paragraphs 3.63–3.97 of the DP. A present obligation arises from past events. An obligation can be viewed as having arisen from past events if the amount of the liability will be determined by reference to benefits received, or activities conducted, by the entity before the end of the reporting period. However, it is unclear whether such past events are sufficient to create a present obligation if any requirement to transfer an economic resource remains conditional on the entity's future actions. Three different views on which the IASB could develop guidance for the Conceptual Framework are put forward:

(a) View 1: a present obligation must have arisen from past events and be strictly unconditional. An entity does not have a present obligation if it could, at least in theory, avoid the transfer through its future actions.

(b) View 2: a present obligation must have arisen from past events and be practically unconditional. An obligation is practically unconditional if the entity does not have the practical ability to avoid the transfer through its future actions.

(c) View 3: a present obligation must have arisen from past events, but may be conditional on the entity's future actions.

The IASB has tentatively rejected View 1. However, it has not reached a preliminary view in favour of View 2 or View 3.

Which of these views (or any other view on when a present obligation comes into existence) do you support? Please give reasons.

EFRAG's response

EFRAG thinks that a present obligation must have arisen from past events and be practically unconditional. Therefore EFRAG supports View 2. However, EFRAG notes that it had difficulties in understanding the exact consequences of the different views presented.

30 The DP includes some examples illustrating the outcome of the three views presented on how to determine whether a present obligation exists. EFRAG is in favour of an approach that will result in the same outcomes as those that are illustrated for the second approach. EFRAG considers that the first approach would sometimes identify liabilities too late. This is, for example, the case when a levy is based on the entity's revenue in one year, but where the obligation only becomes unconditional if the entity is still operating on a certain date the following year. On the other hand, EFRAG thinks that View 3 would probably result in too many liabilities being identified. For example, if an entity has promised its employees a total bonus of CU100 if the entity would have a profit of CU100,000 in year ten from now, EFRAG understands that View 3 would result in an obligation being identified even when the entity needs to grow considerably in order to meet the goal in ten years. EFRAG, however, notes that it and many of its constituents had some difficulties in understanding the various approaches proposed in the DP, and would recommend these being explained further.

31 EFRAG notes that under the second approach whether or not an obligation exists depends on *how* the amount of the obligation is determined. Accordingly, if:

(a) In Jurisdiction A, a particular utility is required to pay a levy of two percent of its revenue of year 20x1 if it is in business on 1 April 20x2, EFRAG interprets the proposal in a manner that would result in a liability for the utility in Jurisdiction A from January 20x1 when the utility starts generating revenue.

(b) In Jurisdiction B, a particular utility is required to pay a levy of a ‘fixed’ amount announced on 1 April 20x1 if it is in business on 1 April 20x2, EFRAG interprets that no liability should be recognised until 1 April 20x2 as the amount of the liability is not directly linked to the entities performance (although the government may try to consider the performance of the utilities when determining the size of the levy, this would not be known with certainty).

32 EFRAG believes that reflecting the scenarios differently does make sense as it could be expected that there is some rationale behind how the jurisdictions in the examples above calculate the levies.

33 Unfortunately, the DP is not clear on what benefits received or activities conducted by an entity would result in a liability. For example, if a utility in Jurisdiction C is required to pay an amount on 1 April 20x2 that is determined based on various parameters such as: the average number of customers over the past ten years; the increase in revenue from 20x0 to 20x1; the estimated increase in customers over the following ten years; and the average asset balance of the past five years. It is not apparent from the DP whether the utility should recognise a liability from the start date of the calculation of the average number of customers.

34 Paragraph 3.66 of the DP states that activities conducted by the entity include that the entity is operating on a particular date. The fact that the entity has customers on a particular date could indicate that it has been operating. Paragraph 3.66 of the DP does, however, not seem particularly clear. It can even be read as an acceptance of different interpretations of the second approach suggested in the DP, as it states “a liability *can* be viewed…”. In the view of EFRAG the IASB would have to specify in a clearer manner how the second approach should be understood by, for example, stating that “a liability *should* be viewed…”.

35 EFRAG notes that the term ‘practically unconditional’ in View 2 is ambiguous as some believe it means ‘virtually certain’, while others believe it means ‘unconditional in practice’. The term may accordingly lead to differing interpretations of View 2. As noted above in relation to Question 6, EFRAG thinks liabilities arise when the entity ‘has no realistic alternative’. Accordingly, we also suggest this term be applied when describing View 2.

36 In EFRAG’s view, the IASB should also further clarify when an obligation is unconditional in practice (or where the entity has no realistic alternative). The IASB could, among other things, consider referring to its discussions about economic compulsion and explain how practicality interacts with the going concern assumption.

Question 7

Do you have comments on any of the other guidance proposed in this section of the DP to support the asset and liability definitions?

EFRAG’s response

EFRAG supports the additional guidance. However, it notes that the definition of control may be different from how some currently interpret the term. In addition EFRAG considers that the Conceptual Framework should provide additional guidance on when economic compulsion should be considered when distinguishing between equity and a liability.

37 EFRAG supports the additional guidance to be included in the Conceptual Framework to explain the meaning of: ‘economic resource’; ‘control’; and ‘transfer an economic resource’. It also supports the guidance provided on executory contracts.

38 However, EFRAG notes that some currently interpret ‘control’ in a different manner than what is proposed in the DP. Some are currently placing more emphasis on legal ownership, possession and ability to sell a resource rather than the ability to obtain the benefits from it. For these, the change may therefore result in different types of assets being identified.

39 The DP only considers economic compulsion inside a contractual arrangement. EFRAG does not generally support economic compulsion outside a contractual arrangement being considered a relevant factor when determining whether an entity has an obligation to deliver an economic resource and therefore recognises a liability. However, EFRAG believes that economic compulsion has a different role to play when it is part of a contractual arrangement.

40 As it appears from paragraph 3.108 of the DP, the IASB considers that even when an option not to redeem a financial instrument has some commercial substance, the overall substance of some financial instruments might still be that of a liability, not equity. The IASB’s proposal that a contractual option should only be ignored if it ‘lacks commercial substance’ may therefore not be appropriate.

41 EFRAG considers that in the cases where an entity can only avoid redeeming a financial instrument by transferring an asset, liability or equity instrument that it would not have otherwise done, a liability exists. EFRAG considers that this could be formulated as a principle that could be included in the Conceptual Framework. We do not support the suggestion in the DP only to deal with the issue at a standards level.

42 Similarly, EFRAG considers that a cumulative dividend blocker often should result in an instrument being a liability. In most cases, however, EFRAG thinks that this would also be the result of considering the commercial substance of an option specifying that if an entity would not pay any amount to the holder of a particular instrument every year, it would not be allowed to pay any dividend to ordinary shareholders (until it would have paid the amount (eventually accumulated) to the holder of the financial instrument). EFRAG considers that profit oriented entities will generally not be established without an intention of providing returns (in the form of dividends) to the ordinary shareholders and therefore an option to not make a contractual payment, subject to a cumulative dividend block, would not have commercial substance.

SECTION 4 RECOGNITION AND DERECOGNITION

Question 8

Paragraphs 4.1–4.27 of the DP discuss recognition criteria. In the IASB’s preliminary view, an entity should recognise all its assets and liabilities, unless the IASB decides when developing or revising a particular Standard that an entity need not, or should not, recognise an asset or a liability because:

(a) recognising the asset (or the liability) would provide users of financial statements with information that is not relevant, or is not sufficiently relevant to justify the cost; or

(b) no measure of the asset (or the liability) would result in a faithful representation of both the asset (or the liability) and the changes in the asset (or the liability), even if all necessary descriptions and explanations are disclosed.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

EFRAG's response

EFRAG agrees with the DP that relevance and faithful representation should be considered when deciding on recognition of assets and liabilities. While EFRAG agrees with the DP that the Conceptual Framework should not include probability thresholds, it thinks that the Conceptual Framework should provide guidance on how uncertainty affects relevance and reliability. This guidance should be used by the IASB when setting probability thresholds/recognition criteria in Standards and by others (including the IFRS Interpretations Committee) through paragraph 11 of IAS 8.

43 EFRAG agrees with the DP that in deciding whether an asset or liability should be recognised, relevance and faithful representation should be considered. In other words, an item that would meet the definition of an asset or a liability should not automatically be recognised.

44 EFRAG notes that the general requirement proposed in the DP is that an entity should recognise all its assets and liabilities. There are exceptions when this would not result in (sufficiently) relevant information and when it would not result in a faithful representation. EFRAG does not agree with this approach as it seems to suggest that recognition, without evidence of the contrary, would result in relevant and reliable information. EFRAG believes that the principles should be worded differently in order to make recognition criteria more effective and call for a genuine assessment of relevance and reliability, without the preconceived idea that recognition would result in relevant and reliable information.

45 EFRAG agrees with the proposals that the Conceptual Framework should not include explicit probability thresholds as it would not be possible to construct thresholds that would result in useful information for all types of assets and liabilities. However, we believe that the Conceptual Framework should clearly articulate that uncertainty is a potential impediment to relevance and reliability. We do not think this is sufficiently emphasised in the DP. Clarifying the role of uncertainty in the Conceptual Framework would provide guidance when introducing probability thresholds for recognition on a standards level, where such thresholds are considered useful. EFRAG therefore thinks that the Conceptual Framework should include further guidance that can be used by the IASB (and others through the reference in IAS 8) when considering how the recognition criteria/probability thresholds should be set in Standards (or when others than the IASB are using the guidance to determine whether an asset or liability should be recognised). This guidance should explain how uncertainty would affect the assessment of whether recognition of an item would result in relevant and reliable information. Parts of the guidance included in paragraph 4.26 of the DP could be used. However, the guidance should be sufficiently specific to ensure consistent recognition criteria in Standards.

46 Consistent with the preliminary views expressed in the Bulletin *Reliability of financial information*[2] and EFRAG's comment letter on the research paper *Toward a Measurement Framework for Financial Reporting by Profit-Oriented Entities*, issued by the Canadian Institute of Chartered Accountants in 2012, EFRAG does not think that disclosures can compensate for large margins of errors in measurement, i.e. for the unreliability of measurement.

47 The IASB is explicitly discussing the cost constraint on useful financial reporting in relation to the recognition criteria. For the avoidance of doubt, EFRAG would like to state that it considers this constraint to be pervasive and should accordingly be considered in relation to all issues.

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[2] This Bulletin was issued by EFRAG, ANC, OIC, ASCG and FRC in April 2013.

Question 9

In the IASB's preliminary view, as set out in paragraphs 4.28–4.51 of the DP, an entity should derecognise an asset or a liability when it no longer meets the recognition criteria. (This is the control approach described in paragraph 4.36(a)). However, if the entity retains a component of an asset or a liability, the IASB should determine when developing or revising particular Standards how the entity would best portray the changes that resulted from the transaction. Possible approaches include:

(a) enhanced disclosure;

(b) presenting any rights or obligations retained on a line item different from the line item that was used for the original rights or obligations, to highlight the greater concentration of risk; or

(c) continuing to recognise the original asset or liability and treating the proceeds received or paid for the transfer as a loan received or granted.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

EFRAG's response

EFRAG supports the proposals included in the DP, but thinks high-level guidance should be provided on the difference between a modification of an asset or liability and derecognition of an asset or liability and recognition of another.

48 EFRAG agrees with the DP that in most cases an asset or a liability should be derecognised when it no longer meets the recognition criteria (or no longer exists), or is no longer an asset or a liability of the entity. However, there may be cases where another approach may result in more useful information. It is our interpretation of the DP that the IASB acknowledges this, and we agree with this.

49 EFRAG therefore also agrees with the DP that when the entity retains a component of an asset or a liability, the IASB should determine, when developing or revising particular Standards, how the entity would best portray the changes that resulted from the transaction. In some cases, one approach could be to prohibit derecognition when there is no significant change in the entity's exposure to risks and rewards.

50 Although EFRAG agrees with the approach described in the DP for derecognition, we believe that the IASB should also include high-level guidance in the Conceptual Framework that could be used to distinguish modifications from derecognition of one asset or one liability and recognition of another asset or liability.

SECTION 5 DEFINITION OF EQUITY AND DISTINCTION BETWEEN LIABILITY AND EQUITY ELEMENTS

Question 10

The definition of equity, the measurement and presentation of different classes of equity, and how to distinguish liabilities from equity instruments are discussed in paragraphs 5.1-5.59 of the DP. In the IASB's preliminary view:

(a) the Conceptual Framework should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.

(b) the Conceptual Framework should state that the IASB should use the definition of a liability to distinguish liabilities from equity instruments. Two consequences of this are:

  (i) obligations to issue equity instruments are not liabilities; and

  (ii) obligations that will arise only on liquidation of the reporting entity are not liabilities (see paragraph 3.89(a) of the DP).

(c) an entity should:

  (i) at the end of each reporting period update the measure of each class of equity claim. The IASB would determine when developing or revising particular Standards whether that measure would be a direct measure or an allocation of total equity.

  (ii) recognise updates to those measures in the statement of changes in equity as a transfer of wealth between classes of equity claim.

(d) if an entity has issued no equity instruments, it may be appropriate to treat the most subordinated class of instruments as if it were an equity claim, with suitable disclosure. Identifying whether to use such an approach, and if so, when, would still be a decision for the IASB to take in developing or revising particular Standards.

Do you agree? Why or why not? If you do not agree, what changes do you suggest and why?

EFRAG's response overview

EFRAG supports distinguishing between equity instruments and liabilities, but does not support either of the two approaches in the DP.

As a first step in deciding on how equity instruments are distinguished from liabilities it is necessary to decide whether financial reporting is from a proprietary or entity perspective. Only following that decision is it possible to decide upon an appropriate basis.

Although the strict obligation approach is consistent with an entity perspective and the narrow equity approach is consistent with a proprietary perspective EFRAG believes both of the proposals have significant and fundamental flaws.

Further work is required before arriving at a conceptual distinction between equity instruments and liabilities.

Overall comments

51 EFRAG does not support either of the two approaches as described in the DP. Both the strict obligation approach and the narrow equity approach have significant problems that we do not feel have yet been adequately investigated.

52 EFRAG supports addressing the distinction between liabilities and equity instruments at the conceptual level but based on our due process there is significant disagreement on how to distinguish equity instruments from liabilities. Before proceeding to an Exposure Draft containing a conceptual basis for distinguishing between equity instruments and

liabilities, the IASB should have a more comprehensive discussion on what this distinction means and is attempting to portray.

53 Additional issues that could be covered, that were not sufficiently included in the DP, include:

(a) Depicting dilution;

(b) Rights to receive equity instruments;

(c) Whether the split between equity instruments and liabilities also needs to drive the definition of income and expense; and

(d) Whether a binary split of the statement of financial position is the most appropriate.

54 EFRAG's response to the various parts of Question 10 are presented below, as follows:

(a) Question 10(a) – The definition of equity (paragraphs 55 to 65);

(b) Question 10(b) – Distinguishing between liabilities and equity instruments (paragraphs 66 to 90);

(c) Question 10(b)(i) – Obligations to issue equity instruments (paragraphs 91 to 100);

(d) Question 10(b)(ii) – Obligations that arise only on liquidation (paragraphs 101 to 103);

(e) Question 10(c) – Remeasurement of equity claims (paragraphs 104 to 119);

(f) Question 10(d) – If an entity has no equity instruments (paragraphs 120 to 124); and

(g) Other matters (paragraphs 125 to 129).

Question 10(a) – The definition of equity

EFRAG's response

EFRAG supports retaining a split between equity and liability claims and equity containing the residual

55 EFRAG notes that the notion of equity as a residual is important because at least one element cannot be directly measured. For the statement of financial position to balance, this element is the residual of all of the other elements.

56 In current IFRS, this residual element is equity and the residual nature is the reason why once something has been recognised in equity it is generally not directly remeasured. Although the carrying values of some parts of equity, for example non-controlling interest, are updated, this is not a direct remeasurement: it simply reflects changes in the part of the residual (assets less liabilities) owned by non-controlling interests.

57 Both the current and proposed Conceptual Framework specifies income and expense in relation to changes in equity. Any increases (decreases) in equity, other than those relating to contributions from (distributions to) equity participants are defined as income (expense). A change in the definition of equity therefore also has consequences for performance reporting.

58 EFRAG believes that, in this context, the notion of residual has two important and distinct meanings as:

(a) The part of the statement of financial position which is not directly remeasured; and

(b) A claim on the entity which is not a liability.

59 In respect of (a) EFRAG, in general, supports the notion of equity as the element of the financial statements that is not directly remeasured, but does not believe defining it as such is entirely consistent with some of the proposals in the DP, especially those with respect to the remeasurement of some equity claims. The effect of the proposals is that

only some equity claims (i.e. primary equity claims – as discussed later) are considered residual. EFRAG has a number of concerns regarding those proposals, which are set out later in this comment letter.

60 In respect of (b), EFRAG notes that this adds to the importance of an appropriate definition of liabilities.

61 EFRAG thinks the issues in paragraph 57 are distinct from each other and this should be stated in the Conceptual Framework. In addition, there are some entities (e.g. some cooperatives and historically the Trustee Savings Banks in the United Kingdom) which have equity in the sense of a residual amount after deduction of liabilities but where there is no claim on that equity. The application of the proposals to such entities should be clarified.

Does the statement of financial position need to be split between equity and liabilities?

62 The claims on an entity have numerous characteristics, including maturity (or lack of), rights to contribute to decision-making, ability to absorb losses and fixed versus variable return. There is no limit to how such characteristics could be combined in a single instrument. Therefore some believe that any split between equity and liabilities based on characteristics of an instrument portrays no more information on the nature of the claim than the chosen criteria.

63 EFRAG is aware of suggestions that the statement of financial position should depict and describe these various claims as a continuum rather than a split between equities and liabilities (described variously as a 'no-split' or 'claims' approach). Under such an approach, the statement of financial position would not be split between liabilities and equity, but would instead list the claims on the entity's assets and disclose the characteristics of each claim in the notes. Any distinction between the different types of capital provided to an entity would be at the discretion of the user of the financial statements who could then make his/her own definition of equity according to his/her specific user needs.

64 However, at least one type of claim cannot be remeasured directly without remeasuring the entire entity[3]. If there were to be a class of claims that were not remeasured, then this would, implicitly, be accepting that some claims are different to others. It would be a liability/equity distinction, even if not called by that name.

65 Given that at least one category of claims cannot be remeasured directly, EFRAG supports explicitly splitting the claims side of the statement of financial position between liabilities and equity, and the retention of a definition of equity as the residual (in this sense) being retained. However, EFRAG notes that this definition of a residual is not consistent with the proposals in the DP for direct remeasurement of equity claims: under the proposals only primary equity claims are a residual.

Question 10(b) – Distinguishing between liabilities and equity instruments

EFRAG's response

Before deciding on specific requirements for identifying equity, EFRAG believes it is important to decide if this is being done from an entity or proprietary perspective to financial reporting.

EFRAG does not support either the strict obligation or narrow equity approach and believes further work is needed before any revised conceptual distinction is adopted.

66 EFRAG does not support either the strict obligation approach or the narrow equity approach, as described in the DP.

[3] Based on the statement in paragraph OB7 of the Conceptual Framework that the purpose of financial reporting is not to show the value of a reporting entity. Without this restriction all claims could be directly measured and something else, such as internally generated goodwill, could be the residual.

67 EFRAG believes that there are two basic approaches to determining how equity (as the residual claim on an entity) is defined:

(a) Equity can be determined as the instruments held by the owners of the entity, and any claim that reduces the returns to these is a liability; or

(b) Equity can be determined based on the characteristics of the instruments issued by an entity.

68 These two approaches could be seen as being consistent with a proprietary perspective and entity perspective to financial reporting, respectively.

A proprietary perspective – the instruments held by the entity's owners are equity

69 If financial statements are being prepared from the proprietary perspective, it appears necessary to identify the instruments that convey an ownership interest and proceed from there: such instruments are equity, and all other claims are liabilities. One way of doing this is set out as the *Narrow Equity Approach* in the DP. We note that the FASB Preliminary Views document *Financial Instruments with Characteristics of Equity* (FICE) started from a basis of identifying an instrument that conveyed a 'basic ownership interest.'

70 EFRAG believes that an approach to distinguishing between liabilities and equity on the basis of ownership interest as equity has a number of attractive features. For example, it would provide a conceptual basis to solving classification problems that have arisen in relation to a number of instruments, including puttable shares, non-controlling interests and puts/forwards over own equity.

71 However, if such an approach to distinguishing liabilities and equity were to be taken, instruments with the same characteristics could be classified differently by different entities, reducing comparability. Some of the roles equity has traditionally been perceived as fulfilling, including as a buffer against losses by holders of less-subordinated claims (such as bond-holders), would also not necessarily be compatible with a notion of equity based on a proprietary approach. As noted in the DP, if such a distinction between equity and liability were to be adopted, it would also require a subsequent change to the definition of a liability.

72 EFRAG also believes that such an approach would raise significant issues in relation to relevance with respect to some corporate structures, for example entities in which the basic ownership instrument is a demand deposit.

73 Within such an approach, there remain a number of significant unanswered questions on how to identify what instruments contain an ownership interest. EFRAG does not believe an approach based on limiting this to the 'most residual' instrument – as suggested in the DP – of an entity is appropriate, because:

(a) The instrument that is most residual may change depending on other instruments (including those issued later);

(b) Different instruments may be the most residual depending on how residual is defined, particularly whether it is defined with respect to participation in ongoing returns, subordination or participation on liquidation; and

(c) It is unclear how the concept of residual interest applies in a group context, given the potential extent of structural subordination. For example, in the case of the insolvency of the parent of a group, equity holders in subsidiaries may have a higher claim on underlying net assets than the creditors of the parent (who would merely have a claim on the shares held by the parent).

74 One potential way of avoiding these difficulties would be to allow entities a free choice of which instrument is designated as the basic ownership instrument.

75 If only a basic ownership instrument were defined as equity there would be some instruments that, despite not imposing any obligation on the entity to transfer an

economic resource, would be labelled as liabilities. As liabilities are measured directly, these instruments would be directly measured (on a basis such as at fair value) and changes in the carrying value taken through comprehensive income.

76 Therefore, the following would be the result:

(a) Shares in subsidiaries held by non-controlling interest would be recognised as liabilities, the carrying value updated at each reporting date and changes in this carrying value taken through comprehensive income;

(b) Other classes of ownership instruments (such as other classes or types of shares including perpetual interest bearing, deferred or preference shares; or the interests of limited partners) would be recognised as liabilities, the carrying value updated at each reporting date, and changes in this carrying value taken through comprehensive income.

77 EFRAG is not convinced that this would provide meaningful information to users of financial statements, but believes it would be consistent with an approach in which equity is determined by reference to the class of instruments held by owners.

78 During the FICE project two possible approaches were explored that would result in equity being defined wider than the basic ownership instrument. These, the *ownership-settlement* approach and the *revised expected outcomes* approach were not pursued further, partially due to the level of complexity required to determine whether any particular instrument was equity.

79 These difficulties were in a US GAAP context of identifying equity in a single legal framework. EFRAG believes that identifying appropriate principles to distinguish which instruments are ownership instruments would be even more difficult in IFRS given that these principles would need to apply across a wide range of legal and regulatory systems.

80 As such, EFRAG believes further work would be required to identify principles that could be used, in the context of a proprietary perspective, to identify what instruments, other than a basic ownership instrument, would also be classified as equity.

An entity perspective to identifying equity

81 An alternative basis to distinguish between equity and liabilities is to distinguish based on the characteristics of the instruments issued, an approach which may be considered to be consistent with an entity perspective.

82 There are a number of characteristics that could be used, including ability to direct the entity, the presence or absence of an obligation to deliver economic resources and loss absorption. Although the DP suggests using presence, or absence, of an obligation to issue economic resources as the distinguishing factor EFRAG believes that using other characteristics would be similarly consistent with an entity perspective: deciding upon an entity perspective to distinguishing equity does not necessarily lead to the suggestions set out in the DP.

83 An approach of distinguishing between equity and liability instruments based on the presence, or absence, of an obligation to deliver economic resources, as is basically the case in current IFRS and the approach suggested by the DP, has a number of advantages. These advantages include:

(a) Consistency with the current and proposed definitions of a liability in that an instrument would not be able to be both simultaneously a liability and equity[4];

(b) Relative simplicity;

(c) Consistency with the accounting identity of assets equalling liabilities plus equity;

[4] However, a single legal contract could contain multiple financial instruments, and thus require separate recognition of each component.

(d) Consistent depiction of an entity's leverage;

(e) Consistency with a view of equity as a 'buffer' that protects holders of less subordinated claims from loss; and

(f) Comparable application across a broad range of instruments and legal/regulatory environments.

84 EFRAG also notes that, although the principle is relatively simple, experience with current IFRS requirements has identified that application of these principles is not without difficulties. In particular, the role of economic compulsion and settlement options with limited or no economic substance have proven to be difficult issues to address in current requirements.

Other potential approaches

85 EFRAG believes that there could be other, perhaps more appropriate characteristics, used to distinguish between equity and liabilities. In particular, EFRAG notes that the current requirements have led to financial reporting that many believe is counter-intuitive for a number of instruments. These instruments include:

(a) Puttable shares;

(b) Derivatives over own equity including NCI Puts;

(c) Perpetual instruments that entitle holders to discretionary payments that are fixed or determinable; and

(d) Instruments that require an entity to distribute an amount based on a proportion of profit or revenue.

86 The 2008 Proactive Accounting Activities in Europe (PAAinE) Discussion Paper *Distinguishing Between Liabilities and Equity* identified a loss absorption approach as one way to distinguish based on the characteristics of instruments. Although this approach was more complex than the current approach in IFRS and did not depict an entity's leverage EFRAG believes that it better depicted the ownership structures of the wide range of entities required to report under IFRS in Europe. As such it, and other similar approaches, should be investigated further.

87 EFRAG believes that relying solely on the presence or absence of an obligation does not always result in appropriate classification of the basic ownership instruments in some corporate structures common across Europe, including partnerships and other structures involving puttable instruments. EFRAG believes that it is important that the Conceptual Framework contains appropriate guidance for the development of Standards that would result in useful information for users, including the holders of these ownership instruments. If the IASB continues with the strict obligation approach.

88 If the IASB continues with the strict obligation approach EFRAG has identified two important factors that it believes should be included in the Conceptual Framework to assist in producing Standards that result in useful information:

(a) The logic expressed in IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments* should be repeated at the conceptual level. The logic of IFRIC 2 is that there is a unit of account issue to equity. Even within the strict obligation approach it is not sufficient to determine whether an individual instrument is a liability or an equity instrument, but it must also be assessed to what extent an obligation exists overall.

In assessing the extent of this overall obligation all of the terms and conditions of a financial instrument, including relevant local laws, regulations and the entity's governing charter are relevant. EFRAG believes that it is important guidance for determining whether and to what extent an obligation exists. As such, this or similar guidance should be included in the Conceptual Framework.

(b) The Conceptual Framework should acknowledge the important role of basic ownership instruments, even within the context of financial reporting where equity is defined based on the characteristics of instruments and should lead to the development of Standards that acknowledge the importance of these instruments. One way in which this could be done would be through disclosure. For example, a future revised Standard on the presentation of financial statements could contain an optional disclosure of a statement of financial position and statement(s) of profit or loss and other comprehensive income where the distinction between equity (as the class of claims not directly remeasured) and liabilities was on the basis of what the entity chose to identify as its basic ownership instruments. These may be similar to those currently contained in Examples 7 and 8 of IAS 32 *Financial Instruments*.

89 This would result in the presentation of information from the perspective of the holders of these basic ownership instruments that would have the status of GAAP, but also preserve the comparability and principles-based financial reporting of the primary statements. If such an approach were taken, it would be important that the XBRL taxonomy reflected this.

90 EFRAG also believes that the ideas being developed in the *Financial Statements Presentation* project (for example separating the operating performance of an entity from its financing activities) were highly relevant to this discussion, and that the content of the final Conceptual Framework should not limit future developments in this area.

Question 10(b)(i) – Obligations to issue equity instruments

EFRAG's response

EFRAG does not support the strict obligation approach as classifying obligations to issue equity instruments as equity may not result in the most relevant financial reporting. EFRAG believes that primary and secondary equity claims are fundamentally different, and that the Conceptual Framework should reflect this.

91 EFRAG does not support the strict obligation approach as classifying all obligations to issue equity instruments as equity may not result in the most relevant financial reporting. We are not convinced that remeasuring equity claim is conceptually sound or always practically possible, as further discussed in paragraphs 104 to 119 below.

92 Nonetheless, EFRAG has the following comments to make with respect to the strict obligation approach.

Primary and secondary equity claims

93 EFRAG believes that primary equity claims (as described in paragraph 5.7 of the DP) are fundamentally different from secondary equity claims: secondary equity claims involve an enforceable right or obligation for the entity to receive or deliver something.

94 A primary equity claim, however, does not, by definition, contain any obligation on the entity to deliver anything.

95 Secondary equity claims involve an entity's contractual obligation to deliver, or contractual right to receive, equity instruments. These include options, warrants and forwards. These enforceable rights and obligations can be measured as if they were financial assets and liabilities. A secondary equity claim is an obligation to deliver (or receive) equity instruments, unlike a primary equity claim which is a claim on the entity without obligation. Secondary equity claims can be remeasured without requiring remeasurement of the entire entity.

96 One possible way for the Conceptual Framework to make clear the differences between primary and secondary equity claims would be to amend the definitions of assets and liabilities to include obligations to receive or deliver own equity (similar to some requirements in current IFRS). However, EFRAG notes that this results in an

inconsistency, particularly with respect to treasury shares: the right to receive them would be classified as an asset, but upon settlement would be recognised as a debit within equity.

97 Holders of secondary equity claims do not have a current unconditional claim on the residual net assets of an entity, but have a potential claim that may or may not result in an eventual claim.

98 EFRAG notes that the DP also explains (in paragraph 5.18) how these two types of claims are different from each other, but believes that the Conceptual Framework should explicitly acknowledge this.

Consequences of the strict obligation approach

99 There are a number of consequences of adopting a strict obligation approach that are not apparent from the DP. If the IASB decides to proceed with the strict obligation approach, EFRAG thinks it is important that these consequences are appreciated in advance. These consequences include:

(a) instruments with settlement options would be classified as equity, even if they were expected to be settled in cash; and

(b) almost any transaction could be structured to achieve equity treatment (and thus not be remeasured through comprehensive income).

100 These are natural consequences of the strict obligation approach. Including anti-abuse provisions at the level of individual Standards to avoid these consequences and require certain instruments or transactions to be classified as liabilities would conflict with the Conceptual Framework and be indicative of problems with the basic conceptual distinction.

Question 10(b)(ii) – Obligations that arise only on liquidation

EFRAG's response

EFRAG generally supports the proposal that obligations that arise only on liquidation of the reporting entity not be classified as liabilities, given that financial statements are prepared on a going concern basis but believes it is important to appropriately distinguish instruments that are, in substance, liabilities.

101 EFRAG supports the proposal in the DP with respect to obligations that will arise only on liquidation of the reporting entity – as this is consistent with a going concern basis to financial reporting – but believes it is important to appropriately distinguish instruments that are, in substance, liabilities.

102 With regards to obligations that will only arise on liquidation of a consolidated subsidiary, EFRAG believes there is an important link to the notion of control, as expressed in IFRS 10 *Consolidated Financial Statements*. For an entity to consolidate a subsidiary it must control it. If it controls a subsidiary, the liquidation of such a subsidiary would be at the discretion of the reporting entity; in such a circumstance EFRAG believes it would be appropriate that obligations that arose on liquidation of the subsidiary not be classified as liabilities.

103 However, if the entity has contractually committed itself to liquidation of such a consolidated entity (for example by inclusion in the contractual arrangements of a special purpose vehicle) and as a result is obliged to transfer an economic resource, EFRAG believes it would be appropriate for such a contractual obligation to be classified as a liability.

Question 10(c) – Remeasurement of equity claims

EFRAG's response

EFRAG does not support the notion of 'wealth transfer' and has identified a number of problems with the proposals in the DP.

EFRAG does not support the proposals with respect to remeasurement of equity claims and has significant concerns regarding the proposal to classify obligations to issue equity instruments as equity.

104 EFRAG believes remeasuring certain classes of equity has the potential to address some long-standing problems but would at the same time create other problems.

105 Given the overall definition of equity as a residual, EFRAG is not convinced that remeasuring certain equity claims is conceptually sound. It may also not always be practically possible to arrive at meaningful measurements because the eventual outcome of many claims will depend on discrete events and/or future management decisions. As such, the remeasured amounts may not be sufficiently reliable or relevant.

Wealth transfers

106 EFRAG believes that the proposal to use a notion of wealth transfers would significantly increase the complexity of financial reporting, reduce understandability and lead to information necessary to understand an entity's performance, including some of its trading, borrowing and investing activities, being reflected in the statement of changes in equity rather than in the statement(s) of profit or loss and other comprehensive income.

107 EFRAG therefore does not support the notion of wealth transfers.

Other problems not addressed by the proposals

108 As noted in paragraph 99 and 100 the proposals would introduce additional problems and anomalous presentation. They would also not provide a basis for addressing the following problems:

(a) depicting potential dilution; and

(b) puttable instruments.

Depicting potential dilution

109 EFRAG is not convinced that the proposals in the DP would provide enough information for holders of equity instruments to understand how they may be diluted, as is implied by paragraph 5.37 of the DP. Furthermore, EFRAG believes that what is important about dilution is potential dilution in the future, not the amount of dilution that had occurred at the reporting date.

110 In particular, EFRAG notes that two important sources of potential dilution would not be portrayed at all under the IASB's proposals:

(a) Dilutive instruments that are liabilities; and

(b) Instruments that dilute the claims of holders of equity instruments on the occurrence of an event that is determined to be within the control of the entity.

<u>Dilutive instruments that are liabilities</u>

111 Some instruments that dilute the returns to holders of equity instruments would be classified as financial liabilities and the potential dilution due to these would not be portrayed. Such instruments include:

(a) Convertible bonds;

(b) Instruments where the entity is required to transfer either cash or an equivalent value of equity instruments at the option of the holder; and

(c) Instruments that convert to equity only if a regulator/supervisor requires them to.

112 As these would meet the definition of financial liabilities under the proposals in the DP, it is not clear how, or if at all, the potential dilutive effects of these would be portrayed.

113 While it may be relatively simple for instruments such as convertible bonds to be split into equity and liability components[5], other such combined instruments are not so easily split at initial recognition. The proposals do not appear to effectively portray the dilutive effect of such instruments.

<u>Instruments that dilute on the occurrence of events within the control of an entity</u>

114 No liability is recognised for obligations that will only arise for situations within an entity's control, and presumably no secondary equity claim would be recognised for these obligations. The obligation to deliver equity instruments could crystallise on circumstances such as:

(a) An Initial Public Offering;

(b) A takeover; or

(c) The disposal of a portion of the entity.

115 These may include obligations that result in significant dilution of the claims of the holders of equity instruments, and the proposals in the DP do not appear to portray them.

<u>How should dilution be portrayed?</u>

116 EFRAG does not believe that dilution, and more importantly potential dilution, can be portrayed effectively in a single statement of changes in equity. Such a statement would necessarily reduce the dilutive effects of multiple scenarios to one dimension, which would not accurately or reliably portray economic substance.

117 It may be more appropriate to portray (potential) dilutive effects through disclosures. Through discussions with users of financial statements, EFRAG has identified potential ways in which this could be done:

(a) Scenario analysis, depicting the instruments in issue and their rights and/or payoffs in various material scenarios; and/or

(b) The provision by the entity of financial models showing the rights holders of various instruments have on net cash inflows, and how the number and types of these instruments may change.

Puttable instruments

118 The proposals in the DP would also not provide a conceptual solution to what some see as the counter-intuitive accounting in comprehensive income for puttable instruments, including puts on shares held by non-controlling interests ('NCI puts'). Current IFRS requires a liability to be recognised for a puttable instrument at the present value of the amount the entity may be obliged to pay. Paragraph 23 of IAS 32 applies that requirement even if the put option is contained within a separate contract. Changes in the carrying value of such a liability are recognised in comprehensive income.

119 For an instrument puttable at fair value, as the entity performs better the liability increases and an expense is recognised. Under the IASB's proposals, the entity's right (upon the put being exercised) to receive the share would presumably be reflected as a wealth transfer: resulting in volatility in both the statement(s) of profit or loss and other comprehensive income and the statement of changes in equity.

[5] A convertible bond can be shown to be identical to a financial liability and a written call option.

Question 10(d) – If an entity has no equity instruments

EFRAG's response

EFRAG appreciates the difficulties presented by situations where an entity has issued no instruments that are purely equity, but is not convinced that the approach proposed is the best one.

120 EFRAG finds the IASB's proposal somewhat confusing in that it appears to contradict the key decisions taken with respect to the definition of equity. The IASB appears to be proposing that all financial statements be prepared with a definition of equity consistent with an entity concept, unless this would result in no equity, in which case a proprietary perspective is appropriate.

121 While EFRAG supports this explicit recognition that the proposed definition of equity does not always result in appropriately classifying the basic ownership instruments in some corporate structures common across Europe, EFRAG believes that this merely reflects the problems inherent in the definition and is not persuaded that an approach of reclassifying the most residual instrument is appropriate. This is especially the case as it would result in different classification in consolidated and separate financial statements of subsidiaries.

122 The requirements of paragraphs 16A to 16F of IAS 32 have led to significant implementation issues and confusion, as evidenced by requests to the IFRS Interpretations Committee. In particular, as noted above, there may be practical difficulties in identifying the most residual instrument.

123 EFRAG believes that a more appropriate approach is to allow entities to present additional information which has the status of IFRS as set out in paragraph 89 above. This would allow entities to present information that defines equity from a proprietary perspective, while preserving the comparability and relevance of an entity perspective. Such an approach provides important information to the holders of basic ownership instruments.

124 Furthermore, the IASB can always override the Conceptual Framework in an individual Standard. EFRAG does not understand why this needs to be stated explicitly for this particular issue.

Other matters

125 Previous debates on the equity/liability distinction and questions to the IFRS Interpretations Committee have resulted in a number of additional issues that EFRAG believes should also be addressed at the conceptual level. These are:

(a) The role of economic compulsion (which EFRAG has discussed above in paragraphs 37 to 42);

(b) The boundaries of the entity in determining whether an obligation exists; and

(c) The nature of instruments that oblige an entity to transfer (or distribute) an amount determined by reference to profit, revenue or cash flows.

Boundaries of an entity

126 EFRAG does not believe the DP adequately addresses the issue of the boundaries of the entity, particularly with respect to the relationship with holders of ownership instruments.

127 There is no clear conceptual basis provided for determining whether an entity's Annual General Meeting (or any meeting of the holders of a class of instruments) is part of the entity or not. The importance of this is if (for example) the attendees could require declaration of a dividend in excess of that proposed by directors. If the meeting were to be determined to not be part of the entity, it would be an obligation outside the control of

the entity and a liability recognised for the amount the entity could be compelled to distribute.

128 EFRAG does not believe this would provide useful financial reporting and believes the issue should be addressed at a conceptual level.

Instruments that oblige an entity to transfer (or distribute) an amount determined by reference to profit, revenue or cash flows

129 EFRAG believes that the current financial reporting requirements, derived from paragraph 24 of IAS 32, do not always result in useful information. This is particularly the case with respect to instruments that oblige the entity to distribute a portion of net income each year. EFRAG believes that it would be more appropriate for any liability in these instruments to be recognised at the same time as the revenue or net income out of which they require distribution. This would result in a more relevant economic depiction of the entity. EFRAG also notes that this is linked to Section 5 of the DP, and an approach of recognising a liability concurrent with the revenue or net income would be consistent with Approach 2 ('A present obligation must have arisen from past events and be practically unconditional') described there.

SECTION 6 MEASUREMENT

Question 11

How the objective of financial reporting and the qualitative characteristics of useful financial information affect measurement is discussed in paragraphs 6.6–6.35 of the DP. The IASB's preliminary views are that:

(a) the objective of measurement is to contribute to the faithful representation of relevant information about:

  (i) the resources of the entity, claims against the entity and changes in resources and claims; and

  (ii) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources.

(b) a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements;

(c) when selecting the measurement to use for a particular item, the IASB should consider what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI;

(d) the relevance of a particular measurement will depend on how investors, creditors and other lenders are likely to assess how an asset or a liability of that type will contribute to future cash flows. Consequently, the selection of a measurement:

  (i) for a particular asset should depend on how that asset contributes to future cash flows; and

  (ii) for a particular liability should depend on how the entity will settle or fulfil that liability.

(e) the number of different measurements used should be the smallest number necessary to provide relevant information. Unnecessary measurement changes should be avoided and necessary measurement changes should be explained; and

(f) the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.

Do you agree with these preliminary views? Why or why not? If you disagree, what alternative approach to deciding how to measure an asset or a liability would you support?

EFRAG's response

EFRAG broadly agrees with the IASB's preliminary views on measurement. EFRAG however believes that the business model should also play an important role in selecting the appropriate measurement basis, and therefore helps implementing the proposed principles in a reliable manner. EFRAG also believes that limiting the number of measurement bases could conflict with the objectives of financial reporting.

Measurement objective, relevance and faithful representation

130 EFRAG agrees that the objective of financial reporting and the fundamental qualitative characteristics of useful financial information should provide the basis for the objective of measurement and the supportive guidance. Nevertheless, EFRAG believes that any measurement objective the IASB develops should not merely repeat the general objective of financial reporting.

131 In addition, EFRAG believes that relevance of information can be judged from different perspectives. As noted in EFRAG's comment letter on the research paper *Toward a Measurement Framework for Financial Reporting by Profit-Oriented Entities,* issued by the Canadian Institute of Chartered Accountants in 2012, empirical evidence seems to indicate that the information that is most relevant for estimating future cash flows may not be the most relevant for assessing stewardship. A Conceptual Framework would therefore have to provide a basis for balancing these different objectives.

132 Measurement affects both the statement of financial position and the statement(s) of profit or loss and OCI and thus both need to provide relevant information for users. Selecting measurements by considering either the statement of financial position alone or the statement(s) of profit or loss and OCI alone will not usually produce the most relevant information for the users of financial statements.

133 Therefore, EFRAG supports the view that when selecting the measurement to use for a particular item, the IASB should consider what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI. In addition, EFRAG believes that the business model should also play an important role in selecting the appropriate measurement bases (see also paragraphs 248 to 266 below).

134 The DP suggests that there is no single measurement basis that always provides the most useful information. In other words, the DP is proposing that some assets (and liabilities) could be measured using a historical basis while others could be based on a current basis. Similarly, different types of income (and expenses) could be based on historical measures while others would be based on current measures. EFRAG supports the view that a single measurement basis for all assets and liabilities will not provide the most relevant information for users of financial statements. EFRAG believes that, on balance, a mixed measurement model provides the most useful information.

135 Nevertheless, EFRAG believes that having different measurement bases for the statement of financial position and the statement(s) of profit or loss and OCI has a direct link to the meaning of the 'bridging item' concept and the use of OCI as discussed in the Section 8 *Presentation in the statement of comprehensive income–profit or loss and other comprehensive income* of the DP. Consistency among measurement and presentation would be of significant importance. In addition, EFRAG believes that using two different measurement bases is only warranted if both measures provide sufficiently useful information about different facets of the entity's financial position and financial performance. In this case, only disclosing a different measurement basis in the notes would not be sufficient. As the use of two measurement bases would result in additional costs and might make the financial statements less understandable, the IASB would need to justify that the benefits of the additional information on the face of primary financial statements would outweigh those disadvantages.

136 In order to create a common understanding as to what the IASB aims to accomplish, EFRAG recommends that the measurement section should state clearly the linkage with the presentation section. This linkage is particularly important when the cash flows from one item are contractually linked to the cash flows from another item. In the cases when assets and liabilities are related in some way, using different measurements for those assets and liabilities can create a measurement inconsistency (sometimes referred to as an ‘accounting mismatch’). Measurement inconsistencies can result in financial statements that do not faithfully represent the reporting entity’s financial position and performance.

Choosing a measurement basis

137 EFRAG supports the view that the selection of a measurement for a particular asset should depend on how that asset contributes to future cash flows and for a particular liability should depend on how the entity will settle or otherwise fulfil that liability. The DP notes (paragraphs 6.75–6.96) that the way an asset will ultimately contribute to cash flows will often not be certain. For most assets there are choices, and choices may change.

138 EFRAG believes that considering the business model (i.e. how the asset contributes to future cash flows and for a particular liability and how the entity will settle or otherwise fulfil that liability) for measurement purposes would help users to better understand the financial performance of an asset (or a group of assets) in comparison with the expected outcome. For more information and analysis on the role of the business model for measurement, please refer to Bulletin *The Role of the Business Model in Financial Reporting,* which was issued in June 2013 by EFRAG, the French Autorité des Normes Comptables (ANC), the Accounting Standards Committee of Germany (ASCG), the Italian Organismo Italiano di Contabilità (OIC) and the UK Financial Reporting Council (FRC); and paragraphs 254-265 below.

Relevance of a particular measurement basis

139 EFRAG supports the IASB’s preliminary view that the relevance of a particular measurement will depend on how investors, creditors and other lenders are likely to assess how an asset or a liability of that type will contribute to future cash flows.

Understandability and other enhancing characteristics

140 Understandability has an important implication for setting measurement requirements. Users need to be able to understand the measurements used. Changes in the types of measurement used for particular items will make it more difficult for users to understand how measurement bases interact to depict the entity’s financial position and financial performance. EFRAG agrees that unnecessary changes in the types of measurement used for a particular item should be avoided; and clear explanations of the reasons for necessary changes and their effects should be required.

141 Nevertheless, EFRAG does not think that a change of measurement basis subsequent to the initial recognition considerably reduces the understandability of financial reporting and therefore is against the principle in paragraph 6.24 of the DP that the subsequent measurement should always be the same as, or at least consistent with, the initial measurement. For example, at initial recognition IAS 39 and IFRS 9 require entities to measure their financial assets at fair value, while subsequent measurement may be based on amortised cost. EFRAG supports those measurement principles. Therefore, EFRAG believes that the principle from paragraph 6.24 of the DP should not artificially limit the IASB’s possibilities of meeting the objectives of financial reporting and/or measurement.

142 In EFRAG’s opinion, the IASB’s preliminary view that the number of different measurements used should be the smallest number necessary seems to suggest that the IASB would like to predetermine the number of measurement bases to be used. EFRAG believes that limiting the number of measurement bases could conflict with the objective of financial reporting − to contribute to the faithful representation of relevant

information about the resources of the entity, claims against the entity, performance of the entity, and stewardship. In addition, EFRAG does not expect that excluding this limitation from the Conceptual Framework would cause a proliferation of measurement bases.

143 The three enhancing characteristics of useful financial information other than understandability – timeliness, verifiability, and comparability – need to be considered when establishing measurement requirements. EFRAG agrees that comparability implies using measurements that are the same between periods and between entities. However, it is important that the measurement is the same for items which contribute to future cash flows in a similar way. EFRAG believes that measurement considering the business model would enhance comparability. Having the same accounting requirements for assets, which are used differently and contribute to future cash flows in a different way, would effectively diminish the comparability of financial statements; thereby, the events or transactions may not be faithfully represented. As noted above, for more information and analysis on the role of the business model for measurement, please refer to the Bulletin *The Role of the Business Model in Financial Reporting*.

Cost constraint

144 EFRAG supports the IASB's preliminary view that the benefits of a particular measurement basis to users of financial statements need to be sufficient to justify the cost for the preparers. Consistent with EFRAG's comment letter on the research paper *Toward a Measurement Framework for Financial Reporting by Profit-Oriented Entities,* issued by the Canadian Institute of Chartered Accountants in 2012 (e.g. paragraph 55) EFRAG believes that cost constraints should be considered in selecting the appropriate measurement basis. That would also be consistent with the general cost constraint of useful financial reporting (QC35 of the existing Conceptual Framework) that reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information.

Faithful representation

145 Consistent with the EFRAG's comment letter on the research paper *Toward a Measurement Framework for Financial Reporting by Profit-Oriented Entities,* issued by the Canadian Institute of Chartered Accountants in 2012 (please see paragraph 56) EFRAG believes that measurement for financial reporting purposes should be capable of reasonable substantiation and also that disclosures should be considered when assessing whether an economic phenomenon is faithfully represented. That is, we think that in some cases it may be necessary to provide disclosures in relation to verifiable figures in order to achieve a faithful representation. However, EFRAG does not think that disclosures can compensate for inherent measurement uncertainty. For further details on the relationship between faithful representation and reliability, please refer to Section 9 *Other Issues*.

Question 12

The IASB's preliminary views set out in Question 11 have implications for the subsequent measurement of assets, as discussed in paragraphs 6.73 – 6.96 of the DP. The IASB's preliminary views are that:

(a) if assets contribute indirectly to future cash flows through use or are used in combination with other assets to generate cash flows, cost-based measurements normally provide information that is more relevant and understandable than current market prices.

(b) if assets contribute directly to future cash flows by being sold, a current exit price is likely to be relevant.

(c) if financial assets have insignificant variability in contractual cash flows, and are held for collection, a cost-based measurement is likely to provide relevant information.

(d) if an entity charges for the use of assets, the relevance of a particular measure of those assets will depend on the significance of the individual asset to the entity.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

EFRAG's response

EFRAG broadly agrees with IASB's preliminary views expressed under Question 12.

146 EFRAG believes that classifying assets into four categories (as set out in the DP) is reasonable because the ways in which cash flows are generated differ significantly depending on the categories. However, EFRAG believes that the Conceptual Framework should not be conclusive about what situations fall under the respective categories. Such generalisation is difficult and the IASB should assess each situation in light of the measurement objective and the supportive guiding principles.

Using assets

147 EFRAG generally agrees with the view that cost-based measures would provide relevant information for assets that are used in (a) purchasing, producing, marketing, or delivering assets or services the entity sells and (b) administration, treasury or any other function necessary to keep the entity operating. EFRAG also supports the IASB's arguments that a current measure and the resulting unrealised gains and losses due to asset price changes may not be relevant for assets the entity is using, unless they indicate impairments or reversals of impairments.

148 However, EFRAG disagrees with the arguments that a current measure would provide better information for assessing how efficiently and effectively an entity's management and governing board have used the entity's resources. That would effectively mean representation of opportunity costs that management and governing board were missing and reflect 'what if' scenarios, which are (in the framework of the entity's business model) seldom possible and thus seldom relevant.

149 EFRAG believes that changes in an asset's capacity to generate cash flows (i.e. adding value through the value chain) through time can be effectively reflected through cost-based 'adjustments' such as depreciation/amortisation expense, impairment losses and reversals of impairment losses. In addition, EFRAG finds it unfortunate that the notions of impairment and depreciation/amortisation are not considered as part of discussion on subsequent measurement in the DP.

Selling assets

150 There are various situations in which assets are being sold. Therefore, each selling situation would need to be separately analysed in order to find an appropriate measurement basis. If an entity holds an asset with the purpose of selling it in the near future and generating a profit from fluctuations in a market price, the fair value (i.e. current exit price) measurement would be relevant so as to predict future cash inflows for the entity, despite the fact that this measurement would result in unrealised gains (or losses) being reported in comprehensive income. These assets are usually fungible and since it is likely any assets held at the end of a reporting period will be sold in the next reporting period, this measurement represents the likely future cash flows.

151 Current exit prices are readily available when deep, liquid markets exist and in this case the measure is also verifiable and can be provided in a timely manner. When a current market price is not readily available, it may be necessary to estimate this. EFRAG believes that as current financial accounting Standards require the use of estimates in many other situations (e.g. impairment, contingent liabilities and retirement benefit liabilities), it would therefore also be possible to use estimates for current exit prices.

Sometimes such estimates might be very uncertain. Consequently, if this uncertainty is properly explained (e.g. in the notes), the information would still be useful.

152 However, an entity that manages a portfolio of financial assets within the 'liability driven hold and sell' business model, where financial assets are managed to match stable liabilities, may be seen as holding financial assets for the long-term investment horizon. In these cases fair value (i.e. current exit price) measurement could be seen as a relevant measurement basis for the statement of financial position, due to the long-term investment horizon. However, reporting unrealised gains (or losses) in profit or loss would not be an appropriate primary measure of performance. The nature of assets might be seen as very different in those two cases.

153 In addition, for inventories, the DP argues that a current market price is less relevant as the sale usually requires the seller to undertake significant activities to identify purchasers (the DP states that this is not the case for most financial instruments or commodities). Furthermore, it is argued that the assessment of prospects for future cash flows from sales of inventories is usually based on expectations about future margins that are derived from cost-based information about past sales, cost of sales, and other recurring components of profit or loss. The use of current market prices could obscure this information. EFRAG welcomes this measurement consideration since we generally believe that current exit prices are inappropriate for entities that buys and sell items in different markets.

154 EFRAG also believes that what is more important is that inventories are actually not a homogenous group of non-monetary assets. EFRAG notes that IAS 2 generally requires inventories to be measured at the lower of cost and net realisable value. However, IAS 2 includes an exception to this general requirement that allows commodity broker-traders to measure their inventories at fair value less costs to sell with changes in fair value less costs to sell recognised in profit or loss. The Standard justifies the different treatment for broker-trader inventories because those inventories are principally acquired with the purpose of selling in the near future and generating a profit from fluctuation in prices and trade margins (IAS 2, paragraph 5). This is similar to financial instruments which are actively traded, which would therefore justify a similar accounting treatment. The benefit in terms of relevant representation of the performance and expected future cash flows is also the same. In EFRAG's opinion fungibility of an asset could thus also play a role in measurement. EFRAG also believes this a good example where the business model was in the past implicitly used in an IFRS.

155 EFRAG believes that it is difficult to generalise the discussion about the appropriate measurement basis; each situation should be assessed in light of the measurement objective of the statement of financial position as well as the statement(s) of profit or loss and OCI and the supportive guiding principles. In order to create a common understanding as to what the IASB aims to accomplish, measurement should explicitly recognise the linkage with presentation, the use of OCI and the concepts underlying the use of OCI. Consistency among measurement and presentation would be of significant importance, when having different measurement bases for the statement of financial position and the statement(s) of profit or loss and OCI.

Holding assets for collection according to terms

156 EFRAG generally agrees with the statement that cost-based measurement provides relevant information for assets held for collection according to terms. In addition, we believe that floating rate financial assets should, despite possible significant variation in cash flows, be eligible for cost-based measurement due to the fact that this variation does not cause a change in the fair value of such instruments. EFRAG also agrees that current market prices are likely to be the most relevant measure for assets with significant variability in either cash flows or net value flows, such as derivative instruments.

Charging for rights to use assets

157 EFRAG recommends that the IASB takes advantage of the discussion on the Conceptual Framework to refine the definition of the right-of-use, distinguish this right from the other rights which are bundled in the asset, consider the implications of the unbundling of the leased asset in the lessor's accounts and refine the guidance to identify what activities convey the ability to direct the use of an asset and how this links with the business models of lessors (providing finance or managing assets).

Question 13

The implications of the IASB's preliminary views for the subsequent measurement of liabilities are discussed in paragraphs 6.97–6.109 of the DP. The IASB's preliminary views are that:

(a) cash-flow-based measurements are likely to be the only viable measurement for liabilities without stated terms.

(b) a cost-based measurement will normally provide the most relevant information about:

 (i) liabilities that will be settled according to their terms; and

 (ii) contractual obligations for services (performance obligations).

(c) current market prices are likely to provide the most relevant information about liabilities that will be transferred.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

EFRAG's response

EFRAG broadly agrees with the IASB's preliminary views expressed under Question 13.

Liabilities without stated terms

158 The IASB's DP states that it is impossible to measure liabilities without stated terms at cost as the liability does not have a cost. It is therefore argued that a cash-flow based measure other than estimates of current prices may be the only possible options for such liabilities.

159 EFRAG believes that applying a cash-flow based measure could be used to estimate a current value or cost, therefore it would also be possible to measure liabilities without stated terms, such as liabilities arising from torts or violations of laws or regulations, at a current value or cost. EFRAG therefore believes that the cash-flow measurement discussion does not address properly which measurement attribute the cash-flow measurement is aiming to achieve.

160 The DP includes a list of issues that should be considered when deciding, on a standards level, how to construct a cash-flow based measure (see paragraphs 6.112–6.130 of the DP). However, EFRAG notes that due to the lack of a precise objective about what measurement attribute the cash-flow base measurement is aiming to achieve, the DP does not provide any preliminary views on how a cash-flow based measure for liabilities without stated terms should be constructed (e.g. how to deal with uncertainties about the amount of cash flows, i.e. the most likely amount or the expected probability-weighed value; whether the view of market participant or reporting entity's perspective should be reflected etc.). Therefore, it is not possible to assess the consequences of that proposal.

Liabilities with stated terms but highly uncertain amounts

161 The DP also concludes that a cash-flow based measurement (other than one that functions to estimate current prices) provides the most relevant information for liabilities

with stated terms but highly uncertain amounts. The argument provided is that for liabilities of this type, a cost-based measure is unlikely to provide relevant information and current market prices may be difficult to determine.

162 EFRAG believes that circumstances in which current market prices are difficult to determine first call into question whether the measurement objective should be to represent current market prices. For example, EFRAG recommended early on in the *Insurance Contracts* project that an entity-specific settlement value measurement objective was more relevant than a current market price objective, as current market price estimates would be highly hypothetical and transferring insurance liabilities was not a characteristic of the business model of an insurer. The absence of observable market prices should call into question whether a market exists and therefore whether a transfer scenario is probable. If, after further analysis, a current measurement objective is confirmed as a fair representation of an entity's business model or of the underlying economics of a specific transaction, cash-flow-based estimates should be used. EFRAG also believes that whenever cash-flow based measurements are used it should be clear whether current value from the perspective of the entity or current value from the market perspective will be obtained.

Liabilities with stated terms that are settled by cash or by delivering other assets according to the terms

163 EFRAG believes that the use of a cost-based measure could be appropriate for a liability that is expected to be settled by an entity through the payment of cash or delivering other assets according to its terms.

164 EFRAG believes that if the obligation is expected to be fulfilled by the payment of cash or delivering other assets according to the term, a cost-based measure would be the appropriate measurement basis for both the statement of comprehensive income and the statement of financial position, because it would reflect future cash outflows from an entity. Nevertheless, EFRAG believes that, contrary to the proposals in the DP, there are some liabilities that will be settled according to their terms but without inherently highly uncertain amounts, as for example lease obligations, where a 'cost-based' measurement will not be appropriate because cash-flow based measures may provide more useful information.

165 Our position on lease liabilities described above demonstrates the need for the Conceptual Framework to clarify whether cash-flow based measurement (other than one that functions to estimate current prices) is a distinct measurement basis or is solely a technique/method to obtain certain cost-based, i.e. non-current measurement bases.

166 For example, if a financial liability cannot be transferred then measuring that liability at a current market price reflects, in comprehensive income, changes in market prices that cannot be realised. Consequently, these liabilities are viewed as analogous to assets held for collection. EFRAG agrees with IASB's preliminary view on this issue.

167 On the other hand, liabilities that are derivatives should generally be measured at a current market price or another measure that varies according to the cash flows required by the contract. EFRAG believes such a measure is generally a much better indicator of ultimate cash flows than a cost-based measurement. However, EFRAG believes that some derivatives create risk exposures similar to some combination of non-derivative financial instruments (for example, simple interest swaps compared to loans and deposits with netting agreements). In those instances, derivatives should be measured consistently with those similar non-derivative instruments.

Liabilities with stated terms that are settled by being transferred to a third party without negotiating for consent of the creditor

168 EFRAG agrees with the argument in the DP that the most relevant measure of a liability that will be settled by being transferred would be a current market price, or a current market price plus transaction costs, because that is an estimate of the cash that will be paid to induce another party to assume the liability.

Liabilities with stated terms that are settled by performing a service or paying others to perform services

169 EFRAG believes that an appropriate measurement basis for those liabilities would differ depending on whether (i) an entity performs the services or (ii) an entity pays others to perform services.

170 If an entity performs the services, a cost-based measure starting with the proceeds received (in some cases with interest accretion) is likely to be appropriate for such obligations, especially if the services are a recurring revenue-generating activity, because it provides information about recurring components of profit or loss. That information can be used to derive expectations about future margins.

171 However, the current market price of the services may be more relevant information if the entity will pay others to perform the services.

Question 14

Paragraph 6.19 of the DP states the IASB's preliminary view that for some financial assets and financial liabilities (for example, derivatives), basing measurement on the way in which the asset contributes to future cash flows, or the way in which the liability is settled or fulfilled, may not provide information that is useful when assessing prospects for future cash flows. For example, cost-based information about financial assets that are held for collection or financial liabilities that are settled according to their terms may not provide information that is useful when assessing prospects for future cash flows:

(a) if the ultimate cash flows are not closely linked to the original cost;

(b) if, because of significant variability in contractual cash flows, cost-based measurement techniques may not work because they would be unable to simply allocate interest payments over the life of such financial assets or financial liabilities; or

(c) if changes in market factors have a disproportionate effect on the value of the asset or the liability (i.e. the asset or the liability is highly leveraged).

Do you agree with this preliminary view? Why or why not?

EFRAG's response

EFRAG agrees with the IASB's preliminary view expressed under Question 14

172 Derivative instruments have contractual terms, but are subject to significant variability in either cash flows or net value flows. As it was already stated in paragraphs 156 and 167 above, EFRAG agrees that current market prices are likely to be the most relevant measure for assessing prospects for future cash flows of derivative instruments. However, when current market prices are not available and the inputs to cash-flow based measurements are not verifiable, then the historical cost may provide the most useful information. Therefore, EFRAG believes that Conceptual Framework's arguments in favour of cost-based measures should generally be based more on cost-benefit considerations and verifiability rather than on superior relevance.

173 On the other hand, EFRAG notes that there is no substantial difference between a simple interest swap and a loan and deposit with netting; therefore there should be no justification for any measurement differences.

Question 15

Do you have any further comments on the discussion of measurement in this section?

EFRAG's response

174 EFRAG suggests that the term 'measurement' in the DP is replaced with the more precise term 'measurement basis'.

175 EFRAG thinks the DP requires a fuller debate on the relevance and usefulness of different measurement bases, especially on entity-specific versus market-based measurement basis and entry versus exit prices. EFRAG also believes the Conceptual Framework should provide a rationale for the circumstances in which Standards should require a measurement basis that takes account of price changes.

176 EFRAG believes that the discussion of cash-flow measurement for liabilities without stated terms does not address properly which attributes a cash-flow measurement is aiming to reflect. Consequently, the DP does not provide any preliminary views on how a cash-flow based measure for liabilities without stated terms should be constructed (for example, how to deal with uncertainties and whether the view of market participant or reporting entity's perspective should be reflected). EFRAG believes that the IASB should always clarify at the Standards level which measurement attribute the applied cash-flow measurement is aiming to reflect and on that basis justify its components.

177 EFRAG also thinks the Conceptual Framework should contain substantial discussion of the notions of expected value, i.e. outcome versus best estimate, the notions that surface in almost each new Standard.

178 EFRAG strongly believes the Conceptual Framework should contain principles on how to estimate cash-flows and the discount rate. The IASB should clarify the objectives for the use of the discount rate and therefore Conceptual Framework should contain a sound conceptual basis for all elements included into the discount rate, including the entity's own credit risk when relevant.

SECTION 7 PRESENTATION AND DISCLOSURE

Question 16

This section sets out the IASB's preliminary views about the scope and content of presentation and disclosure guidance that should be included in the Conceptual Framework. In developing its preliminary views, the IASB has been influenced by two main factors:

(a) the primary purpose of the Conceptual Framework, which is to assist the IASB in developing and revising Standards (see Section 1); and

(b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 7.6–7.8 of the DP), including:

  (i) a research project involving IAS 1, IAS 7 and IAS 8, as well as a review of feedback received on the Financial Statement Presentation project;

  (ii) amendments to IAS 1; and

  (iii) additional guidance or education material on materiality.

Within this context, do you agree with the IASB's preliminary views about the scope and content of guidance that should be included in the Conceptual Framework on:

(a) presentation in the primary financial statements, including:

  (i) what the primary financial statements are;

  (ii) the objective of primary financial statements;

  (iii) classification and aggregation;

  (iv) offsetting; and

  (v) the relationship between primary financial statements.

(b) disclosure in the notes to the financial statements, including:

  (i) the objective of the notes to the financial statements; and

  (ii) the scope of the notes to the financial statements, including the types of information and disclosures that are relevant to meet the objective of the notes to the financial statements, forward-looking information and comparative information.

Why or why not? If you think additional guidance is needed, please specify what additional guidance on presentation and disclosure should be included in the Conceptual Framework.

EFRAG's response

EFRAG agrees with the proposals, but thinks that more guidance is needed for some areas.

179 EFRAG agrees with the proposals, but thinks that more guidance is needed for some areas in order to address the issues raised by constituents during the IASB *Agenda Consultation 2011*.

180 In particular we think more guidance is needed on how to 'provide a structured way to review the need for disclosure', which was one of the issues respondents to the Agenda Consultation identified as an area that should be developed. The DP indicates some subjects of information: the reporting entity, amounts in the primary statements, unrecognised amounts, nature and extent of risks, methods and assumptions; but it does not explain how the IASB should select from different types of disclosure. The DP simply states that 'the IASB can consider different forms of disclosure (e.g. disaggregation, descriptions, roll-forwards, sensitivity analysis) depending on the nature of the item in question.' EFRAG considers this too generic a statement that does not introduce

sufficient discipline in the IASB's process of deciding on disclosure requirements at a standards level.

181 EFRAG thinks that the Conceptual Framework should provide more guidance in order to provide a structured way to review the need (and develop the appropriate requirements) and to enable preparers to understand the rationale behind disclosure requirements and hence guide them in the application of these requirements. EFRAG considers that the discussion paper *Towards a Disclosure Framework for the Notes* (issued by EFRAG, the French Autorité des Normes Comptables (ANC) and the UK Financial Reporting Council (FRC)) and the related Feedback Statement, which presented the comments of constituents, could be useful in that regard.

182 *Towards a Disclosure Framework for the Notes* suggests that notes should fulfil the following categories of users' needs:

(a) what the components of a line item are;

(b) for disaggregated amounts, information on:

(i) what the item is;

(ii) how the item fits into the entity's operation and financial structure;

(iii) how the item has been accounted for.

183 Accordingly, as a starting point, standard setters should require information on relevant terms and conditions for understanding an item when one of these indicators exists – but not in other cases (and entities should provide the information if it is material).

184 The DP provides a list of disclosures the IASB would normally consider requiring. This list includes information about: the reporting entity; the amounts recognised in its primary financial statements; and the nature and extent of its unrecognised assets and liabilities. However, the list also requires information about the nature and extent of risks arising from an entity's assets and liabilities; and the methods, assumptions and judgements and changes in those methods. EFRAG considers that the first three requirements relate to the elements on which an entity should provide information; the latter two requirements relate to the type of information an entity should provide. EFRAG considers that a distinction should be made between these two types of requirements.

185 EFRAG notes that a consequence of the proposals of the DP on forward-looking information is that non-adjusting events after the reporting period should not be disclosed in the notes. EFRAG considers that if note disclosure-overload should be limited by provision of principles for what information the notes should contain, it would be very difficult to set the principles so that all current requirements that are considered useful would be within those principles. EFRAG therefore accepts this consequence and notes that information about non-adjusting events can be provided elsewhere in a financial report or the IASB could treat this information as an exception to the principles on presentation and disclosure.

186 On a more detailed level, EFRAG notes that the DP suggests requiring disclosures about risks with indication of the nature and extent of risks arising from the entity's assets, liabilities, equity, income, expenses and cash flows. Risk may be interpreted in different ways and EFRAG is concerned that information about risk could encompass almost any type of information. In addition, it is not specified what the information should be about which make the list of possible disclosures close to endless.

187 In the view of EFRAG, the categories of information that are useful for assessing risk in relation to the financial position and financial performance of an entity are:

(a) measurement (and recognition) uncertainty;

(b) impact of a potential change in operating objectives (for example when measurement reflects the entity's business model);

(c) exposure to market conditions or other external factors; and

(d) information on an entity's risk appetite.

188 EFRAG therefore considers that information about risks should be limited to these categories, which are further explained in *Towards a Disclosure Framework for the Notes*.

189 EFRAG notes that the DP states that the IASB may choose to require offsetting when such a presentation provides a more faithful representation of a particular position, transaction or other event. EFRAG considers that the IASB may also choose to require offsetting when such a presentation results in more relevant information.

Question 17

Paragraph 7.45 of the DP describes the IASB's preliminary view that the concept of materiality is clearly described in the existing Conceptual Framework. Consequently, the IASB does not propose to amend, or add to, the guidance in the Conceptual Framework on materiality. However, the IASB is considering developing additional guidance or education material on materiality outside of the Conceptual Framework project.

Do you agree with this approach? Why or why not?

EFRAG's response

EFRAG thinks that more general guidance on materiality could be included in the Conceptual Framework.

190 The IASB has chosen to direct the Conceptual Framework towards its own standard setting. The IASB's choice not to consider materiality further in the Conceptual Framework is consistent with this choice, as the assessment of materiality is mostly relevant for preparers, auditors and regulators and less relevant when preparing Standards.

191 However, as mentioned above, EFRAG considers that the Conceptual Framework should also be useful for others (e.g. preparers). It could therefore be useful to include the general guidelines mentioned in paragraph 7.46 of the DP in the Conceptual Framework. More specific guidance should, however, be provided somewhere else in order to avoid the Conceptual Framework becoming an accounting textbook. In addition, including guidance in Standards results in the appropriate authority of the requirements.

192 EFRAG agrees with the DP that additional guidance on the application of materiality could be provided by amending Standards or by providing educational material. The most useful way, may be a combination of both. In the discussion paper *Towards a Disclosure Framework for the Notes*, EFRAG, the ANC and the FRC have developed some indicators for materiality for different types of information. EFRAG considers that these indicators could be a useful basis for developing some concrete guidance on the issue.

Question 18

The form of disclosure requirements, including the IASB's preliminary view that it should consider the communication principles in paragraph 7.50 of the DP when it develops or amends disclosure guidance in IFRSs, is discussed in paragraphs 7.48–7.52 of the DP [which are summarised in paragraphs.

Do you agree that communication principles should be part of the Conceptual Framework? Why or why not?

If you agree they should be included, do you agree with the communication principles proposed? Why or why not?

EFRAG's response

EFRAG agrees that communication principles should be part of the Conceptual Framework and generally agrees with the principles suggested.

193 EFRAG agrees with the DP that communication principles should be part of the Conceptual Framework. Financial statements are aimed at communicating financial information to users. While the content of the notes is of utmost importance to achieve relevance and faithful representation, poor communication hinders the quality of information, especially within lengthy reports.

194 As the notes form part of 'telling the story' of an entity's financial performance and position, it is difficult to establish anything other than high-level generic principles that can be used when presenting information in the notes. In *Towards a Disclosure Framework for the Notes*, EFRAG, the ANC and the FRC developed principles which are broadly similar to those suggested in the DP. EFRAG generally agrees with the high-level generic principles suggested in the DP. In addition to the proposed principles, EFRAG suggests including also that information should be concise and use consistent terminology.

SECTION 8 PRESENTATION IN THE STATEMENT OF COMPREHENSIVE INCOME–PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME (OCI)

Question 19

The IASB's preliminary view that the Conceptual Framework should require a total or subtotal for profit or loss is discussed in paragraphs 8.19–8.22 of the DP.

Do you agree with this preliminary view? Why or why not? If you do not agree do you think that the IASB should still be able to require a total or subtotal profit or loss when developing or revising particular Standards?

EFRAG's response

EFRAG agrees that the Conceptual Framework should require profit or loss to be presented. The Conceptual Framework should explain the objective of presenting profit or loss.

195 EFRAG agrees with the view that users from all sectors incorporate profit or loss in their analyses, either as a starting point for analysis or as the main indicator of an entity's performance. EFRAG also considers that profit or loss is the primary measure of an entity's performance. Therefore, EFRAG believes that profit or loss is an essential number that supports users' needs and agrees that the Conceptual Framework should require profit or loss to be presented.

196 EFRAG does not agree with the arguments by some that splitting items between profit or loss and other comprehensive income will prevent users from seeing and evaluating all items of income and expense. EFRAG believes that providing a profit or loss will provide greater transparency and help a user better assess the entity's performance and prospects for future net cash inflows.

197 EFRAG believes that if profit or loss excludes some items of income and expense resulting from changes of current measures of assets and liabilities (remeasurements), the profit or loss total has more predictive value than total comprehensive income. Nevertheless, EFRAG would strongly oppose shifting cost-based 'adjustments' such as impairment losses and reversals of impairment losses to OCI.

198 Furthermore, EFRAG believes that the Conceptual Framework should provide a definition/description of what profit or loss should depict, so that it plays its role of a primary performance metric that is meaningful in financial communication. This would provide a rationale and meaningful communication tool for what profit or loss should depict and would facilitate its distinction from OCI. EFRAG also thinks an entity's business model should play a role in defining primary performance.

Question 20

The IASB's preliminary view that the Conceptual Framework should permit or require at least some items of income and expense previously recognised in in OCI to be recognised subsequently in profit or loss; i.e. recycled, is discussed in paragraphs 8.23–8.26 of the DP [which are summarised below in paragraphs.

Do you agree with this preliminary view? Why or why not? If you agree, do you think that all items of income and expense presented in OCI should be recycled into profit or loss? Why or why not?

If you do not agree, how would you address cash flow hedge accounting?

EFRAG's response

EFRAG thinks that all items presented in OCI should qualify for recycling to profit or loss unless recycling would not provide relevant information in profit or loss. EFRAG also believes that a clear objective of profit or loss is needed to be able to robustly determine when recycling of OCI items provide relevant information.

199 EFRAG believes that discussions on recycling are closely related to those on the objectives or purposes of profit or loss and OCI. If the objective of profit or loss would be clearly identified then it would be much easier to determine for which items of OCI recycling would provide relevant information.

200 In the absence of an objective of profit or loss, EFRAG's view is that the Conceptual Framework should require at least some items of income and expense previously recognised in OCI to be recognised subsequently in profit or loss (i.e. recycled). Accordingly, EFRAG is not persuaded by the arguments against recycling (Approach 1) presented in the DP. As noted in paragraph 195 above, EFRAG thinks that the Conceptual Framework should require profit or loss to be presented in the financial statements and in the view of EFRAG this would mean that recycling would be needed. Otherwise it would not be possible to provide the correct depiction of an entity's performance, which is primarily reflected in profit or loss.

201 If there were to be no recycling, the Conceptual Framework would not need to specify whether an entity should present profit or loss, or any other total or subtotal. The decision whether to require or permit profit or loss, or any other total or subtotal, would be one that the IASB could take when it developed or revised particular Standards.

202 EFRAG thinks that when an item of income and expense is presented in OCI, it should automatically qualify for recycling, unless recycling would not result in relevant information in profit or loss, the primary measure of an entity's performance.

203 EFRAG finds a lot of appeal in the simple principle that items initially presented outside of profit or loss need to be recycled into it when the reason for initial exclusion no longer applies. However, we recognise that it is not that simple to make such a high level principle operational in practice.

Question 21

In this Discussion Paper, two approaches are explored that describe which items could be included in the OCI: a narrow approach (Approach 2A described in paragraphs 8.40−8.78 of the DP) and a broad approach (Approach 2B described in paragraphs 8.79-8.94 of the DP).

Which of these approaches do you support, and why?

If you support a different approach, please describe that approach and explain why you believe it is preferable to the approaches described in this Discussion Paper.

EFRAG's response

EFRAG supports Approach 2B and believes an entity's business model should play a role in defining primary performance and thus which items of income and expense should go to profit or loss and which into OCI. Therefore, the Conceptual Framework should not artificially limit the IASB's possibilities for defining the primary performance, reflected in profit or loss.

Principles in Approach 2A and Approach 2B

204 EFRAG agrees with principle 1 on the basis that presenting items separately in profit or loss and OCI clearly identifies different components of the return an entity has made on its resources during a period and hence provides useful information for assessing the prospects for future cash flows arising from them. EFRAG agrees with the use of the term 'primary' in principle 1, as it reflects the prominence of profit or loss while at the same time acknowledges that items presented outside profit or loss may still provide relevant information for the user to assess the performance of the entity.

205 In EFRAG's opinion OCI items are unjustifiably treated by many as pieces of information of really minor relevance. OCI contains relevant information for the assessment of the entity's overall performance.

206 EFRAG agrees with principle 2. It also agrees with the reasoning in the DP that presenting in OCI items of income or expense resulting from cost-based measurements, including amortised cost (depreciation and amortisation; accrual of interest, accretion of a discount, or amortisation of a premium; impairment of assets or increases to the carrying amount of liabilities that have become onerous) would not enhance the relevance of profit or loss. EFRAG also believes that OCI should be limited to items of income and expense resulting from changes in current measures of assets and liabilities (remeasurements).

207 EFRAG disagrees with the application of Principle 3 from Approach 2A that prevents the recognition of item of income or expense in OCI if subsequent recycling would not result in relevant information in profit or loss.

208 Since Principle 3 from Approach 2B states that an item that has previously been recognised in OCI should be reclassified (recycled) to profit or loss *when, and only when*, the reclassification results in relevant information, EFRAG supports Principle 3 from Approach 2B. That principle is aligned with EFRAG's preliminary view expressed under Question 20 that all items presented in OCI should qualify for recycling to profit or loss unless recycling would not provide relevant information in profit or loss.

Applying the principles in Approach 2B

209 Based on the three principles described above, Approach 2B proposes that three groups of items would be eligible for recognition in OCI. These are labelled as 'bridging items' (at the moment only changes in the discount rate of the financial assets measured at fair value through OCI from *IFRS 9 2012 ED* and changes in the discount rate of insurance contracts from *Insurance Contracts 2013 ED*), 'mismatched remeasurements' (for

example net investment in foreign operations from IAS 21 *The Effects of Changes in Foreign Exchange Rates*) and 'transitory remeasurements', which are discussed below.

Bridging items

210 The 'bridging items' concept should, in EFRAG's opinion, be used only when this presentation (reporting two measurements) best reflects the entity's financial position and performance in the specified circumstances, based on the entity's business model (please see paragraphs 244 to 265 below).

211 EFRAG agrees that using two different measurement bases is only warranted if both measures provide sufficiently useful information about different facets of the entity's financial position and financial performance. Those measures need to be determined consistently with the measurement concepts as described in Section 6 *Measurement* of the DP. As the use of two measurement bases would result in additional costs and might make the financial statements less understandable, the IASB would need to justify whether the benefits of the additional information would outweigh those disadvantages.

212 In line with EFRAG's view expressed above, bridging amounts in OCI (i.e. the difference between the two measurement bases) should be recycled to profit or loss *unless* recycling would not result in relevant information in the statement of profit or loss. For example, if a debt instrument is measured at fair value in the statement of financial position, but recognised in profit or loss using amortised cost, then amounts previously reported in OCI would generally be recycled.

Mismatched remeasurements

213 'Mismatched remeasurements' arise when one of the items (or part of an item) within a linked set of items is regularly remeasured, while the linked item is not remeasured or is not recognised until later. For example, when all derivatives are measured at fair value and the derivative is used to hedge a forecast transaction, changes in the fair value of the derivative arise in a reporting period or periods before the income or expense resulting from the forecast transaction. To the extent that the hedge is effective and qualifies for hedge accounting, in accordance with Standards, an entity reports in OCI the gains or losses on the derivative, and subsequently recycles those gains or losses into profit or loss when the forecast transaction affects profit or loss. That enables users of financial statements to see the results of the hedging relationship.

214 EFRAG supports the concept of mismatched remeasurements to define additional group of items (other than bridging items) which are eligible for presentation in OCI. When an item of income and expense is delinked from a set of items to which it relates, the item provides little relevant information about the return the entity has made on its economic resources in the period. In this case amounts in OCI related to mismatched remeasurements would be recycled into profit or loss only when they can be presented with the transactions with which they are linked.

Transitory remeasurements

215 In addition to only two groups of items eligible for recognition in OCI under Approach 2A (bridging items and mismatched measurements), Approach 2B introduces 'transitory remeasurements' as an additional category of OCI items. This category is based on the view that remeasurements of some long-term assets or liabilities are best reflected outside profit or loss. Presentation of a remeasurement (or components of a remeasurement) in OCI in these circumstances may provide more transparent information about how the asset is likely to contribute to future cash flows or how the liability is likely to be settled.

216 EFRAG supports the concept of transitory remeasurements under which additional items of income and expense would qualify for presentation in OCI. The inclusion of the transitory remeasurements concept will help avoid mechanical application of OCI recognition and recycling requirements.

EFRAG's position on Approach 2A, Approach 2B and recycling

217 To summarise, EFRAG supports Approach 2B as suggested in the DP, based on the bridging items, mismatched remeasurements and transitory remeasurements concepts. EFRAG believes the business model should play a role in defining primary performance and thus which items of income and expense should go to profit or loss and which into OCI. Therefore, the Conceptual Framework should not artificially limit IASB's possibilities for defining primary performance, reflected in profit or loss, which may be the outcome if Approach 2A were adopted.

218 As already expressed under question 20, EFRAG thinks that all items presented in OCI should qualify for recycling to profit or loss unless recycling would not provide relevant information in profit or loss. Therefore some bridging items (i.e. the difference between the two measures) that should, according to the DP, always be recycled to profit or loss, could be exempted from recycling. EFRAG believes that IASB should in this case set out why it does not think recycling would provide relevant information in profit or loss when developing each Standard (most likely in Basis for Conclusions).

219 In the case of mismatched measurements, EFRAG supports the concept itself and the related recycling principle: the amounts in OCI related to mismatched remeasurements would be recycled into profit or loss only when they can be presented with the transactions to which they are linked. For EFRAG's comprehensive view on recycling please refer to paragraphs 199-203.

SECTION 9 OTHER ISSUES

Chapters 1 and 3 of the existing Conceptual Framework

Question 22

Paragraphs 9.2–9.22 of the DP address the chapters of the existing Conceptual Framework that were published in 2010 and how those chapters treat the concepts of stewardship, reliability and prudence. The IASB will make changes to those chapters if work on the rest of the Conceptual Framework highlights areas that need clarifying or amending. However, the IASB does not intend to fundamentally reconsider the content of those chapters.

Do you agree with this approach? Please explain your reasons.

If you believe that the IASB should consider changes to those chapters (including how those chapters treat the concepts of stewardship, reliability and prudence), please explain those changes and the reasons for them, and please explain as precisely as possible how they would affect the rest of the Conceptual Framework.

Notes to constituents

EFRAG's response

EFRAG thinks that the first chapters of the Conceptual Framework should be revised. Reliability and prudence should be reintroduced. In addition, EFRAG believes that it should be clear from the first chapters that the objective of assessing stewardship is as important as assessing the prospects for future cash flows.

220 EFRAG believes that a fundamental discussion is needed on the Chapters 1 and 3 of the Conceptual Framework on stewardship, reliability and prudence. EFRAG's views on these issues are further explained in the following paragraphs.

Stewardship

221 Paragraph OB4 of the existing Conceptual Framework states:

> To assess an entity's prospects for future net cash inflows, existing and potential investors, lenders and other creditors need information about the resources of the entity, claims against the entity, and how efficiently and effectively the entity's management and governing board have

discharged their responsibilities to use the entity's resources. Examples of such responsibilities include protecting the entity's resources from unfavourable effects of economic factors such as price and technological changes and ensuring that the entity complies with applicable laws, regulations and contractual provisions. Information about management's discharge of its responsibilities is also useful for decisions by existing investors, lenders and other creditors who have the right to vote on or otherwise influence management's actions.

222 Accordingly, the existing Conceptual Framework acknowledges that financial reporting should provide information that would be useful for assessing stewardship.

223 However, paragraph OB4 of Conceptual Framework seems to:

(a) State that providing information to help existing and potential investors assess the prospects for future net cash inflows to an entity is the primary objective of financial reporting. Providing information that is useful for assessing stewardship is just something that could be useful for assessing future cash flows.

(b) Assume that information about stewardship is useful for estimating future cash flows. In other words, information that is useful for assessing stewardship is also useful for estimating future cash flows.

224 As explained in the Bulletin *Accountability and the objective of financial reporting*, EFRAG disagrees with both of these assertions[6].

225 Indeed it may be helpful to consider at this point whether stewardship is exactly the same as accountability. Arguably it is not in that a dictionary definition of stewardship – 'the careful and responsible management of something entrusted to one's care' – is potentially wider than accountability both in the level of authority given and the focus on how something is managed rather than the outcome of that process.

226 EFRAG thinks that providing information that is useful for assessing stewardship is as important as providing information to assess the prospects for future net cash inflows to an entity. EFRAG notes that academic literature shows that information most useful for estimating future cash flows is not always the most useful for assessing stewardship[7]. Accordingly, EFRAG believes that the objective of providing information useful for assessing stewardship should be presented as separate objective in the Conceptual Framework instead of being subsumed in the objective of providing information to assess future cash flows. Although information useful to assess stewardship may be different from information to assess future cash flows, EFRAG thinks that it is possible to ensure that sufficient information to assess both stewardship and future cash flows can be provided in the financial statements. This should be acknowledged in the Conceptual Framework. For example, if a particular measurement basis is providing the most useful information for assessing future cash flows, disclosures can provide additional information for assessing stewardship.

227 EFRAG notes that the Conceptual Framework only deals with financial reporting. In order to avoid doubt, EFRAG would, however, specify that it does not think that financial information is the only means by which stewardship should be assessed.

Reliability

228 EFRAG acknowledges that the DP suggests that an entity should not recognise an asset or liability if no measure of the asset (or liability) would result in a faithful representation of a resource or obligation of the entity, or of a change in its resources or obligations, even if all necessary descriptions and explanations are disclosed.

229 EFRAG agrees with this suggestion. Academic literature suggests that reliability is at least equally important as relevance, and that disclosure of the process and inputs into an estimate cannot always compensate for measurement uncertainty.

[6] The Bulletin was issued by EFRAG, ANC, ASCG, OIC and FRC. Not all the partners issuing the Bulletin share the preliminary view of EFRAG on these issues. The different views are explained in the Bulletin.
[7] EFRAG and ICAS has issued a literature review of studies on capital providers' use of financial statements.

230 Although EFRAG agrees with the suggestion to consider faithful representation when recognising assets and liabilities, it thinks that this should also lead to some changes in how faithful representation is explained in Chapter 3 of the current Conceptual Framework. In the view of EFRAG the most appropriate would simply be to replace the term with 'reliability'. 'Reliability' should be defined in the same way it was in Conceptual Framework before 2010. That is, 'reliability' would, as a starting point, mean that information:

(a) should be free from material error and bias.

(b) can be depended upon by users to represent faithfully that which it either purport to represent or could reasonably be expected to represent. This also means that transactions and other events are accounted for and presented in accordance with their substance and economic reality and not merely their legal form.

(c) is prepared under the exercise of prudence (see below).

(d) is complete.

231 EFRAG acknowledges that besides including the reference to prudence (which is further considered below) and specifying that transactions and other events should be presented in accordance with their substance, the elements of 'reliability' are similar to those used to describe 'faithful representation' in the current Conceptual Framework. However, EFRAG thinks that when the term was changed in 2010 from 'reliability' to 'faithful representation', there was also a change in the context in which reliability should be considered. EFRAG is of the opinion that before the change in 2010, there was a trade-off between relevance and reliability which should be reintroduced. That is, information could be relevant without being reliable and vice versa. After the changes all reference to this trade-off have been removed. EFRAG thinks that reintroducing the trade-off would also be consistent with the proposal in the DP that an entity should not recognise an asset or liability if no measure of the asset (or liability) would result in a faithful representation. If the IASB thought that assets and liabilities should not be recognised when they could not be measured reliably because this would not result in relevant information, the IASB could just have referred to relevance in the recognition criteria. By referring to faithful representation in addition to relevance, it seems as if some assets and liabilities could be relevant to recognise – but recognition would not result in reliable information.

232 In order to reflect its decision on the recognition criteria, the IASB should also amend the wording of paragraphs QC15 and QC16. These paragraphs note that 'if the level of uncertainty in an estimate is sufficiently large, that estimate will not be particularly useful'. However, they also state that 'a representation of [an] estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate' and that 'if there is no alternative representation that is more faithful, that estimate may provide the best available information'. Without any clarification, EFRAG does not believe the latter would reflect EFRAG's view and the IASB's suggestion in the DP as noted in paragraph 228 above.

233 In addition to replacing 'faithful representation' with 'reliability' as defined in the pre-2010 Conceptual Framework, EFRAG considers that verifiability should form part of reliability instead of just being considered an enhancing qualitative characteristic. In the description of verifiability, the meaning seems weak as it requires only a consensus between different knowledgeable and independent observers, rather than a reasonable level of certainty over the measurement of the financial effects of the item.

234 EFRAG's view on reliability is further explained in the Bulletin *Reliability of financial information*[8].

235 No matter whether the IASB chooses to replace faithful representation with reliability or not, we think that the IASB should better explain the relationship between this term and relevance. EFRAG notes that different interpretations exist, as many consider that information cannot be relevant if it is not reliable.

Prudence

236 On prudence, EFRAG agrees with the DP that, although widely accepted as a concept, there are differing views as to what prudence means in practice. In EFRAG's view prudence represents a degree of caution which generally recognises downside risks and not upside potential inherent in uncertain future events.

237 As such a prudence filter within the Conceptual Framework should operate in setting Standards for recognition or measurement – it does not relate to disclosure as the uncertainties/risks can be described at least qualitatively if not quantitatively. For example, when the inflows related to an asset are contingent on an uncertain future event, the filter could prevent this (contingent) asset from being recognised at all on the statement of financial position. However, information about the potential asset could and should be provided in the notes to the financial statements.

238 Prudence is clearly reflected both in Standards in force today and those being developed. For example, the new Standard on revenue recognition requires a customer contract to exist in order to recognise revenue and hence the uplift in inventory above cost; similarly, even with a customer contract, recognition of variable consideration is limited to the amount which is reasonably assured (rather than, for example, the expected amount). In contrast a potential reduction in inventory below cost is recognised as soon as it is expected. Whilst for financial instruments the measurement criteria are generally more even handed, even then, for example, the treatment of day one profits uses the concept of prudence. EFRAG therefore believes that it is essential to include a clearly articulated concept of prudence in the Conceptual Framework in order to ensure that it is applied consistently across the Standards (both current and future).

239 In EFRAG's view, the concept of prudence should be explained after neutrality has been explained (similar to the pre-2010 Conceptual Framework) to highlight that prudence should not be applied in standard setting in a manner that would not result in neutral information.

240 EFRAG's view on prudence is further explained in the Bulletin *Prudence*[9].

Additional issues to consider in Chapters 1 and 3

241 In addition to the comments on stewardship, reliability and prudence, EFRAG has a few other comments on Chapters 1 and 3 in the Conceptual Framework.

242 From a literature review of capital providers' use of financial statements[10], it appears that capital providers have diverse needs. We think that this should be acknowledged in the Conceptual Framework. Similarly, we think that the Conceptual Framework should state that when assessing what information to be included in the financial statements, the specific benefits of requiring information to be presented in the financial statements should be assessed. This includes the features that set the financial statements apart from other information sources with inherent weaknesses such as lack of reliability and verifiability.

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8 The Bulletin *Reliability of financial information* was issued by EFRAG, ANC, ASCG, OIC and FRC.

9 The Bulletin *Prudence* was issued by EFRAG, ANC, ASCG, OIC and FRC.

10 The literature review was published by EFRAG and ICAS in December 2013 and carried out by Stefano Cascino, Mark Clatworthy, Beatriz Garcia Osma, Joachim Gassen, Shahed Imam and Thomas Jeanjean.

243 The DP considers whether the Conceptual Framework should include more guidance on identifying the substance of contractual rights and contractual obligations. While EFRAG agrees with this, we believe that reporting the substance relates to financial statements in general and should not just be considered additional guidance to support the asset and liability definitions. EFRAG therefore suggests that the discussion of reporting substance should be included in Chapter 3 of the Conceptual Framework.

The use of the business model concept in financial reporting

Question 23

The business model concept is discussed in paragraphs 9.23–9.34. This DP does not define the business model concept. However, the IASB's preliminary view is that financial statements can be made more relevant if the IASB considers, when developing or revising particular Standards, how an entity conducts its business activities.

Do you think that the IASB should use the business model concept when it develops or revises particular Standards? Why or why not?

If you agree, in which areas do you think that the business model concept would be helpful?

Should the IASB define 'business model'? Why or why not? If you think that 'business model' should be defined, how would you define it?

EFRAG's response

EFRAG believes that the business model notion should be referred to in IASB's financial reporting requirements on a systematic basis and thus be part of the IASB's *Conceptual Framework*.

244 The role of the business model for financial statements has been subject to extensive research conducted through EFRAG's proactive project undertaken jointly with the French ANC and the UK FRC. The final results of this project, the Research Paper *The Role of the Business Model in Financial Statements*, was issued in December 2013.

245 In addition to the Research Paper, EFRAG and the standard setters from France, Germany, Italy and the United Kingdom issued a Bulletin *The Role of the Business Model in Financial Reporting* in June 2013 as part of a series of papers to promote discussion on topics related to the IFRS Conceptual Framework debate.

246 Both the Research Paper and the Bulletin discuss the following issues:

(a) The use of the business model in IFRS;

(b) An assumed meaning of the term;

(c) The conceptual discussion on the business model;

(d) A discussion on the distinction between the business model and management intent; and

(e) Implications of the business model for IFRS.

247 A summary of this discussion is provided below.

An assumed meaning of the term

248 Both the Research Paper and the Bulletin use an assumed meaning of the term. The assumed meaning focuses on the value creation process of an entity, i.e. how the entity generates cash flows. In case of non-financial institutions, it represents the end-to-end value creation process or processes of an entity within the business and geographical markets it operates.

The conceptual discussion on the business model

249 To assess whether the business model could, or even should, play a role in financial reporting, the Research Paper and the Bulletin discuss whether such a role is essential for, or enhances the response to, the key qualitative characteristics in the IASB Conceptual Framework.

250 Based on this assessment, the tentative view expressed in the Bulletin is that the business model should play a role in financial reporting, including the financial statements. Not doing so would result in less relevant information, would not lead to a faithful representation of economic reality, would harm comparability, and would make the financial statements less understandable. For this reason, the role of the business model should be explicitly incorporated in the IASB literature.

A discussion on the distinction between business model and management intent

251 The Research Paper and the Bulletin provide a discussion on the similarities and differences between the business model and management intent, an issue which has been debated extensively in the academic literature.

252 An important similarity between the business model and management intent is that they are both entity-specific, i.e., the financial statements reflecting both the business model and management intent present what actually happened and how the entity performed. In other words, the financial statements provide information that is useful for an assessment of management's accountability, or stewardship. The resulting information therefore meets the relevance criterion. Both the business model and management intent are also verifiable, if they are documented with the necessary level of detail. Some take these similarities one step further and argue that the business model is the same as management intent or that the two notions are connected, at least, for purposes of financial reporting.

253 The tentative view expressed in the Bulletin is that there is a distinction between the business model and management intent. Both notions provide relevant information, but business models tend to focus on the larger picture, are generally more stable, and usually require much less documentation to make them verifiable.

Implications of the business model for Conceptual Framework

254 EFRAG believes that financial reporting should portray the business model in order to faithfully represent the economic reality of the reporting entity, since it focuses on the actual, past and current transactions and events. Therefore, once the business model is identified and observed, the accounting treatment related to a business model should be derived from the business model.

255 EFRAG, ANC, ASCG, OIC and FRC do not believe that the current status quo, i.e. the business model being referred to in financial reporting requirements only on an ad hoc basis, explicitly or implicitly, at Standards level should be maintained. As a consequence, they support the development of a proper rationale for the use of the business model notion as part of the Conceptual Framework, with appropriate guidance for standard setting purposes.

256 Such guidance would help identify whether and when the business model notion should be explicitly incorporated on individual Standards level. The Conceptual Framework should also require that the business model be based on observable and verifiable evidence.

257 If the business model approach is applied, its meaning would need to be described in the Conceptual Framework and in individual accounting Standards that explicitly incorporate the term. Although we acknowledge that the assumed meaning provided in paragraph 248 could probably be further developed, in our opinion a very general definition/identification of the business model notion similar to the one presented above would suffice for the Conceptual Framework. Nevertheless, if the business model notion

would be explicitly incorporated in individual Standards, then the notion would need to be defined/identified in more detail to be operational.

258 Furthermore, Standards should reflect faithfully an entity's business model or models. If that is not the case, EFRAG believes that financial reporting requirements have not been developed appropriately.

259 Additionally, the Conceptual Framework should highlight and illustrate how the business model can play a role in (i) recognition, (ii) measurement, (iii) presentation and (iv) disclosures. Some suggestions are presented hereafter.

Playing a role in recognition

260 If the business model plays a role in recognition, an item could be an asset for some entities and not recognised by others. An example can be found in IAS 39, paragraph 5, which states that the Standard should be applied to "contracts to buy or sell a non-financial items that can be settled net in cash ... with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements." This means that a contract to receive an amount of coal is a non-recognised executory contract for an energy producer, but a recognised financial instrument for a commodities trader.

Playing a role in measurement

261 Measurement (and the related accounting policy choice) is an obvious place where the business model should play a role, because current IFRS require, or permit, different measurement requirements depending on how an asset or a liability, or a group of assets or liabilities, contribute to the entity's cash flow generation. Please see paragraph 138 above in Section 6 *Measurement* which addresses the measurement of inventory.

262 Furthermore, EFRAG also believe that the business model provides an essential basis for understanding how assets and liabilities are used within a certain entity and thus how the assets contribute to future cash flows and how liabilities will be settled or fulfilled. The DP notes (paragraphs 6.75–6.96) that the way an asset will ultimately contribute to cash flows will often not be certain and that for most assets there are choices that may change. The business model thus actually limits management discretion (management intent) in selecting the appropriate measurement basis.

Playing a role in presentation

263 Presenting assets, liabilities, income and expenses in such a way that investors can understand how they contribute to the entity's cash flow generation can in itself be a way of representing the entity's business model. Segregating assets and liabilities which play a different economic role in the entity, for example helping provide optimum daily cash management versus creating liquidity for acquisitions and capital expenditures, would provide users with both a better basis for looking at financial results and forming expectations of future financial results.

264 To a certain extent, this was the approach presented in the IASB-FASB joint project *Financial Statements Presentation*, which proposed that separation should not only be made into operating, investing and financing activities, based on the nature of the assets and liabilities, but also on the economic role they played in the activities of the entity. These underlying principles were widely welcomed (although constituents active in the financial services industry commented that such distinction was not always easy to make), and such a presentation was supportive of more meaningful sub-totals and performance indicators, such as operating profit.

Playing a role in disclosures

265 Business models could also play a role in the determination of priorities in information provided. In order to help users to clearly identify the most important elements of

information, it could be assumed that the most important and relevant information should be given priority in the primary financial statements. The business model notion would help in identifying this most important information. Complementary (secondary) information would be presented somewhere else, for example in the notes to the financial statements. In particular, if there are two ways of measuring the same item or transaction, the one that is more closely related to the representation of the effects of the application of the business model in terms of cash flow generation should be placed in the primary financial statements and the complementary one in the note disclosures.

266 For more analysis on the above issues, please refer to the Research Paper *The Role of the Business Model in Financial Statements*, which EFRAG and the standard setters from France and the United Kingdom issued in December 2013.

Unit of account

Question 24

The unit of account is discussed in paragraphs 9.35–9.41. The IASB's preliminary view is that the unit of account will normally be decided when the IASB develops or revises particular Standards and that, in selecting a unit of account, the IASB should consider the qualitative characteristics of useful financial information.

Do you agree? Why or why not?

EFRAG's response

EFRAG believes that the IASB should commit itself more explicitly to consider the unit of account in relation to each Standard.

267 EFRAG thinks that the Conceptual Framework should include a section on how to determine the unit of account. The unit of account affects several measurement and recognition issues. It could therefore be relevant to include some guidance on aggregation, segregation and whether economic resources should be considered a bundle of rights (as noted in the DP).

268 EFRAG thinks that when the unit of account is determined on a standards level, the assessment should focus on the figures (the aggregate of events and transactions) ultimately reported in the financial statements taking the entity's business model into account. For example, if an entity has sold one product in the accounting period and has provided a product warranty, the most likely outcome of this obligation may be zero (when the entity has experience that its products are free from errors). However, if the entity has sold thousands of similar products, the most useful information about the likely outcome of the warranty obligation may be to consider the bundle of warranties as the unit of account when reporting the most likely outcome. Similarly, if the entity's business model is to buy and sell equity instruments in bundles rather than individually, it may be more relevant to consider these bundles as the unit of account rather than measuring each equity instrument individually and then add these together (see also the comments to the business model above).

269 For some industries the unit of account may not be a physical item or a contractual right. For example, the unit of account for financial institutions may be the different risk components. In other cases EFRAG believes that the unit of account could consist of both assets and liabilities (e.g. in relation to insurance) if this results in the most relevant information.

270 Although EFRAG agrees with the DP that the unit of account should be considered in relation to each Standard, we think that the Conceptual Framework should commit the IASB more explicitly to consider the unit of account when developing new or revised

guidance. In other words, the Basis for Conclusions to the new or revised guidance should identify the unit of account that has been selected and the reasons for its selection.

Going Concern

Question 25

Going concern is discussed in paragraphs 9.42–9.44 of the. The IASB has identified three situations in which the going concern assumption is relevant (when measuring assets and liabilities, when identifying liabilities and when disclosing information about the entity).

Are there any other situations where the going concern assumption might be relevant?

EFRAG's response

EFRAG agrees with the situations identified. In addition, we think that these situations are so important that the going concern notion should be considered as a fundamental underlying assumption. We also think that the link between the going concern assumption and concepts such as 'practically unconditional' and 'no realistic alternative' should be explained.

271 EFRAG agrees with the situations identified in the DP where the going concern assumption is relevant. These situations are so important that the going concern notion should be considered as a fundamental underlying assumption and highlighted in the Conceptual Framework, as currently.

272 EFRAG notes that there are currently mixed views about whether the going concern assumption should play a role in assessing whether a liability exists. The issue has arisen when the liability depends on the entity's future actions. For example, in situations where the entity will have to pay a levy if it stays in business. In the section on additional guidance to support the asset and liability definitions, the DP, however, notes that the going concern assumption should not play a role for the assessment in those circumstances. The IASB notes that even though financial reporting generally presumes that an entity is in going concern, that fact does not mean that the entity is obliged to remain in business. EFRAG considers this guidance helpful, and thinks that it should be included in the Conceptual Framework.

273 However, EFRAG thinks that more guidance on going concern is needed. For example, if the IASB chooses an approach where liabilities are recognised for obligations that are practically unconditional. In these cases, guidance is needed on how practicality and the going concern assumption interact. Similarly, EFRAG thinks that the going concern assumption indirectly will affect when a constructive obligation should be recognised as 'no realistic alternative' also assumes that the entity will remain a going concern. Both 'practically unconditional' and 'no realistic alternative' are, however, more than just the going concern assumption.

Capital maintenance

Question 26

Capital maintenance is discussed in paragraphs 9.45–9.54 of the DP. The IASB plans to include the existing descriptions and the discussion of capital maintenance concepts in the revised Conceptual Framework largely unchanged until such time as a new or revised Standard on accounting for high inflation indicates a need for change.

Do you agree? Why or why not? Please explain your reasons.

EFRAG's response

> **EFRAG agrees that the IASB should defer its work on capital maintenance until it considers how to account for high inflation.**

274 EFRAG notes that the issue of capital maintenance is more than how to account for high inflation. However, as accounting for high inflation is part of the issue of capital maintenance, EFRAG thinks that it may be beneficial to consider the issue of capital maintenance in connection with a new or revised Standard on accounting for high inflation. EFRAG does therefore not suggest any amendments to the Conceptual Framework on this issue as part of this review.

Additional issues

275 In addition to the issues considered in the DP, EFRAG would like to provide some additional comments related to the reporting entity and the reporting period.

Reporting entity

276 The IASB has decided not to discuss the reporting entity issue in relation to this DP. Instead the IASB will consider the comments received in response to its 2010 Exposure Draft on the reporting entity when preparing an Exposure Draft on the review of the Conceptual Framework for financial reporting. EFRAG considers this unfortunate. EFRAG thinks that several issues could have benefitted from additional discussion before moving to the next phase of the review of the Conceptual Framework. In particular EFRAG believes that the perspective from which financial statements are presented is critical and should be discussed in the Conceptual Framework. EFRAG notes that this issue was not included in the 2010 Exposure Draft on the reporting entity. However, clarifying the perspective is important in assessing how to resolve accounting policy issues and is central to considering how to satisfy the objective of financial reporting. EFRAG therefore thinks that it is necessary to carry out an in-depth analysis of the implications of adopting either perspective and to ensure they are properly debated. It would have been beneficial to initiate this work when developing the DP.

277 In addition, EFRAG thinks that the IASB should examine more comprehensively whether the application of a joint control approach for determining the boundaries of the group reporting entity provides decision-useful information.

Reporting period

278 EFRAG considers that some guidance on what the reporting period represents should be provided. EFRAG questions, for example, the logic of current requirements where:

(a) Impairment of goodwill recognised in one interim period cannot be reversed although it would not have been recognised if only an annual report had been prepared.

(b) A levy relating to an entire year that only meets the criteria for recognition in the last quarter of a financial year would only be reflected in the result of this last quarter. Accordingly, some could argue that the quarterly reports of the first periods of the financial year have provided a too optimistic reflection of the entity's performance.

279 EFRAG acknowledges that these issues may primarily relate to interim reporting, and could thus be considered in relation to IAS 34 *Interim Financial Reporting*. However, EFRAG wants to raise the issue in case the IASB considers it more appropriate to deal with the issue in relation to the Conceptual Framework.