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Hans Hoogervorst, Chairman
International Accounting Standards Board
30 Cannon Street
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25 November 2015

Dear Mr Hoogervorst

Exposure Draft 2015/3 – Conceptual Framework for Financial Reporting

Deloitte Touche Tohmatsu Limited is pleased to respond to the International Accounting Standards Board's (the Board's) Exposure Draft *Conceptual Framework for Financial Reporting* ('the exposure draft').

We think that the exposure draft represents a significant achievement, drawing on many aspects of the research and deliberations underpinning the Board's recent standard-setting activity. However, as explained in greater detail in the Appendix, we think that further improvements are necessary before the revised Conceptual Framework is issued. We wish to highlight some particular issues here:

- We welcome and commend the Board's willingness to review the chapters that were developed with the US FASB, and finalised in 2010. Overall, we think that the small number of changes being proposed in the exposure draft will improve the Conceptual Framework and should not result in a different application of the concepts between the Board's Framework and that of the U.S. FASB. In particular we welcome:
  - the discussion of stewardship, but think the Conceptual Framework would be improved if that term was defined; and
  - the proposal to define prudence, as expressed in the exposure draft.
- The proposed material on the primary financial statements, and in particular the performance statement(s), suffers from a lack of a conceptual basis. We understand that the Board has a current project on primary financial statements and we encourage the Board to give priority to that project. However, until clear objectives and definitions are established for the primary financial statements, in particular performance, it is difficult to provide meaningful comments about the proposals in the exposure draft with respect to profit or loss and other comprehensive income. In the meantime, the Board needs to avoid any inference in the Framework that it is giving primacy to the balance sheet over the statement(s) of financial performance. In addition, we think that the acknowledgement in the exposure draft that an item in the primary financial statements may have more than one measurement base is a consequence of not having clear objectives for the primary financial statements.

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- We also think that it is inappropriate to build rebuttable presumptions into the Framework. In our view a rebuttable presumption is a tool for use in Standards. A Framework should set out clear principles that the Board works with when it develops Standards.
- We think that the Framework would be enhanced by adding a statement that the Framework has been developed on the assumption that arm's-length transactions between entities are fair exchanges – and then address those situations when that assumption might not hold, such as non-reciprocal transfers, at a Standards-level.
- We do not support the proposed section on derecognition. It seems to have been written with collateralised borrowings (i.e. repo-type transactions) in mind, rather than addressing more general derecognition principles. As a consequence, the exposure draft proposes incorporating an exception for some transactions into the Framework. We think this is inappropriate.
- We welcome the discussion of the various measurement bases and some guidance on identifying the circumstances in which a particular measurement basis would provide the most relevant information for users. However, although we agree with the broad categorisation of measurement bases we do not believe that the exposure draft proposal will provide guidance, criteria or indicators that would help the Board decide between a current value and a cost-based amount.

Our detailed responses to the questions in the invitation to comment are included in the Appendix to this letter.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader
Deloitte Touche Tohmatsu Limited

Appendix

Question 1 Proposed changes to Chapters 1 and 2

Do you support the proposals:

(a) to give more prominence, within the objective of financial reporting, to the importance of providing information needed to assess management's stewardship of the entity's resources;

(b) to reintroduce an explicit reference to the notion of prudence (described as caution when making judgements under conditions of uncertainty) and to state that prudence is important in achieving neutrality;

(c) to state explicitly that a faithful representation represents the substance of an economic phenomenon instead of merely representing its legal form;

(d) to clarify that measurement uncertainty is one factor that can make financial information less relevant, and that there is a trade-off between the level of measurement uncertainty and other factors that make information relevant; and

(e) to continue to identify relevance and faithful representation as the two fundamental qualitative characteristics of useful financial information?

Introduction

1.1 We welcome and commend the Board's willingness to review the chapters that were developed with the US FASB, and finalised in 2010. Overall, we think that the small number of changes being proposed in the ED will improve the Conceptual Framework.

Accountability/ stewardship

1.2 The amendments being proposed to paragraph 1.3 will make the 'accountability/ stewardship' role of financial reporting, and its role in assessing management's discharge of their responsibilities to existing shareholders, more explicit. However, the discussion of the objective of financial reporting in paragraphs 1.3-1.4 needs better linkage with the broader discussion of accountability/ stewardship in 1.22-1.23.

1.3 Without such a link, it is difficult to tell what the consequences are for the content of the financial report of having stewardship as an objective. It would be helpful if paragraph 1.3 included examples of the decisions that an investor would make in response to stewardship assessments. The report of the *Effects Analysis Consultative Group* includes the example of voting on shareholder resolutions. Without this type of example the decision set provided by the ED is too narrow. To some readers, "buy, sell

or hold", implies that the information required by the ED is focused only on expectations of returns.

1.4 Having said that, the different potential actions are not exclusively associated with stewardship or the assessment of returns. An investor who is primarily focused on returns might use their voting power to influence the board of an entity because they think that this will have a positive effect on future returns. Similarly, an investor who gives more weight to the stewardship objective might decide to sell their shares in response to the information provided in the general purpose financial report.

1.5 The Conceptual Framework would also be improved if it included a definition of *stewardship*, as is proposed for prudence in paragraph 2.18. Paragraph 1.22 could be used effectively to define the term, which has a long history and (as with *prudence*) means different things to different people.

1.6 Central to the notion of stewardship is accountability of the directors and management (the agents) to the current shareholders, whereas returns to the investors and lenders are typically expressed with reference to the entity. Furthermore, stewardship is often perceived as being focused on the owners (i.e., current shareholders) because the current board and management are acting as stewards for them whereas the returns focus implies a wider range of primary users (current and potential shareholders, creditors and others).

1.7 The Board should develop a definition of 'stewardship'., for which we have two suggestions. The first focuses on the custodial role of stewardship::

> *Stewardship is the responsible planning and management of resources.*

1.8 The second elaborates on what "responsible" utilisation of resources means:

> *Stewardship is the protection and responsible utilisation of the resources of the reporting entity with a view towards long-term sustainability of the business and acting in the best interest of the entity's shareholders.*

1.9 The general purpose financial reports would provide information about the actions management has taken in this regard. The discussion of examples of management's risk management of resources in paragraph 1.23 and the first sentence's use of 'protecting' is too restrictive and passive. In our experience, management is often more pro-active in its actions to balance the choices it makes and to mitigate adverse effects of changes in technology, regulation and other disruptions.

Primary users

1.10 We agree with the statement in paragraph 1.5 (and the related footnote) identifying the primary users as existing and potential investors, creditors and other lenders who must rely on general purpose financial reports for much of the financial information they need. However, we think that this statement needs to be connected with the communication objective of financial reporting, permitting management to report how they see the business and how the entity creates value.

General purpose financial reports

1.11 We agree with the Board's observation that general purpose financial reports are intended to provide relevant decision-useful information to primary users and other stakeholders about:

(a) the effects of transactions and other events; and

(b) the entity's existing resources and claims against those resources

1.12 That paragraph (1.12), is also an appropriate place to state clearly and concisely that general purpose financial reports are a means of communicating with primary users and other stakeholders. The addition of a communication principle would tie the purpose of general purpose financial reports to the specific objectives, particularly stewardship.

Fundamental qualitative characteristics of financial reporting

1.13 We agree that relevance and faithful representation should remain as the fundamental qualitative characteristics of financial reporting. The expanded discussion of the components should assist in improving the application of the *Conceptual Framework*.

Measurement uncertainty

1.14 We agree with the conclusion of the Board that the discussion of measurement uncertainty in QC16 should be improved.. However, although we generally support the new paragraphs, we think that paragraph 2.13 should be simplified. Paragraph BC2.24(c) provides a clearer articulation of how relevance is affected by estimation uncertainty and the need to assess the trade-off between uncertainty and other factors that affect relevance. We think it would also be helpful to note within this section that features of the estimation uncertainty, such as the range of outcomes, can itself be useful information.

Neutrality and prudence

1.15 We welcome the proposal to revise the qualitative characteristics to include references to prudence. Feedback on the DP highlighted the conflicting views about prudence—the symmetrical exercise of caution or asymmetrical bias. It is therefore important that the Board defines prudence in the Conceptual Framework to make it clear which of the conflicting views the Board thinks the concept should capture.

1.16 We support the view that prudence should enhance neutrality. We therefore support the Board's definition in paragraph 2.19, "the exercise of caution when making judgements under conditions of uncertainty."

1.17 We also agree with paragraph BC2.5(a) that it "is important to explain prudence in the *Conceptual Framework* so that it can be applied consistently" and that the concept applies to all judgements made under conditions of uncertainty—gains and assets as well as losses and liabilities.

Asymmetrical bias

1.18 Some respondents to the DP advocated asymmetric prudence. In other words, IFRS should be biased towards ensuring that the threshold for recognising, and measuring, good news is higher than for bad news. Such an approach creates two basic concerns:

(a) The nature of accrual accounting means that any bias in a current period must reverse in a future period. Thus any overly conservative, or biased, estimate in recognising or measuring a liability will reverse in the period of realisation. This can create incentives that reduce the usefulness of financial statements. A simple example is contingent consideration in a business combination. A pessimistic estimate of the amount payable, i.e. a larger liability, would lead to gains being reported when the overestimate of that liability is "realised".

(b) Transactions that are related could fall under the scope of more than one standard. If the recognition and measurement thresholds are different it can create accounting mismatches even though there is no economic mismatch.

1.19 We see such outcomes as undesirable and contrary to providing neutral, decision-useful information to users, which is why we do not advocate asymmetric bias in the conceptual framework.

1.20 We therefore support the Board's decision to reject calls for an 'asymmetric' or biased definition of 'prudence' as a necessary characteristic of useful financial information, for the reasons outlined in paragraphs BC2.14-.15. We think that neutrality of financial information should be the normative qualitative characteristic and that, should the Board decide that an asymmetric application provides the most relevant information, it should make that determination at the standards-level and explain the reasons for departing from the normative treatment in the Basis for Conclusions on that IFRS.

1.21 We think some of the discussion in the Basis for Conclusions should be moved to the Framework itself, including BC2.9 and BC2.12, which would strengthen the discussion in paragraphs 2.17-.18. However, we would delete paragraph BC2.11 as it muddies the Board's conclusions in BC2.14.

1.22 We also suggest that the Framework make it clear that prudence could be applied by the Board to decisions about recognising elements—it does not apply only to measurement. As currently drafted, the ED implies that it relates only to measurement. It is equally valid to use caution in applying the recognition criteria.

Asymmetry at a standards-level

1.23 A basic principle that the information in financial statements should be neutral would not prevent the Board from developing asymmetric accounting requirements in a Standard. As we have emphasised in our comments on profit or loss and OCI, the Framework should not have exceptions to the principles. Instead, if the Board thinks that it is appropriate to depart from the principles it has the ability to do so when it develops a Standard. If the Board does create an exception in a Standard it would be guided to that conclusion by the qualitative characteristics and explain its decision in the Basis for Conclusions.

1.24 Neutrality is part of faithful representation. Therefore, to be useful, the information must be a neutral depiction of the phenomena it purports to represent. This means that neutrality is assessed within the context of a specific measurement base or measurement objective. This means that current values and historical cost-based amounts are both capable of being neutral depictions. Neutrality does not favour the use of current values.

Economic substance

1.25 We agree with the addition to paragraph 2.14 with respect to faithful representation requiring providing information about the economic substance of an economic phenomenon rather than merely providing information about its legal form. However, we suggest using the statement made in BC2.20(a) in place of the last sentence in paragraph 2.14. In addition, we think that there should be an explicit link between the qualitative characteristic of economic substance in 2.14 and its application in paragraphs 4.53-4.56.

Question 2 Description and boundary of a reporting entity

> *Do you agree with:*
>
> *(a) the proposed description of a reporting entity in paragraphs 3.11–3.12; and*
>
> *(b) the discussion of the boundary of a reporting entity in paragraphs 3.13–3.25?*
>
> *Why or why not?*

Introduction

2.1 We think that a chapter on the reporting entity is an important part of the Conceptual Framework. However, as written, we do not think the proposed chapter would be helpful to the Board or other users of the Framework.

2.2 The question the Board asks focuses only on the Reporting Entity part of this Chapter. We comment separately on Paragraphs 3.2 to 3.10 under question 11. Our comments here focus on the latter part of the Chapter (paragraphs 3.11 to 3.25).

The reporting entity

2.3 The chapter uses the terms *reporting entity*, *legal entity* and *entity*, without defining them. It does define *reporting entity* but only by reference to an *entity*.

2.4 The ED does not clarify what is a legal entity. There are many different types of business "entity", with a range of different rights and features—examples include corporations, general partnerships, limited partnerships, trusts, branches, unlimited companies etc. Some such entities have a distinct legal identity whereas others are an extension of their owners. A corporation or company is a common business structure that will generally have a separate legal identity and can transact in its own name. On the other hand, in some jurisdictions, some partnership structures are contractual arrangements that do not have a legal identity—the owners work in partnership together. The term "branch" can have special meaning in some jurisdictions but in others may simply be a way of describing a subsidiary ledger. The specific attributes are sometimes unique to a jurisdiction.

2.5 Understanding how different legal structures (entities) affect the rights and responsibilities of the owners of the entity is important. When presenting "parent-only" financial statements, a parent entity needs to know when to "stop" at a boundary and report its net interest in that entity (e.g. the shares or other ownership instrument), and when to report the assets and liabilities within that structure. Some of the discussions that have arisen at the IFRS Interpretations Committee about the accounting for joint operations would have benefitted from clearer principles about when a legal or contractual structure defines a reporting or investment boundary. The discussions in the ED about control of an entity have as a starting point the presumption that the parent has an interest in an entity and that it is only in the group financial

statements that the assets and liabilities of the controlled entity are reported by the parent. However, the ED does not establish where that starting point should be—i.e. where the boundary is between a parent and a subsidiary.

2.6 The chapter implies, rather than states, that in the case of control (direct or indirect) the reporting entity is the parent. The notions of direct and indirect control determine the "boundaries" of that parent. A parent and a group are therefore not different reporting entities, they are the same entity but with different boundaries. If the chapter had explained how to determine when a boundary exists, then the rest of the chapter might have focused on when to ignore that boundary and report the assets and liabilities within those extended bounds.

2.7 In contrast, combined financial statements are not of a legal entity (or "entity"?). They are of an artificial "entity" drawn around two or more entities (each of which could then have control over other entities) *as if* the two or more combining entities are one entity. Although these issues might appear subtle they are important because whereas group financial statements are developed on the basis of a controlling relationship between a parent and a subsidiary, there is no equivalent relationship to assess for combined financial statements.

2.8 The original proposals discussed by the Board referred to a "circumscribed area of (economic) activity". We think this is helpful, because it implies that a reporting entity must have some substance, shared characteristics or be recognisable as a discrete set of activities. As it stands, the portion of an entity that could be considered a reporting entity could be small, and not even a business.

The reporting boundary and control

2.9 Whilst paragraphs 3.13-3.25 are based on control, there are no concepts that assist in identifying 'control of an entity', when it occurs or how it relates to the provision of a faithful representation of economic phenomena. These matters are important because the consolidated financial statements will be showing assets that are held in other entities and liabilities for which the parent does not have primary responsibility. The arguments in 3.21 and 3.22 could also be read to justify that assets and liabilities of associates and joint ventures should be reported in the group. We do not think that they should, but paragraphs 3.21 and 3.22 leave this open and are therefore less compelling than they could be.

2.10 Although control is addressed at a Standards level, the Conceptual Framework should include a discussion of the fundamental concepts that support control of an entity and the consequences for the boundary of the reporting entity, such that it is clear how application of the concepts is reflected in IFRSs.

2.11 Although we do not expect the Conceptual Framework to have an in-depth discussion of these matters, the current problems with the equity method and the controversy around the elimination of proportionate consolidation suggest that some analysis would be appropriate. That analysis should lead to the conclusion that joint control and significant influence do not give the investor indirect control of the underlying assets.

In other words, it is control alone that defines the reporting entity, and that all other inter-corporate investments are just that, investments.

2.12 We note that the reporting boundary needs to be consistent with the position taken on stewardship in Chapter 1. If directors and management are seen as the stewards of the owners (shareholders), they are within the boundary of the reporting entity and the primary users (as defined) are outside the boundary.

2.13 There is confusion in Chapter 3 about whether control is used solely in terms of how it is employed in IFRS 10 *Consolidated Financial Statements*, or as it is employed in Chapter 4 (as the discussion in 3.17-3.18 demonstrates).

Combined financial statements

2.14 Paragraph 3.17 comments on combined financial statements. We think that those comments are too broad and vague to be useful. More careful consideration is needed because securities markets regulators often require IFRS-compliant financial statements to be prepared on a combined basis in connection with proposed transactions. Examples include proposed business combinations, establishing investment vehicles on the basis of common management (e.g., real estate investment trusts), dispositions in specie ('spin-offs') and carve-outs.

2.15 Such financial statements are filed on public record and are relied upon by regulators and market participants. Consequently, such statements should be considered 'general purpose'. The Board should clarify that combined financial statements may be prepared in a variety of situations, and could be IFRS general purpose financial reports.

2.16 However, there needs to be an objective rationale for when it is appropriate to assert that the combined financial statements are in accordance for IFRS. The Conceptual Framework is not the appropriate place to establish that rationale. Nor is the Framework the appropriate place to discuss specific disclosure requirements, as proposed in paragraph 3.25 of the ED. Both matters should be established at a standards level. However, the Framework should specify that each of the entities being combined should be capable of being a reporting entity in its own right, which would mean that each of the combining entities would be a "circumscribed area of activity".

Question 3 Definitions of elements

Do you agree with the proposed definitions of elements (excluding issues relating to the distinction between liabilities and equity): *(a) an asset, and the related definition of an economic resource;* *(b) a liability;* *(c) equity;* *(d) income; and* *(e) expenses?* *Why or why not? If you disagree with the proposed definitions, what alternative definitions do you suggest and why?*

Asset definition

3.1 We support the definition of an asset proposed in paragraph 4.5. We think that the focus on rights is an important and helpful change.

3.2 The effects analysis section of the Basis for Conclusions does not identify any inconsistencies relating to assets in IFRS and the proposed definition. BC6.29 infers that goodwill is an asset by referring to unrecognised goodwill as an "unrecognised asset". However, other parts of the Basis for Conclusions avoid categorising goodwill, instead focusing on separating assets from goodwill. We think that a discussion about whether goodwill would meet the proposed definition of an asset would have been helpful. Some question whether goodwill arising in a business combination is a right that is controlled by the acquirer, while others think it would meet the definition.

3.3 We have singled out goodwill because we think it is sufficiently controversial to warrant that discussion. The Basis for Conclusions accompanying the ED includes several discussions about goodwill, but those discussions do not include an assessment of whether goodwill meets the proposed definition of an asset.

3.4 In paragraph 4.8, we continue to think that a right must be enforceable, i.e., "rights established by contract, legislation or similar <u>enforceable</u> means…" We note that enforceability appears to be implicit in the discussion of existence uncertainty in paragraph 5.15, which refers to 'contractual or other legal rights.'

3.5 We think the definition can be simplified by removing the words "as a result of past events". These words are redundant because to have control something will have happened. We are also concerned that including these words in the definition places too much emphasis on finding the appropriate past event(s). Instead, references to past events could be part of a brief discussion of how control might have been achieved and would be better placed in paragraphs 4.17-4.23 (where the ED discusses control).

3.6 We note that paragraph 4.8(c) uses a construction different from that in paragraph 4.7: "other rights that give the entity the *potential to receive* future economic benefits…"

[emphasis added] However, the reason for using different words is not discussed. It is not clear whether the difference in wording between paragraphs 4.7 and 4.8(c) is deliberate or is simply an unintended drafting difference.

Control (in the context of an asset)

3.7 We suggest that the focus of paragraph 4.10 be changed to whether the entity has control of rights, rather than identifying the rights. We do not think that the Conceptual Framework should lead preparers and others to undertake an assessment of whether the rights it holds are identical to those of others, when it is clear that the entity cannot restrict the access of others to that asset for their benefit (i.e., it does not control the rights).

3.8 Paragraph 4.17 attempts to illustrate 'control' by referring to an entity having a share in a property and having a proportionate interest in that property. We think this is dangerous because it confuses proportionate consolidation/ interest with the rights they control. The Conceptual Framework should make it clear that the entity accounts for the rights that it controls. Given that the proposed definition of an asset refers to rights, it might be better to use that term ('rights') rather than 'asset' in such examples. In this case para 4.17 should say that the entity's asset is those "rights in the property, which it controls." The rest of that sentence should be deleted. Similarly, paragraph 4.12 would also be easier to follow if it stated simply that "the economic resource is the benefits associated with the rights that the entity controls."

Liability definition

3.9 Our response to Question 4 should be read in conjunction with this section, in particular our comments on paragraph 4.31.

3.10 We agree that the *definition* of a liability should be symmetric with the definition of an asset. Thus we agree that a liability is "a present obligation of the entity to transfer an economic resource" (paragraph 4.24). Consistently with our comment on the definition of an asset, we think that the definition of a 'present obligation' would obviate the need to add 'as a result of past events' in this paragraph.

3.11 Whilst we do not disagree with the statement in paragraph 4.25, we recommend that it be redrafted to remove "(an asset)" at the end of the first sentence, primarily to avoid any suggestion that an entity should seek to identify such "assets".

3.12 We do not agree that the recognition of assets and liabilities need be symmetrical. While we acknowledge the Board's explanation in paragraph 4.26, we are uncertain of the utility of making a definitive statement about an item that, in many cases, the holder of which will be unaware that it possesses. In addition, the simple case of an entity being obliged to transfer resources to a public good (e.g., remediating the effects of an oil spill) stretches this definition.

3.13 The Conceptual Framework should not imply that entities need to look for such items. Further, whilst we do not disagree with the outcomes suggested in paragraph 4.26, the Board should explain clearly its reasoning in the Basis for Conclusions. That discussion

should be framed in the context of providing relevant financial information to the primary users and focus on control of any right to receive a resource.

3.14 We acknowledge that paragraph 4.27 establishes the principle of a stand-ready obligation. We suggest that this paragraph (or the related discussion of 'present obligation') distinguish contractual and non-contractual stand-ready obligations. An insurance policy is a contractual stand-ready obligation; a 'letter of support' in favour of a subsidiary is not.

Other issues related to liabilities

3.15 We continue to encourage the Board to address on an urgent basis non-reciprocal and non-exchange transactions such as income taxes, VAT and levies imposed by statute or other similar enforceable legal provisions. We continue to hold the view that IFRIC 21 demonstrates why the Board should consider non-reciprocal and non-exchange transactions as a separate class of transactions. We think that the Conceptual Framework should be capable of identifying the principles appropriate for reasonably foreseeable non-reciprocal and non-exchange transactions. In our view, such transactions need not follow the same recognition and measurement principles as those arising under exchange transactions.

3.16 We also challenge the Board's conclusions in BC4.65, which we see as too simplistic. Some levies are recognised in full once an entity is active in the market, or meets other conditions, even though the benefit received from the levy is experienced over time.

Equity

3.17 It is unfortunate that the Board has deferred a thorough discussion of the distinction between debt and equity.

3.18 We continue to support defining equity as the residual of assets after deducting liabilities. We also consider that more detailed discussions of issues such as the specific attributes of different types of instruments, including compound instruments, should take place at the standards level. Nevertheless the Framework should set out the basic characteristics that distinguish liabilities from equity, to help guide the Board in setting standards. We therefore expect that an outcome of the Board's research project on liabilities and equity will be the development of those principles so that they can be incorporated in the Framework at an appropriate time.

3.19 In our response to the Agenda Consultation we will be stressing that this project should be given priority by the Board.

Income and expenses

3.20 We understand why the Board proposes defining 'income' and 'expense' in terms of changes in assets or liabilities (other than those related to contributions from or distributions to holders of equity) as well as the amounts generated by transactions and other events occurring during the reporting period. However, we are concerned that this suggests a primacy of the statement of financial position over the statement(s) of

financial performance. This would embed in the Conceptual Framework a recurring criticism of the asset and liability approach.

3.21 We note that, if the statement(s) of financial performance are to include only defined elements, and if recycling is to be required or permitted, it will be necessary to provide a definition of ‘reclassifying adjustments’.

Are there other ‘elements’?

3.22 Cash inflows and outflows are not identified as elements. This calls into question whether the statement of cash flows should be considered as a primary financial statement or as a disclosure item (see our comments on Q11, below).

3.23 Contributions / distributions of equity should be defined as elements in the Conceptual Framework in order to permit their recognition in financial statements, given that such transactions are omitted from paragraph 4.3.

3.24 Alternatively, the Conceptual Framework need not state definitively that only elements can be recognised in financial statements (i.e., delete paragraph 4.3).

Question 4 Present obligation

> *Do you agree with the proposed description of a present obligation and the proposed guidance to support that description? Why or why not?*

4.1 We draw the Board's attention to our comments on paragraphs 4.25 and 4.26 in the response to Question 3, above.

4.2 We agree with the proposed definition of a present obligation in paragraph 4.31, subject to the following observations.

4.3 We would recommend that the order of 4.31(a) and (b) be reversed, as the present order can be read as placing a greater weight on 'no practical ability to avoid the transfer' than the Board may have intended. Paragraph 4.31(b) contains the main characteristics of a present obligation and 4.31(a) is an additional characteristic. Hence:

> 4.31 An entity has a present obligation to transfer an economic resource if the entity has both:
>
> (a) received the economic benefits, or conducted the activities, that establish the extent of its obligation; and
>
> (b) has no practical ability to avoid the transfer.

4.4 In paragraph 4.31(b) of the ED, in relation to liabilities arising from litigation, it may be difficult to determine whether there is an obligation (because the law or contract is unclear), or it may be difficult to determine whether the past event that triggers the liability (i.e., fault) has occurred. The origin (conduct of activities) may be readily identified, but establishing whether there is an obligation, whether the entity is at fault and (if so) 'the extent of [the entity's] obligation' may take considerable time to determine.

4.5 In this case, some sort of 'credit entry' might exist, although, since the existence and extent of the obligation have not been determined, the measurement of the economic phenomenon might be zero.

4.6 Paragraph 4.39 is poorly drafted and it is thus difficult to understand what the Board is trying to communicate. Nor is this paragraph and its propositions discussed in the Basis for Conclusions. If this paragraph is intended to address equally-unperformed executory contracts, as implied by the last sentence, this should be made explicit and the paragraph included in the discussion of such contracts (see also our response to Question 5, below).

Question 5 Other guidance on the elements

> *Do you have any comments on the proposed guidance?*
>
> *Do you believe that additional guidance is needed? If so, please specify what that guidance should include.*

Unit of Account

5.1 We are pleased that a discussion of the Unit of Account has been included in the Exposure Draft and, in particular, the inclusion of indicators that assist in selecting an appropriate unit of account in paragraph 4.62. However, it is incomplete because it does not discuss the unit of presentation. We think this could cause confusion. For example, the discussion on assets refers to different rights being presented as a single unit of account, yet IAS 16 requires componentisation in some circumstances, which we think is consistent with the ED's discussion of rights. Using the aircraft example in IAS 16 to illustrate, does the Board mean that the presentation of a single aircraft with some components depreciated at different rates is one unit of account or several units of account with a single unit of presentation?

5.2 The first sentence in paragraph 4.58 could imply that unit of account is about presentation, because it is selected after considering how recognition and measurement will apply. Yet the second sentence suggests that a different unit may be appropriate for presentation or disclosure purposes.

5.3 We think that the statement in paragraph 4.59 that an element may be recognised using one unit of account and measured on another is unhelpful. In the example given in 4.59 individual customer records are kept but the portfolio of the customers is used for measurement. If the portfolio of customers is presented in the financial statements it is equally arguable that the entity is recording individual contracts but recognising and measuring a portfolio for financial reporting purposes. For example, if it was determined that an appropriate unit of account for an electricity provider was a defined subscriber base rather than a contract with an individual customer for the recognition of a regulatory asset, we might expect the subscriber base to be the regulatory asset being measured, not the individual customer contracts.

5.4 To summarise, the ED is not clear about what a unit of account means. We also think that the proposed Framework should have more discussion about the factors that should be present when recognition and measurement use different "units of account".

Executory contracts

5.5 We see executory contracts as part of the unit of account issue, because it requires a decision to recognise the contract as a single unit of account or to disaggregate on the basis of a series of equally performed (or unperformed) elements. We hold this view because we see paragraph 4.41 as being inconsistent with IFRS 15's approach to identifying performance obligations.

5.6 The appropriate unit of account is the one that provides the most relevant information to users of the financial statements. In many cases, an executory contract will be reported as a single unit of account, but there are other circumstances in which it should be disaggregated (or combined with others) in order to provide relevant information to users.

5.7 We recommend that the Board include executory contracts as a subset of transactions for which Standards-level decisions will determine the appropriate unit of account.

5.8 We concur with the Board's view expressed in BC4.91(b) that 'trade date accounting' 'provides a simple and practical method of managing and recording transactions that have only a short duration' and welcome the determination not to reconsider its use.

Question 6 Recognition criteria

Do you agree with the proposed approach to recognition? Why or why not? If you do not agree, what changes do you suggest and why?

6.1 We think the general discussion in paragraphs 5.4-5.8 on the recognition process would be better placed within Chapter 7, because it explains how the accounting model links the various summary statements. However, if the Board does retain this section we suggest strongly that paragraph 5.8 be amended to remove any implication that 'matching' is a concept. This is the only reference to matching in the ED and, as written, it implies that matching might be used to justify recognition.

6.2 We suggest revised wording, such as:

> 5.8 The concepts in this [draft] Conceptual Framework ~~lead to such matching when it arises from~~ are intended to guide the recognition of income, expenses and changes in assets and liabilities. Related transactions or events ~~The recognition of assets or liabilities arising from transactions or other events~~ sometimes result in the ~~simultaneous~~ recognition of both income and ~~related~~ expenses in the same period. For example, the sale of goods for cash results in the recognition of ~~both~~ income and an increase in cash ~~(from the recognition of an asset for the~~ from the customer consideration,~~)~~ as well as the recognition of a decrease in the asset sold and expenses (cost of goods sold). (~~from the derecognition of the asset comprising the goods that were sold).~~ The simultaneous recognition of income and related expenses reflects the meeting of separate recognition criteria for related items. Recognising income and the related expense together is sometimes referred to as the matching of costs with income. ~~The concepts in this [draft] Conceptual Framework lead to such matching when it arises from are intended to guide the recognition of income, expenses and changes in assets and liabilities.~~ Such simultaneous recognition of income and expenses is a consequence of applying the recognition criteria in this [draft] Conceptual Framework and is not a basis or threshold to justify recognition. ~~these concepts do not allow the recognition in the statement of financial position of items that do not meet the definition of assets or liabilities~~.

A clean version is:

> 5.8 The concepts in this [draft] Conceptual Framework are intended to guide the recognition of income, expenses and changes in assets and liabilities. Related transactions or events sometimes result in the recognition of both income and expenses in the same period. For example, the sale of goods for cash results in the recognition of income and an increase in cash from the customer consideration as well as the recognition of a decrease in the asset sold and expenses (cost of goods sold). The simultaneous recognition of income and related expenses reflects the meeting of separate recognition criteria for related items. Recognising income and the related expense together is sometimes referred to as the matching of costs with income. Such simultaneous recognition of income and expenses is a consequence of applying the recognition criteria in this [draft] Conceptual Framework and is not a basis or threshold to justify recognition.

6.3 Our suggested rewording also refers to the recognition of income and expenses. We have done so because the ED seems to give primacy to assets and liabilities, which

implies primacy of the balance sheet. We have made similar suggestions in other parts of our comment letter.

6.4 We also suggest that paragraph 5.9 be redrafted and made more consistent with the discussion that follows that paragraph:

(a) We suggest that the first two sentences of paragraph 5.9 are removed to follow the general principle of recognition and combined in such a way that it is generally presumed that failing to recognise all assets and liabilities would make the financial statements less useful, etc., but that there are circumstances in which not recognising an element is appropriate. The material in paragraphs 5.11 and 5.12 would then explain this principle.

(b) The sentence 'Failure to recognise…from financial statements' in paragraph 5.9 is too definitive (using the verb 'makes'), and seems contrary to paragraph 5.11. It is also inconsistent with the second sentence in that paragraph, which uses 'can', in which case paragraph 5.11 makes better sense.

Relevance

6.5 We suggest that the section beginning at paragraph 5.13 be labelled 'Relevant Information' as this would be both consistent with wording in 5.9(a) and avoid confusion with the discussion of relevance in paragraphs 2.6-2.13.

6.6 We note that the discussion of 'relevance'/ relevant information in paragraph 5.13 includes existence uncertainty, the probability of an inflow or outflow of economic resources and measurement uncertainty. Of these three factors, only measurement uncertainty was discussed in the general discussion of relevance in Chapter 2. We think that Chapter 2 should be updated to reflect this new discussion.

6.7 In paragraph 5.15, we recall our comments on the definition of an asset that enforceability is important ('similar <u>enforceable</u> means'). This view appears to be supported by the wording in the first sentence: "Some assets…are not contractual or other legal rights."

6.8 The second and third sentences of paragraph 5.15 seem to treat existence uncertainty and separability together, but this may not always be true. (For example, the plaintiff in a legal case can identify separately the lawsuit that might give rise to an asset, the existence of which will be determined only when judgement or settlement is rendered in their favour.) We recommend that the drafting be clarified to remove this suggestion.

6.9 More generally, we found the discussion on existence uncertainty and separability to be more superficial than we would expect in a Framework. Given that the Board has stated that it believes that 'existence uncertainty is not rare' (BC5.31), we suggest that the Board develop a more substantive discussion of this economic phenomenon than currently exists in paragraphs 5.15-.16 and BC 5.25-5.35.

Measurement uncertainty

6.10 We disagree with the statement in paragraph 5.20 that "to be recognised, an asset or liability must be measured." The approach that the Board has taken in the ED is that elements are identified, then recognised and then measured. To be consistent with this approach, we would prefer that "to be recognised, an element must be capable of being measured."

Costs

6.11 We note that the reference in paragraph 5.24 to users of financial statements incurring costs in analysing and interpreting information is the only time that the user-related costs is used in a specific context in the ED. The costs to users was introduced in paragraph 2.39, which correctly states that "users ultimately bear costs in the form of reduced returns." We think that the proposed Conceptual Framework should have more explicit references to costs in other sections, including the costs to users of processing or using informational alternatives.

Question 7 Derecognition

Do you agree with the proposed discussion of derecognition? Why or why not? If you do not agree, what changes do you suggest and why?

7.1 We do not support the proposed section on derecognition. It seems to us to have been written with collateralised borrowings (i.e. repo-type transactions) in mind, rather than addressing more general derecognition principles.

7.2 There are more general examples that have not been addressed, including the case in which an entity holds shares that give it a controlling interest but reduces its holding so that it has only either significant influence or an equity interest. Is the retained interest a new right or a retained right? Similar questions arise in relation to the change from significant influence or joint control to a simple equity interest.

7.3 We think that a fundamental weakness in this section is that it does not relate the analysis supporting derecognition back to the definition of an asset in Chapter 4. None of the discussion in paragraphs 5.25-5.33 refers to rights. Sometimes the section refers to “components”, but generally the discussion refers to “all or part” of “the economic benefits” and “the economic resource”. This more generic language is used in Chapter 1. Having proposed a definition of an asset in Chapter 4, the discussion of derecognition of an asset should also be based on that definition.

7.4 The discussion of modification of contracts in paragraphs 5.33-5.36 is more encouraging because it does refer to rights. However, we think that this section is also too detailed and should be incorporated into a more focused derecognition section—a modification to a contract simply changes the rights relating to an asset, sometimes by removing or adding rights.

7.5 This is an example where the Board is “backing” an existing IFRS requirement into the Conceptual Framework. Whilst it is appropriate for the Board to consider incorporating into the Framework concepts and principles it has developed as part of its work on Standards, it is inappropriate to incorporate exceptions into the Framework. For example, as it reads, the implication is that an entity should continue to recognise rights it no longer controls (expressed as transferred components in paragraph 5.32) because this is more faithfully representative of the “assets and liabilities retained” and the “change in the entity’s assets and liabilities” (as described in paragraph 5.26).

7.6 Instead, the Board should acknowledge that there might be some rights that are no longer controlled by an entity that should nevertheless be recognised by the entity. Such a decision would be made at the Standards level and should be expressed as an exception, or departure from, the recognition criteria and therefore the Conceptual Framework.

7.7 Similarly, we think that unit of account is relevant to this discussion, because decisions will need to be made about how to present related rights. In the ED the Board simply refers to recognising “not only the retained component, but also the transferred component.” (Paragraph 5.32) It seems to us that if the entity controls some

components but not others, it would be inappropriate to present them as a single unit of account—assuming that, at a standards-level, an exception has been made to require an entity to recognise assets it does not control.

7.8 It is arguable that the derecognition discussion is not required because the recognition discussion provides an appropriate basis for when an asset or liability should be recognised. The recognition section could simply state that when an entity no longer meets the recognition criteria the entity would derecognise the related asset or liability.

7.9 However, our preference is that the Board include a separate section and reconcile it with the discussion of rights, addressing the more general issues we have identified.

Question 8 Measurement bases

> *Has the IASB:*
>
> *(a) correctly identified the measurement bases that should be described in the Conceptual Framework? If not, which measurement bases would you include and why?*
>
> *(b) properly described the information provided by each of the measurement bases, and their advantages and disadvantages? If not, how would you describe the information provided by each measurement basis, and its advantages and disadvantages?*

Fair exchange

8.1 We think that the measurement chapter is missing an important assumption that should be included in the Conceptual Framework. In our view, the Framework should assume that transactions between entities are fair exchanges (i.e. they are orderly or negotiated transactions).

8.2 We think that this assumption is descriptive of practice, as well as being an appropriate normative principle. It allows the Framework to state that in a fair exchange the entry price for the acquirer is equal to the exit price for the seller, which is the exchange price.

8.3 With this assumption we also think it is important that the initial measurement reflects the characteristics of the asset acquired or the liability assumed. The subsequent accounting for an asset should not determine its initial measurement.

8.4 The Framework might then discuss the implications of relaxing that assumption, such as when the exchanges are non-reciprocal, under duress or between related parties.

Transaction costs

8.5 We disagree with the statement in paragraphs 6.7 and 6.9 that the historical cost of a non-financial or a financial asset includes the transactions costs to acquire that asset.

8.6 As we have stated earlier, we see the Conceptual Framework as a living document that can be developed along with Standards. Sometimes a significant amount of conceptual thinking takes place during the development of a Standard, and it is appropriate to incorporate concepts developed in a Standards-level project into the Conceptual Framework. We think that the development of IFRS 13 *Fair Value Measurement* is an example where the ED should have captured some of the concepts developed in that project.

8.7 In developing IFRS 13, the IASB (and the FASB) considered which aspects of a transaction were characteristics of the asset and which were characteristics of the broader transaction. In relation to transaction costs, the Boards concluded that they are "not a characteristic of an asset or a liability, but a characteristic of the transaction". The Board also concluded that "[transaction] costs may differ depending on how a particular entity enters into a transaction" (IFRS 13.BC61).

8.8 As proposed in the exposure draft, the acquisition of two identical assets at identical prices would be measured differently if acquired by different means. A poorly judged and more costly transaction would lead to the acquirer as being portrayed as having a more valuable asset than the entity that spent less on transaction costs.

8.9 The concept that should be incorporated in the Conceptual Framework is that articulated in IFRS 13.BC61, that transaction costs are a characteristic of the transaction but are not a characteristic of the asset. We have been unable to identify any Board discussion at which this issue was raised, or why this important concept was put aside. The ED implies that adding such costs when determining historical cost is a concept. We would characterise it as a convention.

Subsequent measurement

8.10 We accept fully that once an entity has control of an asset or responsibility for a liability, it is potentially able to exchange the asset or settle the liability in a different market with other participants. In other words, the exit price (fair value) might now be different from the exchange price. However, this ability occurs, albeit almost simultaneously, after achieving control and should be reflected in any subsequent measurement.

8.11 We think that this symmetry on initial measurement is important and helpful. It means that all subsequent measurements are attributable to the actions, or attributes, of the entity after they have control (responsibility).

Current IFRS

8.12 Our view on the measurement of assets and liabilities on initial recognition at the exchange price, excluding transaction costs, would not prevent the Board from deciding to measure an item on some other basis or require that transaction costs be recognised as part of the acquisition of the asset (incurrence of a liability) taken as a whole.

8.13 There are examples in current Standards where transaction costs are accounted for by adding those costs to the transaction price. We think it is appropriate to consider at the Standards level how to account for acquisition/ transaction costs, although it would also be helpful to have the factors that would lead to the costs being recognised in the same unit of account as the related asset articulated in the Conceptual Framework.

8.14 The logical consequence of our approach is that, in the vast majority of transactions, the measure of an asset (i.e., the purchase price) or liability on initial recognition will not be determined by the subsequent measurement of that item, which promotes more comparability on initial recognition. This conclusion is consistent with the Board's observation in paragraph BC6.18(a) that "there is often little difference between entry and exit values in the same market, except for transaction costs."

Derecognition

8.15 When an entity sells or exchanges an asset, or settles a liability, the exchange should also be assumed to be a fair exchange. In fact, this assumption is simply the initial recognition assumption, but later in the cycle. The difference is that the buyer is now

the seller. If an asset is retired there is no exchange and the entity accounts for the consequence of retiring the asset.

8.16 On this basis, the initial recognition and derecognition of assets (liabilities) are measured at exchange amounts (nil if it is simply retired). Accrual accounting measures and reports what happens between these transactions.

8.17 We also think that the Framework could make explicit the fact that cash flows and accruals are identical over time and that financial accounting is primarily concerned with identifying the periods in which the accrual-based income and expenses should be recognised. Although paragraphs 1.17-1.19 of the ED discuss accrual accounting generally, they do not emphasise that whether an entity measures assets or liabilities after initial recognition using current values or historical cost-based measures, the total income or expenses will be the same over the life of each asset or liability.

Exchanges that might not be fair (negotiated) exchanges

8.18 The Conceptual Framework should discuss the implications of relaxing the assumption that transactions are fair exchanges, such as when the exchanges are non-reciprocal, under duress or between related parties. Additionally, some transactions between a Government and an entity are at amounts that are set by Government, rather than established by direct negotiation or agreement between two parties. In many cases income taxes, some levies and pollutant pricing mechanisms, for example, are transactions that have non-reciprocal components. Our observation is that it is easier to develop concepts for the broad range of transactions that are fair exchanges.

8.19 There are already Standards that address specific circumstances where the exchanges might not be fair exchanges, such as related party transactions. The Board also has a project to look at business combinations under common control, which can be thought of as directed (by the parent) transactions.

8.20 Although we have discussed the fair exchange assumption in relation to measurement, we think that such a distinction could also be helpful in recognition. Some of the difficulties that the Board has faced with levies, rate-regulated activities, pollutant pricing mechanisms and Government grants might benefit from thinking about the assumptions underlying the transactions.

Measurement bases

8.21 We support the inclusion in the ED of a discussion of the various measurement bases and some guidance on identifying the circumstances in which a particular measurement basis would provide the most relevant information for users. We agree with the broad categorisation of measurement bases in paragraph 6.4.

Historical cost

8.22 It is helpful to have a discussion of historical cost. Although the term historical cost implies that the carrying amounts are anchored in the past, it is a widely used term.

8.23 We also think it would be helpful to clarify what is meant by "consumption of the economic resource" (paragraph 6.7). Economic consumption is the value consumed, whereas in IAS 16 *Property, Plant and Equipment* depreciation is generally viewed as the service potential consumed in a given period. The former definition suggests that non-financial assets would be measured at fair value at the end of each reporting period whereas the latter implies a different consumption pattern. The former also tends to be a market measure whereas the latter is entity-specific. This distinction is important because it is fundamental to understanding the nature of depreciation and the nature of the resulting carrying amount.

8.24 The Framework should also make it clear that the purpose of an impairment (or impairment reversal) is to revise the historical cost-based amount—in essence, the establishment of a new initial amount, often using a current value, as a consequence of the lack of recoverability of the asset. It is not, within the context of the proposed Conceptual Framework, a current value.

Current value

8.25 The discussion is generally helpful. Our specific comments follow.

8.26 We think that the Conceptual Framework should identify, define and discuss properly other measurement bases that can be relevant. Consequently, we are disappointed with the discussion of current cost (one of the measurement bases permitted by IAS 29 *Financial Reporting in Hyperinflationary Economies*) in the proposed Conceptual Framework.

8.27 Current cost is discussed in the context of historical cost in paragraph 6.18, but only superficially. We were also surprised at the comment in paragraph BC6.23 that "the Board would be unlikely to consider selecting current cost as a measurement basis when developing future Standards." Not only is no reason for this conclusion given, it also appears to pre-empt the work of the Emerging Economies Group on reporting the effects of hyperinflation. We would expect greater prominence be given to current cost as a measurement base, given that it is in active use in IFRS jurisdictions that apply IAS 29, and is referred to explicitly in paragraph 8.5 of the Exposure Draft. Finally, given that the Board has not addressed capital maintenance in the Exposure Draft, excluding current cost as a measurement basis is presumptive.

8.28 Although Table 6.1 is helpful for the purposes of developing the proposals, we suggest that it be moved into an Appendix to the Framework that accompanies but is not part of the finalised document. It is very detailed and uses terms that are defined and used in Standards. There is a risk that the analysis will be affected by changes to Standards. Moving it to an Appendix reduces the impact of any such consequences.

8.29 Paragraph 6.24 states that failing to fulfil an obligation is "own credit risk". We think that this confuses credit with performance risk, such as an entity not being able to undertake remedial work on land because the technical expertise does not exist to remedy the problem. The reference to own credit risk should be deleted and instead

the paragraph should explain why there might be a failure to meet or fulfil the obligation.

8.30 We also think that the examples in paragraph 6.71 are very specific and should be deleted.

Primacy of the balance sheet

8.31 We are concerned that the discussion in the measurement section focuses almost exclusively on assets and liabilities. We understand why assets and liabilities are primary elements from which other elements are derived. We also understand that the way the elements are defined does not give primacy of financial position over financial performance, particularly when it comes to measurement. The Board appears to hold a similar view, but it is not reflected in the way that the ED has been written. We are concerned that the ED reinforces the misconception that the statement of financial position has primacy.

8.32 Our assessment is that the measurement processes in many Standards focus on the income or expense measure. The simplest examples are depreciation and amortisation, for which the Standards focus on how to measure the expense in a given period. The carrying amount (which is itself a measure) in the statement of financial position is a result of measuring the expense. This approach is not confined to older Standards. IFRS 15 *Revenue from Customers* measures revenue, not the performance obligation—though a performance obligation is identified in the process.

8.33 Even in the case of financial instruments, financial assets being accounted for at amortised cost are carried at amounts determined by first measuring income. This remains so even when the new impairment requirements in IFRS 9 apply, because IFRS measures the impairment which is then used to determine the carrying amount of the relevant financial asset.

8.34 We think the Board is unnecessarily exposing itself to the criticism that it gives primacy to assets and liabilities and therefore favours the balance sheet and current values. We suggest that the Board ensure that Conceptual Framework explain more clearly that asset and liability measurement is often determined by focusing initially on the appropriate measurement of financial performance. We also suggest that when giving examples of measuring items as much emphasis should be given to income and expense items.

Question 9 Factors to consider when selecting a measurement basis

Has the IASB correctly identified the factors to consider when selecting a measurement basis? If not, what factors would you consider and why?

Initial vs subsequent measurement

9.1 We do not agree with the assertion in 6.52 that initial and subsequent measurement "cannot be considered separately." As noted in our response to Question 8, above, we disagree with the ED's treatment of transaction costs, because we do not consider that transaction costs are an attribute of an asset.

Selecting a (subsequent) measurement basis

9.2 Paragraphs 6.48 to 6.63 set out general factors for considering a measurement basis. Paragraph 6.49 states:

> For information provided by a particular measurement basis to be useful to the users of financial statements, it must be relevant and it must faithfully represent what it purports to represent. In addition, the information provided should, as far as possible, be comparable, verifiable, timely and understandable.

9.3 It is difficult to disagree with these statements. However, the question we considered is whether the discussion in paragraphs 6.48 to 6.63 is likely to be helpful to the Board in selecting a measurement basis in a given scenario.

9.4 We do not believe that to be the case because paragraphs 6.48 – 6.63 do not provide guidance, criteria or indicators that would help the Board decide between a current value and a cost-based amount. For example, an entity could hold a corner-stone interest in an associate in which its shares are actively traded. The quoted share price is therefore readily available but holding the investment long-term and benefitting from cooperating with the associate reflects the entity's "business activities". Should this be measured using the readily available quoted price or some cost-based approach? The Board had to make such decisions when it developed IFRS 9, but it is not clear to us that the discussion in paragraphs 6.48 to 6.63 would have helped the Board if they had been in place at the time.

Question 10 More than one relevant measurement basis

Do you agree with the approach discussed in paragraphs 6.74–6.77 and BC6.68? Why or why not?

Purpose of the primary financial statements

10.1 The need to have more than one primary measurement basis for a particular item is a direct consequence of the ED not setting out the purpose of the *primary* financial statements.

10.2 The ED does not set out the purpose of the individual primary financial statements, nor does it say how competing purposes would be resolved. Importantly, as well as determining the objective of each of the primary financial statements, the Board will need to explain how those objectives interact. The accounting model (double-entry accounting) ensures that the statement of comprehensive income and the statement of financial position interact—measurements developed for one primary financial statement affect the other.

10.3 It is valid to have a framework that gives primacy to the statement of financial performance and guides the measurement bases accordingly. In such a case, measures that are more focused on the statement of financial position might be incorporated in IFRS as supplementary (note) disclosure. Similarly, it is equally valid to give primacy to the statement of financial position with supplementary information provided in the notes on aspects of performance that reflect a different notion of performance than is captured by the changes in, say, current values.

10.4 The ED offers a third option. Incorporating more than one measurement basis in the primary financial statements is a consequence of having competing objectives. Other Comprehensive Income (OCI) is used as a bridge between measurement objectives. In that respect, we view this section as being necessary to deal with conflicting objectives, rather than a conceptual basis for having more than one measurement basis. Unfortunately, the discussion in paragraphs 6.74 to 6.77 is a series of assertions with no clear basis. Presumably the different measures meet different information needs (or objectives). It would be helpful to explain what those objectives are and why a particular measure is relevant to that objective or decision.

10.5 The only paragraph in the Basis for Conclusions that relates to paragraphs 6.74-6.77 reads:

> "The IASB considers that, in some cases, consideration of the objective of financial reporting, and of the qualitative characteristics of useful financial information, will indicate that using more than one measurement basis for the same item in the same financial statements could provide useful information to the users of financial statements. Hence, the Exposure Draft discusses how information about more than one measurement basis could be provided." (Paragraph BC6.68)

10.6 This is not especially compelling, and does not explain *why* the Board reached this conclusion.

10.7 We think that the different views of the purpose of OCI can only be addressed by undertaking work on the purpose of the primary financial statements. Even if the Board decides that OCI should be used to manage competing objectives, the Framework should set out what those competing objectives are, and why they will produce information that will help the primary users of the financial statements.

Question 11 Objective and scope of financial statements and communication

Do you have any comments on the discussion of the objective and scope of financial statements, and on the use of presentation and disclosure as communication tools?

The interaction between Chapter 7 and Chapter 3

11.1 This question seems to focus on Chapter 7 of the proposed Conceptual Framework, yet Chapter 3 begins with a section on the role of financial statements. The opening sections of Chapter 3 (3.2 to 3.9) could, and should, be combined with Chapter 7. We think it would be better to move the Chapter 7 material to Chapter 3 and have a general section on the role of general purpose financial reports. Combining the chapters would eliminate repetition and provide a better framework for discussing what goes into the financial statements (the elements) and how to measure them.

11.2 We think that the discussion in paragraph 3.5 is a better conceptual articulation of the purpose of financial statements, and how changes in assets and liabilities and transactions with owners, when combined with the 'financial effects of transactions and other events of a specified period' relate to the performance of the entity. In particular, it accommodates any of the views that the balance sheet, profit or loss/ comprehensive income or cash flows are the most important indicator of 'performance' to any particular user for any particular entity. Without the benefit of the Board's ongoing work on the primary financial statements, we think that paragraph 3.5 accommodates these different views better than paragraph 7.19, which creates a presumption that financial performance is communicated solely via the statement(s) of profit or loss and/or comprehensive income.

11.3 As noted in our response to Question 18, we disagree with the omission of reporting cash flows from the 'objective of financial statements' in paragraph 3.4 and the omission of the cash flow statement from the discussion in paragraph 3.6. The Board notes in BC7.8(b) that whilst "information about cash and cash flows are important to users of financial statements, cash flows are not identified as separate elements of financial statements in the Conceptual Framework." However, it does not justify this statement. Given that IAS 1 *Presentation of Financial Statements* identifies the statement of cash flows as a component of a 'complete set of financial statements', we find the Board's unsupported conclusion surprising.

11.4 We support having *four* primary financial statements. However, given the absence of any discussion in the ED, we think it is probably best to address the relationship between the statements of financial position, changes in equity and the statement(s) of profit or loss and comprehensive income (i.e., financial performance), and the cash flow statement in the project on the primary financial statements.

Objective and scope of financial statements

11.5 We are concerned that paragraph 7.3 might lead to unnecessary duplication of information presented in an annual report containing IFRS financial statements. In our view, it may capture information that, in some jurisdictions, is disclosed in management commentary, such as risk reporting.

11.6 Paragraphs BC7.11-BC7.12 argue that it is appropriate to include risk disclosures in the notes because "information about the risks associated with an entity's existing assets and liabilities is likely to be useful in assessing the entity's ability to generate future cash flows and also in assessing management's stewardship of the entity's resources." However, that argument could also be used to require inclusion in the notes of other types of disclosure usually included in management commentary (for example, business model or sustainability disclosures), which equally provide information that is likely to be useful in assessing the entity's ability to generate cash flows and in assessing management's stewardship.

11.7 We believe the principle should state that the items in 7.3(a) are included in the notes unless they are discussed elsewhere in the financial report (such as in the management commentary). This is more consistent with the desire of many regulators, users and others to make financial reporting and corporate reporting more generally 'clear and concise', and avoiding unnecessary duplication.

Communication

11.8 We continue to support including in the Conceptual Framework a 'communication principle' (referred to as a disclosure principle in our response to the Discussion Paper). In our view, communication principles should be included at the framework level and the Conceptual Framework should include a specific sub-section on communication principles so that they are given sufficient prominence. In particular, we think that this fundamental principle should be based explicitly on the relevance of the information to users of the entity's financial statements and that any disclosure should be clear, concise, balanced and understandable.

Classification and aggregation

11.9 Paragraph 7.13 should be expanded to address the general principle outlined in IAS 1.33 (and in greater detail in IAS 32.42, for example) that is appropriate when 'offsetting reflects the substance of the transaction…' We agree that offsetting is an exception to the principle in paragraph 7.13, but the Board has done sufficient conceptual thinking about the conditions that must be present if offsetting is to be permitted or required to warrant inclusion of this thinking in the Conceptual Framework.

11.10 The discussion of aggregation (paragraphs 7.14-7.15) is helpful, but should be expanded to discuss disaggregation. This would provide a link between information that is presented in line items in the primary financial statements and note disclosures that disaggregate those line items.

Question 12—Description of the statement of profit or loss

> *Do you support the proposed description of the statement of profit or loss? Why or why not?*
>
> *If you think that the Conceptual Framework should provide a definition of profit or loss, please explain why it is necessary and provide your suggestion for that definition.*

Primacy of profit or loss

12.1 We think the statement in paragraph 7.22 that the "total or subtotal for profit or loss provides a highly summarised depiction of the entity's financial performance for the period" overstates its purpose. A depiction is generally something that is associated with pictures, descriptions and representations. Profit or loss is simply a net number that sums the income and expense items included in the total. It is an open question as to what it represents. We think the Board should reserve the term "depiction" for the communication parts of the Framework.

Definition of *performance*

12.2 Our assessment is that, at present, the Board is not in a position to define the concept of performance in terms that are adequate for a Framework, or to define a single metric that encapsulates all views on what constitutes 'performance'. The Board has not debated the matter publicly, and has deferred discussion of financial performance to its project on the primary financial statements. This should be a priority project for the Board.

12.3 Defining performance will be challenging. The experience the IASB and the FASB had with their project on Financial Statement Presentation highlighted how difficult it will be to get a consensus on this matter.

12.4 We have strong advocates of an approach similar to the one developed in the G4+1 Position Paper: *Reporting Financial Performance* (August 1999), whereby income and expenses, including any recognised changes in assets and liabilities, would be reported once, in the period in which they arise. Once recognised, they would not be recognised again in a future period in a different component of the single statement of comprehensive income. This enforces the principle that once income and expenses, and changes of assets and liabilities, can be measured with sufficient reliability to justify recognition they should be presented as a component of net income. In such a model there is no notion of *profit or loss*, but similar components could be grouped in a meaningful way, such as grouping operating and financing activities or on the basis of the persistence of earnings. In simple terms, there is one statement of comprehensive income, categorised appropriately.

12.5 However, we also have strong advocates for an approach that treats profit or loss and OCI as distinct components of comprehensive income. They would use OCI more

frequently than happens today and would recycle all items recognised in OCI. A common basis they would use for determining when an item is included in profit or loss is when the component is "released from risk or uncertainty", which could be in some cases on realisation (exchange) or when the item is derecognised. Recycling might also be appropriate earlier if it enhances the usefulness of profit or loss. OCI is used to hold changes in assets and liabilities until an event or transaction occurs that would lead to reclassifying an item in profit or loss.

12.6 It is difficult to criticise either approach, because each is consistent with a valid framework for reporting financial performance. Also, as we explained in our response to Question 9, using OCI as a bridge to accommodate competing objectives is also supported by some.

12.7 It is for the Board to develop a framework for performance reporting and the primary financial statements more generally. In our view, until the purpose of each of the primary financial statements has been agreed in the Conceptual Framework it not possible to develop meaningful principles for defining profit or loss and OCI.

12.8 We also think that the current work on the Conceptual Framework should not prejudge the outcome of its work on the primary financial statements.

12.9 There is also a case for not incorporating, or mentioning, OCI in the current revision of the Framework. The Board has used OCI in Standards for many years despite it not being in the current framework. Its omission has clearly not been an impediment to its use.

12.10 We do understand the sensitivities around this topic and why the Board set out to address OCI. However, when it started the current project the initial plan was to also address the purpose of the primary financial statements. Having deferred what we see as a foundational part of the Conceptual Framework, we urge the Board to be cautious about how it approaches OCI within the revised scope of the project.

Rebuttable presumption

12.11 The ED proposes a rebuttable presumption that all income and expenses are recognised in profit or loss. In our view a rebuttable presumption is a tool used in Standards, not in a Framework.

12.12 A Framework should set out clear principles that the Board, in particular, works with when it develops Standards. If the Board does persist with a rebuttable presumption approach it must set out how the presumption can be rebutted. We do not consider the statement in paragraph 7.27 provides meaningful criteria or conditions for rebutting the presumption.

12.13 In terms of the presumption itself, we are not convinced that the ED contains sufficient guidance for the Board to be able to determine when moving an item to OCI would "enhance the statement of (profit or loss) for the period." We are reluctant to suggest adding criteria, because this would pre-judge the outcome of the primary financial statement project. The Board has already made a presumption that OCI relates only to

items measured at a current value, even though it has not articulated the meaning, or purpose, of profit or loss. The difficulty with such a presumption is that it could limit the ability of the Board to develop Standards that present related income and expenses in the same parts of comprehensive income, as might be the case for insurance activities.

Question 13 Reporting items of income or expenses in other comprehensive income

> *Do you agree with the proposals on the use of other comprehensive income? Do you think that they provide useful guidance to the IASB for future decisions about the use of other comprehensive income? Why or why not?*
>
> *If you disagree, what alternative do you suggest and why?*

13.1 Our comments on the classification of profit or loss translate directly onto to discussion of OCI.

Question 14 Recycling

> *Do you agree that the Conceptual Framework should include the rebuttable presumption described above? Why or why not?*
>
> *If you disagree, what do you propose instead and why?*

14.1 Our view on recycling is consistent with our view on the use of OCI. We think that the Board should treat the proposal in the ED as an interim step until it has considered more carefully the purpose of the primary financial statements and, in particular, financial performance.

14.2 Again, we do not think it is appropriate to express any principle as a rebuttable presumption within the Framework. That is a standards-level mechanism.

14.3 The views within our network on recycling are consistent with the views about the presentation of comprehensive income. Those that work from a framework where there is a single statement of financial performance, with categories of performance, do not support recycling. They see OCI as a way of presenting some income and expenses separately. Whereas those that work from a framework that treats profit or loss and OCI as distinct components of comprehensive income would always reclassify OCI into profit or loss. We do not think these differences can be resolved until the Board has considered performance reporting in its project on primary financial statements.

14.4 We therefore have difficulty with the suggestion that recycling is presumed to provide better information. This pre-judges the outcome of the performance reporting part of the primary financial statement project.

14.5 In any case, we are not convinced that, if finalised, the ED would be helpful to the Board. It is easy to state that items of other comprehensive income should be reclassified to profit or loss in a subsequent period "when this reclassification results in more relevant information". However, for this to be an effective concept it needs to have some principles to explain the basis for when it would provide more relevant information. The ED does not provide such principles. We know that it is particularly difficult to develop a conceptual basis for recycling when the Board has not yet

established a conceptual basis for separating net income into profit or loss and OCI in the first instance.

14.6 We also think that the ED creates a dilemma for the Board. By giving primacy to profit or loss it leaves open whether the Board considers components of OCI to be relevant in assessing performance. The Basis for Conclusions states:

> "… the statement of profit or loss is not the only source of information about an entity's financial performance for the period. An in-depth understanding of performance requires an analysis of all recognised income and expenses (including income and expenses included in OCI), as well as other information included in the financial statements.

14.7 This suggests that the Board thinks that at least some components of OCI are relevant to assessing performance.

14.8 If the information presented in OCI is relevant to financial performance and has already influenced a decision by a primary user of the financial statements it is not clear that reclassifying it through profit or loss in a later period is helpful or appropriate. For example, if a valuation increment reported in OCI has already been factored into a valuation of the entity by an investor it is not clear how counting it again as part of profit or loss in a later period enhances the information available to that investor. There might be incremental information in terms of removing realisation uncertainty, by confirming the valuation, but that information could equally be conveyed by reporting any gain or loss on realisation (i.e. the difference between the current value and the realisation amount).

14.9 If the reason the OCI component was excluded from profit or loss was because it was not considered to be relevant to assessing financial performance, the Board would have to have a sound basis for reclassifying it in a later period—presumably there is an event that causes it to become relevant.

14.10 We therefore do not think that proposals in the ED will be particularly helpful to the Board in deciding when recycling does, or does not, "enhance the statement of (profit or loss) for the period."

Question 15 Effects of the proposed changes to the Conceptual Framework

> *Do you agree with the analysis in paragraphs BCE.1–BCE.31? Should the IASB consider any other effects of the proposals in the Exposure Draft?*

15.1 As stated in our response to Question 3, we continue to support the idea that the Conceptual Framework is and should remain a 'living document'. Also, it is inevitable that changes to the Framework will be perceived by some as creating conflicts with IFRS.

Potential differences between the Framework and IFRS

15.2 The analysis presented in BCE1-BCE31 sets out what the Board sees as the main inconsistencies as well as minor inconsistencies between the ED and current IFRS requirements.

15.3 We think that there are other inconsistencies, such as not recycling all components of OCI and, arguably, using OCI for some components in the first instance. We know that it is difficult making these assessments, but as the holder of the Framework and IFRS, the Board is in the best position to provide a comprehensive analysis. The better the analysis is, the more fulsome the discussion about the likely implications of the proposed Conceptual Framework is likely to be.

15.4 The Board notes that how assets and liabilities are defined in the ED differ from how they are defined in IAS 38 and IAS 37, respectively. We note that ED includes an additional eight definitions that differ in some way from the terms defined in IFRS—consolidated financial statements, constructive obligation, derecognition, fair value, general purpose financial statements, income, and value in use; and the term *material information* has been used to refer to the term *material* as it is used in IAS 1 and IAS 8, but with slightly different words.

Transition

15.5 We agree with the Board's proposed transitional provisions, including the proposed consequential amendments to IAS 1 and IAS 8. As we noted in our comments on the DP, "constituents may need time to review existing accounting policy judgements". We still hold this view.

15.6 We agree that the Board should start using the revised Conceptual Framework immediately on publication. We noted in our comments on the DP that it would be confusing to allow two versions of the Framework to coexist.

15.7 Although it is also appropriate for the Interpretations Committee to use the revised Conceptual Framework, we think that it will be severely constrained in practice. The IAS 8 hierarchy will prevent the Interpretations Committee from using any definitions in the Framework that conflict with the definitions in an IFRS, for which we have observed that there are ten.

15.8 The biggest effect of this constraint is likely to be the definitions of assets and liabilities. For example, there would be no grounds for the Interpretations Committee to revisit IFRIC 21 in the light of any new liability definition while the current definition of a liability remains embedded in IAS 37.

15.9 We encourage the Board to consider what the Interpretations Committee should do when it is faced with a new definition in the Conceptual Framework that is similar to, but not the same as, a definition in an IFRS. Should it refer to any new discussions in the Conceptual Framework related to that new definition?

15.10 Preparers will be faced with the same hierarchy as the Interpretations Committee, so will not be able to use the new asset or liability definitions. We are comfortable with this outcome. It means that the revised Conceptual Framework should have very little direct impact on preparers.

15.11 It is the Board that should consider initially the direct implications of a revised Framework for financial reporting requirements. For example, the implications of a revised definition of a liability, revised recognition criteria and new measurement principles on liabilities within the scope of IAS 37 would need to be considered by the Board in the context of revising IAS 37. And at that time the Board would need to assess whether it should replace the definition of a liability in that Standard with the Conceptual Framework definition. That would be a significant step because replacing it or deleting it would bring the revised definition into the IAS 8 hierarchy. We think that the Board would need to consider whether such a change had wider consequences, and therefore urge caution.

Summary

15.12 The Board has previously attempted to amend IAS 1 to change references to reliability to reflect the change to faithful representation, but did not finalise the proposed changes. The Board concluded that it would be "premature" to do so. The Board does not appear to have a strategy or plan for addressing these conflicts, but will need one. For example, we would anticipate that the Disclosure Initiative will replace IAS 1, which contains references to terms that are no longer used in the Conceptual Framework and other terms that are likely to change. We would expect the Board to plan to use the new terminology. Having said that, the Board needs to consider carefully the broader implications of shifting terms and concepts from the Framework into Standards.

15.13 We think that the Board is right not to propose modifying any Standards now, apart from the small changes proposed. Any changes are better considered in the context of a broader discussion about a particular Standard.

Question 16—Business activities [Business Model]

Do you agree with the proposed approach to business activities [BCIN.28-.34]? Why or why not?

16.1 We agree that the Conceptual Framework should include a discussion of business activities (business model). However, we think it is unhelpful to use the term *business model* extensively in IFRS 9 and *business activities* in the proposed Conceptual Framework, particularly when they both remain undefined. It is possible to read the descriptions used in IFRS 9 broadly to mean the strategy adopted by management, particularly because it links to the key management personnel.

16.2 The IFRS 9 measurement requirements seem to have a very specific link to how the management expect to realise the cash (through their actions) whereas para 6.76 of the proposed Conceptual Framework suggests that contribution to cash flows measurement could depend partly on the nature of the business activities or on the characteristics of the asset (liability). This tells us nothing to help decide whether a traded asset should be measured at fair value or some other amount if the business model is to hold the investment indefinitely. As it stands, IFRS 9 would, of course, be more determinative than the Conceptual Framework, but it leaves us with little sense of how the Board would set a Standard in the future.

16.3 We encourage the Board to consider further indicators of when business activities enhance the information provided and thus should be incorporated into standards, and indicators of when incorporation of business activities might detract from the value of the information provided and can help achieve the objective of enabling an assessment of stewardship by external users. We also think that the term business model should be defined in the Conceptual Framework. Our preference is for the definition to focus on how the entity expects to consume assets (exchange or use) or meet its obligations (exchange or fulfil). Such a definition would align the idea of a business model to the cash flow realisation process rather than the broader strategy of the business.

Question 17—Long-term investment

> *Do you agree with the IASB's conclusions on long-term investment? Why or why not?*

17.1 We agree with the conclusions in BCIN.38 that an explicit reference to the business activity of long-term investment in an entity is not necessary, for the reasons stated in BCIN.37. However, this is not to say that the interests of long-term investors are unimportant. As we stated in our response to Question 1, the objective of financial reporting should permit management to tell the long-term value creation story of the entity. That objective should be clear, making it unnecessary to discuss the separate needs of long-term investors.

17.2 It would be helpful if the objectives of financial reporting included a brief discussion that explains that an important part of telling the long-term value-creation story of the entity includes providing information to the users of the financial statements that helps them to assess the ability of the entity to meet its more immediate needs, in terms of short-term solvency.

17.3 The need for information about matters that affect an entity in the shorter term should not be confused with short-termism. Financial reporting should not encourage short-termism by the reporting entity or investors. A discussion in the Framework would help explain this important difference.

Question 18 Other comments

> *Do you have comments on any other aspect of the Exposure Draft? Please indicate the specific paragraphs or group of paragraphs to which your comments relate (if applicable).*
>
> *As previously noted, the IASB is not requesting comments on all parts of Chapters 1 and 2, on how to distinguish liabilities from equity claims (see Chapter 4) or on Chapter 8.*

Chapter 3: The role of financial statements

18.1 We agree in general with the discussion of the role of general purpose financial reports in paragraphs 3.2-3.9, but suggest that it be expanded using parts of Chapter 7. For greater detail, please refer to our response to Question 11.

18.2 The discussion of the Going Concern Assumption in paragraph 3.10 does not sit well in this chapter. It would be better to place it in Chapter 6, Measurement, as the concept is fundamental to the consideration of the measurement basis adopted by the entity. Having said that, moving it to Chapter 6 reflects a preference for having the going concern assumption expressed as basis for the preparation of *financial statements*. The Board has proposed a change from the current wording of paragraph 3.10 that states that the *Conceptual Framework* is based on this assumption. That change has not been reflected in the rest of the paragraph, which seems to focus on the basis of preparation, rather than the Framework. The current wording is more appropriate.

18.3 With respect to paragraph 3.10, in our comments on the DP we suggested that should another basis of preparation be necessary, "the fundamental objective of financial reporting remains relevant and that, even when the going concern assumption is no longer appropriate, the financial statements should still provide information that is relevant and a faithful representation of what it purports to represent." We again urge the Board to make this observation.

Chapter 8: Concepts of Capital and Capital Maintenance

18.4 In our comments on the DP we encouraged the Board to use the Framework to establish and articulate the concept of capital maintenance and what role it plays in financial reporting. We also commented that the DP confused capital maintenance with the unit of measurement (the currency unit). We note that the Board has decided not to make any substantive changes to paragraphs 4.57-4.65, but we continue to believe that the Board needs to consider these fundamental aspects of the Framework.

Inflation

18.5 It is our experience that, while few jurisdictions apply IAS 29, there are many more jurisdictions in which inflation is significant. Inflation adjustments are related with the currency used (nominal currency or adjusted currency); they are not capital maintenance adjustments.

18.6 We encourage the Board to continue to work with its Emerging Economies Group on matters related to the reporting of high inflation.

Appendix A: Cash flow-based measurement techniques

18.7 We do not support having an appendix on cash-flow measurement techniques in the Conceptual Framework. As the ED states, it is a discussion of a particular type of measurement technique. It is not a conceptual discussion but a practical one, and is better placed in a standards-level document. We suggest it be removed entirely.

Appendix B: Glossary

18.8 In general, we found it helpful to have a Glossary of the terms used in the Conceptual Framework. However, a Glossary is not part of an IFRS, but is included with the Bound Volumes compiled by the Board. Additionally, the Conceptual Framework is not part of IFRS and care needs to be taken to ensure that terms defined in an IFRS are not confused with terms defined in the Conceptual Framework.

18.9 The nature of the Bound Volume Glossaries remains unclear. Several years ago the Glossary contained only terms defined in the Standards, which we support. More recently the Glossary has been amended to include "extracts" from the Conceptual Framework, which does not have a Defined Terms section. There are four such extracts—*asset*, *liability*, *measurement* and *realisable value*. *Asset* and *liability* are also defined in Standards (IAS 38 and IAS 37), so the glossary references involve only the addition of two unique Conceptual Framework references.

18.10 We think it would be better if the Conceptual Framework had an appendix of Defined Terms rather than a glossary. This would allow the Bound Volumes to revert to, and preserve, the concept that the Glossary is a collection of Defined Terms.

18.11 However, a more careful review of the definitions to be included in the Conceptual Framework Defined Terms is necessary. Each definition should be consistent with how the term is defined in the body of the document and it should be a positive and helpful definition. For example, the ED proposes a definition of 'principal' that is circular (it simply refers to the definition of an agent); it would be helpful to define some additional items, such as *stewardship*; and terms used only in a narrow context might be better explained in full rather than being included as a definition—*commercial substance* is referred to only in a small group of sentences and is defined negatively in the body of the Conceptual Framework and positively in the glossary.

18.12 We noted in our response to Question 15 that the proposed Conceptual Framework has 10 terms that will be different from the terms defined in IFRS. If terms defined in the Conceptual Framework are included in the glossaries of the Bound Volumes, the definition in the Conceptual Framework and the definition in the Standard should both be included and the relevant source identified clearly.