Financial Reporting Committee

Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

13 January 2014

Dear Mr Hoogervorst,

DP/2013/1 – A Review of the Conceptual Framework for Financial Reporting

I am pleased to submit the comments of The 100 Group of Finance Directors on the Discussion Paper.

<u>Who we are</u>

The 100 Group of Finance Directors is a non-political, not-for-profit organisation which represents the finance directors of the UK's largest companies, with membership drawn mainly, but not entirely, from the constituents of the UK FTSE100 Index. Our aim is to contribute positively to the development of UK and international policy and practice on matters that affect our businesses, including taxation, financial reporting, corporate governance and capital market regulation. The views expressed in this letter are not necessarily those of our individual members or their respective employers.

<u>Our views</u>

We summarise our views below and set out our responses to the specific questions asked by the Board in the Appendix.

Overall comments

<u>We welcome the initiative</u>

We welcome the Board's initiative to complete its review of the Conceptual Framework. We have been consistent over the years in urging the Board to give priority to this project and to address it as a whole rather than on a piecemeal basis. We would like to see the Board complete its review before embarking on the development of any major new or revised Standards.

<u>We are concerned about convergence</u>

We note that the Conceptual Framework project is now being conducted by the IASB on its own rather than jointly with the FASB. While we understand the reasons for this, we feel that it is regrettable because the lack of progress towards a common framework decreases the likelihood of eventual convergence between IFRS and US GAAP.

Undue emphasis on the balance sheet

We are concerned that the Board continues to place undue emphasis on the balance sheet in that it proposes no change to the current Conceptual Framework in which assets and liabilities are considered to be the primary elements of financial statements and income and expenses are changes in those assets and liabilities. We believe that financial performance has more to do with transactions and cash flows than with changes between opening and closing balance sheets. We therefore consider that the Conceptual Framework should identify income and expenses as well as assets and liabilities as the primary elements of financial statements.

Consistency of Standards with the Conceptual Framework

When the current review of the Conceptual Framework is concluded, we suggest that the Board reviews its existing Standards for consistency with it. Any significant inconsistencies should be either addressed by amendment of the relevant Standard or justified under the Board's proposed 'comply or explain' approach.

Asset and liability definitions

Probability is not relevant to existence

We agree with the Board that probability of outcome is not relevant to whether an asset or liability exists and therefore agree that the definitions of an asset and a liability should not be restricted to expected inflows or outflows.

Obligations may be legal or constructive

We agree with the Board that liabilities should represent both legal and constructive obligations. We consider that restricting the definition of a liability to obligations that are only enforceable through legal or equivalent requirements would not provide useful information and may create inconsistencies in practice due to differences between legal jurisdictions.

Obligations may not be avoided in practice

We consider that an obligation exists if it has arisen from past events and, although the entity may in theory be able to avoid it through its future actions, it is not practicable for it to do so (we believe that this is consistent with 'View 2' proposed in paragraphs 3.77 to 3.83 of the Discussion Paper).

Recognition and derecognition

A probability threshold should be retained

We believe very strongly that the recognition criteria for an asset or a liability should retain reference to probability of outcome.

We believe that an asset or a liability should not be recognised unless it is probable (i.e. more likely than not) that an inflow or outflow will occur. If recognition of a liability were no longer dependent on the probability of the outcome, in many cases it would be necessary to recognise a liability that in management's judgement will probably not materialise. We believe that this would be detrimental to the relevance and reliability of financial statements.

Derecognition is not always appropriate

We do not agree that an entity should always derecognise an asset or a liability when it no longer meets the conditions for recognition. While this may improve comparability between the balance sheets of different entities, it may cause important information about the profit or loss associated with the transaction to be lost. We illustrate this in our answer to Question 9 by reference to sale and repurchase transactions ('repos').

Measurement

Perspective of measurement of assets and liabilities

We question the use of the perspective of investors, creditors and other lenders (users) in determining the relevance of a particular measurement basis.

Consistent with the Board's preliminary view that it should consider the entity's business model when developing Standards, we believe that the measurement basis should be depend on how management actually intends to use the asset or settle the liability as this is likely to better reflect future cash flows. Moreover, we believe that such an approach is more compatible with reporting the results of management's stewardship of the resources entrusted to it.

Bases of measurement

We believe that the principles underlying the proposed use of different measurement bases for assets are unclear. We suggest that the Board starts from a default position whereby assets are measured at historical cost except in circumstances where another measurement basis provides more relevant information. We believe that the Board will find it easier to rationalise and explain the departures from the default position.

Similarly, we suggest that the Board starts from a default position whereby liabilities are measured on the basis of the expected cost of settling the liability whether in cash or other assets (settlement basis) except in circumstances where another measurement basis provides more relevant information.

Measurement techniques

We consider that the method by which a measurement basis is applied is an important aspect of the measurement of assets and liabilities. For the reasons set out in our responses to the Board's specific questions, we urge the Board to address in the Conceptual Framework the appropriate use of 'best estimate' and 'expected value' measurement techniques.

Presentation and disclosure

Performance reporting

We believe that the Conceptual Framework should set out broad concepts and should not seek to address matters that should be dealt with by specific Standards. We therefore do not believe that the Conceptual Framework should seek either to define the primary financial statements or to specifically discuss the presentation of financial performance in the statements of profit or loss and OCI because these are matters that should be dealt with by specific Standards.

We understand that the Board intends to conduct a research project reviewing IAS 1, IAS 7 and IAS 8 in parallel with the Conceptual Framework project. We believe that this would cause an unacceptable delay in finalising the Conceptual Framework and strongly recommend that the Board de-couples the two projects.

Materiality and the 'disclosure problem'

We do not believe that the 'disclosure problem' arises principally from a failure to exercise professional judgement in applying the concept of materiality. Rather, we believe that it stems largely from the growing list of disclosures required by the Board in its Standards together with the fact that regulators and others are increasingly using the Annual Report as a repository for information considered important to users other than those identified in paragraph OB2 of the Conceptual Framework.

We believe that the disclosure problem will get worse unless the Board exercises restraint in specifying only those disclosures that it considers are likely to be material in relation to most entities. It might also be helpful if the Board were to reiterate in each of its Standards that the disclosure requirements apply only to material items.

Communication principles

We believe that financial reporting is fundamentally an exercise in communication. We therefore welcome the inclusion in the Conceptual Framework of communication principles to guide the Board in determining what disclosures should be required by its Standards. Whilst we are generally supportive of the communication principles set out by the Board, we caution it against seeking to enforce standardisation across different industries

Other matters

Chapters 1 and 3 of the Conceptual Framework

We do not consider that fundamental reconsideration of Chapters 1 and 3 of the Conceptual Framework is warranted, but we urge the Board to re-consider the following:

a) giving greater prominence to stewardship reporting as an objective of financial statements;

b) re-introducing reliability as an enhancing characteristic to augment the concept of faithful representation; and

c) re-introducing prudence as a concept when making estimates in conditions of uncertainty.

Business model

We believe that financial reporting should reflect management's actual or intended use or disposition of assets and holding or settling of obligations. Otherwise, we struggle to see how the resulting financial information could satisfy the fundamental characteristics of relevance and faithful representation. We therefore support the Board's view that the measurement of assets and liabilities should reflect the reporting entity's 'business model'.

Please feel free to contact me if you wish to discuss our comments.

Yours sincerely

Russ Houlden
Chairman
The 100 Group - Financial Reporting Committee

APPENDIX – SPECIFIC QUESTIONS

Section 1: Introduction

Q1: Paragraphs 1.25-1.33 set out the proposed purpose and status of the Conceptual Framework. The IASB's preliminary views are that:

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

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

We agree that the primary purpose of the Conceptual Framework should be to assist the IASB when it is developing and revising IFRS. We suggest, however, that the Board acknowledges very clearly the usefulness of the conceptual framework to preparers of financial statements when determining the appropriate accounting treatment of a transaction that is not addressed by Standards.

We do not consider that the Conceptual Framework should be a straitjacket that restricts the Board's deliberations. We recognise that there may be situations in which the Board considers it necessary to depart from the Conceptual Framework and we support the 'comply or explain' approach that is proposed by the Board.

We believe that the Conceptual Framework will itself need to evolve over time so as to remain appropriate in the context of the developing commercial environment. We therefore suggest that the Board should review the Conceptual Framework on a regular basis (say, every ten years).

When the current review of the Conceptual Framework is concluded, we suggest that the Board reviews its existing Standards for consistency with it. Any significant inconsistencies should be either addressed by amendment of the relevant Standard or justified under the 'comply or explain' approach.

Section 2: Elements of financial statements

Q2: The definitions of an asset and a liability are discussed in paragraphs 2.6-2.16. The IASB proposes the following definitions:

- ***a) an asset is a present economic resource controlled by the entity as a result of past events.***
- ***b) a liability is a present obligation of the entity to transfer an economic resource as a result of past events.***
- ***c) an economic resource is a right, or other source of value, that is capable of producing economic benefits.***

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

We broadly agree with the proposed definitions of 'asset' and 'liability', noting that:

- the proposed definition of an asset is a very broad one (as is the existing definition) and would include many items that are not currently recognised in the balance sheet without strict recognition conditions.
- the proposed definition of a 'liability' could be construed as too narrow (as might be the existing definition) and requires consideration of whether constructive obligations and transfers of resources that depend on a company's future actions are liabilities.

Q3: Whether uncertainty should play any role in the definitions of an asset and a liability and in the recognition criteria for assets and liabilities, is discussed in paragraphs 2.17-2.36. The IASB's preliminary views are that:

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

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

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

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

We agree with the Board that probability of outcome is not relevant to whether an asset or liability exists and therefore agree that the definitions of an asset and a liability should not be restricted to expected inflows or outflows. As we explain in our answer to Question 8, however, we believe very strongly that the recognition criteria for an asset or a liability should retain reference to probability of outcome.

Q4: Elements for the statement(s) of profit or loss and OCI (income and expense), statement of cash flows (cash receipts and cash payments) and statement of changes in equity (contributions to equity, distributions of equity and transfers between classes of equity) are briefly discussed in paragraphs 2.37-2.52.

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

We are concerned that the Board continues to place undue emphasis on the balance sheet in that it proposes no change to the current Conceptual Framework in which assets and liabilities are considered to be the primary elements of financial statements and income and expenses are changes in those assets and liabilities. We believe that financial performance has more to do with transactions and cash flows than the changes between opening and closing balance sheets. We therefore consider that the Conceptual Framework should identify income and expenses as well as assets and liabilities as the primary elements of financial statements.

As outlined in our response to question 16, we believe that following completion of the review of the Conceptual Framework the Board should embark on a separate project on financial statement presentation.

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

Q5: Constructive obligations are discussed in paragraphs 3.39-3.62. The discussion considers the possibility of narrowing the definition of a liability to include only obligations that are enforceable by legal or equivalent means. However, the IASB tentatively favours retaining the existing definition, which encompasses both legal and constructive obligations – and adding more guidance to help distinguish constructive obligations from economic compulsion. The guidance would clarify the matters listed in paragraph 3.50.

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

We agree that liabilities should represent both legal and constructive obligations. We consider that restricting the definition of a liability to obligations that are only enforceable through legal or equivalent requirements would not provide useful information and may create inconsistencies in practice due to differences between legal jurisdictions.

Q6: The meaning of 'present' in the definition of a liability is discussed in paragraphs 3.63-3.97. A present obligation arises from past events. An obligation can be viewed as having arisen from past events if the amount of the liability will be determined by reference to benefits received, or activities conducted, by the entity before the end of the reporting period. However, it is unclear whether such past events are sufficient to create a present obligation if any requirement to transfer an economic resource remains conditional on the entity's future actions. Three different views on which the IASB could develop guidance for the Conceptual Framework are put forward:

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

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

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

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

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

We agree with the Board's rejection of View 1. We consider that the requirement for the obligation to be strictly unconditional could result in the understatement of liabilities (in particular, constructive obligations). Under View 1, for example, restructuring provisions would not be recognised where management has the ability to reverse its decisions irrespective of how impracticable such a reversal may be.

We consider that View 2 and View 3 are difficult in practice to distinguish. Returning to the example of the restructuring provision, we believe that the current accounting under IAS 37 is appropriate in that in order to provide for a restructuring management must be demonstrably committed to the restructuring, i.e. have initiated a plan from which it cannot realistically withdraw. We believe that this is akin to View 2, i.e. it would be possible in theory for management to withdraw from the plan but it would not be practicable for it to do so.

Under View 3, management would have too much freedom to manipulate financial performance by establishing a provision for a restructuring in one period and releasing it in the next.

Another example could be an equity instrument with a dividend step-up or dividend-stopper feature. Under View 2, such instruments would seem to be liabilities whereas under View 3 they would seem to continue to be equity instruments. On balance, we consider View 2 to give the most appropriate result.

Q7: Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?

We would welcome the inclusion in the Conceptual Framework of a more explicit definition of the term 'executory contract'.

Otherwise, we have no further comments.

Section 4: Recognition and derecognition

Q8: Paragraphs 4.1-4.27 discuss recognition criteria. In the IASB's preliminary view, an entity should recognise all its assets and liabilities, unless the IASB decides when developing or revising a particular Standard that an entity need not, or should not, recognise an asset or a liability because:

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

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

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

We believe very strongly that the recognition criteria for an asset or a liability should retain reference to probability of outcome. We believe that an asset or a liability should not be recognised unless it is probable (i.e. more likely than not) that an inflow or outflow will occur. We suggest that our position is best illustrated in the context of a legal case. At present, no liability is recognised in respect of litigation where management does not consider it probable that an outflow will occur but the action may be disclosed as a contingent liability. If recognition of the liability were no longer dependent on the probability of the outcome, it would be necessary to recognise a liability that in management's judgement will probably not materialise. We believe that this would be detrimental to the relevance and reliability of financial statements.

On a related point, we would caution the Board against any proposed extension of the use of 'expected value' in measuring assets and liabilities. As we pointed out in recent years in our comments on the Board's various proposals to revise IAS 37 and IAS 12, we believe that the use of expected value is appropriate only where there is a large population of items. In most situations, in particular where there is a binary outcome (such as in many legal cases), the use of expected value would not provide meaningful information as it would almost certainly cause a liability to be recognised which represents neither of the possible outcomes. In the majority of cases, we believe that 'best estimate' should be used to measure assets and liabilities. We therefore urge the Board to address in the Conceptual Framework the appropriate use of 'best estimate' and 'expected value' measurement techniques.

Q9: In the IASB's preliminary view, as set out in paragraphs 4.28-4.51, an entity should derecognise an asset or a liability when it no longer meets the recognition criteria. (This is the control approach described in paragraph 4.36(a).) However, if the entity retains a component of an asset or a liability, the IASB should determine when developing or revising particular Standards how the entity would best portray the changes that resulted from the transaction. Possible approaches include:

a) enhanced disclosure;

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

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

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

We do not agree that an entity should always derecognise an asset or a liability when it no longer meets the conditions for recognition. While this may improve comparability between the balance sheets of different entities, it may cause important information about the profit or loss associated with the transaction to be lost.

For example, an entity may enter into a sale and repurchase ('repo') transaction in relation to securities. In a repo, the entity holding the securities sells them to another entity but agrees to buy them back at a future date at a specified price (the price is usually set so as to provide the entity that purchased the securities with a return). We are concerned that in this situation the Board's preferred control-based derecognition approach (paragraph 4.5) would lead to derecognition of the underlying securities with the inherent collateralised financing element not recognised. We believe this would not give useful information.

In paragraph 4.50, the Board addresses the concerns of inappropriate accounting when retaining a component of an asset or a liability, suggesting it could be remediated by enhanced disclosure or the reflection of the retained component in the financial statements. Nevertheless, we believe that for financial instruments some form of risk and rewards analysis should be included when assessing derecognition.

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

Q10: The definition of equity, the measurement and presentation of different classes of equity, and how to distinguish liabilities from equity instruments are discussed in paragraphs 5.1-5.59. In the IASB's preliminary view:

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

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

i. obligations to issue equity instruments are not liabilities; and

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

c) an entity should:

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

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

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

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

Question 10(a)

We agree with the proposal to retain the existing definition of equity which is simple and well understood.

Question 10 (b)

We generally agree with the principle of the strict obligation approach which would classify as liabilities only obligations to deliver economic resources. However, we are concerned that this proposal would conflict with IAS 32 which classifies as debt those obligations which are settled in a variable number of shares. One of the reasons the Board provided for the current treatment of such contracts was that precluding equity treatment for such instruments would limit structuring options and manipulations to obtain equity treatment (IAS 32.BC14). We suggest that the Board addresses this conflict in its further deliberations on the conceptual framework.

Question 10 (c)

We are unclear as to what the Board intends and have significant concerns regarding the practicability of any proposal to remeasure each class of equity at the end of each reporting period as outlined in paragraph 5.13. We not only believe that such an approach is likely to be very complex but also are unsure whether it would provide users of financial statements with relevant information. We are also concerned that the Board is suggesting 'an enhanced statement of changes in equity' given the current challenges in making the significant amount of information already contained in this statement understandable to the user.

Question 10 (d)

We believe that the proposal to treat the most subordinated class of instruments as if it were an equity claim is arbitrary and may not always be appropriate. Some classes of instrument have the commercial characteristics of equity, without being the most subordinated. Moreover, some instruments that are the most subordinated do not necessarily have the characteristics of equity.

Section 6: Measurement

Q11: How the objective of financial reporting and the qualitative characteristics of useful financial information affect measurement is discussed in paragraphs 6.6-6.35. The IASB's preliminary views are that:

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

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

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

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

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

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

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

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

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

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

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

We agree with these preliminary views, except for the reliance on the use of the perspective of investors, creditors and other lenders (users) in determining the relevance of a particular measurement basis. We believe that such an approach may be unreliable as different user groups could have different views and may lack relevance as it may not be indicative of actual future cash flows.

We believe that the measurement basis should be depend on how management actually intends to use the asset or settle the liability as this is likely to better reflect future cash flows. Moreover, we believe that such an approach is more compatible with reporting the results of management's stewardship of the resources entrusted to it.

We note that the Discussion Paper does not address the techniques that should be used to apply the appropriate measurement basis. For the reasons set out in our answer to Question 8, we urge the Board to address in the Conceptual Framework the appropriate use of 'best estimate' and 'expected value' measurement techniques.

Q12: The IASB's preliminary views set out in Question 11 have implications for the subsequent measurement of assets, as discussed in paragraphs 6.73-6.96. The IASB's preliminary views are that:

a) ***if assets contribute indirectly to future cash flows through use or are used in combination with other assets to generate cash flows, cost–based measurements normally provide information that is more relevant and understandable than current market prices.***
b) ***if assets contribute directly to future cash flows by being sold, a current exit price is likely to be relevant.***
c) ***if financial assets have insignificant variability in contractual cash flows, and are held for collection, a cost-based measurement is likely to provide relevant information.***
d) ***if an entity charges for the use of assets, the relevance of a particular measure for those assets will depend on the significance of the individual asset to the entity.***

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

We believe that the principles underlying the proposed use of different measurement bases for assets are unclear. For example, on first reading of the principles it appears that it is being suggested that inventory should be measured at current exit price since it will "contribute directly to future cash flows by being sold". In paragraph 6.80, however, the Board clarifies that inventory should be measured at cost because it is "used in combination with other assets to generate cash flows". While we support the Board's conclusion, we find the logic rather tenuous.

When considering assets that an entity charges for use, the reference to significance seems a little out of place. We suspect that it may be related to the Board's separate proposals on accounting for leases in which distinction is drawn between Type A and Type B assets. We are not convinced that significance to an entity should influence the measurement basis although it may be relevant to the cost/benefit decision in individual accounting standards.

We suggest that the Board starts from a default position whereby assets are measured at historical cost except in circumstances where another measurement basis provides more relevant information. We believe that the Board will find it easier to rationalise and explain the departures from the default position.

Q13: The implications of the IASB's preliminary views for the subsequent measurement of liabilities are discussed in paragraphs 6.97-6.109. The IASB's preliminary views are that:

a) ***cash-flow-based measurements are likely to be the only viable measurement for liabilities without stated terms.***
b) ***a cost-based measurement will normally provide the most relevant information about:***
    i. ***liabilities that will be settled according to their terms; and***
    ii. ***contractual obligations for services (performance obligations).***
c) ***current market prices are likely to provide the most relevant information about liabilities that will be transferred.***

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

We struggle to see why the Board seeks to distinguish between cash flow based measurement and cost based measurement. We believe that cost based measurement encompasses settlement in cash or by the transfer of other assets. We agree with the Board that current market prices are likely to provide the most relevant information about liabilities that will be transferred.

We suggest that the Board starts from a default position whereby liabilities are measured on the basis of the expected cost of settling the liability whether in cash or other assets (settlement basis) except in circumstances where another measurement basis provides more relevant information.

Q14: Paragraph 6.19 states the IASB's preliminary view that for some financial assets and financial liabilities (for example, derivatives), basing measurement on the way in which the asset contributes to future cash flows, or the way in which the liability is settled or fulfilled, may not provide information that is useful when assessing prospects for future cash flows. For example, cost-based information about financial assets that are held for collection or financial liabilities that are settled according to their terms may not provide information that is useful when assessing prospects for future cash flows:

- ***a) if the ultimate cash flows are not closely linked to the original cost;***
- ***b) if, because of significant variability in contractual cash flows, cost-based measurement techniques may not work because they would be unable to simply allocate interest payments over the life of such financial assets or financial liabilities; or***
- ***c) if changes in market factors have a disproportionate effect on the value of the asset or the liability (ie the asset or the liability is highly leveraged).***

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

We think that there is a mistake in the first sentence of the question and in paragraph 6.19 in that both should read "basing measurement on their cost may not provide information that is useful in assessing prospects for future cash flows". If this is the case, we generally agree with the preliminary view. We would, however, caution the Board that fair value is not necessarily a good predictor of future cash flows.

We are concerned that level of detail in this section of the Discussion Paper is high and we would be cautious about including some of this detail in the final framework. We believe that the complexities surrounding derivatives and similar assets and liabilities should not be addressed in the conceptual framework but in individual Standards.

Q15: Do you have any further comments on the discussion of measurement in this section?

We have no further comments.

<u>Section 7: Presentation and disclosure</u>

Q16: This section sets out the IASB's preliminary views about the scope and content of presentation and disclosure guidance that should be included in the Conceptual Framework. In developing its preliminary views, the IASB has been influenced by two main factors:

- ***a) the primary purpose of the Conceptual Framework, which is to assist the IASB in developing and revising Standards (see Section 1); and***
- ***b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 7.6-7.8), including:***
  - ***i. a research project involving IAS 1, IAS 7 and IAS 8, as well as a review of feedback received on the Financial Statement Presentation project;***
  - ***ii. amendments to IAS 1; and***
  - ***iii. additional guidance or education material on materiality.***

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

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

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

We believe that the Conceptual Framework should set out broad concepts and should not seek to determine accounting treatments or specify disclosures that should be dealt with by individual Standards. We therefore do not believe that the Conceptual Framework should seek either to define the primary financial statements or to specifically discuss the presentation of financial performance in the statements of profit or loss and OCI because these are matters that should be dealt with by individual Standards.

We understand that the Board intends to start a research project reviewing IAS1, IAS7 and IAS8 including a review of the feedback it received on the financial statement presentation project in 2010 with the objective of replacing those standards and creating a disclosure framework. We believe that the Board intends to conduct this research in parallel with the Conceptual Framework project. As long-standing contributors to the Board's deliberations on financial statement presentation, we recognise that this is a difficult and hotly debated topic. We therefore believe that running this research project in parallel is likely to cause an unacceptable delay in finalising the Conceptual Framework project. We are among those

who have consistently urged the Board to prioritise its review of the Conceptual Framework and we strongly believe that it should be finalised before the Board embarks on the development of any major new Standards.

Q17: Paragraph 7.45 describes the IASB's preliminary view that the concept of materiality is clearly described in the existing Conceptual Framework. Consequently, the IASB does not propose to amend, or add to, the guidance on the Conceptual Framework on materiality. However, the IASB is considering developing additional guidance or education material on materiality outside of the Conceptual Framework project.

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

We consider that the definition of materiality contained in QC11 is quite clear to the effect that information is material "if omitting it or misstating it could influence the decisions that users make on the basis of financial information about a specific reporting entity". We do, however, believe that it might be helpful if the Board was to reiterate in each of its Standards that the required accounting treatment and specified disclosures need not be applied to immaterial items.

We agree with the Board that the application of materiality is a matter for professional judgement that must be made in the context of the specific entity and that therefore the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation. As discussed in our answer to Question 18, we do not believe that the so-called 'disclosure problem' arises from a lack of guidance on materiality. While we would welcome additional guidance on the application of materiality, we recommend that it should be kept relatively brief and that it should be contained within the Conceptual Framework, not developed outside it.

Q18: The form of disclosure requirements, including the IASB's preliminary view that it should consider the communication principles in paragraph 7.50 when it develops or amends disclosure guidance in IFRSs, is discussed in paragraphs 7.48-7.52.

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

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

In its discussion of materiality in paragraph 7.46, the Board identifies the current 'disclosure problem' in financial reporting. We do not believe that this problem arises principally from a failure to exercise professional judgement in applying the concept of materiality. Rather, we believe that it stems largely from the growing list of disclosures required by the Board includes in its Standards together with the fact that regulators and others are increasingly using the Annual Report as a repository for information considered important to users other than those identified in paragraph OB2 of the Conceptual Framework.

We live in an increasingly litigious and regulated commercial environment. Preparers and their auditors naturally seek to limit the risk of litigation or censure by regulators. For this reason, many consider that if a disclosure is required by a Standard and they have the necessary information it makes sense to include the disclosure in the financial statements, even though they do not consider it to be material, rather than leave it out. We therefore believe that the disclosure problem will get worse unless the Board exercises restraint in specifying only those disclosures that it considers are likely to be material in relation to most entities.

We believe that financial reporting is fundamentally an exercise in communication. We therefore welcome the inclusion in the Conceptual Framework of communication principles to guide the Board in determining what disclosures should be required by its Standards. Whilst we are generally supportive of the communication principles set out in paragraph 7.50, we caution the Board against seeking to enforce standardisation across different industries.

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

Q19: The IASB's preliminary view that the Conceptual Framework should require a total or subtotal for profit or loss is discussed in paragraphs 8.19-8.22.

Do you agree? Why or why not?

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

As we point out in our answer to Question 16, we do not believe that this is a matter for that should be addressed in the Conceptual Framework. Rather, it should be addressed in a specific Standard.

Preparers typically have a different view of financial performance than the Board. As discussed in paragraph OB15, the Board essentially considers financial performance to be the net change in economic resources and claims (put simply, the difference between two balance sheets). Preparers generally consider that financial performance is best represented by transactions and cash flows and in our experience of actually dealing with investors most of them do too.

We therefore believe that sub-totals should be presented that distinguish between trading performance during the period (profit or loss) and other items (OCI).

Q20: The IASB's preliminary view that the Conceptual Framework should permit or require at least some items of income and expense previously recognised in OCI to be recognised subsequently in profit or loss, ie recycled, is discussed in paragraphs 8.23-8.26.

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

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

Consistent with our answer to Question 19, we believe that items of income and expense previously recognised in OCI should be recognised subsequently in profit or loss if they are indicative of trading performance during the period. So, for example, we would recycle gains and losses on cash flow hedges but would not recycle actuarial gains and losses or currency translation adjustments.

Q21: In this Discussion Paper, two approaches are explored that describe which items could be included in OCI: a narrow approach (Approach 2A described in paragraphs 8.40-8.78) and a broad approach (Approach 2B described in paragraphs 8.79-8.94).

Which of these approaches do you support, and why?

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

We support Approach 2B because it produces the profit or loss measure that most appropriately presents the results of trading transactions and cash flows during the period (trading performance).

We would like to re-iterate, however, that we do not believe that the presentation of financial performance in the statements of profit or loss and OCI should be addressed in the Conceptual Framework.

Section 9: Other issues

Q22: Chapters 1 and 3 of the existing Conceptual Framework

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

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

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

Summary

We do not consider that fundamental reconsideration of Chapters 1 and 3 of the Conceptual Framework is warranted, but we urge the Board to reconsider the following:

a) giving greater prominence to stewardship reporting as an objective of financial statements;

b) re-introducing reliability as an enhancing characteristic to augment the concept of faithful representation; and

c) re-introducing prudence as a concept when making estimates in conditions of uncertainty.

Stewardship

When we commented on the Board's proposals during the development of Chapters 1 & 3 of the Conceptual Framework, we explained our view that stewardship reporting is the primary objective of general purpose financial statements, i.e. management reporting to investors on how it has performed in employing the resources entrusted to it.

The Board concluded that the objective of general purpose financial reporting is "to provide financial information about the reporting entity that is useful to existing and potential

investors, lenders and other creditors in making decisions about providing resources to the entity" (OB2).

While Chapters 1 & 3 do not explicitly use the term 'stewardship', the Board did implicitly acknowledge the notion of stewardship reporting in stating that information about "how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources" is useful in assessing the entity's prospects for future net cash inflows and "is also useful for decisions by existing investors, lenders and other creditors who might have the right to vote on or otherwise influence management's actions" (OB4).

We continue to believe, however, that stewardship reporting should be a primary objective of financial reporting, not a secondary consideration. We recognise that the term 'stewardship' itself may not translate readily into other languages but we think that its meaning can be conveyed without actually using the term. We suggest that OB2 be simply amended as follows:

"The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to present and potential investors, lenders and other creditors in making decisions about providing resources to the entity *and* to *present management's performance in employing the resources that have been entrusted to it."*

Reliability

We did not support the replacement of the concept of 'reliability' with that of 'faithful representation'. We acknowledge the Board's explanation in paragraphs 9.10-9.14 that the concept of reliability was often misunderstood and that the concepts of reliability and faithful representation have much in common in that both require neutrality, completeness and freedom from error, but we consider that the change was more than a clarification of terms.

By removing the concept of reliability, the Board paved the way for every asset and liability to be recognised in the financial statements regardless of whether it can be measured on a reliable basis. We believe that reliability is as important as relevance and that sometimes measurement uncertainty is so great that it is not appropriate to recognise an asset or a liability in the financial statements. We believe that it is appropriate that a number of the Board's existing Standards preclude the recognition of assets and liabilities that cannot be reliably measured (for example, internally-generated intangible assets). We therefore urge the Board to consider reinstating reliability as an enhancing characteristic to augment the concept of faithful representation.

Prudence

We recognise that the Board considers that prudence is incompatible with neutrality and therefore removed reference to prudence from Chapters 1 & 3 of the Conceptual Framework.

Some commentators have identified the use of fair value to measure certain financial instruments as a root cause of the financial crisis and suggest that a return to prudence in accounting may provide some protection against future crises. While this may or may not be the case, it is a fact that many financial instruments can only feature on balance sheet if they are measured at fair value (as they have no cost).

While it could be argued that measurement of assets and liabilities at fair value is incompatible with the use of prudence, this is really the case only for some Level 1 financial instruments where fair value represents quoted market values. In the majority of cases, fair values are based on estimates that are made in conditions of uncertainty where it is possible to adopt a prudent approach.

We believe that the concept of prudence should be re-introduced to the Conceptual Framework. We recognise that prudence means different things to different people and might be a difficult concept to convey but we suggest that the Board starts by referring back to the pre-2010 Conceptual Framework in which prudence was described as "the inclusion of a degree of caution in the exercise of the judgements needed in making estimates required under conditions of uncertainty".

We recognise that even if the concept of prudence is re-introduced to the Conceptual Framework, the use of fair value in relation to financial instruments is likely to remain contentious.

We suggest that the solution to this problem lies in the separate presentation in the financial statements of unrealised fair value gains and losses on financial instruments and their treatment by regulators in determining the capital adequacy of regulated entities. While the former can be addressed by the Board in its financial statement presentation project, the latter is beyond its remit but is already being addressed by some regulators.
In the financial sector, for example, regulators require banks to make capital adjustments to their financial statements for prudential reporting purposes. Such adjustments reflect the possibility that banks may realise only a reasonable worst case valuation for financial instruments rather than the more neutral value required by IFRSs. We believe that this is a helpful development which goes some way to addressing the underlying concern that excessive use of fair values may contribute to financial instability, by providing a false sense of security in good markets and excessive losses when markets are disrupted. It also reflects how regulators may have specific uses for financial statements (such as supporting financial stability) which do not align with the needs of the users of general purpose financial statements identified by the Board (e.g. understanding entity performance).

We believe that it is preferable that regulatory adjustments are made to financial statements prepared in accordance with IFRS rather than IFRS being manipulated to address the needs of regulators.

Q23: Business model

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

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

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

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

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

We believe that financial reporting should reflect management's actual or intended use or disposition of assets and holding or settling of obligations. Otherwise, we struggle to see how the resulting financial information could satisfy the fundamental characteristics of relevance and faithful representation.

We consider that the Board has set out in paragraphs 9.24-9.28 the areas where the use of this concept is helpful under existing Standards.

We caution the Board against using the term 'business model' in this context as this term is typically used in relation to the entire entity rather than individual assets and liabilities. We therefore suggest that the Conceptual Framework states clearly that financial information shall reflect management's actual or intended use or disposition of assets and holding or settling of obligations.

Q24: Unit of account

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

Do you agree? Why or why not?

We agree that the unit of account should be decided when the Board develops or revises particular Standards because we do not believe that it would be practicable to determine a single unit of account to be used in every situation. We suggest, however, that this approach is made clear in the Conceptual Framework.

Q25: Going concern

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

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

We have no comments.

Q26: Capital maintenance

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

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

Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power. We agree that the discussion of financial capital maintenance need not be changed until such time as a new or revised Standard on accounting for high inflation is promulgated.

We do however suggest that the Board reflects on the discussion of the physical capital maintenance concept in the Conceptual Framework. Application of this concept requires the adoption of the current cost basis of measurement for which there is no specific Standard and which is not therefore an option under IFRS.